[PRIVY COUNCIL]

1971 *Present :* Lord Hodson, Viscount Dilhorne, Lord Wilberforce, Lord Diplock, Lord Cross of Chelsea

THE JUPITER CIGARETTE & TOBACCO CO., LTD., Appellant,

and H. C. HENRY SOYSA and others, Respondents

PRIVY COUNCIL APPEAL No. 40 OF 1970

S. C. 156/66—D. C. Colombo, 9039/MB

Company law—Mortgage debt incurred by Company within the powers of the Company—Formalities required for the transaction—Sufficiency—Number of Directors who should sign the mortgage bond.

Where the borrowing of a sum of money is fully within the powers of a Company as such and does not require a resolution of a general meeting of the Company, a mortgage debt incurred honestly and bona fide by the Company, without causing any prejudice to the shareholders, binds the Company notwithstanding that the number of Directors who have signed the mortgage bond happens to be less than the number required by the Articles of the Company. (In the present case the mortgage bond was approved by only two instead of three Directors.)

APPEAL from a judgment of the Supreme Court reported in *(1968) 72 N. L. R. 12.*

B. J. Fernando, for the defendant-appellant.

H. W. Jayewardene, Q.C., with *Ben Eliyatamby*, for the plaintiffs-respondents.

Cur. adv. vult.

May 24, 1971. [*Delivered by* LORD WILBERFORCE]—

This is an appeal from the Supreme Court of Ceylon which allowed an appeal from the judgment of the District Court of Colombo whereby a hypothecary action instituted by the respondents against the appellant was dismissed with costs. The Supreme Court entered judgment for the respondents in the terms sought by the plaint.

The action was brought by the respondents upon Mortgage Bond No. 432 dated 13th August 1960. This Bond was executed under seal by the appellant to secure repayment to the respondents of Rs. 125,000/- said to have been lent by the respondents in specified amounts to the appellant. The Bond charged certain property of the appellant by way of mortgage to secure the loan. The appellant in its answer raised a number of defences. It denied having borrowed and received the money : it pleaded that the alleged borrowing was not for the purposes of the Company and that there was no resolution or decision, in accordance with the Articles of the appellant Company, to borrow the sum alleged or

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authorising the alleged execution of the Bond: it contended that, for those reasons, the alleged borrowing or the alleged execution of the Bond was *ultra vires* the Company. There was also a plea of misjoinder of parties and causes of action.

At the trial in the District Court the execution of the Bond by the appellant, under its seal, was established. It was proved that the appellant had received the sum of Rs. 125,000/- from the respondents and had not repaid it. But it was held that there was no resolution or decision of the appellant Company to borrow the sum, or for the execution of the Bond, or authorising the borrowing or the execution of the Bond. It was further held that the borrowing or execution of the Bond was *ultra vires* the appellant.

On appeal, the Supreme Court decided that, under the terms of the appellant's articles, the borrowing in question did not require a resolution of a general meeting of the Company and could be authorised by the Directors. It held that as the Bond was signed by two persons who were Directors of the Company the Company could not avoid liability. Even if there was some irregularity in the appointment of the Directors, the borrowing had been ratified by the Company.

The Supreme Court also decided that there had been no misjoinder of parties or causes of action—a matter with which the District Court had not found it necessary to deal. This point was not pursued before the Board.

Thus the questions outstanding on the present appeal were —

(i) whether the borrowing was authorised by the appellant Company, either through a resolution in general meeting, or by its Directors, or in some other manner,

(ii) whether, if not, the borrowing was capable of being and was ratified by the appellant Company,

(iii) whether the money was borrowed for the purposes of the appellant Company.

Before dealing with these issues it is necessary to refer to some factual matters.

The appellant Company is a private Company the shareholders in which before 13th August 1960 were Messrs Edirisinghe, Soysa, H. R. Fernando, Selvanathan and Chapman, as well as various associates of these persons. The five persons mentioned were also Directors of the Company. One Sivadas was Secretary, and held one share. The Company was to manufacture cigarettes but had not gone into production for lack of funds. Mr. Edirisinghe therefore offered to acquire all the shares of the other shareholders.

On or about 12th or 13th August 1960, certain meetings took place between the shareholders or some of them and figures were provided in a statement of affairs which were to form the basis of the purchase.

This statement, as at 31st May 1960, showed the liabilities of the Company (apart from its capital) as amounting to Rs. 229,995. Of this Rs. 108,252 represented money due to some suppliers of machinery and Rs. 9,355 sundry bills; so that the total of outstanding borrowing came to approximately Rs. 112,000. The issued and paid up capital amounted, it appears, to Rs. 324,000.

The agreement reached was that Mr. Edirisinghe should purchase all the shares of the other shareholders for Rs. 84/75 per share of Rs. 100/-, that the shareholders should lend the Company Rs. 125,000 on a mortgage, and that the Directors' outstanding loans (amounting to Rs. 84,413) should be repaid. On 13th August 1960 the shareholders executed transfers of their shares, and received cheques for the appropriate amounts (at Rs. 84/75 per share) from Mr. Edirisinghe. All the shares were transferred to Mr. Edirisinghe personally. Mr. Edirisinghe at the same time transferred one share to each of Samel Appuhamy and O. Podihamine who were respectively the father and mother of Mr. Edirisinghe. It seems clear that the money for these shares was paid by Mr. Edirisinghe and that Appuhamy and Podihamine acquired them as nominees for Mr. Edirisinghe. Mr. Edirisinghe stated in evidence that the Company thereupon was a one man Company. Later annual returns of the appellant Company showed that the transfers were registered on 16th August 1960: but the position seems, clearly enough, to be that as from 13th August 1960 Mr. Edirisinghe was, in equity, the beneficial owner of the entire share capital.

The mortgage Bond, the subject of the action, was, as stated, executed on 13th August 1960. It was sealed by the Company's seal and witnessed by Mr. Edirisinghe, who signed it, and Mr. S. Appuhamy who affixed his mark. It was attested by Mr. M. Ranganathan, Notary Public. Both Mr. Edirisinghe and Mr. Appuhamy were described as Directors. The Bond contained a recital that the Mortgagor (sc. the appellant Company) at a meeting of its members held on 12th August 1960 had resolved to borrow sums totalling Rs. 125,000 from the respondents on the security of the land and premises specified, and proceeded with appropriate clauses recording the loan and establishing the mortgage. Particulars of the mortgage were duly registered on 22nd August 1960 in the Companies Registry pursuant to s. 78 of the Companies Ordinance. The registration is stated to have been effected by Mr. Edirisinghe.

The Bond having, on the face of it, been duly executed and notarially attested, it was for the appellant Company to establish, to the satisfaction of the Court, that, notwithstanding this fact, and the recital above mentioned, the Bond was invalid, or *ultra vires* the Company. At the trial, the appellant Company concentrated its efforts towards proving that the recital was incorrect and that no meeting of shareholders had taken place to authorise the borrowing. There were produced at the trial purported minutes of three meetings supposedly held on 12th August 1960. The first was a meeting of the then Directors of the appellant Company at which it was stated that two transfers of shares

were passed in favour of Appuhamy and Podihamine. The second was of an extraordinary general meeting of the shareholders at which two directors resigned and Appuhamy was appointed a director and at which the transfer of shares to Appuhamy and Podihamine was "ratified and confirmed". The third was of an extraordinary general meeting of the shareholders at which three of the former directors resigned and Podihamine was appointed a director. There followed according to the minute an authorisation of the borrowing of Rs. 125,000 from the respondents and a resolution that Edirisinghe and Appuhamy "two of the Directors of the Company" be authorised to execute the Bond under the seal of the Company. The minute recorded the presence of all the main shareholdres, and of Appuhamy and Podihamine and stated that Mr. Abeywardene and Mr. Ranganathan. Proctors. were present on invitation.

The learned trial judge heard witnesses with regard to these alleged meetings. Those who gave evidence were Mr. Edirisinghe, Mr. H. R. Fernando, Mr. Abeywardene and the son of Mr. Chapman. In his judgment the learned judge reviewed this evidence in detail and held that no meeting of the shareholders was held on 12th August 1960 at which a resolution was passed with regard to the alleged loan. The appellant Company had therefore no power to borrow the money.

The Supreme Court, in their judgment delivered by Sirimane, J. dealt with the matter on different lines. They held that the trial judge attached too much importance to the exact date of the meeting at which directors were appointed. At the time the Bond was signed, Mr. Edirisinghe was admittedly a Director, and Mr. Edirisinghe in evidence had said that his father—Appuhamy—was a director on 13th August 1960. "This fact was never in dispute". There was no need for a shareholders' resolution, since, under the terms of Article 69 of the appellant Company, the Directors had power to authorise the borrowing. The borrowing was validly approved by two directors for the purposes of the Company. No formal resolution was required. The Bond was therefore valid and binding. In any event the Company had clearly ratified the borrowing.

In their Lordships' opinion, the approach of the Supreme Court to the question of the validity of the Bond was correct. They emphasised that the transaction was honest and *bona fide*, and that no shareholders were prejudiced. The Company undoubtedly had received the money. The Court was clearly right in holding that the money was borrowed for the purposes of the Company and in rejecting the argument that it was borrowed for the purpose of purchasing the shares. Mr. Edirisinghe had enough money of his own: the Rs. 125,000/- was paid into the Company's account, where it remained for about a month, and Mr. Edirisinghe paid for his shares with his personal cheques. Indeed the trial judge himself seems to have been of the same opinion on this point.

Equally, in their Lordships' opinion, the Supreme Court correctly decided that no resolution of a general meeting was required to authorise the borrowing. Under Article 69, any borrowing could be authorised by the Directors provided that the total amount borrowed and then outstanding did not exceed the amount of the subscribed capital of the Company. The court had no difficulty from the statement of affairs previously mentioned in showing that this condition was met. The relevant figures have been set out above.

There remained however the difficulty that the Bond was approved only by two directors. The Articles require the Company to have not less than three directors. There is no finding whether, on 13th August 1960 Podihamine was a director nor, if so, whether she approved the Bond. The authority must therefore rest on that of either Mr. Edirisinghe himself or that of Mr. Edirisinghe and Mr. Appuhamy jointly.

In consjdering the question of authority, it has to be borne in mind that the act, whose validity is in question, namely the borrowing of Rs. 125,000/- was one fully within the powers of the Company as such. The Memorandum, Clause 3 (34) amply covers the transaction. The question therefore is whether the machinery used was such as to bind the Company. In considering questions such as this, which are of common occurrence, particularly in relation to private companies, the Courts have evolved principles, basically of common sense, which, while respecting the separate corporate entity of the company concerned, enables it to bind itself, as against third parties, in the absence of technicality or the formalities of internal procedure. One example of this is furnished by the rule known by the name of *Royal British Bank v. Turquand*[1] (1856) 6 E. & B. 327 namely that persons contracting with a company and dealing in good faith may assume that acts within its powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular. Another is that an *intra vires* act which has the approval or acquiescence of all the shareholders may be valid even in the absence of a meeting of the shareholders, and notwithstanding that it is performed without the formality required by its articles.

It is clear that the Supreme Court had these principles in mind in relation to the facts of the present case : either would suffice to validate the loan and either is potentially relevant to a company, and a situation, such as we have here. Their Lordships have some doubt whether, on the evidence which was before the District Court, the proved facts were such as to justify the application of the first ; for it might be said, and there was no clear finding to the contrary, that the respondents, or one or more of them, had sufficient notice that irregularities in the constitution of the Board of Directors of the appellant at the relevant date may have existed. But, however that may be, their Lordships are clearly of opinion that the second principle may be invoked by the respondents. The width of cases to which it may be applied is shown by the case before the

[1] *(1856) 6 E. & B. 327.*

Supreme Court of Canada of *Walton v. Bank of Nova Scotia et al.*[1] (1966) 52 D.L.R. vol. 2 p. 506 where numerous other authorities are reviewed. The present falls precisely into the category of cases in which the Courts have applied the rule. Mr. Edirisinghe (to use the words of the Supreme Court of Canada) not only approved the borrowing: he instigated it throughout as part of the arrangements under which he took over the Company from the pre-existing shareholders: In these circumstances he was in no position to set up alleged irregularities in the appointment or proceedings of the Directors of the company as a defence to an action upon the loan of which the Company had the benefit.

Their Lordships therefore find themselves in agreement with the Supreme Court in holding that the borrowing was authorised and the bond valid. The question of subsequent ratification does not arise.

Their Lordships will humbly advise Her Majesty that the appeal be dismissed: the appellant must pay the costs of the appeal.

Appeal dismissed.