DAWSON SILVA
v.
MONETARY BOARD OF THE CENTRAL BANK OF SRI LANKA AND ANOTHER

SUPREME COURT.
G. P. S. DE SILVA, C.J.
KULATUNGA, J. AND
RAMANATHAN, J.
S.C. SPL. 6/93
DECEMBER 15 AND 17, 1993 AND
FEBRUARY 13, AND APRIL 6, 1995

Writ of Certiorari – Direction by Monetary Board of Central Bank of Sri Lanka directing the Director in charge of Finance Companies to apply for winding up of Mercantile Credit Ltd., a finance company – Sections 12, 18, 20(2) and 43(2)(a) of the Finance Companies Act, No. 78 of 1988.

The Finance Companies Act, No. 78 of 1988 provides for the control and supervision of Finance Companies by the Central Bank. The main object of the Act appears to be to safeguard the interests of depositors.

Faced with a lack of funds to carry on its current business Mr. N. U. Jayawardena, President of Mercantile Credit Ltd. (2nd respondent) had applied on 28.11.90 for a re-financing facility through the Central Bank. On 22.05.91 the Cabinet decide to provide financial assistance to the company subject to conditions. The Articles of Association were amended on 5.07.91 after which six nominee directors representing the funding Banks were included in the Board of Directors. On 23.07.91 the new Board decided that A. N. U. Jayawardena son of N. U. Jayawardena will continue as Chairman of the Board but will cease to be Managing Director. This post was taken over by J. A. R. Felix who thus became Chairman of the Management Committee. N. U. Jayawardena was to be present on the premises to advise Felix.

Notwithstanding the above arrangements the relationship between the share owning Directors and the Management Committee deteriorated very early and on 05.02.92 all the share owning Directors resigned. Consequently on 06.02.92 the Board took over the administration and management of the company under Section 20 of the Act. On 30.06.92 there was a change of Governors and on 25.07.92 the Central Bank called for competitive offers from banking and financial institutions to take over the company on a management contract but no offers were forthcoming and the Bank decided to direct the Director to apply for a court winding-up of the company as it could not be made solvent and viable.

The petitioner does not seriously challenge the above state of affairs in the company but alleges that this was due to mismanagement by the 1st respondent. (monetary Board of the Central Bank in particular by its failure to invest monies recovered on loans in new revenue generating businesses.) The petitioner seeks to quash the impugned decision to apply for a winding-up on the basis –

firstly it was *male fide*;

secondly it was made for a collateral purpose namely to shield the situation created by the 1st respondent by mismanaging the affairs of the company;

thirdly it was contrary to Section 12A of the Act which required the 1st Respondent to furnish to the company a copy of the report made under Section 18 and to give the company an opportunity to state its position and therefore contrary to the principles of natural justice.

Held:

(1) The question of re-organisation of the Company was discussed at length with the share owning Directors before the decision to apply for winding-up was made. Hence the decision was *intra vires* and not vitiated by *mala fides*.

(2) Action which may be taken by the Board is prescribed by Section (2) of the Act as there was no person or institution who was prepared to collaborate with the Board in reviving the company. The decision was not unlawful.

APPLICATION for a writ of certiorari.

Case referred to:

(1) *Durayappah v. Fernando* 69 N.L.R. 265 (P.C.)

E. D. Wickremanayake for petitioner.
A. S. M. Perera D.S.G. for 1st respondent.

Cur. adv. vult.

May 02, 1995.
KULATUNGA, J.

This is an application in terms of Section 43(2) (a) of the Finance Companies Act, No. 78 of 1988 for a writ of certiorari to quash a decision of the 1st respondent (Monetary Board of the Central Bank of Sri Lanka) directing the Director in charge of Finance Companies to apply to Court for a winding-up of the 2nd respondent (Mercantile Credit Ltd.). The 2nd respondent is a public company which is registered as a finance company under Section 2(5) of the Act. The petitioner is a shareholder of the said company having 463 shares.

The Act provides for the control and supervision of finance companies. The main object of the Act appears to be to safeguard the interests of depositors. Thus, Section 4 provides –

"A finance company shall at all times conduct its business in such manner so as to safeguard its deposits and shall take all such measures as are reasonably necessary to ensure that deposits and interest on deposits, are payable to depositors on the due dates".

Section 27 of the Act provides for the establishment of schemes for insuring deposits held by finance companies and empowers the Central Bank to require finance companies to insure deposits held by them. Appreciation of the object of the Act as is evidenced by these provisions is of some relevance in resolving the dispute before us regarding which the contending parties have taken up diametrically opposite positions. It is also appropriate at this point to refer briefly to the provisions which contain the scheme of the Act in terms of which the impugned decision was made.

Sections 9 and 10 empowers the Monetary Board to give directions to finance companies on a wide range of matters. Sections 11 and 12 empowers the Director to examine books and accounts of a finance company. Sections 13 to 16 provide for the maintenance of accounts and the auditing of accounts of a finance company. Section 18(1) empowers the Board to take steps for the winding-up of a finance company where "it is insolvent or is likely to become unable to meet the demands of the depositors or that its continuance in business is likely to involve loss to its depositors or cerditors".

Where winding-up is contemplated, the Board may direct the finance company to suspend its business and order the Director to take over its books, records and assets. Next, the Board is required, as soon as practicable to notify the finance company that it intends to direct the Director to apply to a competent Court for the winding-up. In the absence of an application to the Supreme Court under Section 43, the Director shall apply to a competent Court for the winding-up. The Court may order the winding-up, in which event, the provisions of the Companies Act relating to winding-up subject to the supervision of Court shall, *mutatis mutandis*, apply. The Director or any person

authorised in that behalf by the Board shall be appointed to be the liquidator (S. 18 (4)(b), S. 18(5), S. 18(7), S. and 18(9).)

If, after inquiry, the Court is of the opinion that the company is not insolvent, it may make a declaration permitting the finance company to resume business unconditionally or subject to such conditions as the Court may consider necessary in the public interest or in the interest of depositors and other creditors of the company (S.18(11) (b)).

Every order made by a competent Court under Section 18 is subject to an appeal to the Supreme Court (S.18(12)).

S. 20(1) empowers the Board to take over the administration and management of a finance company where the Board is of the opinion that the company may be made solvent and viable by action provided for therein. Some of the measures provided are –

(a) entering into an agreement with any person or body of persons for the management of the finance company;

(b) amalgamation of the finance company with any other finance company;

(c) re-organisation of the finance company by increasing its capital and arranging for new shareholders.

Where the Board takes over the administration and management of a finance company, the Board may exercise, perform and discharge the powers, duties and functions of the Board of Directors of such company; whereupon every Director, Manager and Secretary of such company shall, unless expressly authorised to do so by the Board, cease to exercise, perform and discharge any powers, duties and functions with respect to such company (S. 20(2) (a) and S. 20 (3)).

However, if it appears to the Board that the company cannot be made viable and solvent within a reasonable period the Board may direct the Director to apply to a competent Court to wind-up the company in which event, the provisions of Section 18 shall apply (Proviso to S. 20 (4)).

Section 21 enables the Monetary Board to arrange for temporary financial accommodation to a finance company where it would be in the interest of depositors to provide such assistance; and the Board may grant a loan or advance to a Commercial bank from the Fund established under Section 88(E) of the Monetary Law Act, for the purpose of lending to such finance company on such terms or conditions as may be determined by the Board.

As regards the facts, the starting point is a letter dated 28.11.90 addressed by N. U. Jayawardena President of the 2nd respondent company to the then President of the Republic (exhibit 'A'). The letter states that the company has a deposit base of Rs. 1,984 million with 31,700 depositors; that its business had broken down due to the insurgency; that there were also delinquent loans amounting to Rs. 1,232 million, that depositor confidence had also been affected by the collapse of the HPT Ltd. and an "episode at Sampath Bank" (an Associated Company); that in the result, deposits being redeemed exceeded new deposits; and hence there was a lack of funds to carry on its current business. In the circumstances N. U. Jayawardena applied for a re-financing facility through the Central Bank in a sum of Rs. 759 million "exclusively for encashment of maturing deposits".

On 22.05.91 the Cabinet decided to provide financial assistance to the company subject to conditions including the following:

(1) The funding banks to be given a majority number of Directors in the Boards of Company and its subsidiaries.

(2) The management of the company should be irrevocably vested in a Management Committee to be nominated by the funding banks.

(3) The entire sum of Rs. 750 million will be used only to pay off the depositors. (exhibit YB).

The Articles of Association were accordingly amended after which, on 05.07.91 six nominee directors representing the funding banks, namely the Bank of Ceylon and the People's Bank were included in the Board of Directors of the Company. On 23.07.91 the

new Board decided that A. N. U. Jayawardena (son of N. U. Jayawardena) will continue as Chairman but will cease to be Managing Director, which post will be taken over by J. A. R. Felix, Chairman of the Management Committee. It was agreed that N. U. Jayawardena will be present in the premises so that he could guide and offer his advice to Felix as Managing Director who would however have the final decision making power subject to the control of the Board of Directors (exhibit Y17).

Notwithstanding the above arrangements, the relationship between the share owning Directors and the Management Committee appears to have deteriorated very early. Thus on 24.12.91 the Director, Bank Supervision addressed a letter to the Chairman, Management Committee that the Management Committee will be given instructions from time to time by the Governor of the Central Bank and the Monetary Board; hence the Committee should "completely ignore instructions of any other party, given orally or in writing" (exhibit 'D'). This was followed by a letter dated 27.12.91 addressed to A. N. U. Jayawardena, Chairman, by the Managing Director requesting him to release the office area allocated to the Chairman as his functions were then limited to attending Board meetings and associated matters (exhibit 21).

The petitioner alleges that the relationship between share-owning Directors and the Management Committee became strained due to ill will on the part of the then Governor of the Central Bank towards N. U. Jayawardena. Learned Counsel for the petitioner submitted that the Governor by a series of press statements (some of which contained disparaging remarks against the original Directors) caused further loss of depositor confidence, leading to the collapse of the company. The relevant newspaper reports which have been produced without contradiction show that there is substance in the allegation that the then Governor was motivated by ill will.

The culmination of the above situation was that on 05.02.92 all the share owning Directors resigned. Consequently, on 06.02.92 the Board took over the administration and management of the company under Section 20 of the Act (exhibit 'F'). This was not challenged before this Court by an application under Section 43. As at that date, the deposit liability of the company was Rs. 1331.1 million. On

30.06.92 the former Governor ceased to hold office and the present Governor was appointed.

Next, we find the progressive reduction of deposit liability. By 31.12.92 it was reduced to Rs. 627.8 million. On 31.10.93, it was Rs. 440 million. By 06.01.94 it was further reduced to Rs. 425 million. In the process financial assistance provided to the company by the banks up to 15.09.93 totalled Rs. 965.6 million.

Although the deposit liability was so reduced, as at 31.03.92 unrecovered loans granted by the company to its subsidiaries was Rs. 348,022,153/- whilst its liability to the banking sector as at 31.12.92 was Rs. 1647 million.

According to a press statement by the new Governor on 25.07.92, the Central Bank intended to call for competitive offers from banking and financial institutions to take over the company on a management contract, as the Central Bank does not have the expertise to manage finance companies. He explained that Bank control of companies is a temporary phase intended to make them viable so that they will be able to settle their depositors and manage on their own (exhibit 'H'). However, there was no statutory body or institution prepared to take over the company; and the Bank, acting on a report of the Director was of the opinion that the company could not be made viable and solvent and hence decided to direct the Director to apply to a competent Court to wind-up the company. This was communicated to the company by letter dated 28.10.93 (exhibit 'J').

The petitioner does not seriously challenge the above state of affairs in the company but alleges that this was due to mismanagement on the part of the 1st respondent, in particular by its failure to invest monies recovered on loans in new revenue generating businesses. The petitioner seeks to quash the impugned decision on the basis that firstly, it was *mala fide*; secondly it was made for a collateral purpose, namely, to shield the situation created by the 1st respondent by mismanaging the affairs of the company; thirdly it was contrary to Section 12A of the Act which required the 1st respondent to furnish to the company a copy of the report made under Section 18 and to give the company an opportunity to state its position; hence it was also contrary to the principles of Natural Justice.

Learned Counsel for the petitioner argued that if the 1st respondent has settled deposit liabilities winding-up is not justified. In any event, the 1st respondent's decision should be quashed as it was *mala fide*. Counsel added that on the other hand, if winding-up is absolutely necessary, it is open to the Central Bank, the Bank of Ceylon or the People's Bank to apply for a winding-up by Court, in their capacity as creditors of the company.

Learned Deputy Solicitor General for the 1st respondent submitted that even assuming that the former Governor of the Central Bank was actuated by *mala fides* it has no relevance to the decision to apply for a winding-up; that in making the said decision the 1st respondent acted within its statutory power; and that there is no nexus between the conduct of the former Governor and the impugned decision which was made long after he had ceased to hold office. He also submitted that as the evidence shows, the said decision was taken after long and protracted discussions with the share owning Directors led by N. U. Jayawardena regarding the affairs of the company. Hence, there is no breach of the principles of Natural Justice. He submitted that in all the circumstances, it should be left to the competent Court to make the decision on the winding-up of the company.

The D.S.G. also made the point that the company which is the party most affected by the impugned decision has not challenged the proposed winding-up. Hence, this Court should not entertain the application of the petitioner who is only a minority share holder. This raises the question of the status of the petitioner as in the case of *Durayappah v. Fernando* [1]. However, I do not propose to consider this question particularly in view of the fact that by reason of the take over of the administration and management of the company by the Board, every Director, Manager and Secretary of the company ceased to exercise, perform and discharge any powers, duties and functions in respect of the company.

As regards the failure of the 1st respondent to furnish to the company a copy of the Director's report and to allow it to state its position, it is to be noted that in terms of Section 12A relied upon by the petitioner, the Board is permitted to act without allowing such

opportunity where it is necessary to take immediate action, in the interest of the depositors and the finance company. In any event, as the D.S.G. submitted, the evidence shows that the question of re-organisation of the company was discussed at length with the share owning Directors, before the decision to apply for winding-up was made. I, therefore, hold that the said decision was *intra vires*. It is also not vitiated by *mala fides*.

As regards the complaint that the 1st respondent mismanaged the affairs of the company by failing to invest monies recovered on loans in new businesses, I am of the view that action which may be taken by the Board is prescribed by Section 20(2), which is what the new Governor explained in his press statement (exhibit 'H'). That section does not appear to contemplate the kind of action contemplated by the petitioner. What is relevant here is the fact that there was no person or institution who was prepared to collaborate with the Board in reviving the company. This is understandably due to the fact that the company which had a deposit base of Rs. 1,984 million had developed serious liquidity problems. Nobody in the business world would possibly agree to take over the management of such a company which had lost depositor confidence and was without funds to carry on its current business, as early as 28.11.90, as evidenced by N. U. Jayawardena's letter 'A'.

I am of the view that in the circumstances it is not a matter for this Court to consider whether the company may be wound up because that is essentially a decision for the competent Court, subject to an appeal to this Court. Suffice it to hold that the impugned decision was not unlawful. The petitioner has failed to establish sufficient cause for quashing that decision. I accordingly, dismiss the application. In all the circumstances, I make no order as to costs.

G. P. S. DE SILVA, C.J. – I agree

RAMANATHAN, J. – I agree

Application dismissed.