

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

In the matter of an application for Leave to Appeal to the Supreme Court of the Democratic Socialist Republic of Sri Lanka under and in terms of Article 128(2) of the Constitution read with the Supreme Court Rules of 1990 and Section 5(2) of the High Court of the Provinces (Special Provisions) Act, No. 10 of 1996.

Jaqa Lanka International (Pvt) Ltd
No. 46/1, Fife Road,
Colombo 05.

Petitioner

SC. APPEAL 50/A/2013
SC/(CHC) Appeal/50/2013
HC (Civil) 4/2008/CO

~Vs

Bank of Ceylon
No. 04, Bank of Ceylon Mawatha,
Colombo 01.

Respondent

AND NOW BETWEEN

Bank of Ceylon
Formerly at No. 04, Bank of Ceylon
Mawatha, Colombo 01
And presently at, 'BOC Square'
No. 01, Bank of Ceylon Mawatha,
Colombo 01

Respondent-Petitioner-Appellant

~Vs~

Jaqa Lanka International (Pvt) Ltd
No. 46/1, Fife Road,
Colombo 05.

Petitioner-Respondent

BEFORE: Hon. Buwaneka Aluwihare, PC, J.
Hon. Murdu N.B. Fernando, PC, J.
Hon. Yasantha Kodagoda, PC, J.

COUNSEL: Milinda Gunetilleke, ASG, PC with Ms. N. N. P. Sandeepani for the Respondent-Appellant.
Avindra Rodrigo, PC with Ms. Nishika Fonseka instructed by M.J.S. Fonseka for the Petitioner-Respondent.

ARGUED ON: 07.02.2023.

WRITTEN SUBMISSIONS: Respondent-Petitioner-Appellant on 19.11.2013 and 24.08.2018
Petitioner-Respondent on 14.06.2018 and 27.02.2023

DECIDED ON: 31.10.2023.

Judgement

Aluwihare, PC, J.,

- 1) This is an appeal against an Order of the Commercial High Court of the Western Province holden in Colombo, relating to the winding up and liquidation of a company, and payment of its Creditors according to their character. Before examining the questions of law, I find it prudent to note the factual matrix of this case.

The Facts

- 2) The Petitioner-Respondent (hereinafter referred to as the Respondent) had obtained five banking facilities from the Respondent-Petitioner-Appellant Bank (hereinafter referred to as the Appellant) including an overdraft facility, a term loan, a hypothecation loan and a trust receipt. The overdraft facility for USD 40,000 had been secured by way of mortgage over leasehold property of a Factory Building and a Corporate Guarantee. For that purpose, a Mortgage Bond bearing No. 443/219 dated 06.12.1990 and a Corporate Guarantee was entered into between the parties. **The present dispute relates to this facility.**
- 3) The Respondent subsequently made an application before the Commercial High Court to be wound up by court under **Section 270(a) and 270(e) of the Companies Act**. The Winding Up order was issued on 29th April 2008 and a liquidator was appointed by the Court. Subsequently, the Appellant bank made a statement of claim to the liquidator and was recognised in the liquidator's report (marked 'A' in the Petition of Appeal) as a 'secured creditor' in respect of the factory building, among other things. Thereafter, the liquidator by letter dated 04.12.2009 (marked 'D' in the Petition) informed the Appellant Bank that the entire machinery and equipment of the Company situated in the Factory Building have been disposed of and the only remaining asset is the building itself. He further informed the bank that as the building is mortgaged to the bank, **proceeds of the disposal of the factory building are payable to the bank subject to the deduction of expenses and fees.** The letter also noted the

direct expenses incurred by the Liquidator in respect of insurance amounting to Rs. 30,647 (for three months) and security charges amounting to Rs. 102,583 (per month) for safeguarding the building and requested the Appellant Bank to reimburse the costs borne for those expenses with effect from 01.01.2010.

- 4) On or around 8th October 2009, the Appellant Bank filed a Statement of Objections to a Report filed by the Liquidator on 31st August 2009 objecting to the Liquidator deducting a sum of Rs. 806,268.15 as fees and expenses incurred by the Liquidator in relation to the sale of machinery mortgaged by the Respondent to the Appellant Bank. The sale proceeds amounted to Rs. 518,000.00. The Liquidator had also stated a sum of Rs. 288,268.15 as being due from the Appellant in the Report dated 31st August 2009. On or around 4th December 2009, the Liquidator requested the Appellant to meet the expenses relating to insurance and security of the factory building of the Respondent under liquidation, which had been mortgaged to the Appellant. **The Appellant did not respond.**
- 5) On 06.01.2010, the Appellant Bank sent a letter to the Liquidator stating that in 'voluntary winding up' matters, the cost of winding up including for the safeguarding of assets should be borne by the company and its directors. Responding to that letter, the Liquidator wrote back (letter marked 'E') noting that the proceedings were not in the nature of a 'voluntary winding up', but a 'winding up by court' in terms of Section 270 of the Companies Act. The letter further informs the Appellant Bank that a sum of Rs. 2,272,617.41 has been paid to cover expenses pertaining to insurance, security, maintenance and other expenses, and that these expenses "*should be reimbursed from the proceeds that would be realized on the disposal of the said building and premises in the course of liquidation proceedings.*"
- 6) Thereafter, the liquidator, acting in terms of Section 358(8) of the Companies Act sent a letter (marked 'G' in the Petition) requiring the Appellant Bank, as a secured creditor, to elect which of the Powers under Section 358(1) it wished to exercise, within 20 working days. **The Appellant Bank did not respond to**

this letter either. By motion dated 3rd March 2010 the Appellant contended that the Liquidator's letters aforementioned had created a dispute between the Liquidator and the Appellant and sought an inquiry from the Court. The Court inquired into the issue by way of written submissions and delivered its Order (marked 'H') stating that:

1. Where a secured creditor has not acted in terms of Section 358(1), the Liquidator is entitled to recover costs and expenses from the assets, including assets mortgaged to the Bank;
2. The objection that the Liquidator cannot deduct costs and expenses from the proceeds realised from the sale of the mortgaged assets cannot be accepted;
3. The application of the Bank that the Liquidator's letters must be withdrawn cannot be accepted.

This Order has not been appealed against by the Appellant.

- 7) Thereafter, with the permission of the High Court and the Appellant bank, the Liquidator sold the factory building which had been mortgaged to the Appellant Bank for a sum of USD 375,000 out of which **USD 56,761.29 (Rs. 6,597,644.21), being the sum secured by Mortgage Bond No. 443/219 in favour of the Appellant, was directly paid to the Appellant by the Purchaser** (documents marked 'J, K1, K2, L' in the brief). On 22nd September 2011, the Liquidator wrote to the Appellant Bank (marked 'M') informing the Bank of the amounts due after the realisation of the machinery and factory building was realised. The amounts were stated as follows:

Mortgaged Machinery	Rs. 518,000.00	
Mortgaged Building	<u>Rs. 6, 597,644.21</u>	Rs. 7,115,644.21
Less:-		
Paid to Bank of Ceylon as Secured Creditor		<u>Rs. (6,597,644.21)</u>
		Rs. 518,000.00

Less:-

Fees and Expenses incurred

by the Liquidator and

Remuneration of the

Liquidator as at 22.09.2011 Rs. 2,573,445.75

Factory Building Insurance Rs. 436,925.96

Factory Building Security Rs. 4,611,871.60 Rs. (7,622,243.31)

Net Amount Receivable from BOC as at 22.09.2011 Rs. (7,104,243.31)

8) In a subsequent report filed by the Liquidator before the Commercial High Court, dated 9th May 2012, the Liquidator reported the costs and expenses incurred in relation to the sale of the factory building which included Liquidator's fees, insurance of the building and provision of security for the building aggregating Rs. 7,622,243.31. The Report further states that the net amount receivable from the Appellant Bank as at 22.09.2011 was Rs. 7,104,243.31. The Liquidators' said report alleges that although the Appellant Bank was called upon to meet the said amount by letters dated 14.07.2010 and 22.09.2011, the Liquidator had not received a response from the Appellant Bank. The Liquidator also informed the Appellant that this sum was due. The Liquidator sought to recover the said sum from the Appellant Bank; claiming that the proceeds of the sale now formed part of the general pool of assets of the Company as the Appellant had lost its character as a Secured Creditor.

9) The Appellant Bank objected to the Liquidator's report referred to in the preceding paragraph and sequel to which an inquiry was held, and the High Court made an Order (dated 7th June 2013 marked 'P'). **The Order stated that the Appellant Bank be treated as a 'unsecured creditor' and that the money paid to the Appellant bank must be recovered from the Appellant Bank, to be returned to the liquidation pool.** Aggrieved by the said Order, the Appellant made an application for leave to appeal on 18th July 2013. This court granted Special Leave to Appeal on the questions of law referred to in sub-paragraphs (i)-(xiii) of paragraph 24 of the Petition of the Appellant Bank.:

(i) Did the Learned High Court Judge err in law holding that a creditor in winding up proceedings is under an obligation to reimburse the liquidator for

expenses incurred, from moneys already recovered via a winding up process?

(ii) Did the Learned High Court Judge misdirect himself in fact and/or law by failing to consider that the entire proceeds of the sale were paid to the Respondent?

(iii) Did the Learned High Court Judge err in law in holding that the rights of parties in relation to the dispute referred to in written submissions dated 09.07.2012 and 21.09.2012 has been conclusively determined by the Order of the Commercial High Court dated 07.06.2013?

(iv) Did the Learned High Court Judge err in fact and/or law in failing to recognise that the liquidator had by his own admission and conduct admitted that the Appellant is a secured creditor?

(v) Did the Learned High Court Judge err in fact and/or law in holding that the Appellant should be treated as an unsecured creditor in terms of Section 358(1)(c) of the Companies Act, No. 07 of 2007?

(vi) Did the Learned High Court Judge err in fact and/or law in failing to recognise the right conferred on the Appellant Bank by Mortgage Bond No. 443/219 dated 06.12.1990?

(vii) Did the High Court err in law in failing to consider that the Mortgage over the relevant property had been released on the basis that the sums secured by the said Mortgage be paid to the Appellant?

(viii) Did the High Court err in fact and/or law in failing to consider that the transaction for the sale of the property subject to Mortgage Bond No. 443/219 was carried out upon the condition that the Appellant's rights under the said Mortgage would be given effect to?

(ix) Is the Order of the Learned High Court Judge in contravention of Section 365 and the Ninth Schedule to the Companies Act, No. 07 of 2007?

(x) Did the learned High Court Judge err in failing to recognise that the liquidator has failed to substantiate his claim?

(xi) Did the Learned High Court Judge err in failing to recognise that the liquidator has failed to recover all costs incurred by him in the manner provided in the Section 365 and the Ninth Schedule to the Companies Act, No. 07 of 2007?

(xii) Did the Learned High Court Judge err in failing to recognise that the liquidator's demands are illegal, unreasonable and are inconsistent with the

purpose of liquidation?

(xiii) Did the Learned High Court Judge err in failing to recognise that the liquidator has no legal right/power to demand repayment of any sum duly paid to a creditor in a liquidation action?

10) In the course of argument of this matter, the parties focused on two questions of law and as such, I wish to confine this judgement to to the two issues relating to which submissions were made by the learned Counsel for the respective parties as the two questions would succinctly address all questions of law on which special leave was granted. The two questions are reproduced below..

1. Did the Appellant become an Unsecured Creditor by operation of and under and in terms of Section 358 of the Companies Act, No. 07 of 2007?
2. Is the Liquidator entitled to deduct expenses including the sum paid for the discharge of mortgage from and out of the sums realised from the sale of assets of the Company under liquidation?

Analysis

1. Did the Appellant become an Unsecured Creditor by operation of and under and in terms of Section 358 of the Companies Act, No. 07 of 2007?

I wish to reproduce Section 358 of the Companies Act in its entirety for ease of reference as I would be referring to several limbs of that Section in this judgement.

Section 358 states:

“(1) A secured creditor may—

(a) seize, attach and realise, issue execution against or appoint a receiver in respect of property subject to a charge, if entitled to do so;

(b) value the property subject to the charge and claim in the liquidation—

(i) as a secured creditor for the amount of his claim, up to the value of the security; and

(ii) as an unsecured creditor for the balance due, if any; or

(c) surrender the charge to the liquidator for the general benefit of creditors, and claim in the liquidation as an unsecured creditor for the whole debt

(2) A secured creditor may exercise the power referred to in paragraph (a) of subsection (1) whether or not the secured creditor has exercised the power referred to in paragraph (b) of subsection (1).

(3) A secured creditor who realises property subject to a charge—

(a) may claim as an unsecured creditor for any balance due after deducting the net amount realised;

(b) shall account to the liquidator for any surplus remaining from the net amount realised after satisfaction of the debt, including interest payable in respect of that debt up to the time of its satisfaction and after making any proper payments to the holder of any other charge over the property subject to the charge.

(4) If a secured creditor values the security and claims as a secured creditor, the valuation and claim shall be made in the prescribed form and shall—

(a) contain full particulars of the valuation and claim;

(b) contain full particulars of the charge including the date on which it was given; and

(c) identify any documents that substantiate the claim and the charge,

and the provisions of sections 359, 360 and 362 shall apply to any claim as

a secured creditor.

(5) The liquidator may—

(a) require production of any document referred to in paragraph (c) of subsection (4); and

(b) require a claim under subsection (4) to be verified by affidavit.

(6) Where a claim is made by a secured creditor under subsection (4), the liquidator shall either—

(a) accept the valuation and claim; or

(b) reject the valuation and claim in whole or in part, but—

(i) where a valuation and claim is rejected in whole or in part, the creditor may make a revised valuation and claim within ten working days of receiving notice of the rejection; and

(ii) the liquidator may if he subsequently considers that a valuation and claim was wrongly rejected in whole or in part, revoke or amend that decision.

(7) Where the liquidator—

(a) accepts a valuation and claim under paragraph (a) of subsection (6);

(b) accepts a revised valuation and claim under subparagraph (i) of paragraph (b) of subsection (6); or

(c) accepts a valuation and claim on revoking or amending a decision to reject a claim under subparagraph (ii) of paragraph (b) of subsection (6),

the liquidator shall unless the secured creditor has realised the property,

redeem the security on payment of the amount of the claim or the assessed value, whichever is the less.

(8) The liquidator may at any time by notice in writing, require a secured creditor within twenty working days after receipt of the notice—

(a) to elect which of the powers referred to in subsection (1) the creditor wishes to exercise; and

(b) if the creditor elects to exercise the power referred to in paragraph (b) or paragraph (c) of that subsection, to exercise the power within that period.

(9) A secured creditor on whom notice has been served under subsection (8) and who fails to comply with the notice shall be taken to have surrendered the charge to the liquidator under paragraph (c) of subsection (1) for the general benefit of creditors, and may claim in the liquidation as an unsecured creditor for the whole debt.

(10) A secured creditor who has surrendered a charge under paragraph (c) of subsection (1) or who is deemed to have surrendered a charge under subsection (9) may, with the leave of the court or the liquidator and subject to such terms and conditions as the court or the liquidator thinks fit, at any time before the liquidator has realised the property charged—

(a) withdraw the surrender and rely on the charge; or

(b) submit a new claim under this section.

(11) Every person who—

(a) makes or authorises the making of a claim under subsection (4) that is false or misleading in a material particular knowing it to be false or misleading; or

(b) omits or authorises the omission from a claim under subsection (4) of any matter knowing that the omission makes the claim false or misleading in a material particular,

shall be guilty of an offence and be liable on conviction to a fine not exceeding one million rupees or to a term of imprisonment not exceeding five years or to both such fine and imprisonment.”

- 11) In my view, the procedural Scheme provided by Section 358 attempts to reconcile the needs of efficient administration of liquidation with reasonable opportunity for recognition of a claim of a secured creditor, by providing rights, options, and duties for the secured creditors. It is a known fact that our Companies Act of 2007 drew inspiration from the New Zealand Companies Act of 1993 [K. Kanag-Isvaran and Dilshani Wijayawardana, *Company Law* (2014), at p. vii], and Section 305 of the New Zealand Companies Act, although not identical, is similar to Section 358. Section 305(1) of the New Zealand Companies Act contemplates three courses of action for the secured creditor;
1. Realising the property subject to a charge, if entitled to do so;
 2. Valuing the property subject to the charge and claiming in the liquidation as an unsecured creditor for the balance due, if any; or
 3. Surrendering the charge to the liquidator for the general benefit of creditors and claiming in the liquidation as an unsecured creditor for the whole debt.
- 12) It is recognized under the Companies Act of New Zealand that a secured creditor who does not prove a claim in accordance with Section 305 is excluded from distribution. The principle was recognized in *Re H (a Bankrupt)* [1968] NZLR 231 at 237–238, 241 and subsequently it was incorporated under Section 305 of the Companies Act of 1993 of New Zealand [Lisele Theron, *Guide to Company Liquidation* (Lexis Nexis 2013) at p. 63].
- 13) In my opinion, similar to that of the scheme laid down in Section 305 of the

New Zealand Act, as per Section 358(1)(a)(b) and (c) of our Act, a secured creditor may claim his dues in the liquidation **in the manner prescribed**. Section 358(8) provides the process by which a secured creditor may elect which of the powers referred to in Section 358(1) he wishes to exercise. Section 358(9) states that a Creditor who has been noticed, yet *‘who fails to comply with the notice shall be taken to have surrendered the charge to the liquidator under paragraph (c) of subsection (1) for the general benefit of creditors and may claim in the liquidation as an unsecured creditor for the whole debt’* **[emphasis added]**. It is by virtue of this provision that a Creditor who fails to respond to the Liquidator, loses his character as a Secured Creditor and is then compelled to claim in the liquidation process as an Unsecured Creditor. Section 358(10) allows a Secured Creditor who had surrendered a charge under Section 358(1)(c), or who is deemed to have surrendered the charge as per Section 358(9) (as in the instant case), to withdraw the surrender and rely on the charge or submit a new claim before the liquidator realises the property *‘with the leave of the court or of the liquidator’*.

- 14) The Appellant Bank had not responded to the notice sent by the Liquidator (‘BOC 2’) requesting the Appellant to **elect which of the powers mentioned in subsection (1) of Section 358 the Appellant Bank wished to exercise within 20 working days**. It is therefore, correct to state, that as per Section 358(9) the Appellant’s failure to make a selection resulted in the surrendering of the charge to the Liquidator for the general benefit of all Creditors, and the Appellant could then only claim in the liquidation as an Unsecured Creditor for the whole debt. The character of the Appellant effectively changed thereupon from that of a Secured Creditor to that of an Unsecured Creditor.

- 15) The learned ASG argued however that the manner in which the Liquidator treated the Appellant Bank clearly tantamount to the treatment of a Secured Creditor and as such, the Liquidator’s conduct constituted an admission that the Appellant Bank was in fact a Secured Creditor. In the circumstances, he argued, that the Appellant Bank therefore entitled to all Rights and Privileges bestowed upon Secured Creditors under the Companies Act. Importantly, the learned ASG noted the fact that the Liquidator sought the

‘approval’ of the Appellant Bank to sell the property mortgaged, reaffirmed the Appellant’s position as a Secured Creditor.

- 16) It was submitted by the learned President’s Counsel appearing for the Respondent that the purpose of Section 358(9) is to ensure that Creditors in Liquidation are not prejudiced by the inaction on the part of Secured Creditors and that the Liquidation process is not hampered by inordinate delay. It was also submitted that having been allowed the option of exercising its powers, the Appellant Bank’s failure to do so should not permit the Appellant Bank to retain the monies erroneously conveyed to the Appellant by the Purchaser for the sole purpose of obtaining the discharge of the mortgage in order to facilitate the sale of the mortgaged building. Additionally, the learned President’s Counsel noted that such conduct would be wholly contrary to the procedural scheme set out in Section 358(8) and 358(9) of the Act.
- 17) This Court is in agreement with the submissions of the learned President’s Counsel for the Respondent and also wishes to add that the legislature has set out an exhaustive procedural scheme under Section 358 for Secured Creditors to exercise their Rights. Subsections (3) to (7) of Section 358 of the Act provide an exhaustive and meticulous detailing of the procedures to be adopted and performed by Secured Creditors where they wish to exercise their Rights. This court cannot therefore accept the submissions of the learned ASG for the Appellant Bank that the Liquidator has by conduct and action inferred the nature of the Appellant to be that of a Secured Creditor. The purpose of Section 358 is to provide a procedural scheme by which the Rights of a Secured Creditor are exercised and where such procedural scheme is not adhered to and followed by a Secured Creditor, as spelled out in Section 358(9), the Creditor is *“taken to have surrendered the charge to the liquidator under paragraph (c) of subsection (1) for the general benefit of creditors, and may claim in the liquidation as an unsecured creditor for the whole debt”*.
- 18) In the hearing of oral submissions, the learned ASG for the Appellant Bank argued that Section 358(1)(b), 358(1)(c) and 358(2) and 358(9) have no practical application to a situation where the entire debt can be recovered from

the sale of the secured asset, and that in the present case, as the secured asset was worth enough to realise more than the sum secured by the mortgage, the court should interpret the aforesaid sections of the Companies Act in a manner which provides opportunity for the Creditor to practically resolve claims. The learned High Court Judge addresses this contention in his Order dated 7th June 2013 where he notes that where the law specifically provides for the manner in which a secured creditor may realise/surrender its security, the creditor and the liquidator or a third party cannot enter into private arrangements for the realisation of the security beyond the procedural scheme set out in the Act. I am in agreement with the observation of the learned High Court Judge and also wish to note that **it is not for the court to presume that the legislature overlooked the practical application of the relevant sections.** To do so would be to operate on the assumption that the Legislature committed a mistake, which would be violative of fundamental principles of statutory interpretation. As Lord Halsbury stated in *Commissioners for Special Purposes of Income Tax v. Pemsel* [1891] AC 531, at p. 549:

“...a Court of Law is bound to proceed upon the assumption that the legislature is an ideal person that does not make mistakes. It must be assumed that it has intended what it has said...”

And, as Bindra states in **N.S. Bindra’s Interpretation of Statutes, 12th Edition**, at p. 205 *“Even where there is a casus omissus, the remedy lies not with the court, but with the legislature.”*

- 19) In my opinion, it would be incorrect to state that there is a *casus omissus* at all since the procedural scheme of the Act laid down in Section 358 is exhaustive and thorough in its statement of procedures to be adopted for the exercise of a Secured Creditor’s rights in liquidation proceedings.
- 20) Additionally, I wish to note that where the scheme of the Act also provides an opportunity for Secured Creditors to act upon their security diligently via Section 358, the Appellant’s **failure to act** upon such security **according to the procedure mandated by the Act, cannot subsequently be allowed to benefit the**

Appellant as though he was still a Secured Creditor. If such consequence is permitted to be **rationalised** based on the **conduct or behaviour of actors**, as opposed to being **determined by procedure**, the procedural scheme of the act would lose all meaning.

- 21) It was also contended on behalf of the Appellant Bank that the learned High Court Judge erred in holding that the Appellant Bank had to obtain leave of the Liquidator or the Court to withdraw the surrender of its charge *before* the realisation of the property. This argument is not consonant with the wording of subsection (10) as it clearly states that “*A secured creditor who has surrendered a charge under paragraph (c) of subsection (1) or who is deemed to have surrendered a charge under subsection (9) may, with the leave of the court or the liquidator and subject to such terms and conditions as the court or the liquidator thinks fit, at any time before the liquidator has realised the property charged—*

- a. withdraw the surrender and rely on the charge; or*
- b. submit a new claim under this section.”*

- 22) Therefore, it can be settled that the Appellant Bank lost its character as a Secured Creditor by failing to act per the notice under Section 358(8) and did not regain such character as it failed to obtain the leave of the court or the liquidator to withdraw the charge surrendered as mandated by Section 358(10).

2. Is the Liquidator entitled to deduct expenses including the sum paid for the discharge of mortgage from and out of the sums realised from the sale of assets of the Company under liquidation from a Creditor who lost its character as a Secured Creditor?

- 23) It is the Liquidator’s position that the sum expense of Rs. 7,622,243.31 was incurred by the Liquidator as a direct result of the Liquidator having had to secure the assets of the Company that had been mortgaged to the Bank. In the Liquidator’s letter to the Appellant Bank dated 04.12.2009, the Liquidator requested the Bank to meet the said expenses (*vide* ‘G’). This request was

refused. In his subsequent letter to the Bank ('BOC 2'), the Liquidator clarifies his position, notes that he has reserved the right to recover Rs. 2,272,617.41 spent on Insurance and Security charges, requests the Appellant Bank to notify him within 20 working days which of the Powers referred to in S. 358(1) of the Companies Act it wishes to exercise, and requests that should the Appellant elect to use powers referred to in (b) or (c) of S. 358(1), to do so within the mentioned period.

- 24) The Appellant Bank maintains that it is a secured creditor, and as such, the Bank is entitled to full payment of the secured claim regarding the mortgaged property. The Appellant contends that the secured assets of the Company under liquidation do not fall within the ordinary asset pool of the Company and that expenses in relation to insurance and security of the mortgaged asset must be met by the Liquidator without it being set off against the Bank's security. Since it is now settled that the Appellant Bank lost its character as a Secured Creditor and effectively became an Unsecured Creditor by operation of the law, the questions which remains are whether the (now) Unsecured Creditor loses any right to make preferential claims as per the Companies Act, and whether the Liquidator is entitled deduct expenses incurred including the amounts paid to secure the assets before their realisation.

- 25) Section 365 of the Companies Act states:

“(1) The liquidator shall pay out of the assets of the company the expenses, fees, and claims set out in the Ninth Schedule to the extent and in the order of priority specified in that Schedule and that Schedule shall apply to the payment of those expenses, fees, and claims according to its tenor.

(2) Without limiting paragraph 7(b) of the Ninth Schedule, the terms “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.”

- 26) The Ninth Schedule, detailing the manner in which preferential claims must be

addressed by the Liquidator states:

“1. The liquidator shall first pay, in the order of priority in which they are listed: —

- a. the fees and expenses properly incurred by the liquidator in carrying out the duties and exercising the powers of the liquidator and the remuneration of the liquidator;*
- b. the reasonable costs of a person who applied to the court for an order that the company be put into liquidation, including the reasonable costs of a person appearing on the application whose costs are allowed by the court;*
- c. the actual out-of-pocket expenses necessarily incurred by a liquidation committee.*

- 27) Therefore, it is apparent that the Act mandates the sum deduction of costs and expenses incurred by the Liquidator in the procuring of assets subject to a charge for their realisation, **deemed to have been surrendered for the general benefit of Creditors under Section 358(1) of the Act**. Essentially, the collated meaning of the scheme is such that assets subject to a charge are excluded from the general pool of assets from which the liquidator may deduct his expenses and comprise the preferential claim of the relevant secured creditor **unless the charge is surrendered or deemed to have been surrendered as per Section 358(9)**. Accordingly, when a charge is deemed to have been surrendered, such asset forms part of the general pool of assets of the company out of which the claims of unsecured creditors are satisfied upon equal footing as per the ‘*pari passu*’ principle under and in terms of Section 366 which deals with the ‘Claims of other Creditors and distribution of Surplus assets’.
- 28) Furthermore, it is observed that the expenses for the preservation of the Mortgaged building was borne out of the funds generated by the sale of the assets of the company. [Liquidator’s letters marked, D, D2 & E] These funds ought to have been distributed among the Creditors in order of priority as mandated by the Companies Act. The Liquidator was compelled to use the funds of the general pool of assets to cover the expenses as the Appellant had ignored the Liquidator’s request to pay for the security and insurance charges

of the building. Therefore, it was submitted that the Appellant's refusal to reimburse these expenses is unfairly detrimental and prejudicial to other creditors.

- 29) By failing to respond to the letter issued to the Appellant Bank which requested it to elect which powers it wished to exercise under S. 358(1) of the Companies Act, the Appellant Bank surrendered its authority to claim treatment as a secured creditor and the consequences of its own inaction must not be borne by another. Effectively, the whole liquidation process is hampered by the Appellant's inaction and refusal to return to the liquidation the proceeds paid to it for the discharge of the mortgage and its refusal to reimburse the liquidator's expenses.
- 30) Furthermore, it must be noted that the learned High Court Judge, in his wisdom, comprehensively analysed the procedural impropriety which had ensued at the hands of the Appellant Bank and noted the distinction between sum amounts paid for the setting off and discharge of a mortgage and that of sums paid as result of pursuing the procedural scheme set out for the realisation of security and preferential claims set out in Section 358 of the Companies Act. Importantly, the learned High Court Judge notes that if the Appellant Bank claims to have acted as a Secured Creditor, it should have done so after making a valuation and claim in the manner prescribed in Section 358(4) and the Liquidator should have, upon receipt of the claim in the prescribed form, either accepted, revised or rejected the valuation as per Section 358(6) and 358(7). As correctly observed by the learned High Court Judge, the fact that the Appellant Bank had not pursued this procedural scheme would therefore indicate that the Appellant Bank was not, in fact, and by operation of the law, a Secured Creditor and that the proceeds of the realisation paid to the Appellant Bank to set off and discharge the mortgage should be returned to the liquidation process.
- 31) The order of the learned High Court Judge dated 7th June 2013 states that the expenses incurred by the Liquidator (including the amount paid for the discharge of the mortgage) must be recovered from the sale proceeds of

property released from the mortgage. It also states that in the event the sale proceeds are insufficient to recover the Liquidator's expenses, the liquidator is entitled to recover the expenses from the Appellant Bank, in an amount not exceeding the amount paid for the discharge of the mortgage.

- 32) **The Liquidator is therefore entitled to deduct expenses from the proceeds of the realisation of assets** which were previously mortgaged to the Appellant Bank and now surrendered for the general Benefit of Creditors under Section 358(1) of the Act, **in an amount not exceeding the amount paid for the discharge of the mortgage. The Appellant may claim any sums due and owed from the general pool of assets of the Respondent along with other creditors. Accordingly, I uphold the order made by the learned High Court Judge dated 7th June 2013 directing the Appellant to return the monies which were paid to it by the Purchaser amounting to Rs. USD 56,761.29 (Rs. 6,597,644.21), to the Liquidator to be used for the general benefit of all creditors. Accordingly, the appeal is dismissed,**

Appeal dismissed.

Judge of the Supreme Court.

MURDU FERNANDO, PC, J

I agree.

Judge of the Supreme Court.

YASANTHA KODAGODA, PC, J

I agree.

Judge of the Supreme Court.