[IN THE PRIVY COUNCIL.]

1936 *Present:* **Lord Maugham, Lord Salvesen, and Sir Lancelot Sanderson.**

SOCKALINGAM CHETTIAR *v.* RAMANAYAKE *et al.*

Mortgage bond—Security for loan—Fictitious promissory notes given—Action on bond—Loan recoverable—Notes inadmissible in evidence—Money Lending Ordinance, No. 2 of 1918, ss. 2, 10, and 14.

Where a mortgage bond was entered into to secure a loan in respect of which promissory notes, which were "fictitious" within the meaning of section 14 of the Money Lending Ordinance, were given,—

***Held*, that an action may be maintained on the bond to recover the loan, notwithstanding the provisions of section 10 of the Money Lending Ordinance.**

***Held, further*, that the Court has power under section 2 of the Money Lending Ordinance to reopen the transaction and to take an account between the parties.**

The fictitious promissory notes are not admissible in evidence to prove the loan.

APPEAL from a judgment of the Supreme Court [1].

R. M. Montgomery K.C. (with him *Hallett*, K.C., and *L. M. de Silva*, K.C.), for appellants.

Chinnadurai and *Lady Chatterjee*, for the respondents.

November 19, 1936. Delivered by SIR LANCELOT SANDERSON.

This is an appeal by the plaintiffs against two decrees of the Supreme Court of the Island of Ceylon dated August 1, 1933, whereby the Supreme Court set aside an order and a decree of the District Court of Colombo dated December 9 and 21, 1932, respectively and dismissed the action with costs. The respondents are the first and second defendants in the action.

The material facts are as follows:—

By a mortgage bond dated July 28, 1928, the first defendant (Ramanayake) covenanted with the first plaintiff (Sockalingam) and one Ramasamy to pay any sum of money which might thereafter be or become owing and payable to the first plaintiff or the said Ramasamy or either of them upon or in respect of any promissory notes or cheques made or endorsed by the first defendant or upon chits, tundus, or other writings or in respect of any loans or advances or in respect of any accounts or transactions whatsoever with interest at the rate of 12 per centum per annum. The bond further secured all such sums by the mortgage of certain properties therein specified.

On April 1, 1931, the said Ramasamy assigned all his rights under the said mortgage bond to the second plaintiff, and the action in which this appeal arises was brought on the same day.

The plaintiffs thereby sought to recover the sum of Rs. 129,415.87 alleged to be due in respect of money lent on the security of the said bond and upon certain promissory notes: they prayed further for the usual mortgage decree for sale of the mortgaged property in default of payment of the said sum.

[1] *35 N. L. R. 33.*

The second defendant was made a party to the action as a puisne encumbrancer of the mortgaged property.

Certain pleas were made and issues raised to which it is not now necessary to refer, and the questions which arise in this appeal relate to the issues numbered 8 and 9 in the judgment of the District Judge. They are as follows :—

" (8) Are the promissory notes mentioned in paragraph (6) of the plaint or any notes of which they are renewals not enforceable by reason of the failure to give details required by section 10 of Ordinance No. 2 of 1918 ?

" (9) In view of the several allegations in the plaint is the second defendant entitled to ask that the transactions between the first defendant and the plaintiffs or either of them be reopened and an account taken ? "

The District Judge decided that the promissory notes in question were themselves not enforceable but at the same time he held that they were admissible in evidence to prove the amount due on the mortgage bond.

On the 9th issue he held that the second defendant was entitled to ask that the transactions between the plaintiffs and the first defendant should be reopened.

Accordingly on December 9, 1932, he directed the plaintiffs to file in Court a statement showing the moneys actually lent by the first plaintiff and Ramasamy to the first defendant from time to time on promissory notes, the amount of interest actually deducted in advance, the interest which they were entitled to deduct if calculated at 12 per cent. for the period when each note fell due and the amounts paid by the first defendant with the date of each payment.

Accounts were filed by the plaintiffs in accordance with the said order and on December 21, 1932, the District Judge, after investigating the accounts and hearing evidence, held that a sum of Rs. 10,518.13 had been overcharged by the first plaintiff and that a sum of Rs. 7,378.96 had been overcharged by the second plaintiff. He therefore made a decree that the first defendant should pay to the plaintiffs jointly the sum of Rs. 111,518.78 with interest thereon at 12 per centum per annum from April 1, 1931, to date of decree and thereafter on the aggregate amount of the decree at 9 per centum per annum till payment in full and costs of suit forthwith. He further made the usual mortgage decree in respect of the said sums.

The first and second defendants appealed to the Supreme Court by two petitions. The first was against the order of the District Judge of December 9, 1932, and the second against the decree of the said Judge dated December 21, 1932. The Supreme Court held that as the plaintiffs were money lenders the provisions of the Ordinance relating to money lending—viz., No. 2 of 1918—applied to the transactions, that the promissory notes failed to comply with the provisions of section 10 of the Ordinance because some of them did not show the amount of money deducted as interest paid in advance and because others which were renewal notes failed to show the capital sum actually borrowed ; and that under sub-section (2) of the said section the promissory notes were not enforceable.

The Court held that though the bond was not in itself illegal, the promissory notes were illegal, and that the Court would refuse to enforce

the security for those illegal transactions, the bond so far as it secured the illegal transactions being tainted with the same illegality.

Accordingly on August 1, 1933, by the two decrees of that date the Supreme Court allowed both appeals, set aside the order and decree of the District Judge, dismissed the plaintiff's action and directed that the plaintiffs should pay the taxed costs of the first and second defendants.

It is against the above-mentioned decrees that the plaintiffs have appealed to His Majesty in Council.

The material sections of the Ordinance are as follows:—

"2 (1) Where proceedings are taken in any court for the recovery of any money lent after the commencement of this Ordinance, or the enforcement of any agreement or security made or taken after the commencement of this Ordinance in respect of money lent either before or after the commencement of this Ordinance, and there is evidence which satisfies the court—

(*a*) That the return to be received by the creditor over and above what was actually lent (whether the same is charged or sought to be recovered, specifically by way of interest, or in respect of expenses, inquiries, fines, bonuses, premia, renewals, charges, or otherwise), having regard to any sums already paid on account, is excessive, and that the transaction was harsh and unconscionable, or, as between the parties thereto, substantially unfair; or

(*b*) That the transaction was induced by undue influence, or is otherwise such that according to any recognized principle of law or equity the court would give relief; or

(*c*) that the lender took as security for the loan a promissory note or other obligation in which the amount stated as due was to the knowledge of the lender fictitious, or the amount due was left blank—

the court may reopen the transaction and take an account between the lender and the person sued, and may, notwithstanding any statement or settlement of account or any agreement purporting to close previous dealings and create a new obligation, reopen any account already taken between them, and relieve the person sued from payment of any sum in excess of the sum adjudged by the court to be fairly due in respect of such principal, interest, and charges as the court, having regard to the risk and all the circumstances, may adjudge to be reasonable; and if any such excess has been paid or allowed in account by the debtor, may order the creditor to refund it; and may set aside, either wholly or in part, or revise, or alter any security given or agreement made in respect of money lent, and if the lender has parted with the security may order him to indemnify the borrower or other person sued.

(2) Any court in which proceedings might be taken for the recovery of money lent shall have and may, at the instance of the borrower or surety or other person liable, exercise the like powers as may be exercised under the last preceding sub-section, and the court shall have power, notwithstanding any provision or agreement to the contrary, to entertain any application under this Ordinance by the borrower or surety or other person liable, notwithstanding that the time for repayment of the loan or any instalment thereof may not have arrived.

(3) In any insolvency proceedings on any application relating to the admission or amount of a proof in respect of any money lent, the court may exercise the like powers as may be exercised under this section when proceedings are taken for the recovery of money.

(4) The foregoing provisions of this section shall apply to any transaction which, whatever its form may be, is substantially one of money lending.

(5) Nothing in this section shall be construed as derogating from the existing powers or jurisdiction of any court.

8(1) A person who carries on the business of money lending, or who advertises or announces himself or holds himself out in any way as carrying on that business, shall keep or cause to be kept a regular account of each loan, clearly stating in plain words and numerals the items and transactions incidental to the account, and entered in a book paged and bound in such a manner as not to facilitate the elimination of pages or the interpolation or substitution of new pages.

(2) If any person, subject to the obligations of this section, fails to comply with any of the requirements thereof, he shall not be entitled to enforce any claim in respect of any transaction in relation to which the default shall have been made.

Provided that in any case in which the court is satisfied—

(*a*) That the default was due to inadvertence and not to any intention to evade the provisions of this section ; and

(*b*) That the receipt of the loan, the amount thereof, the amount of the payments on account, and the other material transactions relating thereto satisfactorily appear by other evidence—

the court may give relief against any such default on such terms as it may deem just.

10 (1) In every promissory note given as security for the loan of money after the commencement of this Ordinance, there shall be separately and distinctly set forth upon the document—

(*a*) The capital sum actually borrowed ;

(*b*) The amount of any sum deducted or paid at or about the time of the loan as interest, premium, or charges paid in advance ; and

(c) The rate of interest per centum per annum payable in respecrt of such loan.

(2) Any promissory note not complying with the provisions of this section shall not be enforceable.

Provided that in any case in which the court shall be satisfied that the default was due to inadvertence and not to any intention to evade the provisions of this section, it may give relief against the effect of this sub-section on such terms as it may deem just.

(3) The setting forth of the particulars required by sub-section (1) shall not affect the negotiability of any promissory note.

(4) Any promissory note setting forth the said particulars substantially in the form given in the schedule to this Ordinance shall be deemed to be in compliance with this section.

(5) The provisions of this section shall apply to renewals of any loan, and in all such cases the amount stated as the capital sum actually borrowed shall be the amount of the original loan.

13. Any person who shall take as security for any loan a promissory note or other obligation in which the amount stated as due is to the knowledge of the lender fictitious, or in which the amount due is left blank, shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding five hundred rupees, or in the event of a second or subsequent offence, either to a fine not exceeding one thousand rupees, or to simple imprisonment for a period not exceednig six months.

14. A promissory note given in respect of a loan with regard to which a deduction was made or a sum paid at or about the time of the loan in respect of interest, premium, or charges payable in advance, without such deduction or payment being set forth upon the documents in accordance with section 10 (unless the circumstances are such as reasonably to entitle the lender to relief under that section), and any promissory note or other obligation in respect of a loan, with regard to which at or about the time of the loan any payment was

made, or any collateral transaction entered into with a view to disguising the actual amount of the sum advanced, or the rate of interest payable in respect thereof, shall be deemed to be a promissory note or obligation in which the amount stated as due is, to the knowledge of the lender, fictitious within the meaning of sections 2 and 13 of this Ordinance."

Particulars required by "The Money Lending Ordinance, No. 2 of 1918."

1. Capital sum borrowed, Rs. —.
2. interest, premium, or charges deducted or paid in advance, if any, Rs.—.
3. Rate of interest per centum per annum —.

SCHEDULE.

Promissory Note given in respect of a Loan.

Stamp.

On demand (or ——— months after date) I promise to pay to ———, or order, the sum of Rupees ———, with interest thereon at the rate of ——— per centum per annum.

———

(Signature of Borrower.)

At the hearing of the appeal before their Lordships it was admitted by learned Counsel for the plaintiffs that the promissory notes did not comply with the provisions of section 10 inas much as they did not state the interest, premium, or charges deducted or paid in advance and consequently that the promissory notes were not enforceable. Further, it was admitted that the default was not due to inadvertence and that the promissory notes must be taken to be fictitious within the meaning of the Ordinance to the knowledge of the lenders. It was however contended that the District Judge had jurisdiction to reopen the transactions under section 2 of the Ordinance and to take an account between the lenders, viz., the plaintiffs and the person sued, viz., the first defendant and relieve the first defendant from payment of any sum in excess of the sum adjudged by the District Judge to be fairly due in respect of principal, interest, and charges as the District Judge might adjudge to be reasonable.

On the other hand it was contended on behalf of the defendants that inasmuch as the promissory notes were taken as security for the loans and were not only unenforceable by reason of section 10 of the Ordinance but were, by necessary implication from section 13, prohibited, the plaintiffs were not entitled to recover the loans, or any part thereof.

In considering the above-mentioned contentions the first thing to be observed is that in the Ordinance the loan is treated as being something different from the promissory note, which is therein described as a security.

The provisions of section 10 make that clear. The section begins with the sentence, "In every promissory note given as security for the loan of money".

This must be remembered in construing the material words of section 10, sub-section (2), viz.: "any promissory note not complying with the provisions of this section shall not be enforceable," that is to say, the security, consisting of the promissory note, for the loan is not to be enforceable. The sub-section does not provide that the loan shall be irrecoverable. If that had been intended it could easily have been so provided.

It is to be noted that the above-mentioned provision is very different from the words of section 8, sub-section (2), which provides that :—

"If any person subject to the obligations of this section fails to comply with any of the requirements thereof he shall not be entitled to enforce any claim in respect of such transaction in relation to which the default shall have been made."

The difference between the provisions of the two above-mentioned sections is striking and it is abundantly clear that when it was intended to prevent any claim in respect of a transaction being enforced, it was stated in clear and unmistakable language.

In their Lordships' opinion section 2 affords evidence that the provisions of section 10 were not intended to make the loan therein referred to irrecoverable ; for that section provides that where proceedings are taken in any Court for the recovery of any money lent or the enforcement of any security made or taken after the commencement of the Ordinance in respect of any money lent, the Court may reopen the transaction in certain events. One of the events is if the Court is satisfied that the lender took as security for the loan a promissory note in which the amount stated as due was to the knowledge of the lender fictitious or the amount due left blank.

To ascertain what is meant by the phrase in this section "a promissory note in which the amount stated as due was to the knowledge of the lender fictitious" reference must be made to section 14 which provides that a promissory note given in respect of a loan with regard to which a deduction was made or a sum paid at the time of the loan in respect of interest, premium, or charges payable in advance without such deduction or payment being set forth upon the document in accordance with section (subject to the proviso therein stated) is to be deemed to be a promissory note in which the amount stated as due is to the knowledge of the lender fictitious within the meaning of sections 2 and 13 of the Ordinance.

It follows therefore that although the promissory notes in this case were notes in which the amounts stated as due were to the knowledge of the lender fictitious within the meaning of section 14 and could not be enforced by reason of the provisions of section 10, the Court had jurisdiction under section 2 of the Ordinance to reopen the transaction and to take an account between the plaintiffs and the first defendant.

It was argued on behalf of the defendants that section 2 applies only to cases where action is taken by the borrower or by a third person to whom the security in question has passed by way of assignment and that otherwise section 2 would be inconsistent with the provisions of section 10.

Their Lordships are unable to accept that contention.

The provisions of the section are clear and unqualified and there is no justification for putting a construction upon the section which confines the jurisdiction of the Court to the cases suggested in the argument.

Further it appears to their Lordships that there is no inconsistency between section 2 and section 10.

Section 10 provides that if the Court is satisfied that the default was due to inadvertence and not to any intention to evade the provisions of the section the Court may give relief on such terms as it may deem just.

That provision is directed to a state of things quite different from that contemplated in section 2, which provides for a case where the lender has taken as security for the loan a promissory note in which the amount stated as due was *to the knowledge* of the lender fictitious.

In such a case jurisdiction is given to the Court to reopen the transaction and to take an acccount of what is actually due to the lender.

Stress was laid by learned Counsel for the defendants upon the provisions of section 13, and it was argued that inasmuch as the Ordinance provided a penalty for taking a "fictitious" promissory note as security for a loan, it must have been intended that the loan could not be recovered.

There is no doubt that this section and other sections of the Ordinance were intended for the protection of members of the public who might be borrowers from money lenders, and it is quite intelligible that it was considered of great importance that a promissory note taken by a money lender as security for a loan should bear on the face of it the particulars specified in section 10, and that with a view to enforce such protection a penalty was imposed on the money lender in the event of his non-compliance with the provisions thereof.

It does not necessarily follow that it was intended that the loan in respect of which such "fictitious" promissory notes were taken should be irrecoverable, and when the other sections of the Ordinance are taken into consideration and in the absence of any specific provision such as is found in section 8, sub-section (2), to the effect that the money lender should not be entitled to enforce his claim their Lordships are of opinion that the provisions of section 13 do not prevent the Court from reopening the transaction and taking the account under the provisions of section 2.

Their Lordships cannot refrain from saying that in their opinion the true construction of the provisions of the Ordinance is by no means free from difficulty, and they appreciate the point of view adopted by the learned Judges of the Supreme Court, and the reasons stated in support thereof, but after due consideration they have come to the conclusion that the District Judge was right in holding that he had jurisdiction to reopen the transaction and to take the account between the plaintiffs and the first defendant. That being so it was in his discretion to decide whether he should reopen the transaction and take the account, and their Lordships are not prepared to hold that he exercised that discretion wrongly.

Their Lordships, however, are of opinion that the promissory notes which were not enforceable by reason of section 10 and by implication from section 13 prohibited, should not have been admitted in evidence to prove the loans. It is to be observed that the admission in evidence of the notes would make the sections practically valueless. Their Lordships' attention was drawn to certain English decisions, to which in their opinion it is not necessary to refer, inasmuch as their Lordships' decision is based upon the true construction of the provisions of the Ordinance.

The learned Counsel for the defendants desired to rely on the provisions of section 8 of the Ordinance alleging that the books of the plaintiffs were not kept in accordance with the terms of that section. It appears

however, that the defendants wished to raise an issue upon this point at the trial, and upon objection by the plaintiffs the District Judge refused to allow that matter to be relied upon by the defendants as it had not been referred to in the pleadings, and he declined to state any issue in respect thereof.

Their Lordships are of opinion that the District Judge's decision was right in this respect since the proposed issue might well have involved the calling of evidence and they refused to allow learned Counsel for the defendants to argue the point.

It must be clearly understood that on the further taking of accounts, to which reference will presently be made, the above-mentioned defence will not be open to the defendants.

The District Judge apparently allowed a rate of interest higher than 12 per cent. per annum in respect of certain loans for short periods. In their Lordships' opinion this was not permissible, and that matter alone would necessitate a further taking of the account.

The more important matter, however, is the admission by the District Judge of the promissory notes, which were not enforceable, as evidence to prove the loans, which as already stated was not permissible.

In their Lordships' opinion the proper course is to remit the case to the Supreme Court in order that the Supreme Court may give such directions as are necessary for taking a further account between the parties to ascertain what amount is due by the first defendant to the plaintiffs in respect of money lent and interest at the rate of 12 per cent. per annum, on the footing that the promissory notes given by the defendants are neither enforceable, nor admissible in evidence to prove the loans.

The plaintiffs will be entitled to the usual mortgage decree for such amount, if any, as may be found due to them on the taking of the further account.

It will be in the discretion of the Supreme Court to make such orders as are necessary for carrying out this direction, but their Lordships are of opinion that the further account should not be taken by the District Judge who took the account in the first instance. It is, of course, not intended to make any reflection upon the learned Judge, but he, having seen the promissory notes and admitted them in evidence, might be placed in a difficult position if he were asked to take the account again.

The result is that the appeal must be allowed and the two decrees of the Supreme Court and the order and decree of the District Judge must be set aside, and the matter remitted to the Supreme Court with the above-mentioned direction.

The defendants must pay to the plaintiffs their costs of the appeals to the Supreme Court and two-thirds of their costs of the appeal to His Majesty in Council.

There will be no order as to the costs of the suit except that the plaintiffs must pay to the defendants the costs incurred by them in respect of the taking of the account directed by the District Judge and in respect of the further hearing before the District Judge on December 21, 1932.

The procedure to be adopted for the taking of the account hereby directed and the costs thereof will be a matter for the direction of the Supreme Court.

Their Lordships will humbly advise His Majesty accordingly.

Appeal allowed.