



LL.B. III Term

Special Contracts
(Partnership and Sale of Goods)

LB - 304

Cases Selected and edited by

Gunjan Gupta
Sanjivini Raina
C.K.Negi Bisht
Shikha Kamboj
Akash Anand
Ashutosh Acharya
Kislay Soni
Ezekial Jarain

FACULTY OF LAW
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LL. B. III Term

Paper – LB – 304 – Special Contracts **(Partnership and Sale of Goods)**

Objectives of the Study

The law recognizes various Special Contracts among other are (i) Partnership and (ii) Sale of Goods. Special Contracts is a logical and imperative extension of the Law of Contracts paper of the 1st Term which dealt with the general principles of contract. Since the commercial activities are ever increasing, the present paper aids in understanding the application of the general principles of contract in specific circumstances which are the footholds for business associations and commercial transactions. It will familiarize students with the evolution of business associations. The first part of paper deals with partnerships as a business association which covers types, formation, registration, rights of partners and their liabilities, rights of third parties, reconstitution and dissolution. Here the students will be introduced to Limited Liability Partnership as well. The later part of this paper is sale of goods which is a special commercial transaction affecting not only daily lives but also major part of small, medium and large scale transactions in the business relations and associations. The topic Sale of goods deals with the components of sale, point of sale, passing of property, right and liabilities of seller and buyer, goods and its classes such as ascertained goods, specific goods and appropriated goods..

The present course is aimed at a study of the Law relating to Agency particularly the provisions of sections 182-238 of the Indian Contract Act, 1872, the Indian Partnership Act, 1932, Limited Liability Partnership Act, 2008 and Sale of Goods Act, 1930 in the light of judicial pronouncements. A student of Law will be advantaged with the study of this paper as it will provide an in-depth study of principles and concepts on which commercial transaction are based , the workings of business associations and how such transaction are different from a company and LLP

Prescribed Legislations:

1. The Indian Partnership Act, 1932
2. The Limited Liability Partnership Act, 2008 (6 of 2009)
3. The Indian Contract Act, 1872
4. The Sale of Goods Act, 1930

Prescribed Books:

1. G.C ., Bharuka, *The Indian Partnership Act*
2. Avtar Singh, *Law of Partnership*
3. V.P. Verma (Rev.), S. D. Singh and J.P. Gupta, *Law of Partnership in India*
4. R.G. Padia (ed.), *Pollock & Mulla, Indian Contract and Specific Relief Acts*
5. Banks, Roderick I'Anson, *Lindley and Banks on Partnership*
5. Sanjiv Agarwal and Rohini Agarwal, *Limited Liability Partnership: Law and Practice.*
6. K. Ramamoorthy, *Pollock & Mulla The Sale of Goods Act*
7. V. Krishnamachari and Surender K. Gogia, *T.S. Venkatesa Iyer's Sale of Goods Act, 1930*

Topic 1 – Concept of Agency and The Nature of Partnership

‘Agent’ and ‘Principal’ defined; Who may employ an agent; who may be appointed as agent; Rights, duties and liabilities of principal and agent, scope and limitation, ratification and revocation of authority; appointment of sub-agent (The Indian Contract Act, 1872). Definition of “partnership”, “partner”, “firm” and “firm name” (section 4); partnership not created by status (section 5); Mode of determining existence of partnership (section 6); partnership at will (section 7); Particular partnership (section 8), Concept and nature of Unlimited Liability Partnerships; Distinction between a partnership, a limited liability partnership and a company;

Narandas Morardas Gajiwala v. SPAM Papammal, AIR 1967 SC 333

Kuchwar Lime and Stone Co. v. Dehri Rohtas Light Rly. & Co. Ltd.,
AIR 1969 SC 193

Lakshminarayan Ram Gopal v. Govt. of Hyderabad, AIR 1954 SC 367

Snow White Indl. Corpn. v. Collector of Central Excise,
AIR 1989 SC 1555

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| 1. <i>K.D. Kamath & Co. v. CIT</i> (1971) 2 SCC 873 | 01 |
| 2. <i>Cox v. Hickman</i> (1860) 8 H.L.C. 268 | 10 |
| 3. <i>Mollwo, March & Co. v. The Court of Wards</i> (1872) L.R. 4 P.C. 419 | 16 |

Topic 2 - Relations of Partners to One Another and to the Third Parties

General duties of partners (section 9); duty to indemnify for loss caused by fraud (section 10); determination of rights and duties of partners by contract between the partners (section 11); the conduct of the business (section 12); Mutual rights and liabilities (section 13); The

property of the firm (section 14); Application of the property of the firm (section 15); Personal profits earned by partners (section 16); Rights and duties of the partners (section 17). Partners to be agent of the firm (section 18); Implied authority of partner as agent of the firm (section 19); Extension and restriction of partner's implied authority (section 20); Partner's authority in an emergency (section 21); Mode of doing act to bind firm (section 22 Holding out (section 28); Right of transferee or a partner's interest (section 30); Minors admitted to the benefits of partnership.

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| 4. <i>Miles v. Clarke</i> (1953) 1 All ER 779 | 22 |
| 5. <i>Trimble v. Goldberg</i> (1906) AC 494 (PC) | 26 |
| 6. <i>Holme v. Hammond</i> (1872) L.R. 7 Ex. 218 : 41 L.J. Ex. 157 | 31 |
| 7. <i>Rhodes v. Moules</i> (1895) 1 Ch. 236 (CA) | 35 |
| 8. <i>Hamlyn v. Houston & Co.</i> (1903) 1 K.B. 81 | 39 |
| 9. <i>Tower Cabinet Co., Ltd v. Ingram</i> (1949) 1 KBD 1032 | 41 |
| <i>Snow White Food Products Ltd. v. Sohan Lal</i> , AIR 1964 Cal. 239 | |
| <i>Scarf v. Jardine</i> (1882) 7 A.C. 345 | |
| 10. <i>Shivgouda Ravji Patil v. Chandrakant Neelkanth Sadalge</i> ,
AIR 1965 SC 212 | 46 |

Topic 3 - Incoming and Outgoing Partners and Registration of a Firm

Introduction of a partner (section 31); Retirement of a partner (section 32); expulsion of partners (section 33); Insolvency of a partner liability of estate of deceased partner (section 35); rights of outgoing partner to carry on competing business (section 36)

Application for registration (section 58); Registration (section 59); Disabilities attach with non-registration (section 69)

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| 11. <i>CIT v. Jaylakhmi Rice & Oil Mills Contractor Co.</i> , AIR 1971 SC 1015 | 49 |
| 12. <i>Jagdish Chandra Gupta v. Kajaria Traders (India) Ltd.</i> ,
AIR 1964 SC 1882 | 52 |
| 13. <i>Haldiram Bhujawala v. Anand Kumar Deepak Kumar</i>
(2000) 3 SCC 250 | 56 |
| 14. <i>M/S Umesh Goel v. Himachal Pradesh Cooperative Housing Society Ltd</i> ,
(2016) 11 SCC 313 | 63 |

Topic 4 - Dissolution of a Firm

Dissolution of a firm (section 39); Dissolution by agreement (section 40); Compulsory dissolution (section 41); Dissolution on the happening of certain contingencies (section 42); Dissolution by notice of partnership at will (section 43); Dissolution by the Court (section 44); Liability for acts of partners done after dissolution (section 45); Right of partners to have business wound up after dissolution (section 46); Continuing authority of partners for purpose of winding up (section 47); Mode of settlement of accounts between partners (section 48).

15.	<i>Saligram Ruplal Khanna v. Kanwar Rajnath</i> , AIR 1974 SC 1094	77
16.	<i>M/s. Juggilal Kamlatpat v. M/s. Sew Chand Bagree</i> , AIR 1960 Cal. 463	87
17.	<i>Sharad Vasant Kotak v. Ramniklal Mohanlal Chawda</i> (1998) 2 SCC 171	90
18.	<i>S.V. Chandra Pandian v. S.V. Sivalinga Nadar</i> (1993) 1 SCC 589	98

Topic 5 - General : Formation of Contracts of Sale

The Sale of Goods Act, 1930 (sections 1-10)

(a) Concept of 'Goods'

19.	<i>R.D. Saxena v. Balaram Prasad Sharma</i> , AIR 2000 SC 2912	108
20.	<i>Commr. of Sales Tax, M.P. v M.P. Electricity Board, Jabalpur</i> , AIR 1970 SC 732 : (1969) 1 SCC 200	115

(b) 'Sale' and 'Agreement to sell'

21.	<i>State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd.</i> , 1959 SCR 379	119
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(c) Statutory Transactions

22.	<i>Vishnu Agencies (P) Ltd. v. Commercial Tax Officer</i> , AIR 1978 SC 449 : (1978) 1 SCC 520	131
23.	<i>Coffee Board, Karnataka v. Commr. of Commercial Taxes</i> , AIR 1988 SC 1487	139

(d) Contract for 'Works'/'Labour'(Pre and Post 46th Constitutional Amendment)

24.	<i>Commr. of Commercial Taxes v. Hindustan Aeronautics Ltd.</i> , AIR 1972 SC 744 : (1972) 1 SCC 395	153
25.	<i>Sentinel Rolling Shutters & Engg. Co. (P) Ltd. v. CST</i> , AIR 1978 SC 545 : (1978) 4 SCC 260	156
26.	<i>Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi</i> (1978) 4 SCC 36 & (1980) 2 SCR 650	163
27.	<i>State of Karnataka v. Udipikrishna Bhawan</i> (1981) 3 SCC 76	166
28.	<i>Larsen & Toubro Ltd. v. State of Karnataka</i> , (2014) 1 SCC 708 <i>Kone Elevators v. State of Tamil Nadu</i> (2014) 7 SCC 1	167
29.	<i>State of Karnataka and Ors. v. Pro Lab and Ors.</i> AIR 2015 SC 1098	190

Topic 6 : Conditions and Warranties

Stipulations as to time; Implied Conditions and Warranties – as to title, quality, fitness, etc.,
Sale by Description and by Sample; Treating conditions as warranties

The Sale of Goods Act, 1930 (sections 11-17, 62, 63)

- Priest v. Last* (1903) 2 KB 148
30. *British Paints (India) Ltd. v. Union of India*, AIR 1971 Cal. 393 204
Niblett v. Confectioners Material Co. Ltd. (1921) 3 KB 387
Wallis v. Patt (1911) AC 394
Baldry v. Marshall (1925) 1 KB 260 (CA)

Doctrine of Caveat Emptor

- 31 *Jones v. Just* (1868) 3 Q.B. 197 210
32 *Richard Thorold Grant v. Australian Knitting Mill, Ltd.*
AIR 1936 PC 34 216
Bristol Tramways v. Fiat Motors Ltd. (1910) 2 KB 831

Topic 7 : Effects of the Contract of Sale

Transfer of property; Doctrine of *Nemo dat quod non habet* – sale by a person other than the owner, sale by joint owner, sale by mercantile agent, sale under voidable contract, sale by seller or buyer in possession after sale; sale in Market Overt

The Sale of Goods Act, 1930 (sections 18-30)

33. *CIT v. Mysore Chromite Ltd.* (1955) 1 SCR 849 :
AIR 1955 SC 98 227
34. *P.S.N.S. Ambalavana Chettiar v. Express Newspapers Ltd.*
(1968) 2 SCR 239 : AIR 1968 SC 741 232
35. *Agricultural Market Committee v. Shalimar Chemical Works
Ltd.* (1997) 5 SCC 516 : AIR 1997 SC 2502 236
36. *Pearson v. Rose & Young, Ltd.* (1950) 2 Ch. D. 1027 240

Topic 8 : Rights of Unpaid Seller

Who is an un-paid seller ? Un-paid Seller's Rights – Right of lien, Right of stoppage in transit; Transfer of goods by buyer and seller

The Sale of Goods Act, 1930 (sections 45-54)

37. *Mysore Sugar Co. Ltd., Bangalore v. Manohar Metal Industries,
Chikpet, Bangalore* AIR 1982 Kant. 283 247

Special Contracts

K. D. Kamath & Co. v . CIT

(1971) 2 SCC 873

[The entire deed must be considered to decide the existence of partnership]

The appellant was a firm consisting of six partners and the partnership was constituted under the document, dated March 20, 1959, The business of the partnership, as recited in the deed, is stated to have been carried on in partnership from October 1, 1958. The partnership was registered under the Indian Partnership Act, 1932, (the Partnership Act) on or about August 11, 1959. For the assessment year 1959-60, corresponding to the previous year ending March 31, 1959, the appellant filed an application to the ITO under Section 26-A for registration of the partnership in the name of M/s K. D. Kamath and Company. The ITO declined to grant registration on the ground that there was no genuine partnership brought into existence by the deed of March 20, 1959 and that the claim of the firm having been constituted was not genuine. The ITO further held that the business should be held to be the sole concern of K. D. Kamath. The sum and substance of his finding was that there was no relationship of partners inter se created under the said document. The Department did not challenging the genuineness of the document. On appeal of the assessee, the AAC confirmed the order of ITO. The Appellate Tribunal came to the conclusion that the two essential requirements as laid down by the Courts for determining whether there was a partnership, namely, an agreement between the parties to share profits and each of the parties acting as agent of all were fully satisfied in this case. The Tribunal held that the partnership deed made it clear that profits and losses were to be shared between the parties and that, subject to the over-riding authority of K. D. Kamath, the other partners could act for the firm. In this view, the Appellate Tribunal held that the deed did create a relationship of partners inter se between the parties and directed the ITO to register the firm under Section 26-A of the Income-Tax Act.

The CIT made an application under Section 66(1) of the Income-tax Act praying for a reference being made by the Appellate Tribunal to the High Court of the question of law mentioned in the application. The Tribunal referred to the High Court for its opinion the following question of law:

“Whether, on the facts and in the circumstances of the case, M/s K.D. Kamath & Co., could be granted registration under Section 26-A of the Act for the assessment year 1959-60?”

The High Court answered the question against the assessee.

Partnership deed: *“Instrument of partnership.*—Articles of agreement made at Hubli, this 20th day of March, 1959, among (1) Shri Krishnarao Dadasaheb Kamat, hereinafter called the party hereto of the 1st part, (2) Shri Narayan Ganesh Kamat hereinafter called

the party hereto of the 2nd part, (3) Shri Shripadrao Damodara Kamat, hereinafter called the party hereto of the 3rd part, (4) Shri Dayanoba Jotiram Mohite, hereinafter called the party hereto of the 4th part, (5) Shri Shankar Govind Joshi, hereinafter called the party hereto of the 5th party, and (6) Shri Yashavant Bhawoo Kate, hereinafter called the party of the 6th part. All Hindu inhabitants, residing at Hubli, and whereas the parties from 2 to 6, who have been serving with party No.,1 since a very long time and in view of the appreciation of their honest and sincere services which the above parties have rendered in past and with the object that the above parties should also have their material and economical progress, party No. 1, i.e., Shri K.D. Kamat has been pleased to convert his sole proprietary concern, as a partnership concern, by admitting the above parties from 2 to 6 as working partners and the party No. 1 shall be the main financing and managing partner and the business of the partnership is agreed and is being carried on accordingly in partnership as from 1st day of October, 1958, as 'Contractors' or any other business that the parties may think fit under the name and style of 'Messrs. K. D. Kamat & Co., Engineers and Contractors, Hubli' and it is hereby agreed by and among the parties to this Agreement as under.

2. That the business of the partnership is running under the name and style of 'Messrs. K. D. Kamat & Co., Engineers and Contractors, Hubli' as from the 1st day of October 1958, and this agreement shall take retrospective effect and shall be deemed to have come into operation as from the commencement of October 1, 1958.

3. That the duration of the partnership shall be at will.

4. That the business of the partnership is running at Hubli and shall run at Hubli or at such other place or places, as the case may be under the name and style of 'Messrs. K. D. Kamat & Co., Engineers and Contractors' or in such other name or names that the parties may from time to time decide and agree upon.

5. That the final accounts of the partnership firm shall be made up on the last day of each year of account, which shall generally be on 31st day of March every year of account and the accounts shall be taken up to that date of all the stock-in-trade and after providing for all the working expenses, the remaining net profits or losses, as the case may be, shall be shared by the parties hereto as under omitted).

6. That it is agreed among the partners that the party No. 1, i. e., Shri K. D. Kamat, shall be the principal and financing partner and the rest of the partners, i.e., from 2 to 6 are admitted only as working partners contributing labour.

7. That the good-will of the firm shall be wholly and solely belong to party No. 1, i.e., Shri K.D. Kamat.

8. That the party No. 1, i.e., Shri K.D. Kamat, who is the principal and financing partner and by virtue of his having the longstanding experience in the line of business together with the technical knowledge of Engineer, shall have full right of control and management of the firm's business and in the best interest of the firm, it is thus decided and agreed upon among all the partners that all the working partners from 2 to 6 shall always work according to the instructions and directions given from time to time by Shri K. D. Kamat, in the actual execution of works and in any other matter connecting thereof, pertaining to this partnership business. The decision of the principal partner on the aspect of taking any new business or giving tenders for new works, shall always vest with him, whose decision shall be final and binding upon all the working partners,

9. That it is also agreed among the partners that no working partner or partners is/are authorised to raise a loan for and on behalf of the firm or pledge the firm's interest directly or indirectly and such an act shall not be binding on the firm, except under the written authority of the principal partner.

10. That it is further expressly agreed that excepting the parties No. 1 and 2, i.e. Shri K.D. Kamat and Shri N.G. Kamat, the other parties from 3 to 6 shall not do contract business, so long as they are partners in this firm and this clause is inserted in the betterment of the firm's business and with the object that the firm's business should not suffer and the works if taken or standing in the name of the said parties from 3 to 6, the same shall be the business of the firm.

11. That it is also further agreed that the Managing Partner Shri K.D. Kamat shall alone operate the Bank accounts and in case of any need for convenience, the partner authorised by him in writing and so intimated to the Bank or Banks, shall operate the Bank accounts.

12. That in the course of the business or during the existence of the firm's business, the principal partner has reason to believe that any working partner or partners is/are not working and conducting to the best interest of the firm, the principal partner shall have a right to remove such a working partner or partners from the partnership concern and in such an eventuality the out-going working partner or partners, shall have only right of the profit or loss up to the date of his retirement, as may be decided by the principal partner in lump sum either by paying or receiving, regard being had to the progress of the business or otherwise up to the date of retirement, only on the completed works.

13. That proper books of accounts shall be kept by the said parties and entries made therein of all such matters, transactions and things as are usually entered in the books of accounts kept by the persons engaged in business of a similar nature; all books of

accounts, documents, papers and things shall be kept at the principal place of business of the firm and each partner shall at all times, have free and equal access to them.

14. That each partner shall be just and faithful to the other or others in all matters relating to the business of the firm, shall attend diligently to the firm's business and give a true account and shall give information relating to the same without fail.

15. That each partner shall withdraw such sums as will be mutually determined by the partners from time to time, in anticipation of the profit falling to their individual share and in case of loss, the same shall be made good by the partners.

16. Thus subject to the provisions herein mentioned and laid down and made thoroughly known by each of the parties to this Agreement with sound mind and body, the firm's affairs be carried on for mutual gain and benefit and if any questions which may arise or occur touching to the conduct or management or liability of the firm, the same shall be amicably settled among the parties with the consent of principal partner, whose decision in the matter shall be final and binding on all partners").

C.A. VAIDIALINGAM, J. - 8. The High Court has generally considered the effect of Clauses 5 to 9, 12 and 16 of the partnership deed. The High Court also considered the question whether the partnership deed satisfies the two essential requisites to constitute the partnership, namely: (1) whether there is an agreement to share profits as well as the losses of the business, and (2) whether each of the partners under the deed can act as agent of all. From the discussion in the judgment, the learned Judges, so far as we could see, have not thought it necessary to consider elaborately the question whether there is an agreement in the partnership deed to share the profits and losses of the business. Obviously, the High Court must have been satisfied from the recitals in the partnership deed that this requirement is amply satisfied in this case. That is why we find that the learned Judges have focussed their attention as they themselves say in the judgment on the question whether it is possible to hold from the recitals in the partnership deed that each partner is entitled to act as agent of all. In considering this aspect, the learned Judges have referred particularly to Clauses 8, 9 and 16 of the partnership deed and have held that it is clear from these clauses that the management, as well as the control of the business, is entirely left in the hands of the alleged first partner K.D. Kamath and that the other partners are only to work under his directions and share profits and losses in accordance with the proportions mentioned in Clause 5. It is the further view of the High Court that it is not within the power of the other five parties to act as agent of the other partners as they cannot accept any business except with the consent of K.D. Kamath; nor can they raise any loan or pledge the firm's interest. On this reasoning the High Court has come to the conclusion that there is no relationship of partners created under the partnership deed and as this essential element of agency is lacking, the appellant was not eligible to be granted registration under Section 26-A.

9. Mr S.K. Venkataranga Iyengar, learned counsel for the assessee appellant, referred us to the various clauses in the partnership deed and urged that the view of the High Court that the essential element of agency is absent in this case, is erroneous. The counsel further urged that the partnership deed, read as a whole, leaves no room for doubt that there is an agreement to share the profits and losses of the business in the proportion mentioned in the deed. Therefore, one of the essential ingredients to constitute a partnership is satisfied in this case. He further urged that though a large amount of control regarding the conduct of business may have been left in the hands of the first partner K. D. Kamath, that circumstance, by itself, does not militate against the view of one partner acting as agent of the other partners. He referred us in this connection, to certain decisions of the High Courts as well as of this Court, where under circumstances similar to the one existing before us, it has been held that the mere fact that more control is to be exercised only by one of the partners is not a circumstance which militates against the parties having entered into a partnership arrangement as understood in law.

10. Mr S.K. Iyer, learned counsel for the Revenue, supported the reasoning of the High Court in its entirety. According to the learned counsel, the question whether there is an agreement to share the profits and the losses of the business and the further question whether each of the partners is entitled to act as agent of all are to be determined by looking into all the facts as borne out by the deed of partnership. He urged that on a consideration of all such facts, the High Court has held that one of the essential conditions, namely, the right of one partner to act as agent of all, does not exist in the present case. If so, the opinion expressed by the High Court that the appellant is not eligible for registration under Section 26-A is correct.

11. In considering the question whether the partnership deed creates the relationship of partners as between the parties thereto, as understood in law, it is desirable to have a complete picture of the entire document.

12. The High Court has rested its decision on five circumstances for holding that there is no relationship of partners as between the parties inter se created under the partnership deed. They are based on consideration in particular of Clauses 8, 9 and 16. The following are the circumstances, which according to the learned Judges militate against holding in favour of the assessee: (1) The management as well as the control of the business is entirely left in the hands of the alleged first partner K. D. Kamath; (2) The other partners can merely work under his directions and share in the profits and losses in accordance with the proportion mentioned in Clause 5; (3) It is not within the power of the parties Nos. 2 to 6 to act as agent of other partners; (4) The said parties cannot accept any business except with the consent of K.D. Kamath; and (5) Those parties cannot raise any loan or pledge the firm's interest, directly or indirectly except under the written authority of K.D. Kamath. In view of all these circumstances, according to the High Court, one of the essential element to constitute partnership, namely, agency is lacking.

16. From a perusal of the partnership deed one thing is clear, namely, under clause (1) what was originally the sole proprietary concern of K.D. Kamath has been converted as partnership concern by admitting parties Nos. 2 to 6 as working partners, along with party No. 1,

and party No. 1 is the main financing and managing partner of the business. That clause has to be read along with clause (6) whereunder the partners have agreed that K. D. Kamath shall be the principal and financing partner and the rest of the partners, namely, parties Nos. 2 to 6 are admitted only as working partners contributing labour. Clause (4) deals with the running of the partnership business at Hubli as also other place or places or with such other name or names that the parties (which means partners Nos. 1 to 6) may from time to time decide and agree upon. From clauses (1), (2) and (3), it is clear that the business of the partnership is that of Engineers and Contractors. We are referring to this aspect because it will have a bearing regarding the control of the business agreed to be vested in K. D. Kamath. There does not appear to be any controversy that party No. 1 has been carrying on such business as a proprietary concern for a long time before the partnership was formed and as such he is considerably experienced in the said technical type of business. Clause (5) provides that final accounting is to be taken as on March 31 of every year and the net profits and losses are to be shared by the parties thereto in the proportion of the shares specified in the said clause.

17. Under clause (11), apart from the managing partner, K. D. Kamath operating the bank accounts, any other partner authorised by him is also eligible to operate the bank accounts. Clause (12) entitles a partner, when he ceases to be a partner to be paid his share of profit or loss, up to the date of his so ceasing to be a partner. Clause (13) provides that books of accounts are to be properly maintained and each partner has a right at all times to have free and equal access to them. Clause (14) enjoins on each partner to be just and faithful to the other partners in all matters relating to the business of the firm and each of them has got a duty to diligently attend the business of the firm. Each of them has also an obligation to give a true account and information regarding the business of the firm. Clause (15) enables the partners to withdraw the amounts in anticipation of profits falling to their individual share; and in case of loss, each of them is also liable to make good the same in proportion to his share in the partnership. Clause (16) enjoins on the partners to carry on the affairs of the firm for mutual gain and benefit.

18. All the above clauses clearly, in our opinion, establish that the sole proprietary concern of K.D. Kamath has vanished. The above clauses also establish the right of each of the partners to share the profits and also to bear the losses in the proportion of their shares mentioned in clause (5). Therefore, one of the essential ingredients to constitute partnership, namely, that there should be an agreement to share the profits and the losses of the business is more than amply satisfied in this case.

19. Then the question is whether the circumstances pointed out by the High Court and referred to by us earlier, necessarily lead to the conclusion that no relationship of partners, as understood in law, has been created as between the parties under the partnership deed.

23. In certain decisions of the High Courts the two essential conditions necessary to form the relation of partnership have been stated to be:(1) that there should be an agreement to share the

profits and losses of the business, and (2) that each of the partners should be acting as agent of all. Though, these two conditions, by and large, have to be satisfied when the relationship of partners is created between the parties, we would emphasise that the legal requirements under Section 4 of the Partnership Act to constitute a partnership in law are: (1) there must be an agreement to share the profits or losses of the business; and (2) the business must be carried on by all the partners or any of them acting for all. There is implicit in the second requirement the principle of agency.

28. From a review of the above decisions, it is clear that the mere nomenclature given to a document is by itself not sufficient to hold that the document in question is one of partnership. Two essential conditions to be satisfied are: (1) that there should be an agreement to share the profits as well as the losses of business; and (2) the business must be carried on by all or any of them acting for all, within the meaning of the definition of “partnership” under Section 4 of the Partnership Act. The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

29. In the light of the principles laid down by this Court in *Steel Brothers and Co. Ltd. v. Commissioner of Income-tax* [AIR 1958 SC 315], the reasons given by the High Court for holding that the relationship of partners has not been created under the deed of partnership before us, cannot be sustained. As the control and management of business can be left by agreement in the hands of one partner to be exercised on behalf of all the partners, the other consequence by way of restriction on the rights of the other partners lose all significance. In fact the clauses providing that the working partners are to work under the directions of the managing partner and the further clause restricting their right to accept business or raise any loans or pledge the firm’s interest except with the consent of the managing partner K.D. Kamath, have all to be related with the agreement entered into by the partners regarding the management and control by K.D. Kamath. We are of the opinion that under the partnership deed the relationship which has been brought into existence between the six parties is a relationship of partners who have agreed to share the profits and losses of business carried on by all or any of them acting for all and it satisfies the definition of “Partnership” under Section 4 of the Partnership Act. We have already pointed out that there is a sharing of the profits or losses of the business by the partners in the ratio of the proportion mentioned in clause (5). That clause read with other clauses already discussed by us clearly shows that the first condition, namely, all persons agreeing to share profits or losses is satisfied’. Even on the basis that the entire control and management of the business is vested in K. D. Kamath, party No. 1, and that parties Nos. 2 to 6 as working partners have to work under his direction, from all the other circumstances it is clear that the conduct of business by party No. 1, is done by him acting for all the partners. There is no indication to the contrary in the partnership deed. Therefore, even without anything more, it is clear that as the partnership business is carried on by party No. 1, acting for all, the second condition of agency is also satisfied. This- idea is reinforced by clause (16) which provide that the firm’s affairs are to be

carried on for mutual benefits. That clause is to the effect that the firm's affairs which are managed by party No. 1 is really for the mutual gain and benefits of all the partners.

30. It is, no doubt, true that the second essential test of the business being carried on by all or any of the partners acting for all must be satisfied. The provisions in the partnership deed clearly establish that K.D. Kamath, the managing partner, carries on the business, acting for all the partners.

31. Much stress has been laid by the High Court on the fact that under clause (9) parties Nos. 2 to 6 have no right to raise loans for and on behalf of the firm or pledge the firm's interest. This circumstance, according to the High Court, is destructive of the element of partnership. We have already held that the management and control of the business done by party No. 1, is carrying on of the business on behalf of all the partners. No doubt under Section 18 of the Partnership Act, a partner is the agent of the firm for the purpose of the business of the firm. But that section itself clearly says that it is subject to the provisions of the Act. It is open to the parties under Section 11 to enter into an agreement regarding their mutual rights and duties as partners of the firm and that can be done by contract, which in this case is evidenced by the deed- of partnership. Further Section 18 will have to be read along with Section 4. If the relationship of partners is established as a "partnership" as defined in Section 4, and if the necessary ingredients referred to in that section are found to exist, there is no escape from the conclusion that in law a partnership has come into existence. It is in the light of these provisions that Section 18 will have to be appreciated. Section 18 only emphasises the principle of agency which is already incorporated in the definition of "partnership" under Section 4.

32. It should be remembered that so far as the outside world is concerned, so long as the parties Nos. 2 to 6 are held out as partners of this firm, as has been done under the partnership deed, their acts would bind the whole partnership. The provision in clause (9) in our opinion, is only an inter se arrangement entered into by the partners, in and by which, the working partners have agreed not to raise loans or pledge the firm's interest.

33. Mr S.K. Iyer, learned counsel for the Revenue, placed some reliance on Section 14 of the Partnership Act. According to the counsel, there is no contract to the contrary in the partnership deed that the assets brought in by party No. 1, do not belong to the partnership. It is his further contention that under Section 14, those assets will belong to the partnership, in which case, it will be open to any partner, as agent of the other partners to pledge the firm's interest or raise loan for partnership purposes. This right, according to the counsel is restricted by clause (9) and that clause negatives the theory of agency. In our opinion, this contention of the learned counsel cannot be accepted. Section 14 of the Partnership Act itself clearly shows that the provisions contained therein are subject to the contract between the parties. We have already held that the provision regarding the control and management vesting in party No. 1 is not by itself destructive of the theory of partnership. Clause (9) in our opinion, itself shows that the theory of agency is recognised. But the parties, by mutual agreement, have placed a restriction on the working

partners' right to borrow on behalf of the firm or pledge the firm's interest without the written authority of the principal partner.

35. To conclude, we are of the opinion that all the ingredients of partnership are satisfied under the partnership deed, dated March 20, 1959 and that the view of the High Court that the appellant-firm cannot be granted registration under Section 26-A of the Income-tax Act for the assessment year 1959-60, cannot be sustained.

36. In the result, we answer the question of law in the affirmative in favour of the assessee.

* * * * *

Cox v. Hickman

(1860) 8 H.L.C. 268

[Mode of determining the existence of a partnership –sharing of profits – creditor-debtor relationship]

Smith and Smith carried on business under the name of B. Smith & Son. They got into difficulties and called a meeting of their creditors. Later they executed a deed of arrangement in favour of their creditors. The parties to the deed being S. and S. of the first part, five of the creditors (including Cox and Wheatcroft) of the second part, and the general body of creditors of the third part, and the deed provided that the five creditors of the second part were to carry on the business of S. and S. as trustees for the creditors under the name of “The Stanton Iron Company,” and to divide the net income of the business, after paying the expenses, among the general creditors of S. and S., such net income to be deemed to be of the creditors to be held, and that at any such meeting a majority in value of the creditors present was to have power to make rules as to the mode of conducting the business, or to order its discontinuance, and that when all the debts had been paid the trustees were to hold the property assigned under the deed in trust for S. and S. themselves. The deed also contained a covenant by the parties who executed it, not to sue S. and S. for their debts. Cox never in fact acted as a trustee, and Wheatcroft resigned six weeks after the deed, and before the goods for which bills now sued were given had been supplied, and no new trustees were appointed in place of Cox and Wheatcroft. The remaining three of the five creditors who were the parties to the deed, of the second part, carried on the business under the provisions of the deed, and goods were supplied to the business by Hickman. Hickman drew three bills of exchange for the goods supplied by him, those bills were accepted on behalf of the Stanton Iron Company by one of the above-mentioned three creditors. Hickman sued Cox and Wheatcroft on those three bills, and alleged that they were liable upon them as partners in the business of the Stanton Iron Company because they were two of the five creditors who were the original parties to the deed of the second part and had executed the deed accordingly.

THE LORD CHANCELLOR (LORD CAMPBELL) - The only question in these cases is whether the defendants by executing the deed of 13th November, 1849, as creditors of Messrs. Smith & Co., rendered themselves liable to the creditors who should afterwards deal with the trustees appointed by this deed to carry on the concern of Messrs. Smith & Co., under the new firm of “The Stanton Iron Company.” The Plaintiff alleges that although the Defendants never acted or held themselves out as partners in this new firm, and the creditors of the new firm are entitled to sue the creditors of the old firm as partners in the new firm.

It is quite clear that the creditors of the old firm, by executing the deed, never intended to incur such a liability, and I think that the creditors of the new firm cannot be supposed to have

dealt with this firm in the belief that they could have a remedy against all or any of the creditors of the old firm.

Is there such a participation in the profits of the new firm by the creditors of the old firm, as to make them partners in the new firm? *They certainly are not partners inter se, as was properly held by the Master of the Rolls and they could derive no profits from the new business, beyond the payment of the debts due to them from the old firm. There was a formal release of these debts; but we must look at the real nature of the transaction, according to the understanding of all who were parties to it. The business of Messrs. Smith & Co. was to be carried on by the trustees till the debts of that firm were paid, and then the business was to be transferred back to Messrs. Smith & Co.*

I am of opinion that the creditors of the old firm cannot be considered, by executing the deed, as having authorised the trustees as their agents either to purchase the goods or to accept the bills....

I must, therefore, advise your Lordships to reverse the judgment of the Court of Common Pleas, and to adjudge that the Defendants below are not liable, as acceptors of the bills of exchange, on which the action is brought.

LORD CRANWORTH - In the first place let me say, that I concur with those of the learned Judges who are of opinion that no solid distinction exists between the liability of either defendant in an action on the bills, and in an action for goods sold and delivered. If he would have been liable in an action for goods sold and delivered, it must be because those who were in fact carrying on the business of the Stanton Iron Company, were carrying it on as his partners or agents, and, as the bills were accepted, according to the usual course of business for ore supplied by the plaintiff, I cannot doubt that if the trade was carried on by those who managed it as partners or agents of the defendant, he must be just as liable on the bills as he would have been in an action for the price of the goods supplied. His partners or agents would have the same authority to accept bills in the ordinary course of trade, as to purchase goods on credit.

The liability of one partner for the acts of his co-partner is in truth the liability of a principal for the acts of his agent. Where two or more persons are engaged as partners in an ordinary trade, each of them has an implied authority from the others to bind them all by contract entered into according to the usual course of business in that trade. Every partner in trade is for the ordinary purposes of the trade, the agent of his co-partners, and all are therefore liable for the ordinary trade contracts of the others. Partners may stipulate among themselves that some one of them only shall enter into particular contracts, or into any contracts, or that as to certain of their contracts none shall be liable except those by whom they are actually made; but with such private arrangements third persons, dealing with the firm without notice, have no concern. The public have a right to assume that every partner has authority from his co-partners to bind the whole firm in contracts made according to ordinary usages of trade. This principle applies not only to persons acting openly and avowedly as partners, but to others who, though not so acting, are by

secret or private agreement, partners with those who appear ostensibly to the world as the persons carrying on the business.

In the case now before the House, the Court of Common Pleas decided in favour of the respondent that the appellant, by his execution of the deed of arrangement, became, together with the other creditors who executed it, a partner with those who conducted the business of the Stanton Iron Company. The Judges in the Court of Exchequer Chamber were equally divided so that the judgment of the Court of Common Pleas was affirmed. The sole question for adjudication by your Lordships is, whether this judgment thus affirmed was right.

In the first place there is an assignment by Messrs. Smith to certain trustees of the mines and all the engines and machinery used for working them, together with all the stock in trade, and in fact, all their property, upon trust to carry on the business, and after paying its expenses, to divide the net income rateably amongst the creditors of Messrs. Smith, as often there shall be funds in hand sufficient to pay one shiling in the pound; and after all the creditors are satisfied, then in trust for Messrs. Smith.

Upto this point the creditors, though they executed the deed are merely passive, and the first question is, what would have been the consequence to them of their executing the deed if the trusts had ended there? Would they have become partners in the concern carried on by the trustees merely because they passively assented to its being carried on upon the terms that the net profits should be applied in discharge of their demands. I think not; it was argued that as they would be interested in the profits, therefore they would be partners. But this is a fallacy. It is often said that the test, or one of the tests, whether a person not ostensibly a partner, is nevertheless, in contemplation of law, a partner, is whether he is entitled to participate in profits. This, no doubt is in general, a sufficiently accurate test; for a right to participate in profits affords cogent, often conclusive evidence that the trade in which the profits have been made, was carried on in partnership for or on behalf of the person setting up such a claim. But the real ground of the liability is that the trade has been carried on by persons acting on his behalf. When that is the case he is liable to the trade obligations, and entitled to its profits, or to a share of them. It is not strictly correct to say that his right to share in the profits, makes him liable to the debts of the trade. The correct mode of stating the proposition is to say that the same thing which entitles him to the one makes him liable to the other, namely, the fact that the trade has been carried on his behalf, i.e., that he stood in the relation of principal towards the persons acting ostensibly as the traders by whom the liabilities have been incurred and under whose management the profits have been made.

Taking this to be the ground of liability as a partner, it seems to me to follow that the mere concurrence of creditors in an arrangement under which they permit their debtor, or trustees for their debtor, to continue his trade, applying the profits in discharge of their demands, does not make them partners with their debtor, or the trustee. The debtor is still the person solely interested in the profits, save only that he has mortgaged them to his creditors. He receives the

benefit of the profits as they accrue, though he has precluded himself from applying them to any other purpose than the discharge of his debts. The trade is not carried on by or on account of the creditors; though their consent is necessary in such a case, for without it all the property might be seized by them in execution. But the trade still remains the trade of the debtor or his trustees; the debtor or the trustees are the persons by or on behalf of whom it is carried on.

I have hitherto considered the case as it would have stood if the creditors had been merely passively assenting parties to the carrying on the trade, on the terms that the profits should be applied in liquidation of their demands. But I am aware that in this deed special powers are given to the creditors, which, it was said, showed that they had become partners, even if that had not been the consequence of their concurrence in the previous trust. The powers may be described briefly as, first, a power of determining by a majority in value of their body, that the trade should be discontinued, or, if not discontinued, then, secondly, a power of making rules and orders as to its conduct and management.

These powers do not appear to me to alter the case. The creditors might, by process of law, have obtained possession of the whole of the property. By the earlier provisions of the deed, they consented to abandon that right, and to allow the trade to be carried on by the trustees. The effect of these powers is only to qualify their consent. They stipulate for a right to withdraw it altogether; or, if not, then to impose terms as to the mode in which the trustees to which they had agreed should be executed; I do not think that this alters the legal condition of the creditors. The trade did not become a trade carried on for them as principals, because they might have insisted on taking possession of the stock, and so compelling the abandonment of the trade, or because they might have prescribed terms on which alone it should be continued. Any trustee might have refused to act if he considered the terms prescribed by the creditors to be objectionable. Suppose the deed had stipulated, not that the creditors might order the discontinuance of the trade, or impose terms as to its management, but that some third person might do so, if, on inspecting the accounts, he should deem it advisable. It could not be contended that this would make the creditors partners, if they were not so already; and I can see no difference between stipulating for such a power to be reserved to a third person, and reserving it to themselves.

I have on these grounds, come to the conclusion that the creditors did not, by executing this deed, make themselves partners in the Stanton Iron Company, and I must add that a contrary decision would be much to be deprecated. Deeds of arrangement like that now before us, are, I believe, of frequent occurrence; and it is impossible to imagine that creditors who execute them, have any notion that by so doing they are making themselves liable as partners. This would be no reason for holding them not to be liable, if, on strict principles of mercantile law, they are so; but the very fact that such deeds are so common, and that no such liability is supposed to attach to them, affords some argument in favour of the appellant. The deed now before us was executed by above a hundred joint creditors; a mere glance at their names is sufficient to show that there was not intention on their part of doing anything which should involve them in the obligations of a partnership. I do not rely on this; but, at least, it shows the general opinion of the mercantile

world on the subject. I may remarks that one of the creditors I see is the Midland Railway Company, which is a creditor for a sum of £ 39, and to suppose that the directors could imagine that they were making themselves partners is absurd.

LORD WENSLEYDALE - The question is whether either of the defendants, Cox or Wheatcroft, was liable as acceptor of certain bills of exchange... drawn by the plaintiff below on the Stanton Iron Company, and accepted by one James Haywood as “per Pro” that Company. And the simple question will be this, whether Haywood was authorised by either of the defendants, as partner in that Company, to bind him by those acceptances. Haywood must be taken to have been authorised to accept for them by those who actually carried on business under that firm. Were the appellants partners in it? The case will depend entirely on the construction of the deed... There is no other evidence affecting either of them. And the question is whether the subscription of both, as creditors of the Smiths, made them partners in the business carried on by the trustees in the name of the Stanton Iron Company. Wheatcroft could not be liable in the character of trustee, for he had ceased as such before the bills were drawn, and the plaintiff knew it.

One of the provisions in the deed was this: that it gave authority to the trustees to execute all contracts and instruments in carrying on the business, which would certainly authorise the making or accepting bills of exchange. The question then is, whether this deed makes the creditors who sign in partners with the trustees, or what is really the same thing, agents, to bind them by acceptances on account of the business.

The law as to partnership is undoubtedly a branch of the principal and agent; and it would lend to simplify and make more easy of solution, the questions which arise on this subject, if this true principle were more constantly kept in view. Mr. Justice Story lays it down in the first section of his work on *Partnership*. He says, “Every partner is an agent of the partnership, and his rights, powers, duties, and obligations, are in many respects governed by the same rules and principles as those of an agent; a partner virtually embraces the character of both a principal and agent.”

A man who allows another to carry on trade, whether in his own name or not, to buy and sell and to pay over all the profits to him, is undoubtedly the principal, and the person so employed is the agent, and the principal is liable for the agent’s contracts in the course of his employment. So if two or more agree that they should carry on a trade, and share the profits of it, each is a principal, and each is an agent for the other, and each is bound by the other’s contract in carrying on the trade, as much as a single principal would be by the act of an agent, who was to give the whole of the profits to his employer. Hence it becomes a test of the liability of one for the contract of another, that he is to receive the whole or a part of the profits arising from the contract by virtue of the agreement made at the time of the employment. I believe this is the true principle of partnership liability. Perhaps the maxim that he who partakes the advantage ought to bear the

loss, often stated in the earlier cases on this subject is only the consequence, not relation of principal, agent, and partner.

Can we then collect from the trust deed that each of the subscribing creditors is a partner with the trustee and by the mere signature of the deed constitutes them his agents for carrying on the business on the account of himself and the rest of the creditors? I think not. It is not true that by this deed the creditors will gain an advantage by the trustees carrying on the trade; for if it is profitable, they may get their debts paid, but this is not that sharing of profits which constitutes the relation of principal, agent and partner.

If a creditor were to agree with his debtor to give the latter time to pay his debt till he got money enough out of his trade to pay it, I think no one could reasonably contend that he thereby made him his agent to contract debts in the way of his trade; nor do I think that it would make any difference that he stipulated that the debtor should pay the debt out of the profits of the trade.

The deed in this case is merely an arrangement by the Smiths to pay their debts, partly out of the existing funds and partly out of the expected profits of their trade; and all their effects are placed in the hands of the trustees, as middlemen between them and their creditors, to effect the object of the deed, the payment of their debts. These effects are placed in the hands of the trustees as the property of the Smiths, to be employed as the deed directs, and to be returned to them when the trusts are satisfied. I think it is impossible to say that the agreement to receive this debt, so secured, partly out of the existing assets, partly out of the trade, is such a participation of profits as to constitute the relation of principal and agent between the creditors and trustees. The trustees are certainly liable, because they actually contract by their undoubted agent; but the creditors are not, because the trustees are not their agents. I, therefore, advise your Lordships to reverse the judgment. Judgment reversed.

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Mollwo, March & Co. v. The Court of Wards

(1872) L.R. 4 P.C. 419

[Creditor-debtor relationship]

The Plaintiffs/Appellants, merchants of London, brought an action against the late Rajah Pertab Chunder Singh, to recover a balance of nearly three lacs of rupees claimed to be due to them from the firm of W.N. Watson & Co. of Calcutta. The Rajah having died during the pendency of the suit, the defence was continued by the Respondent, the Court of Wards, on behalf of his minor heir.

The plaint alleged that the firm of W. N. Watson & Co. consisted of W.N. Watson, T.O. Watson, and the Rajah, liable as a partner in it. The two Watsons commenced business in partnership, as merchants at Calcutta, in 1862, under the firm of W.N. Watson & Co. Their transaction consisted principally in making consignments of goods to merchants in England, and receiving consignments from them. The Watsons had little or no capital. The Rajah supported them, and in 1862 and 1863, he made large advances to enable them to carry on their business, partly in cash, but chiefly by accepting bills, which the Rajah met at maturity. In the middle of 1863, the total amount of these advances was considerable and the Rajah desired to have security for his debt and for any future advances he might make and also wished to obtain some control over the business by which he might check what he considered to be the excessive trading of the Watsons.

Accordingly, an agreement was entered into on the 27th of August, 1863, between the Rajah of the one part, and “Messrs. W.N. Watson & Co.” on the other part, by which, in consideration of money already advanced and which might be thereafter advanced by the Rajah to them, the Watsons agreed to carry on their business subject to the control of the Rajah in several important particulars. Under the agreement, whilst the advances made by the Rajah remained unpaid, the Watsons bound themselves not to make shipments, or order consignments, or sell goods, without his consent. No money was to be drawn from the firm without his sanction, and he was to be consulted with regard to the office business of the firm, and he might direct a reduction or enlargement of the establishment. It was also agreed that the shipping documents should be at his disposal, and should not be sold or hypothecated, or the proceeds applied, without his consent; and that all the proceeds of the business should be handed to him, for the purpose of extinguishing his debt. They further agreed to, and in fact did, hand over to the Rajah “as security” the title deeds of certain tea plantations, and they also agreed, that “as further security” all their other property including landed or otherwise including their stock in trade, should be answerable for the debt due to him. This agreement was not signed by the Rajah, but he was undoubtedly an assenting party to it.

Subsequent to the agreement, the Rajah made further advances, and the amount due to him ultimately exceeded three lacs of rupees. In 1864 and 1865, the firm of W.N.

Watson & Co. fell into difficulties. An arrangement was then made under which the Rajah upon the Watsons executing to him a formal mortgage of the tea plantations, to secure the amount of his advances, released to them, by a deed bearing date the 3rd of March, 1865 all right to commission and interest under the agreement of August, 1863, and all other claims against them.

In point of fact, the Rajah up to this time, had never received possession of any of the properties or moneys of the firm, nor any of the proceeds of the business; and did not in fact receive any commission. A sum of Rs. 27,000 on this account was, indeed, on the 30th of September 1863 placed to his credit in the books of the firm in a separate account opened in his name, but the sum so credited was never paid to him and was subsequently "written back" by the Watsons. Some evidence was given as to the extent of the interference of the Rajah in the control of the business. It seems the Rajah knew little of its details for it was conceded that the Rajah availed himself only in a slight degree of the powers of control conferred upon him by the agreement; in fact, that he did no more, but much less, than he might have done under it.

SIR MONTAGUE E. SMITH - It may be assumed, although the exact amount is a question in dispute in the appeal, that a large balance became due from the firm to the Plaintiffs during the time when it is contended that the Rajah was in partnership with the two Watsons.

The question in the appeal depend, in the main, on the construction and effect of a written agreement entered into between the Watsons and the Rajah....The subsequent acts of the Rajah do not in any way add to or enlarge his liability.

(N)o liability can in this case be fastened upon the Rajah on the ground that he was an ostensible partner, and, therefore, liable to third persons as if he was a real partner. It is admitted that he did not so hold himself out; and that a statement made by one of the Watsons to the Plaintiffs to the effect that he might be in law a partner, by reason of his right to commission on profits, was not authorized by the Rajah.

The liability, therefore, of the Rajah for the debts contracted by W.N. Watsons & Co. must depend on his *real relation* to that firm under the agreement.

It was contended, for the Appellants, that he was so liable:

First, because he became by the agreement, at least as regards third persons, a partner with the Watsons; and

Secondly, because, if not "a true partner", the Watsons were the agents of the Rajah in carrying on the business and the debt to the Plaintiffs was contracted within the scope of their agency.

The case has been argued in the Courts of India and at their Lordships Bar, on the basis that the law of England relating to partnership should govern the decision of it. Their Lordships agree that, in the absence of any law or well established custom existing in India on the subject, English law may properly be resorted to in mercantile affairs for principles and rules to guide the

Courts in that country to a right decision. But whilst this is so, it should be observed that in applying them, the usages of trade and habits of business of the people of India, so far as they may be peculiar, and differ from those in England, ought to be borne in mind.

The agreement, on the face of it, is an arrangement between the Rajah, as creditor, and the firm consisting of the two Watsons as debtors, by which the Rajah obtained security for his past advances; and in consideration of forbearance, and as an inducement to him to support the Watsons by future advances, it was agreed that he should receive from them a commission of 20 per cent, on profits, and should be invested with the powers of supervision and control above referred to. The primary object was to give security to the Rajah as a creditor of the firm.

It was contended at the Bar that, whatever may have been the intention, a participation in the net profits of the business was in contemplation of law such cogent evidence of partnership that presumption arose sufficient to establish, as regards third parties, that relation unless rebutted by other circumstances.

It appears to their Lordships that the rule of construction involved in this contention is too artificial: for it takes one term only of the contract and at once raises a presumption upon it. Whereas the whole scope of the agreement, and all its terms, ought to be looked at before any presumption of intention can properly be made at all.

It certainly appears to have been at one time understood that some decision of the English courts had established, as a positive rule of law, that participation in the net profits of a business made the participant liable as a partner to third persons. The rule had been laid down with distinctness by Eyre. C.J. in *Waugh v. Carver* [(1793) 2 W.B. 998] and the reason of the rule the Chief Justice thus states: "Upon the principle that, by taking a part of the profits, he takes from the creditors a part of that fund which is the proper security to them for the payment of their debts. That was the foundation of *Grace v. Smith* [(1775) 2 W.B. 998] and we think it stands upon fair grounds of reason."

The rule was evidently an arbitrary one, and subsequent discussion had led to the rejection of the reason for it as unsound. Whilst it was supposed to prevail, much hardship arose from its application, and a distinction, equally arbitrary was established between a right to participate in profits generally "as such" and a right to a payment by way of salary or commission "in proportion" (to use the words of Lord Eldon) "to a given quantum of the profits."

It was also affirmed and acted on the *Pott v. Eyton*. [(184) 3 C.B. 32]. Where C.J. ... in giving the judgment of the Court, adopts the rule as laid down the Lord Eldon and say, "Nor does it appear to make any difference whether the money is received by way of interest on money lent, or wages, or salary as agent, or commission on sales."

The present case appears to fall within this distinction. The Rajah was not entitled to a share of the profits "as such", he had no specific property or interest in them qua profits for, subject to the power given to the Rajah by way of security, the Watsons might have appropriated

or assigned the whole profits without any breach of the agreement. The Rajah was entitled only to commission, or a payment equal in proportion to one-fifth of their amount.

This distinction has always been admitted to be thin, but it may be observed that the supposed rule itself was arbitrary in the sense of being imposed by law and of being founded on an assumption opposed in many cases to the real relation of the parties; and when the law thus creates a rule of liability and a distinction both equally arbitrary, the distinction which protects from liability is entitled to as much weight as the rule which imposes it.

But the necessity of resorting to these fine distinctions has been greatly lessened since the presumption itself lost the rigid character it was supposed to possess after the full exposition of the law on this subject contained in the judgment of the House of Lords in *Cox v. Hickman* (1860) 8 HLC 268 and the cases which have followed that decision. It was contended that these cases did not overrule the previous ones. This may be so, and it may be that former cases were rightly decided on their own facts; but the judgment in *Cox v. Hickman* had certainly the effect of dissolving the rule of law which had been supposed to exist, and laid down principles of decision by which the determination of cases, of this kind is made to depend, not on arbitrary presumptions. Profits of trade is a strong test of partnership, and that there may be cases where, from such participation alone, it may as a presumption not of law but of fact, be inferred; yet that whether that relation does or does not exist must depend on the real intention and contract of the parties.

It is certainly difficult to understand the principle on which a man who is neither a real nor ostensible partner can be held liable to a creditor of the firm. The reason given in *Grace v. Smith* [(1975) 2 W.B. 998], that by taking part of the profits he takes part of the fund which is the proper security of the creditors, is now admitted to be unsound and insufficient to support it; for of course the same consequences might follow in a far greater degree from the mortgage of the common property of the firm, which certainly would not of itself make the mortgagee a partner.

Where a man holds himself out as a partner, or allows others to do it, the case is wholly different. He is then properly estopped from denying the character he has assumed, and upon the faith of which creditors may be presumed to have acted. A man so acting may be rightly held liable as a partner by estoppel.

Again, wherever the agreement between parties creates a relation which is in substance a partnership, no mere words or declarations to the contrary will prevent, as regards third persons, the consequences flowing from the real contract.

It was strongly urged that the large powers of control and the provision for empowering the Rajah to take possession of the consignments and their proceeds, in addition to the commission on net profits, amounted to an agreement of this kind, and that the Rajah was constituted, in fact, the managing partner.

The contract undoubtedly confers on the Rajah large power of control. Whilst his advances remained unpaid, the Watsons bound themselves not to make shipments, or order consignments, or sell goods, without his consent. No money was to be drawn from the firm without his sanction, and he was to be consulted with regard to the office business of the firm, and he might direct a reduction or enlargement of the establishment. It was also agreed that the shipping documents should be at his disposal, and should not be sold or, hypothecated, or the proceeds applied, without, his consent; and that all the proceeds of the business should be handed to him, for the purpose of extinguishing his debt.

On the other hand, the Rajah had no initiative power; he could not direct what shipments should be made or consignments ordered, or what should be the course of trade. He could not require the Watsons to continue to trade, or even to remain in partnership; his powers, however large, were powers of control only. No doubt he might have laid his hands on the proceeds of the business; and not only so but it was agreed that all their property, landed and otherwise should be answerable to him as security for his debt.

Their Lordships are of opinion that *by these agreements the parties did not intend to create a partnership, and that their true relation to each other under the agreement was that of creditor and debtors.* The Watsons evidently wished to induce the Rajah to continue his advances, and for that purpose were willing to give him the largest security they could offer; but a partnership was not contemplated and the agreement is really founded on the assumption, not of community of benefit, but of opposition of interests.

It may well be that where there is an agreement to share the profits of a trade, and no more, a contract of partnership may be inferred, because there is nothing to show that any other was contemplated; but that is not the present case, where another and different contract is shown to have been intended, viz. that of loan and security.

It was strongly insisted for the Appellants that if “a true partnership” had not been created under agreement, the Watsons were constituted by it the agents of the Rajah to carry on the business, and that the debt of the Plaintiffs was contracted within the scope of their agency.

Of course, if there was no partnership, the implied agency which flows from that relation cannot arise, and the relation of principal and agents must on some other ground be shown to exist. It is clear that this relation was not expressly created, and was not intended to be created by the agreement, and that if it exists it must arise by implication. It is said that it ought to be implied from the fact of the commission on profits, and the powers of control given to the Rajah. But this is again an attempt to create, by operation of law, a relation opposed to the real agreement and intention of the parties, exactly in the same manner as that of partners was sought to be established, and on the same facts and presumptions. Their Lordships have already stated that reasons which have led them to the conclusion that the trade was not agreed to be carried on for the common benefit of the Watsons and the Rajah so as to create a partnership; and they think there is no sufficient ground for holding that it was carried on for the Rajah as principal, in any other character. He was not, in any sense, the owner of the business, and had no power to

deal with it as owner. None of the ordinary attributes of principal belonged to him. *The Watsons were to carry on the business; he could neither direct them to make contracts, nor to trade in the manner which he might desire; his powers were confined to those of control and security, and subject to those powers, the Watsons remained owners of business and of the common property of the firm. The agreement in terms and, as their Lordships think, in substance, is founded on the relation of creditor and debtors, and establishes no other.*

Their Lordships opinion in this case is founded on their belief that the contract is really and in substance what it professes to be viz., one of loan and security between debtors and their creditor. If cases should occur where any persons, under the guise of such an arrangement, are really trading as principals, and putting forward, as ostensible traders, others who are really their agents, they must not hope by such devices to escape liability; for the law, in cases of this kind, will look at the body and substance of the arrangement, and fasten responsibility on the parties according to their true and real character.

For the above reasons their Lordships think that the Judges of the High Court, in holding that Rajah was not liable for the debts of the firm of W.N. Watson & Co., took a correct view of the case; and they will, therefore, humbly advise Her Majesty to affirm their judgement, and to dismiss this appeal with costs.

* * * * *

Miles v. Clarke

[1953] 1 All ER 779

[*Partnership Property*]

HARMAN, J. – This is a partnership action in which the issues on the writ, at the hearing of a motion, and on the pleadings when the matter came to be dealt with in this court were two: First, was there a partnership at all? Secondly, if there was a partnership, what were the assets of the partnership? The defendant was advised, and I think obviously rightly advised, that to contest the issue whether in law there was a partnership was to contest the incontestable, and that, therefore, at the outset he would be wise to concede that a partnership had existed, and that a partnership at will had begun on April 1, 1950, and had expired at the issue of the writ in the action. This advice he rightly took. The expiry of the partnership may conveniently be taken to have occurred on May 29, 1952. That left to be decided the question: What were the partnership assets? Though it was pleaded in the defence that none of the assets used in the business belonged to anyone but the defendant, yet the statement of claim, as it stood, did not conveniently raise that matter. It seemed to me and to counsel who represented the parties that the right course to take was to treat the hearing as deciding that a partnership existed and make an order on that footing, and then order the ordinary partnership accounts with an addition in a special form in order to raise the matters which remained in controversy between the parties. Consequently, on Feb. 19, 1953, I made an order declaring that there was a partnership between the plaintiff and the defendant, and that it began on April 1, 1950, and was dissolved on May 29, 1952. I ordered, first, the following inquiry:

Any inquiry whether any and if so which of the following items as at April 1, 1950, formed part of the partnership property or whether any and if so which of them remained the separate property of the plaintiff or the defendant as the case may be....

and then follows the list: (i) the lease of the property at Shepherd's Market where the business was carried on; (ii) the furniture and fittings in the studio; (iii) and, perhaps, most important, the equipment of the studio; (iv) the plaintiff's and the defendant's photographic negatives and prints which were brought in by each of them at the outset; (v) the defendant's goodwill or reputation; and (vi) the plaintiff's goodwill or reputation. That order was followed by an order (in para. 2 and para. 3) for the taking of the usual account and inquiry in a partnership, in common form. In para. 4 I ordered an inquiry whether either the plaintiff or the defendant was entitled to be credited in the partnership accounts with any sum on account of any of the items referred to. I then treated the summons to proceed as having been issued and having come before the master and the inquiries ordered in para. 1 and para. 4 of the order as having been adjourned into court. This judgment will be a judgment to assist the master in answering the inquiry ordered in paras. 1 and 4 when the matter is sent back to him.

The defendant, who was a gentleman of some means, was minded to start a business in commercial and fashion photography. After looking about for some time, he found the premises which subsequently became the place of business of the partnership and in June 1948, he entered into a lease whereby the property, which consisted of two squash racquets courts, dressing-rooms, and so forth, was demised to him for a period of seven years from midsummer, 1948, at a rent of £400 a year, which was, I am told, an advantageous lease,

bearing in mind the neighbourhood and the fact that squash racquets courts are easily adaptable as photographic studios, having a good overhead light. One court was left open as a large studio, the other was divided by partitions and a floor put in, part of it being used as dark rooms, part as offices, and part as a smaller studio. There the defendant started to carry on a photographic art or craft, but he employed persons to carry out the photographic work for him. At the beginning he made a very considerable loss. In January, 1950, after some earlier approaches which were ineffective, he applied to the plaintiff to see whether he would come into business as a partner. The plaintiff has been taking photographs all his life, and he is, apparently, well-known and has a good connection in this particular work. He was at that time working for others, using their studio partly for his own purposes and partly on their behalf, and he was making a very considerable income as what he called a free-lance photographer. He, it seems, was not very anxious to come in, and during the first month or so of 1950 he came down occasionally to the defendant's studio and took photographs, but from about the beginning of April he attended there as a full-time occupation and brought with him his own considerable connection. He took photographs of such subjects and such models as the defendant on his side should provide. The upshot of it was a very successful business. The plaintiff's faithful clients followed him, and brought their work to him. The business is now in the hands of a receiver, after the partnership quarrel, in a flourishing condition.

These two people, having, as it were, thrown in their lot together in this way, were too busy to think about the terms on which they should carry on business. They agreed that the profits, if there should be any, should be shared equally, and I take it the losses also, though, of course, they did not contemplate losses, and they did not have to face any. There also appears to have been an agreement reached that the plaintiff should draw £125 a month on account of his share of the profits, but that arrangement did not always continue, because the plaintiff appears to be a rather improvident person who is almost incapable of managing his own life. The only two matters that were agreed were that there should be an equal sharing of the profits and that the plaintiff should have these monthly drawings on account. They both contemplated a regular legal connection, and the plaintiff employed as his solicitors Messrs. Blacket Gill & Topham, who, as early as January 1950, can be found writing to the defendant setting out what the plaintiff understood. At that time the plaintiff, by the advice, no doubt, of his solicitors, contemplated that there would be a limited company and not a partnership to carry on the business. Whether the matter was carried on in one guise or the other really made no difference in substance to the parties. Miss Blacket Gill, the senior partner in that firm of solicitors, who conducted all the negotiations on the part of the plaintiff, wrote on January 31, 1950, in these terms:

We understand from (the plaintiff) that you and he are desirous of forming a limited company to carry on business as photographers. The business will be carried on at 5, Shepherd Street and the assets of the company will consist of Mr. Miles's goodwill, your goodwill and a lease and you will each hold shares in accordance with the value of the assets you put into the company. We understand that very little detail has been arranged between you except that you both agree that you wish to proceed on these lines.

The defendant employed an accountant who treated as an item on the debit side of the business a bank overdraft of £1,000 or so, which was, in fact, the defendant's private bank

overdraft which neither party had contemplated for one moment as being a liability of the business. As the so-called accounts start from that monstrous unreality, it seems to me impossible to place any reliance on what should be put on the other side. On the other side, in fact, certain assets, including the lease and the stock-in-trade, are set down as assets of the business, but when one knows that the chief liability shown is not a business liability I do not think one is entitled to assume that that which appears as an asset is in truth an asset of the business. It is obvious that these parties and their advisers, so far as they thought about it at all, always contemplated that the lease, the equipment and the studio furniture, and the stock-in-trade and so forth should all be brought into the common pool, but the fact is that nothing was ever finally agreed about it, and they just drifted on.

On what terms were these people partners? The only answer one can give is that they were partners on the terms that they shared the profits between them. What more? It is said, and I think rightly, that, even though there was no further agreement, one must assume that the stock-in-trade, such as stocks of film, was put into the pool and cannot be taken out again, but must become part of the partnership assets. That is not denied. There remain, however, more important items. The first is the lease and the second is the claim which may be worth £2,000. It is said with force by counsel for the plaintiff that those two classes of assets were put forward throughout as being brought in as part of the assets of the intended association, and, the plaintiff having come into the business on that footing, it would be inequitable now to deny him a right to share in those assets. It is said on the other side that it is not necessary to assume any further agreement between the parties, but one need only say that everything that belonged to one of them at the beginning of the partnership still belonged to that one at the end, and that the law will not make any imaginary agreement between the parties, it being ascertained as a fact that there was no agreement. In my judgment, no more agreement between the parties should be supposed than is absolutely necessary to give business efficacy to that which has happened, and that, I think, is the only safe way to proceed.

It is absolutely necessary to assume that things *quae ipso usu consumuntur*, the stock-in-trade, must be treated as having been brought into the partnership and their value must be ascertained by inquiry. They were all brought in by the defendant. I do not see the necessity of assuming that anything else went into the partnership. It seems to me that, as the parties failed to agree, it is not for me to say that the defendant must be assumed to have thrown the lease and the plant into the pool. The partnership could get on quite well if he gave his partner a licence to go on the leasehold property for the purposes of the business and to use the cameras to make the joint profile. Therefore, in my judgment, nothing changed hands except those things which were actually used and used up in the course of the carrying on of the business. The stock of negatives which each of these partners brought in was for the use of the business so long as it was going on. As I understand there is no great difficulty in separating them again now, and, indeed, being *ex necessitate* negatives or photographs taken before 1950, so far as they are fashion negative I cannot think that, except historically, they have any great value. However, if desired, the parties can each take away their negatives. Of course, the stock of negatives of photographs taken during the course of the partnership must be a partnership asset. Everything that changed its existence during the currency of the partnership must be.

It was said that, apart from those matters, each party brought in a connection, and that the plaintiff brought in something of value in the shape of his good will or connection which must in some way be quantified or valued and treated as an asset of his. Some such scheme was, undoubtedly, envisaged, but it was never agreed on, and it seems to me it would be idle to suggest that, as the parties had not agreed anything of that sort, it ought to be treated as having happened. The plaintiff came there because, having the connection he did, if he had the studio and the equipment to his hand, he could make a good profit and presumably it would be worth his while to take half that profit in return for the benefit of the use of the studio and the equipment. I see no reason to suppose that, though his connection and skill were very useful to make profits, one ought to treat them in some way as capital assets. Therefore, neither his connection, nor the defendant's connection, if it was of any value (which I doubt), should be treated in any way as being a partnership asset.

The only partnership assets remaining are, I think, the studio name, or the goodwill, such as it is, which has been attaching to it (and should have thought that was probably little), and the photographs in so far as they accumulated during the two years when the partnership was subsisting. Now that the parties have separated, the plaintiff will take away his own connection, no doubt, and his own clients, just as he brought them, and the defendant will presumably keep his own. It may be that it will be to his advantage that he will be able to keep the leasehold premises, but, as they were his before and he did not agree to assign them or to sub-let them, that is the inevitable result of the failure of the parties to make a more reasonable bargain.

Therefore, I propose to answer the inquiries by declaring that the lease, furniture and fittings, and the equipment of the studio did not form part of the partnership property, but remained the separate property of the defendant; that the plaintiff's and defendant's photographic negatives and prints brought into the business on April 1, 1950, remain the property of the person bringing them in; and, further, that neither the defendant's nor the plaintiff's goodwill or reputation form part of or should be treated as assets of the partnership. I will make a general declaration on the contrary that the stock-in-trade and consumable chattels ought to be treated as partnership property brought in by the defendant, and, in default of an agreement, I will direct a further inquiry, namely, as to what value ought to be attributed to those things in taking the partnership account. Lastly, it is suggested that, if the property remains that of the defendant, it is not right, in taking the accounts, to treat any depreciation as a charge against the profits, which would mean that the plaintiff would pay half of it. In my judgment, that is right. It would not be right to assume that the defendant leased or licensed either the leasehold property or the plant in the partnership at any price at all, because he did not, and, therefore, in my judgment, the result of no agreement works in the plaintiff's favour, and is that he does not have to contribute to wear and tear on those assets. That being so, in taking the accounts no sum ought to be charged against profit by way of depreciation. It is also said that certain partnership profits have been devoted to making improvements. For all I know that may be true or there may be nothing in it. The accounts are not sufficient to show. If it turns out that there is nothing in it the parties need not proceed with that inquiry.

Trimble v. Goldberg

(1906) AC 494 (PC)

[*Accountability for profits of competing business -section 16*]

LORD MACNAGHTEN - This is an appeal from an order of the Supreme Court of the Transvaal reversing the judgment of the Witwatersrand High Court at Johannesburg.

The trial of the action took place before Smith J. On all questions of disputed fact and on all questions of law but one of the learned judges of the Supreme Court agreed with the trial judge. On one point they differed from him. Founding their opinion on an equity he had failed to appreciate or discover, they entered judgment for the respondent declaring him entitled to share with the appellants in the profits of a purchase which they had made secretly and meant to keep to themselves. Considering the purchased property, though not within the scope of the partnership adventure, yet connected with it indirectly and thinking the purchase injurious to the common interest, they held on general principles that the appellants were liable to account to their partner for any profit derived from the transaction; and they regarded the veil of secrecy as a damning proof of guilt and aggravation of the wrong of which, in their view, Goldberg was entitled to complain.

Goldberg was a land speculator. Trimble was an auctioneer: he had been acting chief detective of the whole of the Transvaal before the war. Bennett was a merchant in Durban in a good financial position. The partnership agreement between Goldberg, Trimble and Bennett was dated February 10, 1902. The object of the joint adventure was the purchase and re-sale of certain properties belonging to a gentleman named Hollard. They consisted of 5500 shares in a company called the Sigma for building and other real estate in Johannesburg and elsewhere in South Africa.

There was nothing special in the partnership agreement of February 10, 1902. Profits and losses were to be shared equally. No partner was to sell or dispose of his interest without the consent in writing of his partners, All dealings with the property of the partnership were to be transacted by and through Trimble, to whom the other partners were to give powers of attorney.

The Sigma Syndicate, whose full title was the Sigma Building Syndicate, Limited, had been formed in 1896 under the laws of the South African Republic with limited liability. Its capital was £ 25,000/- divided into 25,000 shares of 1 £ each all fully paid up. The Board of Directors was to consist of at least four and at most six members of the company. The management of the company's affairs was committed to the board "with the most extended powers and without limit or reserve". The powers of the board specially enumerated included "any purchase, sale, or exchange of immovable properties".

The syndicate was formed for the purpose of making profit by purchasing and re-selling a number of stands on Marshall Square and Government Square in Johannesburg.

In the early part of 1902 Hollard, a wealthy man and a director of the Sigma Syndicate, was about to leave South Africa and anxious to dispose of everything he had there before quitting the country. He put all his properties on the market for sale through Goldberg.

Goldberg was furnished with a prospectus or proposal containing a schedule of the various lots shewing the aggregate price of the lots and the value placed on each. The total was £ 94,566/-. The Sigma shares were put at £ 30,000/-. The prospectus was accompanied by an elaborate report prepared by a Mr. Dumat, an attorney in Johannesburg. Goldberg's original intention seems to have been to form a syndicate for the purpose of purchasing the property, charging the syndicate 9500/- as commission for his services. The gentlemen who were to compose the syndicate wanted further time. After carefully considering Dumat's report and expressing no little disappointment and dissatisfaction with it, Goldberg advised Hollard not to grant an extension of time to the syndicate, and proposed to accept Hollard's offer and buy on his own account. Bennett and Trimble joined him in the adventure. The one would not come in without the other, and so the syndicate disappeared, and the partnership agreement of February 10, 1902, was arranged. To meet Hollard's requirements a remittance of £ 12,500/- was telegraphed in advance and Trimble was dispatched to Johannesburg to complete the business.

Armed with powers of attorney from his two partners, Trimble went to Johannesburg, saw Hollard there, and settled the terms of the purchase offhand. The purchase deed was executed by Hollard and by Trimble on behalf of himself and his partners on February 14, 1902. The purchase price as proposed was £ 94,566/- The sum of £ 12,500/-, which had been sent forward, was taken as part payment; the balance was secured by mortgage bonds over the several properties comprised in the purchase.

After this matter was settled, Trimble went one day with Hollard to see the stands belonging to the Sigma Syndicate. When they came to Government Square Trimble asked Hollard if the syndicate would sell the stands there en bloc. Hollard said "Yes", adding that he thought the board would sell for £120,000/- Trimble asked about conditions, and Hollard referred him to Davis, the secretary, who would, he said, lay the matter before the board. It seems that the syndicate had tried without much success to sell their stands. They had put them up for sale by auction, but had only managed to sell one stand on Marshall Square. The board, holding as they did 23,000 shares out of 25,000, decided in the presence of all the shareholders to take 100,000/- for their stands on Government Square, and negotiations were going on with the Government or the private secretary to his Excellency on that footing. Trimble, of course, was not made aware of this fact, and after some negotiation with Davis he was content to take an option to buy for £110,000/- Trimble at once communicated with Bennett, and told him that he thought from some secret information he had gained, which it seems would not bear the light, that money was to be made out of the deal. He asked Bennett to join with him in the speculation, intimating that he was prepared to give even a larger price. Bennett consented to join, and agreed to finance the enterprise. The directors of the syndicate were only too glad to accept Trimble's offer, and thus he secured the stands on Government Square for himself and Bennett at the price of £110,000/-.

Goldberg was not told anything about this purchase at the time. He did not hear of it until the end of 1902 or some time in 1903. Meeting Trimble one day in the street, he said, according to Trimble's uncontradicted evidence, corroborated by an accountant called Winship, who was present, "Don't you think you might have let me have a show in"? Later on, however, he took a more exalted view of his rights, and in June, 1904, he brought this

action, alleging, in the first place, that the partnership had given Trimble a mandate to buy the stands on joint account - an allegation which both Courts held not proved. He also contended that, on general principles applicable to all cases of partnership, he was entitled to share with his partners in the benefit of their purchase. On this ground the Court of Appeal gave effect to his claim.

It seems to their Lordships that judgment of the Court of Appeal is not well founded. The purchase was not within the scope of the partnership. The subject of the purchase was not part of the business of the partnership, or an undertaking in rivalry with the partnership, or indeed connected with it in any proper sense. Nor was the information on which it seems Trimble acted acquitted by reason of his connection with the Sigma Syndicate. The way in which the information was acquired may have been much to Trimble's discredit, as the Court of Appeal has pointed out; but Goldberg is not in a position to complain of that. He at least is not averse to sharing the profit to which it seems to have conducted.

Now if the purchase from Hollard had been completed so far as to make the partnership the absolute and unincumbered owner of the 5500 shares in the Sigma Syndicate, and if those shares had been divided between the three partners and registered in their separate names any one of the three would have had as good a right to buy any property of the syndicate which the direction might think fit to offer for sale as any other shareholder in the syndicate or any member of the general public.

The Court of Appeal appears to have regarded the purchase in question, though not expressly prohibited by the partnership articles, as a breach of good faith and consequently as a violation of the fundamental condition of the partnership. Suppose it had been forbidden in express terms, what would have been the result? The other partners or partners discovering the breach of contract might have claimed immediate dissolution, or even damages, on proof of actual loss to the partnership. But a claim to share in the profits of the forbidden purchase would not have been warranted by principle or precedent. And here there was no loss to the partnership; only a disappointment to the partner left out in the cold. The purchase apparently was an advantage to the partnership. Through it the directors of the Sigma Syndicate were enabled to obtain for their property £10,000/- more than they would have obtained if they had sold to the Government at their own price. And the partnership, as a shareholder in the syndicate, was proportionately the gainer.

The Court of Appeal seems to have been much impressed by the secrecy of the transaction. No doubt it would have been better if Goldberg had been told at the time that Trimble and Bennett were making this purchase. In a case in the House of Lords, which will be mentioned presently, in which the circumstances were somewhat analogous, Lord Blackburn observed, "I generally think it is advisable as a matter of prudence, as well as on other grounds, to let everything be above board" That is a very proper sentiment, worthy, perhaps of a more unhesitating acceptance. But still there was no legal obligation on Trimble or Bennett to tell Goldberg what they were doing unless he had a right to take part in the speculation if he chose to do so. Their excuse for silence, if it be an excuse, was that they considered Goldberg an undesirable partner and not financially strong.

The learned judges of the Court of Appeal also seem to lay some stress on a provision in the articles of association of the Sigma Syndicate which states that “Each share gives, according to the issued shares, a right to a proportionate share in the ownership of the company’s assets and in the distribution of profits”. But there is nothing special in that provision. It is no more than an accurate description of the position of every shareholder in every trading company limited by shares.

Then there was an argument which it is very difficult to follow. It was said that the moment Trimble determined to buy these stands, he put himself in a position in which his interest and his duty conflicted. It was his interest to buy as cheaply as he could. It was his duty to sell the Sigma shares as dearly as possible. The value of the shares depended on the value of the stands, and so it was his duty to enhance the value of the stands by every legitimate means in his power. He ought not to have thought of buying them for less than the utmost price he felt he might have been forced or tempted to give. He knew he was buying cheaply, he told Bennett so. The fallacy of this line of argument lies in assuming that Trimble had anything to do with selling the stands, or any right to meddle with the conduct of the sale. That was in the hands of the directors. They were dealing at arm’s length with him. It seems extravagant to suppose that he would have advanced the interests of the partnership by retiring from the field and declining to enter into a competition which actually had the effect into a competition which actually had the effect of raising the price of the stands and so improving the value of the Sigma shares.

In *Cassels v. Stewart*, which was an appeal from two concurrent judgments in Scotland, three gentlemen, Reid, Cassels and Stewart, were partners in an undertaking called the Glasgow Iron Company. The contract of co-partnership contained an article forbidding any partner to assign his interest, or give any person or persons a right to interfere with the business, and declaring further that any such assignation should be of no effect as regards the company. There was also a clause declaring that on the retirement of a partner, the remaining partners should have power to buy his interest at the amount standing to his credit at the last balance. Reid sold all his interest to Stewart. Reid’s name, however, remained on the books, and he signed all deeds relating to the business until his death, which occurred seven years after the sale. Cassels was not till then informed of the arrangement. When he found it out he claimed to participate in the purchase on the ground—(1) that a mandate had been given to Stewart to buy Reid’s interest for the partnership; (2) that under the terms of the partnership agreement the purchase could only be legally made with his consent; and (3) that Stewart had secretly acquired a benefit for himself within the scope of the partnership business. It was held that the alleged mandate was not proved. But it was argued by Sir F. Herschell, the Solicitor-General, and the Lord Advocate that, putting aside the alleged mandate, “the agreement was entered into under such circumstances as entitled the appellant to participate in it”, “the acquisition of the shares of outgoing partners...was one of the objects of the company”. “Apart from the express terms of the contract the secret agreement by which the respondent acquired for himself alone a benefit falling within the scope of the partnership business was a breach of the good faith of the partnership, and when such a benefit was acquired each partner had a right to demand that it should be communicated to each of them equally”—“on general principles it was inequitable, having regard to the fiduciary relations

due to each other, that such an agreement should be made behind the back of another partner". Without calling on to the respondent, the House, consisting of Lord Selborne L.C. and Lords Penzance, Blackburn and Watson dismissed the appeal.

It seems to their Lordships that the decision of the Supreme Court of the Transvaal in the present case cannot stand with the decision in *Cassels v. Stewart*. There was at least as close a connection between the partnership and the partner's purchase in that case as there is in this. In their Lordships' opinion the order under appeal cannot be supported on authority or on any recognized doctrine of equity. Their Lordships will therefore humbly advise His Majesty that the appeal should be allowed, the order of Smith J. restored, and the appeal from that order dismissed with costs.

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RELATIONS OF PARTNERS TO THIRD PARTIES

Holme v. Hammond

(1872) L.R. 7 Ex. 218; 41 L.J. Ex. 157

[*Section 19 – Duty of a partner as an agent of the firm*]

Thomas and William Henry Fisher and George Henry Smith carried on business in co-partnership as auctioneers, under a deed which provided that in case of the death of Thomas Fisher, the other two partners should carry on the business, or what was called the co-partnership and should pay to the executors of Thomas Fisher the share of the profits to which he would have been entitled if he had survived. Thomas Fisher died in August, 1869; the two survivors carried on the business until the death of Smith, when William Henry Fisher continued to carry it on alone. W.H. Fisher and Smith having sold a mill and machinery in May, 1870, on account of the plaintiff and having received the proceeds of the sale in the following month of July. The plaintiff brought an action against W.H. Fisher and the defendants to recover that sum as money had and received insisting that the defendants, who are the executors of Thomas Fisher, and who have claimed to be entitled to the share of the profits which the testator would have been entitled to if he had lived and in respect of which they have received certain sums together with other moneys due to the estate of Thomas Fisher not specifically as profits, but generally on account), became partners with W.H. Fisher and Smith upon or after the death of Thomas Fisher, and as such are liable to the demand in this action.

KELLY, C.B. – The single question in this case is, whether the defendants at the time when this money was received were the partners of W.H. Fisher and Smith; and this depends upon whether they have expressly or impliedly entered into a contract of co-partnership, since the death of Thomas Fisher, with W.H. Fisher and Smith, who survived him. It is contended that having claimed and actually received portion of the profits of the business as supposed to have been ascertained upon an account taken from the 30th of June, 1869 to the 30th of June 1870, the defendants have made themselves, or must be taken to have become, partners, and as such liable to this action.

Upon a careful consideration of the authorities bearing on this question, it certainly appears to have been thought in former times, and there are judicial dicta to that effect, that the mere reception of a share in the profits of a commercial co-partnership made the participator a partner and liable to the debts and losses of the firm. But looking to the decisions themselves in which the question has arisen, it will be seen that in no one case has the party sought to be charged been held liable except where a contract of co-partnership has been found to have been entered into.

In *Grace v. Smith* [Wm. Blacks 998] in which the language of De Gray, C.J., and Blackstone, J., appears to support the argument for the liability as partners of all who participate in the profits of a commercial concern, the decision was that there was no sufficient evidence of a contract of co-partnership and so no liability as partners.

In the leading case of *Waugh v. Carver* [(1763) 2 Hy. Bl. 235] where the defendant was held liable as partner, it was because the contract proved was decided, and rightly decided, to be a contract establishing a commercial co-partnership, and the agreement in the articles that neither should be liable for the acts or the losses of the others, but each for his own (though valid and binding inter se), was of no effect against the creditors of the co-partnership firm.

So in *Cox v. Hickman* [(1860) 8 H.L.C. 268]; *Bullen v. Sharp*, [(1865) L.R. 1 C.P. 86], and the Irish case of *Shaw v. Galt* [16 Irish Com. Law Rep. 357], the parties sought to be charged were held not liable, on the ground that the acts done and the contracts entered into in those cases did not amount to contracts of co-partnership so that the parties had not become partners. It is necessary to consider the various terms and provisions of the contracts which were brought into question in those and other cases. It is enough to say, that whenever the plaintiff has failed to establish a contract of co-partnership the action has failed and the decision has been that the defendant was not liable.

In some of those cases the law of principal and agent has been referred to as governing the matters in question, but this branch of the law has really no bearing upon the case of partnership, except, indeed, that whenever a contract of partnership among commercial men exists, each partner is in point of law the agent for the others and for the firm collectively, and they are bound by any contract he may enter into within the scope of the partnership with reference to the nature of the undertaking, this agency being an incident to the contract of co-partnership.

It has also been argued that the statute 28 & 29 Vict. C. 86, enacting that widows, lenders of money, and some other classes of persons taking a share in the profits of a co-partnership shall not be deemed partners, would be useless if these and other classes of persons might at common law become sharers in profits without incurring such liability. But it seems to me that the effect of the statute is sharing in profits shall be no evidence at all of a contract of partnership, whereas, with regard to others, it is evidence, though insufficient of itself to establish the liability.

We have, therefore, now to look to the facts of the present case to determine whether upon the evidence the defendants have become parties to contract of partnership. Upon the death of Thomas Fisher the partnership before subsisting was dissolved by operation of law; W.H. Fisher and Smith from that time carried on the business; But this was, in contemplation of law, a new partnership. The defendants could not become partners with them but by some agreement, express or implied, to which they were parties. At the trial, taking into consideration the claims of the defendants to a share in the profits the acquiescence in that claim by the two survivors, and the actual payment and acceptance of the proportion of the profits supposed to have been ascertained, together with the accounts made out of the transactions of the firm, which were alleged, and which indeed did seem, to show that the defendants instead of calling for an account of the state of the partnership at the death of their testator, and withdrawing from the concern whatever money or stock of property belonged to his estate, had left a portion of his capital and his share in the partnership stock and property in the business. I was, with all the circumstances before me and the accounts unexplained, inclined, to think that, upon the whole evidence, a contract by the defendants to succeed their testator and to become partners in his stead might be inferred. But now that it appears that

there was no capital at all, either of the testator's or the other partners, employed in the business; that the stock and co-partnership property consisted merely of a small quantity of furniture and fittings in the office of the value of £ 100.00; that the defendants neither left in nor drew out any money of the testator's except that they drew out several successive sums of £100.00, upon the general account of what might turn out to be due to the estate; and that, consequently, the whole case for the plaintiff was reduced to the single fact that, in pursuance of the clause in the articles of partnership, the parties considered that in paying and receiving those sums they were to be taken as well on account of the share of the profits as of other moneys due to the testator; I am of opinion that there is no evidence whatever to establish a contract of co-partnership on the part of the defendants, and, consequently, that the action is not maintainable.

MARTIN, B. – I was under the impression that Thomas Fisher had left capital in the concern, and that the defendants had suffered this capital to remain, but it appears that this was not so, and that the testator, Thomas Fisher, had drawn out all his capital, and that the defendants did nothing more than claim and receive profits under the above clause. In my opinion this act did not make them liable to the plaintiff's demand. They did nothing on their own behalf at all; they merely did that which a court of equity would have compelled them to do as executors under the will, and in my opinion it would be contrary to reason to hold them liable by that act to a responsibility which must of necessity be borne by them in their own personal capacity, and paid out of their private funds; *Wightman v. Townroe* [(1813) 1 M. & S. 412]. It seems admitted by the learned counsel for the plaintiff that the defendants could not have interfered in or meddled with the sale; so also the money, the proceeds of it; was not their the property, and if they had taken possession of it against the will of the surviving partners in order to pay it to the plaintiff they would have been trespassers; and it is difficult to understand how defendants can, in contemplation of law, have received money of which they had neither right nor possession, and their taking which against the will of the surviving partners would have been a wrongful act.

As I have said, up to a certain time in the argument I was in favour of the plaintiff. I understood that part of Thomas Fisher's capital remained, by the permission of the defendants, in the firm, and that they took a share in the profits in part earned by it. Under such circumstances I thought it not unreasonable that they should be liable upon a valuable contract by means of which the profits were in part earned, and that the principle of *Waugh v. Carver* [(1793) 2 Hy. Bl. 235], applied; but upon consideration, I doubt whether this was correct. The principle of *Waugh v. Carver* has been much broken in upon...(It seems to me that the principle on which their opinions Lord Wensleydate and Lord Cranworth in *Cox v. Hickman* [(1860) H.L.C. 268] proceeds is correctly stated by O'Brien, J., in the case of *Shaw v. Galt* [16 Irish Com. Law Rep. 357]. He there expresses himself as follows: "The principle to be collected from them appears to be, that a partnership, even as to third parties, is not constituted by the mere fact of two or more persons participating or being interested in the net profits of a business; but that the existence of such partnership implies also the existence of such a relation between those persons as that each of them is a principal and each an agent for the others." If this principle be correct, the defendants are clearly not liable. The surviving

partners were not agents of theirs in any sense; all that the defendants did was in an adverse character to them, and was a requirement that they should fulfil their contract with the testator by paying the one-third of the net profits for the benefit of his estate...As I have already said, in my opinion the defendants are entitled to the judgment of the Court.

* * * * *

Rhodes v. Moules

(1895) 1 Ch. 236 (CA)

[*The securities misappropriated by one partner were habitually held by the firm*]

LORD HERSCHELL L.C. – This is one of those painful cases in which whatever judgment is pronounced the loss must fall upon some innocent person who has not by act or default contributed to it.

The litigation in this case has arisen out of the frauds of Mr. *Rew*, who practiced his profession as a solicitor in partnership with Messrs. *Hughes* and *Masterman* and the City of *London*. There is no doubt that the certificates of 280 *De Beers* shares were placed in his hands by Mr. *Rhodes*, the Plaintiff, in August, 1891. Those shares he has fraudulently misappropriated, and the first question is whether his partners, Messrs. *Hughes* and *Masterman*, are liable to make good the loss to the Plaintiff. Before stating the circumstances under which the shares were received by *Rew*, it is necessary to revert to some prior transactions between the Plaintiff and Mr. *Rew* acting on behalf of the firm. It is clear that Mr. *Rhodes* was a client of the firm, and that the firm had acted for him in previous matters. [His Lordship stated that facts as given above, and then proceeded as follows: –]

Some criticisms were presented to the Court on the evidence of Mr. *Rhodes*, and the learned Judge in the Court below has adverted to some inconsistencies in his evidence. I have read his evidence, and there seem to me to be no inconsistencies in it which are at all material. I think it cannot be doubted that Mr. *Rew* had represented to Mr. *Rhodes* that the lenders required some security beyond the mortgage of the freehold, that such security was to be collateral and to consist of these *De Beers* shares, and that he induced Mr. *Rhodes* to leave the *De Beers* shares with him on the representation that he would arrange with the lenders that he should hold them as for them collateral security or their loan. Whatever verbal differences there may be, I think there can be no doubt that this is the substance of the transaction in view, not merely of Mr. *Rhodes*' statements, but of the letters to which I have referred written previously by Mr. *Rew* to Mr. *Rhodes*.

The question is whether under these circumstances the firm are liable in respect of these shares which have been misappropriated in the manner I have mentioned. It is said that they are not, inasmuch as it was beyond the scope of Mr. *Rew*'s authority as a solicitor to take the shares for any such purpose, or under such circumstances, and that, inasmuch as his partners were admittedly ignorant of his having so taken them, they cannot be bound by the transaction or incur any liability in respect of it. It is clear that on previous occasions the firm had acted for Mr. *Rhodes* in negotiating loans, and in receiving from him these very securities and transmitting them to the lenders, and in the first instance certainly receiving them back from the lenders. That that was a firm transaction I think it is impossible to dispute, because as I have shewn, it passed through the books of the firm, the firm credited themselves with the charges in respect of it, and an account was sent in the name of the firm, and that account was discharged by Mr. *Rhodes*. Therefore, it is impossible to dispute that Mr. *Rhodes* had on the previous occasion actually carried through a transaction with the firm, and as a part of the transaction they not only negotiated the loan, but received from him these very securities to be

handed to the lender. Even apart from that, I am not satisfied that it would be outside the scope of a solicitor's business when they were negotiating a loan for one of their clients to receive from him securities, whatever their nature, for the purpose of transmission to any of their clients who were making the loan. It is not necessary to decide that as a matter of law; all I say it, I am not satisfied. But, in the present case, having regard to the prior dealings of this gentleman with the firm, I think it is impossible for them to say that Mr. *Rhodes* was not perfectly justified in assuming that the partner with whom on this occasion he dealt had authority from the firm to receive from him the shares which he handed for the purpose of carrying out the mortgage transaction which they were negotiating for him. If these shares had been handed over to the lenders the transaction would be on all fours with the one which had been previously carried through by him on behalf of the firm. In the present case it is true that the shares were not handed over to the lenders; but Mr. *Rew* represented to the Plaintiff that this was by arrangement between him and the lenders, who were also his clients, and who had arranged that he, or rather that the firm, should hold the securities on behalf of the lenders instead of handing them over to him. It seems to me that that can make on possible difference in the result. That was merely a matter between Mr. *Rew*, or the firm, and their other clients with whom they had negotiated the loan. If in fact that authority had been received—a question which I shall have to deal with presently—it seems to me it would be quite immaterial whether the transaction was carried out in that way or by Mr. *Rew* receiving them to hand them over afterwards to his clients, the lenders.

For these reasons, apart from authority, I find it difficult to discover any ground upon which it could be said that Mr. *Rhodes* was not justified in treating, and entitled to treat, the transaction as a transaction with the firm which rendered, not Mr. *Rew* only, but the firm responsible, if the shares received under the circumstances I have detailed were misappropriated and not forthcoming. This, of course, is subject to the question whether the firm had discharged themselves by shewing that they were held for the Defendants *Moules* under such circumstances that those Defendants are liable to the Plaintiff; in which case, of course, the firm would be discharged from liability, because they would in fact have handed them over to the lenders, and be freed from responsibility to Mr. *Rhodes*, the lenders being then the persons responsible; but that is a subsequent part of the case which I will deal with presently.

The Defendants relied mainly upon the case of *Cleather v. Twisden* [28 Ch. D. 340], decided in this Court in the year 1884. It was said that this case established that it was not part of the business of a solicitor to take over for custody bonds payable to bearer, and, consequently, when one partner had done so without his other partners being aware of it, they were under no liability if he misappropriated them. I do not think that case covers the present one. In the view which I take, these bonds were not handed to Mr. *Rew* merely for safe custody: they were handed to him in connection with a mortgage transaction which he was carrying out, in order that they should pass through him as collateral security to the lenders for whom he was acting. But it is to be observed that in the case of *Cleather v. Twisden* Lord Justice Bowen said [28 Ch. D. 349]: “The claim is against the firm to which *Parker* belonged in respect of the custody of certain bonds by *Parker*. This is conceded to be beyond the ordinary scope of the business of solicitors, though, of course, it may be brought within it by

special circumstances". There was, therefore, there no evidence on the question; but it was conceded by those who were arguing the case that such a transaction was beyond the ordinary scope of the solicitors. It cannot be said, therefore, that in that case it was held as a matter of law to be so, because obviously when that had been conceded as a matter of fact any finding as a matter of law would have been superfluous. So that I do not think the case can be taken as a decision in point of law that such a transaction would be beyond the scope of solicitor's authority. As the Lord Justice said, it must depend upon the special circumstances; and certainly if it were to appear that it had been part of the practice of solicitors in the City to take securities of this description for safe custody, or if indeed in the case of a particular firm it appeared that such had been the practice, the case would have been one requiring the Court to determine whether in the case of that firm at all events, if not generally, it was not a matter within the scope of the authority of one of the partners. I should say the decision in *Cleather v. Twisden* appears to me substantially to have amounted only to this, that Parker had really taken charge of the bonds for a client as a personal matter as between him and that client, as a solicitor of course, but still not as a member of the firm, but as an individual. That seems to have been the conclusion at which the Court arrived, and there were undoubtedly circumstances which point to that conclusion to which it is not necessary to refer further. Lord Justice Bowen says this [28 Ch. D. 351]: "That the bonds were in the custody of *Parker* is common ground, the real question is whether in letters for which the firm are responsible, language has been used which would justify the plaintiffs in assuming that *Parker's* custody was the custody of the firm". In the present case I have a difficulty in seeing how it can be doubted that letters for which the firm were responsible - letters relating to the previous transaction to which I have alluded, which passed through the letter-book of the firm, charges made by the firm and paid by the Plaintiff - would justify the Plaintiff in assuming that when *Rew* received those shares he received them, not as an individual, but on behalf of the firm, and that his receipt of them was the receipt of the firm. In Lord Justice Fry's judgment he says this [28 Ch. D. 356]: "He" (that is, *Parker*) "was advising the trustees in the realization of the property, and I do not doubt that as to any parts such as the mortgages, which were received by *Parker* for distribution, the firm would be responsible; but as to the bonds they were not received for the purpose of distribution but for safe custody long before the distribution began". Therefore, I do not see any reason to think that if circumstances such as we have in the present case had been brought before the Court which decided that case - if they had been aware of such previous transaction as we are aware of here, and had seen that the securities were received in connection with a mortgage transaction in the way they were here - they would have come to any other conclusion than that in which we have arrived.

But then it is said on behalf of the Plaintiff, the Defendants *Moules* are responsible for these shares, and the receipt of them by Mr. *Rew* was a receipt on their behalf. He held them on their behalf, and whatever the liability of the firm to the *Moules* they cannot call upon the Plaintiff to repay the sum lent without not only reconvening to him, but giving up to him these *De Beers* shares. In order to establish this case I think they must make out two things: first, that Mr. *Rew* did in fact receive and hold these *De Beers* shares for the Defendants *Moules*; and secondly, that he did so with the authority of the *Moules*. Now, I have not been satisfied that he did in fact receive them, or ever intended to receive them and hold them for

the *Moules*. No doubt he led Mr. *Rhodes* to believe that he did: but that is quite a different question.

The case is a very peculiar one. Mr. *Rew* when he drew up the mortgage from Mr. *Rhodes* to the *Moules* made himself a mortgage, not only without any authority to do so, but without any legitimate reason for doing so. He was, of course, not a mortgagee. He had told Mr. *Rhodes* that the mortgagees would require some collateral security and that he thought they would take the *De Beers* shares. He had no communication on the subject with the *Moules* at all; they never required further security, and he never communicated with them on the subject. He told Mr. *Rhodes* that it was by arrangement with them that the shares were to be left in the custody of the firms. No such arrangement had been made: and again, as I have said, there was no communication on the subject. We know that Mr. *Rew* had commenced the *Stock Exchange* transactions which ultimately led to his ruin at a date prior to this, viz., in the January of that year, and he ultimately did dispose of those shares as his own. Under those circumstances I cannot say, in the absence of any evidence, that he ever identified them as their property, that he ever put them in an envelope or wrote their name on them or did anything to earmark them as theirs; and, in view of the falsehoods and irregularities to which I have referred, I cannot be satisfied that at the time he received those shares he ever meant to hold them really for the *Moules*. But even if he did, is there evidence that he had authority to receive and hold these shares on behalf of the *Moules* so as to make them liable? It was not suggested that he received any express authority, that they ever actually heard anything of the transaction: but it is said that he had a general authority, that the whole of the business in connection with the estate in which they were interested was left so entirely to Mr. *Rew* that he was intended to be by them absolutely master of the situation, taking what he pleased and doing what he pleased. Now, I have read the correspondence, and it conveys to my mind precisely the opposite impression. I do not find Mrs. *Moules* leaving everything to him in that blind way at all. She requires to know about everything. He professes to tell her about everything. He asks her approval at every step, and that approval is conveyed, and doubts were sometimes suggested, and, seeing that neither she nor her son ever learned that these shares had been taken or held for them by Mr. *Rew* or the firm, it seems to me it would be somewhat extravagant to arrive at the conclusion, notwithstanding all that, that they were held by the firm or Mr. *Rew* for the *Moules*, or that, having been in effect handed to them, they had become responsible for them.

For these reasons I am unable to come to the conclusion that the Defendants the *Moules* are liable. I do not think that the firm who undoubtedly received these shares from Mr. *Rhodes* have discharged themselves of liability. It follows in the result, I think, that as regards the *Moules*, the appeal should be dismissed with cost; and as regards the other Defendants the judgment must be reversed with the usual result, and that judgment with costs should be for the Plaintiff.

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Hamlyn v. Houston & Co.

(1903) 1 K.B. 81

[Liability of other partners/firm for wrongful acts of a partner- One partner bribed the clerk of a competing firm to obtain information relating to contracts]

COLLINS, M.R. – The decision of the learned judge in this case was, in my opinion, right. The defendant Strong appears to have been a sleeping partner in a firm consisting of himself and the defendant Houston, or, at any rate, he delegated the transaction of the whole of the firm's business to Houston. The jury have found that it was in the course of the business of the firm *to obtain by legitimate means information in regard to contracts made or tendered for with brewers and with buyers of grains by competing firm* What Houston did for the purpose of obtaining information which, according to the finding of the jury, it was within the scope of his authority to obtain by legitimate means, was to bribe the clerk of the plaintiff, who was a competitor in business, to give him access to documents belonging to the plaintiff; indeed, it would appear that he actually had possession of one of the plaintiff's books for a time. It was argued for the defendants that this action by Houston was so completely outside the scope of the authority given to him that the defendants' firm cannot be responsible for it in an action brought against them by the plaintiff for damages thereby occasioned to him. The defendants' counsel have endeavoured to frame a definition with regard to what is and what is not within the scope of an agent's authority so as to render his principal liable. They suggested that, where the end sought to be obtained by the agent is in itself illegal, and the means employed to accomplish it are illegal, it cannot be said that the action of the agent is within the scope of the general authority given to him to conduct a business, but that it is otherwise where the end and the means employed are legal, or where the end is legal or illegal. Trying this case by the test so suggested, was the end to be obtained here in itself illegal? The defendants' counsel say that it was, but it does not appear to me to be so. According to the finding of the jury it was part of the defendants' business to obtain information as to the contracts and tenders of competitors in business, and, the more secret these matters were, the greater was the value of that information to the defendants' firm. The jury have in effect found that it was within the scope of the authority given to Houston to obtain such information by legitimate means, and I do not see that there was anything illegal in so obtaining it. It is too well established by the authorities to be now disputed that a principal may be liable for the fraud or other illegal act committed by his agent within the general scope of the authority given to him, and even the fact that the act of the agent is criminal does not necessarily take it out of the scope of his authority. If the act done by the agent is within the general scope of the authority given to him, it matters not for the present purpose that it was directly contrary to the instructions of his principal, or even that it may have been an offence against society itself. The test is that which is applied to this case by the learned judge. Was it within the scope of the authority given to Houston to obtain this information by legitimate means? If so, it was within the scope of his authority for the present purpose to obtain it by illegitimate means, and the defendants are liable. That is the law as expressed in the Partnership Act, 1890, and as laid down by decisions previous to that Act, in which it has been held that a principal is liable for the fraud or other wrongful act of his agent if committed within the scope of his employment.

This doctrine does not appear to rest upon the notion of the principal's holding out the agent as having authority. The grounds upon which it seems to rest, as explained in cases such as *Barwick v. English Joint Stock Bank* [(1867) L.R. 2 Ex. 259], appear to be that the principal is the person who has selected the agent, and must therefore be taken to have had better means of knowing what sort of a person he was than those with whom the agent deals on behalf of his principal; and that, the principal having delegated the performance of a certain class of acts to the agent, it is not unjust that he, being the person who has appointed the agent, and who will have the benefit of his efforts if successful, should bear the risk of his exceeding his authority in matters incidental to the doing of the acts the performance of which has been delegated to him. For these reasons I think this application must be dismissed.

METHEW, J. - I agree. A little confusion has been introduced into this case by the reference made to the criminal law. It is not suggested that Houston's partner would be liable determinally; the question is only one of civil liability. The rule of law applicable is perfectly plain. The question is whether the action of Houston was within the scope of his authority for the purpose of making the firm liable. I think the jury were entirely warranted in finding that Houston was authorized to obtain information as to the contracts and tenders made by competing firms by legitimate means. He did obtain such information by illegitimate means. It being within the scope of his authority to procure the information, it is immaterial for the present purpose whether the acts which he committed in order to procure it were fraudulent or even criminal or not, and his partner is responsible for those acts.

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Tower Cabinet Co., Ltd v. Ingram

(1949) 1 KBD 1032

[*Holding out - section 28*]

LYNSKEY, J. - The respondent company, the Tower Cabinet Co., Ltd., claimed from Merry's, who in the writ were described as "sued as a firm", the sum of £23.17s. for the price of six suites of furniture sold and delivered. Judgment was obtained, and the company then sought to render a Mr. S. G. Ingram liable for the debts of Merry's. They alleged that he was liable, first, under s. 14, and, secondly, under s. 36, of the Partnership Act, 1890. The matter was referred for trial before Master Grundy, the issue being whether Mr. Ingram had represented himself to be, or knowingly suffered himself to be represented to be, a partner under S. 14, or was liable under the provisions of S. 36 as, a partner.

The facts found by the learned master were that in January, 1946, Mr. A. H. Christmas and Mr. Ingram commenced together to carry on business in partnership as household furnishers under the name of Merry's at Silver street, Edmonton. The partnership was registered under the Registration of Business Names Act, 1916, as being carried on by Mr. Christmas and Mr. Ingram. That partnership subsisted until Apr. 22, 1947, on which date the parties agreed to dissolve it. The master was satisfied that there was a dissolution of this partnership in April, 1947, and that Mr. Ingram had given notice to the firm's bankers that he had ceased to be a partner in the business carried on in the name of Merry's. From then until some time in May, 1948, Mr. Ingram had no connection with the partnership except that Mr. Christmas had agreed to pay him for his share of the partnership a sum of some £3,000, and by May, 1948, about £1,000 had been paid by instalments. Mr. Ingram was not professionally represented at the time of the dissolution. He arranged with Mr. Christmas to notify those dealing with the firm that he (Mr. Ingram) had ceased to be connected with it, but he did not advertise or procure the advertisement in the London Gazette of the fact that he had ceased to be member of the firm. After his cessation of membership, new notepaper was printed for use in the future business of the firm. While Mr. Ingram had been a partner, the notepaper had been headed "Merry's" and thereunder had borne the names: "A. H. Christmas and S. G. Ingram", indicating that they were both partners. After the dissolution the name "Merry's" appeared on the new notepaper, and "A. H. Christmas, Director", apparently as being the person responsible for the running of the business.

In January, 1948, Mr. Christmas, or Merry's, were approached by the Tower Cabinet Company through their representative, a Mr. Harold Selbey, who obtained an order for six suites of furniture. He reported the order to one of the directors of the company, Mr. Jack Smead, who telephoned to Merry's and asked for a director in order to secure confirmation of the order. It is not clear to whom he spoke. In pursuance of that conversation, a letter was written in the form of an order, and dated Jan. 5, 1947, in mistake for Jan. 5, 1948. That order form read: "Merry's, A. H. Christmas, S. G. Ingram. Household Furnishers. To Tower Cabinet Co., Ltd. Please supply six light bedroom suites 168 units on delivery". It was signed by Mr. Christmas as the manager. That order or confirmation was given on the notepaper which had been the notepaper of the firm at the time when Mr. Ingram was a

member, but Mr. Christmas had no authority from Mr. Ingram to use it, and in using it he was acting in direct conflict with the arrangement that he had made with Mr. Ingram that he should notify people that Mr. Ingram was no longer interested in the firm.

In May, 1948, Mr. Ingram was worried about the state of the business, and he came to try and see if he could resuscitate it in order to salvage his share in the previous partnership. He seems to have put some £300 into the business, and to have endeavoured to take control again. A letter was written by Mr. Christmas to the company in May, 1948, saying:

Dear Sirs, I wish to advise you that as from today I am no longer connected with the above business. Mr. S. G. Ingram is now sole proprietor and responsible for all outstanding debts. Yours faithfully, (signed) A. H. Christmas.

According to the evidence of Mr. Ingram, that letter was written without his knowledge and without his authority and he had no idea it was being sent, but it is not of any great materiality from the point of view of the questions which we have to decide in this case. It is clear on the master's finding that in January and February, 1948 when the goods were ordered and delivered Mr. Ingram was not in fact a partner in this business. The question is whether the company are able to make him liable as a partner by reason of the provisions of the Partnership Act, 1890, dealing either with holding out or with failure to give notice when a partnership has ceased and credit has been given to the partnership firm as if the outgoing partner were still a partner.

[Section 14 of the Act of 1890 was identical with the provisions of section 28 of the Indian Partnership Act, 1932. The court re-produced section 14 and proceeded.]

Before the company can succeed in making Mr. Ingram liable under this section, they have to satisfy the court that Mr. Ingram, by words spoken or written or by conduct, represented himself as a partner. There is no evidence of that. Alternatively, they must prove that he knowingly suffered himself to be represented as a partner. The only evidence of Mr. Ingram's having knowingly suffered himself to be so represented is that the order was given by Mr. Christmas on notepaper which contained Mr. Ingram's name. That would amount to a representation of Mr. Christmas that Mr. Ingram was still a partner in the firm, but on the evidence and the master's finding that representation was made by Mr. Christmas without Mr. Ingram's knowledge and without his authority. That being the finding of fact, which is not challenged, it is impossible to say that Mr. Ingram knowingly suffered himself to be so represented. The words are "knowingly suffers" – not being negligent or careless in not seeing that all the notepaper had been destroyed when he left.

The company also rely on s. 36 which provides:

(1) Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change. (2) An advertisement in the LONDON GAZETTE as to a firm whose principal place of business is in England or Wales, in the EDINBURGH GAZETTE as to a firm whose principal place of business is in Scotland, and in the DUBLIN GAZETTE as to a firm whose principal place of business is in Ireland, shall be notice as to persons who had not dealings with the firm before the date of the dissolution or change so advertised. (3) The estate of a partner

who dies, or who becomes bankrupt, or of a partner who, not having been known to the person dealing with the firm to be a partner, retires from the firm, is not liable for partnership debts contracted after the date of the death, bankruptcy, or retirement respectively.

It is said by counsel for the company that sub-s. (1) deals with the case in which it appears to the world that a man is still a partner in a firm and notice must be given before his liability as a retiring partner can cease. Secondly, he says that sub-s. (2) equally applies to the position of a partner when it is apparent to the world that he was a partner.

Referring to the old authority of *Farrar v. Delfinne*, counsel for the company says that the distinction has to be drawn between what are described by Cresswell, J., in that case as notorious partners of the partnership and partners who are "profoundly secret" members of the partnership. Counsel says that this section, being in a codifying Act, re-enacts the law as it existed in 1843 and later. It should be noticed that even in *Farrar* case Cresswell, J., laid considerable emphasis on the question of actual notice. He said (1 Car. & Kir. 580):

Todd and the defendant were once in partnership, but they have not been so since the year 1837. The plaintiff dealt with the firm during the partnership, and he continued to do so afterwards; and the question is, whether the defendant is liable in respect of such subsequent dealings now that the partnership is dissolved. The law stands thus: If there had been a notorious partnership, but no notice had been given of the dissolution thereof, the defendant would have been liable. If there had been a general notice, that would have been sufficient for all but actual customers; these, however, must have had some kind of actual notice. If the partnership had remained profoundly secret, the defendant could not have been affected by transactions which took place after he had retired; but if the partnership had become known to any person or persons, he would be in the same situation, as to all such persons, as if the existence of the partnership had been notorious. The question for you, therefore, is was this partnership actually known to the plaintiff, either by general report, or by direct communication? Because, if it were, and he did not know, either from notice of the fact, or from surmise, that the dissolution had taken place, you must infer that he still dealt on the faith of the partnership, and the defendant will therefore be liable.

It is said by counsel for the company, who seeks to adopt this judgment in his favour, that s. 36(1) and (2) are dealing with what are described in the judgment as "notorious" partnerships, and sub-s. (3) is dealing with cases of "profoundly secret" partnerships. Looking at the Act itself, I find difficulty in adopting that suggested construction. The words of sub-s. (1) are:

Where a person deals with a firm after a change in its constitution he is entitled to treat all apparent members of the old firm as still being members of the firm until he has notice of the change.

The point depends, in my view, on what is the meaning of sub-s. (1) of "apparent members." Apparent to whom? Does it mean apparent to the whole world, or notorious, or does it mean apparent to the particular person with whom the section is dealing? In my reading of that sub-section, "apparent members" means persons who appear to be members to

the person who is dealing with the firm, and they may be apparent either by the fact that the customer has had dealing with them before, or because of the use of their names on the notepaper, or from some sign outside the door, or because the customer has had some indirect information about them. Both sub-s. (1) and sub-s. (2), in my view, deal with cases where they are apparent members.

Sub-section (3) again deals with the particular individual. It does not deal with the public at large. Its words are, to my mind, simple and obvious. It does not deal merely with question of apparent members or non-apparent members. It implies the test: "... a partner who, not having been known to the person dealing with the firm to be a partner..." Whether he was to other people an apparent partner, or whether he was a dormant partner, the words seem to me to be equally applicable. If the person dealing with the firm did not know that the particular partner was a partner, and if that partner retired, then, as from the date of his retirement, he ceases to be liable for further debts contracted by the firm with that person. The fact that later the person dealing with the firm may discover he was a partner seems to be to be irrelevant, because the date from which the sub-section operates is the date of the dissolution. If the person who subsequently deals with the firm had no knowledge prior to the dissolution that the retiring partner was a partner, then sub-s. (3) comes into operation, and, in effect, relieves the person retiring from liability.

It is said by counsel for the company that the company did know that Mr. Ingram was a partner because the order for the goods contained a statement to the effect, or, apparently, to the effect, that he was a partner of the firm. In my view, that document, which only came into existence in January, 1948, was, no doubt, a representation by Mr. Christmas that Mr. Ingram was a partner at that particular date. That representation was untrue. He was not a partner at that date, and it seems to me one cannot draw the inference that that gave the company knowledge that, in fact, Mr. Ingram had been a partner prior to the date of his dissolution of the partnership in April, 1947. Even if it did give such notice, in my view, the section had already commenced to operate, and it would not avail, subject to s. 14 dealing with holding out, to render Mr. Ingram liable.

The result is that, in my view, the learned master was not correct in his view of the effect of the sub-section or of the decision which he quoted. In my view, it is established that the company had no knowledge that Mr. Ingram was a partner prior to the date of the dissolution. That being so, Mr. Ingram is brought directly within the words of sub-s. (3), and is, therefore, under no liability to the company in respect of the debts subsequently incurred by Mr. Christmas at a time when he was not a partner. This appeal ought to be allowed.

LORD GODDARD, C.J. - I agree. I need only add that, in my opinion, the words "all apparent member" in s. 36(1) mean all members apparent to the person dealing with the firm. Secondly, I think sub-s. (3) exactly applies to the facts of this case, and I can see no good reason for holding that that they apply to the case of a dormant partner. I think that the Act, which is a codifying Act, intends in this section to incorporate the law, except with regard to the notices in the LONDON GAZETTE, which was new, laid down by Cresswell, J. in *Farrar v. Deflinne* (1), to which my brother has referred, or, at any rate, to adopt the statement of law which he there lays down when he told the jury that the question for them was : "Was this partnership actually known to the plaintiffs, either by general report, or by

direct communication?" I feel convinced that the true construction to put on this section is that there must be actual knowledge which may be acquired either because of the fact that it is notorious, or because it has been directly communicated, but it is not enough to say that other people knew. The fact may be so notorious that a jury would be justified in finding that the person did know a certain fact, but it does not follow because other people know it that he knew it. I think what Cresswell, J. meant in that case was that the jury must be satisfied that there was actual knowledge, which might be gained from either of one of two sources.

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Shivagouda Ravji Patil v. Chandrakant Neelkanth Sadalge

AIR 1965 SC 212

[Can a minor who was admitted to the benefits of a partnership can be adjudicated insolvent on the basis of debt or debts of the firm after the partnership was dissolved, on the ground that he attained majority subsequent to the said dissolution, but did not exercise his option to become a partner or cease to be one of the said firm]

K. SUBBA RAO, J. - 2. The facts are not in dispute and may be briefly stated. Mallappa Mahalingappa Sadalge and Appasaheb Mahalingappa Sadalge, Respondents 2 and 3 in the appeal, were carrying on the business of commission agents and manufacturing and selling partnership under the names of two firms "M. B. Sadalge" and "C.N. Sadalge". The partnership deed between them was executed on October 25, 1946. At that time Chandrakant Nilakanth Sadalge, Respondent 1 herein, was a minor and he was admitted to the benefits of the partnership. The partnership had dealings with the appellants and it had become indebted to them to the extent of Rs 1,72,484. The partnership was dissolved on April 18, 1951. The first respondent became a major subsequently and he did not exercise the option not to become a partner of the firm under Section 30(5) of the Indian Partnership Act. When the appellants demanded their dues, Respondents 2 and 3 informed them that they were unable to pay their dues and that they had suspended payment of the debts. On August 2, 1954, the appellants filed an application in the Court of the Civil Judge, Senior Division, Belgaum, for adjudicating the three respondents as insolvents on the basis of the said debts. The 1st respondent opposed the application. The learned Civil Judge found that Respondents 2 and 3 committed acts of insolvency and that the 1st respondent had also become partner as he did not exercise his option under Section 30(5) of the Partnership Act and, therefore, he was also liable to be adjudicated along with them. The first respondent preferred an appeal to the District Judge, but the appeal was dismissed. On second appeal, the High Court held that the 1st respondent was not a partner of the firm and, therefore, he could not be adjudicated insolvent for the debts of the firm. The creditors have preferred the present appeal against the said decision of the High Court.

3. Learned counsel for the appellants, Mr Pathak, contends that the 1st respondent had become a partner of the firm by reason of the fact that he had not elected not to become a partner of the firm under Section 30(5) of the Partnership Act and, therefore, he was liable to be adjudicated insolvent along with his other partners.

4. The question turns upon the relevant provisions of the Provincial Insolvency Act, 1920 (5 of 1920) and the Indian Partnership Act. Under the provisions of the Provincial Insolvency Act, a person can only be adjudicated insolvent if he is a debtor and has committed an act of insolvency as defined in the Act: see Sections 6 and 9. In the instant case Respondents 2 and 3 were partners of the firm and they became indebted to the appellants and they committed an act of insolvency by declaring their inability to pay the debts and they were, therefore, rightly adjudicated insolvents.

5. But the question is whether the first respondent could also be adjudicated insolvent on the basis of the said acts of insolvency committed by Respondents 2 and 3. He could be, if he

had become a partner of the firm. It is contended that he had become a partner of the firm, because he did not exercise his option not to become a partner thereof under Section 30(5) of the Partnership Act. Under Section 30(1) of the Partnership Act a minor cannot become a partner of a firm but he may be admitted to the benefits of a partnership. Under sub-sections (2) and (3) thereof he will be entitled only to have a right to such share of the properties and of the profits of the firm as may be agreed upon, but he has no personal liability for any acts of the firm, though his share is liable for the same. The legal position of a minor who is admitted to a partnership has been succinctly stated by the Privy Council in *Sanyasi Charan Mandal v. Krishnadhan Banerji* [ILR 49 Cal, 560, 570] after considering the material provisions of the Contract Act, which at that time contained the provisions relevant to the law of partnership, thus:

A person under the age of majority cannot become a partner by contract ... and so according to the definition he cannot be one of that group of persons called a firm. It would seem, therefore, that the share of which Section 247 speaks is no more than a right to participate in the property of the firm after its obligations have been satisfied.

It follows that if during minority of the 1st respondent the partners of the firm committed an act of insolvency, the minor could not have been adjudicated insolvent on the basis of the said act of insolvency for the simple reason that he was not a partner of the firm. But it is said that sub-section (5) of Section 30 of the Partnership Act made all the difference in the case. Under that sub-section the quondam minor at any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, may give public notice that he has elected to become or that he has elected not to become a partner in the firm and such notice shall determine his position as regards the firm. If he failed to give such a notice, he would become a partner in the said firm after the expiry of the said period of six months. Under sub-section (7) thereof where such person becomes a partner, his rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership and his share in the property and profits of the firm shall be the share to which he was entitled as a minor. Under the said two sub-sections, if during the continuance of the partnership, a person, who was admitted at the time when he was a minor to the benefits of the partnership, did not within six months of his attaining majority elect not to become a partner, he would become a partner after the expiry of the said period and thereafter his rights and liabilities would be the same as those of the other partners as from the date he was admitted to the partnership. It would follow from this that the said minor would thereafter be liable to the debts of the firm and could be adjudicated insolvent for the acts of insolvency committed by the partners. But in the present case the partnership was dissolved before the first respondent became a major; from the date of the dissolution of the partnership, the firm ceased to exist, though under Section 45 of the Act, the partners continued to be liable as such to third parties for the acts done by any of them which would have been the acts of the firm if done before the dissolution until public notice was given of the dissolution. Section 45 *proprio vigore* applies only to partners of the firm. When the partnership itself was dissolved before the first respondent became a major, it is legally impossible to hold that he had become a partner of the dissolved

firm by reason of his inaction after he became a major within the time prescribed under Section 30(5) of the Partnership Act. Section 30 of the said Act presupposes the existence of a partnership. Sub-sections (1), (2) and (3) thereof describe the rights and liabilities of a minor admitted to the benefits of partnership in respect of acts committed by the partners; sub-section (4) thereof imposes a disability on the minor to sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm. This sub-section also assumes the existence of a firm from which the minor seeks to sever his connection by filing a suit. It is implicit in the terms of sub-section (5) of Section 30 of the Partnership Act that the partnership is in existence. A minor after attaining majority cannot elect to become a partner of a firm which ceased to exist. The notice issued by him also determines his position as regards the firm. Sub-section (7) which describes the rights and liabilities of a person who exercises his option under sub-section (5) to become a partner also indicates that he is inducted from that date as a partner of an existing firm with co-equal rights and liabilities along with other partners. The entire scheme of Section 30 of the Partnership Act posits the existence of a firm and negatives any theory of its application to a stage when the firm ceased to exist. One cannot become or remain a partner of a firm that does not exist.

6. It is common case that the first respondent became a major only after the firm was dissolved. Section 30 of the Partnership Act, therefore, does not apply to him. He is not a partner of the firm and, therefore, he cannot be adjudicated insolvent for the acts of insolvency committed by Respondents 2 and 3, the partners of the firm. The order of the High Court is correct. In the result, the appeal fails and is dismissed with costs.

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REGISTRATION OF FIRMS

CIT v. Jayalakshmi Rice and Oil Mills Contractor Co.

AIR 1971 SC 1015 : (1971) 1 SCC 280

[Date of registration of a partnership firm - section 60]

The assessee firm was constituted under a deed of partnership, dated October 6, 1955. It was to come into existence with effect from November 5, 1954. The assessee filed an application under Section 26-A of the Act for registration of the firm for the assessment year 1956-57. The 'previous year' of the firm was shown as the year ending October 26, 1955. This application was received by the Income-tax Officer on October 14, 1955. On October 20, 1955, the assessee filed before the Registrar of Firms a statement under Section 58 of the Indian Partnership Act, 1932. On November 2, 1955, the Registrar of Firms filed the statement of the assessee and made entries in the register of firms. On March 23, 1961, the Income-tax Officer passed an order refusing to register the firm under Section 26-A, inter alia, for the reason that the application had not been made in time. The appeal taken to the Appellate Assistant Commissioner by tax assessee failed. The Income-tax Appellate Tribunal also upheld the order of the Income tax Officer and the Appellate Assistant Commissioner. On that a reference was sought and the High Court answered the question referred in favour of the assessee on the ground that the application had been filed in time.

Section 26-A of the (Income Tax) Act provides that an application may be made to the Income-tax Officer on behalf of any firm constituted under an instrument of partnership specifying the individual shares of the partners for registration for the purposes of the Act. The application has to be made by such person or persons and at such time and has to contain such particulars, *etc.*, as may be prescribed. Rules 2 to 6(6) of the Rules made under Section 59 of the Act deal with registration of firms. The material portion of Rule 2 reads:

“Such application shall be made.....

(a) Where the firm is not registered under the Indian Partnership Act, 1932 (IX of 1932) or where the deed of Partnership is not registered under the Indian Registration Act, 1908 (XVI of 1908) and the application for registration is being made for the first time under the Act.

(i) Within a period of six months of the constitution of the firm or before the end of the 'previous year' of the firm whichever is earlier, if the firm was constituted in that previous year,

(ii) before the end of the previous year in any other case,

(b) Where the firm is registered under the Indian Partnership Act, 1932 (IX of 1932) or where the deed of partnership is registered under the Indian

Registration Act (XVI of 1908) before the end of the previous year of the firm.....”

A.N. GROVER, J. - Now it is common ground that the application for registration was not made within the period prescribed by Rule 2 (a). What has been urged throughout on behalf of the assessee is that the application to the Income-tax Officer was governed by Rule 2(6) and was in time as the firm should be deemed to have been registered not on the date on which it was actually registered by the Registrar of Firms but with effect from the date on which the application for registration was presented to the Registrar. In other words the firm should be considered to have been registered on October 20, 1955, on which date the statement under Section 58 of the Partnership Act was filed by the assessee before the Registrar of Firms.

4. The real question which has to be determined is whether the registration of a firm under the Partnership Act takes place with effect from the date on which the application for registration is made in accordance with Section 58 of that Act. Section 58(1) provides that the registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated a statement in the prescribed form and accompanied by the prescribed fee stating..... under Section 59 when the Registrar is satisfied that the provisions of Section 58 have been duly complied with he shall record an entry of the statement in a register called the “register of firms” and shall file the statement. In *Ram Prasad v. Kamla Prasad* [AIR 1935 All. 898], it was laid down that the registration of a firm under the Partnership Act takes place only when the necessary entry is made in the register of firms. Even under Section 69 of the Partnership Act which deals with the effect of non-registration it has been consistently held that the registration of a firm subsequent to the filing of the suit did not cure the defect. Thus under the Partnership Law it can be taken to have been settled by decisions of High Courts from a long time that the registration of a firm takes place only when the necessary entry is made in the register of firms under Section 59 of the Partnership Act by the Registrar. It is true that sub-section (1) of Section 58 employs language which without anything more may lend support to the view that the registration of a firm may be effected merely by sending an application which would mean that as soon as an application is sent and if entry is made under Section 59 pursuant to it the registration would be effective from the date when the application was presented. But Section 58(1) is not to be read in isolation and has to be considered along with the scheme of the other provisions of the Act, namely Section 59 and Section 69. The latter section may not have a direct bearing on the point under our consideration but it throws light on what was contemplated by the Legislature with regard to the point of time when the firm could be regarded as registered. The Kerala High Court has in *Kerala Road Lines Corporation v. Commissioner of Income-tax Kerala* [51 ITR 711] clearly expressed the view that reading Sections 58 and 59 of the Indian Partnership Act together a firm cannot be said to be registered when the statement prescribed by Section 58 and the required fee are sent to the Registrar and that the registration of the firm is effected only when the entry of the statement is recorded in the register of firms and the statement is filed by the Registrar as provided in Section 59. In that case also an identically similar question arose in respect of registration of a firm under Section 26-A of the Income-tax Act.

5. The High Court in the judgment under appeal referred to the statement extracted from the report of the Special Committee which had been appointed by the Government of India to examine the provisions of the Bill before it came to be passed by the Central Legislature as the Partnership Act and reference was made in particular to the statement relating to Clause 58 corresponding to Section 59 of the Partnership Act to the effect that the Registrar was a mere recording officer and that he had no discretion but to record the entry in the register of firms. We are unable to see how that statement can be taken into consideration for the purpose of interpreting the relevant provisions of the Partnership Act. We also cannot concur with the other reasoning of the High Court for coming to the conclusion that the partnership should be deemed to have been registered on the date when the application was presented and that the requirement of Rule 2(b) would be satisfied if it became registered under the Partnership Act even after the application was filed. For the reasons given above the appeal is allowed. The answer to the question referred must be given in the affirmative and against the assessee.

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Jagdish Chandra Gupta v. Kajaria Traders (India) Ltd.

AIR 1964 SC 1882

[Reference of dispute to arbitration as envisaged in the partnership agreement – whether barred by section 69]

M. HIDAYATULLAH, J. - By a letter dated July 30, 1955, M/s. Kajaria Traders (India) Ltd. and M/s. Foreign Import and Export Association (sole proprietary firm owned by the appellant Jagdish C. Gupta) entered into a partnership to export between January and June 1956, 10,000 tons of manganese ore to Phillips Brothers (India) Ltd., New York. Each partner was to supply a certain quantity of manganese ore. We are not concerned with the terms of the agreement but with one of its clauses which provided:

“That in case of dispute the matter will be referred for arbitration in accordance with the Indian Arbitration Act.”

The company alleged that Jagdish C. Gupta failed to carry out his part of the partnership agreement. After some correspondence, the company wrote to Jagdish C. Gupta on February 28, 1959 that they had appointed Mr R.J. Kolah (Advocate O.S.) as their arbitrator and asked Jagdish Chander Gupta either to agree to Mr Kolah’s appointment as sole arbitrator or to appoint his own arbitrator. Jagdish Chander Gupta after consideration and on March 17, 1959 the company informed Jagdish Chander Gupta that as he had failed to appoint an arbitrator within 15 clear days they were appointing Mr Kolah as sole arbitrator. Jagdish C. Gupta disputed this and the company filed on March 28, 1959 an application under Section 8(2) of the Indian Arbitration Act, 1940 for the appointment of Mr Kolah or any other person as arbitrator.

2. Jagdish Chander Gupta appeared and objected inter alia to the institution of the petition. Two grounds were urged (i) that Section 8(2) of the Indian Arbitration Act was not applicable as it was not expressly provided in the arbitration clause quoted above that the arbitrators were to be by consent of the parties and (ii) that Section 69(3) of the Indian Partnership Act, 1932 afforded a bar to the petition because the partnership was not registered. The petition was referred by the Chief Justice to a Divisional Bench consisting of Mr Justice Mudholkar (as he then was) and Mr Justice Naik. The two learned Judges agreed that in the circumstances of the case an application under Section 8 of the Indian Arbitration Act was competent and that the court had power to appoint an arbitrator. They disagreed on the second point. Mr Justice Mudholkar was of the opinion that Section 69(3) of the Indian Partnership Act barred the application while Mr Justice Naik held otherwise. The case was then referred to Mr Justice K.T. Desai (as he then was) and he agreed with Mr Justice Naik with the result that the application was held to be competent.

3. In this appeal it was not contended that the conclusions of the learned Judges in regard to Section 8(2) were erroneous. The decision was challenged only on the ground that Section 69(3) was wrongly interpreted and the bar afforded by it was wrongly disallowed.

The section, speaking generally, bars certain suits and proceedings as a consequence of non-registration of firms. Sub-section (1) prohibits the institution of a suit between partners inter se or between partners and the firm for the purpose of enforcing a right arising from a

contract or conferred by the Partnership Act unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm. Sub-section (2) similarly prohibits a suit by or on behalf of the firm against a third party for the purpose of enforcing rights arising from a contract unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm. In the third sub-section a claim of set-off which is in the nature of a counter claim is also similarly barred. Then that sub-section bars "other proceeding". The only doubt that has arisen in this case is regarding the meaning to be given to the expression "other proceeding". One way to look at the matter is to give these words their full and natural meaning and the other way is to cut down that meaning in the light of the words that precede them. The next question is whether the application under Section 8(2) of the Arbitration Act can be regarded as a proceeding "to enforce a right arising from a contract", and therefore, within the bar of Section 69 of the Indian Partnership Act.

4. Mr Justice Mudholkar in reaching his conclusion did not interpret the expression "other proceeding" ejusdem generis with the words "a claim of set-off". He held further that the application was to enforce a right arising from the contract of the parties. Mr Justice Naik pointed out that the words used were not "any proceeding" nor "any other proceedings" but "other proceeding" and that as these words were juxtaposed with "a claim of set off" they indicated a proceeding of the nature of a claim in defence. On the second point Mr Justice Naik held that this was not a proceeding to enforce a right arising from a contract but was a claim for damages and such a claim could be entertained because it was based on something which was independent of the contract to supply ore. He held that the right which was being enforced was a right arising from the Arbitration Act and not from the contract of the parties. Mr Justice K.T. Desai agreed with most of these conclusions and suggested that the words preceding "other proceeding", namely, "a claim of set-off" had "demonstrative and limiting effect". He seems to have ascertained the meaning of the expression "other proceeding" by reference to the meaning of the words "a claim of set-off", which he considered were associated with it.

5. The first question to decide is whether the present proceeding is one to enforce a right arising from the contract of the parties. The proceeding under the eighth section of the Arbitration Act has its genesis in the arbitration clause, because without an agreement to refer the matter to arbitration that section cannot possibly be invoked. Since the arbitration clause is a part of the agreement constituting the partnership it is obvious that the proceeding which is before the Court is to enforce a right, which arises from a contract. Whether we view the contract between the parties as a whole or view only the clause about arbitration, it is impossible to think that the right to proceed to arbitration is not one of the rights which are founded on the agreement of the parties. The words of Section 69(3), "a right arising from a contract" are in either sense sufficient to cover the present matter.

6. It remains, however, to consider whether by reason of the fact that the words "other proceeding" stand opposed to the words "a claim of set-off" any limitation in their meaning was contemplated. It is on this aspect of the case that the learned Judges have seriously differed. When in a statute particular classes are mentioned by name and then are followed by general words, the general words are sometimes construed ejusdem generis i.e. limited to the

same category or genus comprehended by the particular words but it is not necessary that this rule must always apply. The nature of the special words and the general words must be considered before the rule is applied. In *Allen v. Emersons* [(1944) IKB 362]. Asquith, J., gave interesting examples of particular words followed by general words where the principle of ejusdem generis might or might not apply. We think that the following illustration will clear any difficulty. In the expression “books, pamphlets, newspapers and other documents” private letters may not be held included if “other documents” be interpreted ejusdem generis with what goes before. But in a provision which reads “newspapers or other document likely to convey secrets to the enemy”, the words “other document” would include document of any kind and would not take their colour from “newspapers”. It follows, therefore, that interpretation ejusdem generis or noscitur a sociis need not always be made when words showing particular classes are followed by general words. Before the general words can be so interpreted there must be a genus constituted or a category disclosed with reference to which the general words can and are intended to be restricted. Here the expression “claim of set-off” does not disclose a category or a genus. Set-offs are of two kinds — legal and equitable — and both are already comprehended and it is difficult to think of any right “arising from a contract” which is of the same nature as a claim of set-off and can be raised by a defendant in a suit. Mr B.C. Misra, whom we invited to give us examples, admitted frankly that it was impossible for him to think of any proceeding of the nature of a claim of set-off other than a claim of set-off which could be raised in a suit such as is described in the second sub-section. In respect of the first sub-section he could give only two examples. They are (i) a claim by a pledger of goods-with an unregistered firm whose good are attached and who has to make an objection under Order 21 Rule 58 of the Code of Civil Procedure and (ii) proving a debt before a liquidator. The latter is not raised as a defence and cannot belong to the same genus as a “claim of set-off”. The former can be made to fit but by a stretch of some considerable imagination. It is difficult for us to accept that the legislature was thinking of such far-fetched things when it spoke of “other proceeding” ejusdem generis with a claim of set-off.

7. Mr Justice Naik asked the question that if all proceedings were to be excluded why was it not considered sufficient to speak of proceedings along with suits in sub-sections (1) and (2) instead of framing a separate sub-section about proceedings and coupling “other proceeding” with “a claim of set-off”? The question is a proper one to ask but the search for the answer in the scheme of the section itself gives the clue. The section thinks in terms of (a) suits and (b) claims of set-off which are in a sense of the nature of suits and (c) of other proceedings. The section first provides for exclusion of suits in sub-sections (1) and (2). Then it says that the same ban applies to a claim of set-off and other proceeding to enforce a right arising from a contract. Next it excludes the ban in respect of the right to sue (a) for the dissolution of a firm, (b) for accounts of a dissolved firm and (c) for the realisation of the property of a dissolved firm. The emphasis in each case is on dissolution of the firm. Then follows a general exclusion of the section. The fourth sub-section says that the section as a whole, is not to apply to firms or to partners and firms which have no place of business in the territories of India or whose places of business are situated in the territories of India but in areas to which Chapter VII is not to apply and to suits or claims of set-off not exceeding Rs 100 in value. Here there is no insistence on the dissolution of the firm. It is significant that in the latter part of clause (b) of that section the words are “or to any proceeding in execution or other

proceeding incidental to or arising from any such suit or claim” and this clearly shows that the word “proceeding” is not limited to a proceeding in the nature of a suit or a claim of set-off. Sub-section (4) combines suits and a claim of set-off and then speaks of “any proceeding in execution” and “other proceeding incidental to or arising from any such suit or claim” as being outside the ban of the main section. It would hardly have been necessary to be so explicit if the words “other proceeding” in the main section had a meaning as restricted as is suggested by the respondent. It is possible that the draftsman wishing to make exceptions of different kinds in respect of suits, claims of set-off and other proceedings grouped suits in sub-sections (1) and (2), set-off and other proceedings in sub-section (3) made some special exceptions in respect of them in sub-section (3) in respect of dissolved firms and then viewed them all together in sub-section (4) providing for a complete exclusion of the section in respect of suits of particular classes. For convenience of drafting this scheme was probably followed and nothing can be spelled out from the manner in which the section is sub-divided.

9. In our judgment, the words “other proceeding” in sub-section (3) must receive their full meaning untrammelled by the words “a claim of set-off”. The latter words neither intend nor can be construed to cut down the generality of the words “other proceeding”. The sub-section provides for the application of the provisions of sub-sections (1) and (2) to claims of set-off and also to other proceedings of any kind which can properly be said to be for enforcement of any right arising from contract except those expressly mentioned as exceptions in sub-section (3) and sub-section (4).

10. The appeal is, therefore, allowed.

* * * * *

Haldiram Bhujiawala v. Anand Kumar Deepak Kumar

(2000) 3 SCC 250

[Sections 69(2), 2(d)]

M. JAGANNADHA RAO, J. - 2. This appeal has been preferred by the two defendants, M/s Haldiram Bhujiawala and Shri Ashok Kumar against the judgment of the Delhi High Court in FAO No. 365 of 1999 dated 30-11-1999. By that order the High Court summarily dismissed the appellants' appeal against the order of the learned Single Judge dated 2-11-1999 in IA No. 5996 of 1999 in Suit No. 635 of 1992. The IA was filed under Order 7 Rule 11 CPC by the appellants for rejection of the plaint filed by two plaintiffs, Anand Kumar Deepak Kumar trading as Haldiram Bhujiawala and Shiv Kishan Aggarwal, — on the ground that the 1st plaintiff was a partnership not registered with the Registrar of Firms on the date of the suit i.e. on 10-12-1991 and that the subsequent registration of the firm on 29-5-1992 would not cure the initial defect.

3. The suit was filed by the plaintiff (1) for permanent *injunction* restraining the defendant appellants, their partners, servants etc. from infringing Trademark No. 285062 and from using the trademark/name "HALDIRAM BHUJIAWALA" or any identical name/mark deceptively similar thereto, (2) for *damages* in a sum of Rs 6 lakhs, and (3) for destruction of the material etc.

4. As we are dealing with a matter arising under Order 7 Rule 11 CPC, it will be necessary to refer to the plaint allegations. One Ganga Ram (*sic* Bishan) alias Haldiram, carried on business in the name of Haldiram Bhujiawala, since 1941. In 1965, he constituted a partnership with his two sons Moolchand, Shiv Kishan and his daughter-in-law Kamla Devi (wife of another son R.L. Aggarwal) to carry on business under the same name. In December 1972, the said firm applied for registration before the Registrar of Trademarks for registration of the name Haldiram Bhujiawala - Chand Mal - Ganga Bishan Bhujiawala, Bikaner. The Registrar of Trademarks granted registration with No. 285062. On 16-11-1974, the partnership was dissolved and under the terms of the dissolution deed the above trademark fell exclusively to the share of Moolchand, son of Ganga Bishan and father of the plaintiffs, for the whole country (except West Bengal). Thus Shri Moolchand became sole proprietor of the trademark in the said area while Smt Kamla Devi was given ownership of the trademark rights for West Bengal. It is stated that Shri Lala Ganga Bishan Haldiram executed his last will dated 3-4-1979 and also reiterated the rights conferred by the dissolution deed on the respective parties. Ganga Bishan died in 1980. His will was later acted upon. Later, the testator's son, Shri Moolchand too died in 1985 leaving behind his four sons, Shiv Kishan, Shiv Ratan, Manohar Lal and Madhusoodan. All of them got their names recorded as subsequent joint proprietors. The latter three formed a partnership in 1983 and were running a shop in Chandni Chowk, New Delhi selling various goods under the abovesaid trademark of Haldiram Bhujiawala. In the meantime, on 10-10-1977, Moolchand's brother Shri R.L. Aggarwal (husband of Kamla Devi) and his son Prabhu Shankar, Calcutta applied for registration in this very name at Calcutta claiming to be full owners of the said trademark without disclosing the dissolution deed dated 16-11-1974. When the Registrar objected on 14-4-1978, they replied on 18-7-1978 that they alone were trading in this name in Calcutta. The

defendants have no right to use the said trademark beyond Calcutta. The plaintiffs' registered trademark was, in the usual course, renewed on 29-12-1986 till 28-12-1993. The plaintiffs have also acquired a right on account of prior adoption and long user. The 1st plaintiff firm, consisting of three sons of Moolchand and the 2nd plaintiff (the fourth son of Moolchand) are joint owners of the trademark (except in West Bengal). The 1st defendant firm is a newly-constituted firm intending to start its business and has been formed by Ashok Kumar, son of Kamla Devi. The 2nd defendant is Ashok Kumar himself in his individual capacity. They have no right to use this trademark outside West Bengal. The plaintiffs came to know of the violation of the trademark by Defendants 1 and 2 in December 1991 when the defendants opened a shop at Arya Samaj Road, Karol Bagh, New Delhi. The cause of action for the suit is the fact that the defendants acted

“in violation of the *common law* and *contractual rights* of the plaintiff”.

On these grounds, the defendants are to be restrained by permanent injunction from using the trademark and a sum of Rs 6 lakhs is payable as damages.

6. In this appeal, learned Senior Counsel for the appellants, Shri Ashok Desai and Shri R.F. Nariman contended that the 1st plaintiff firm was not registered with the Registrar of Firms on the date of suit, that the plaint repeatedly referred to the proprietary right of the late Moolchand as having arisen out of the dissolution deed dated 16-11-1974 and that without reference to the said document - which was a contract - the plaintiffs could not prove their right to the trademark through Moolchand and the suit was barred since Section 69(2) referred to a right “arising from a contract”. The plaintiffs' right was based on the contract dated 16-11-1974. The words “arising from a contract” were akin to the words “arising out of a contract” used in *Ruby General Insurance Co. Ltd. v. Pearey Lal Kumar* [AIR 1952 SC 119], wherein while construing those words in relation to an arbitration clause, this Court held that the said words had to be construed widely. The learned counsel contended that, on the facts of this case and as stated in the plaint at several places, the 1st plaintiff was compelled to rely on the contract of dissolution dated 16-11-1974 to prove title to the trademark and thereby for an injunction and hence it was not a right claimed under common law or under any statute, like the Trade Marks Act.

7. On the other hand, learned Senior Counsel for the respondent-plaintiffs, Shri Gopal Subramaniam supported the view of the High Court by contending that the suit for injunction was based upon two rights, one being statutory under the Trade Marks Act arising out of prior registration of the trademark and alternatively, the suit was also based on the common law right available in a passing-off action. The suit was not based on any contract between the plaintiffs and the defendants. The provision in Section 69(2) did not apply if the right sought to be enforced did not arise out of a contract between the plaintiffs' firm and the defendants. The reference in the plaint to the dissolution deed dated 16-11-1974 was merely a reference to a historical fact that that was the source of the right of Moolchand and on his death, the said right to the trademark devolved on his sons, - three of whom are joined in a firm (i.e. the 1st plaintiff) and the fourth son is the second plaintiff. The plaintiffs were not parties to the deed of dissolution. The defendants too were not parties to the dissolution deed though their mother was. Hence, the bar under Section 69(2) did not apply.

8. The points that arise for consideration are:

(i) Whether Section 69(2) bars a suit by a firm not registered on the date of suit where permanent injunction and damages are claimed in respect of a trademark as a statutory right or by invoking common law principles applicable to a passing-off action?

(ii) Whether the words “arising from a contract” in Section 69(2) refer only to a situation where an unregistered firm is enforcing a right arising from a contract entered into by the firm *with* the defendant during the course of its business or whether the bar under Section 69(2) can be extended to any contract referred to in the plaint unconnected with the defendant, as the source of title to the suit property?

Point 1

9. The question whether Section 69(2) is a bar to a suit filed by an unregistered firm even if a statutory right is being enforced or even if only a common law right is being enforced came up directly for consideration in this Court in ***Raptakas Brett Co. Ltd. v. Ganesh Property*** [(1998) 7 SCC 184]. In that case, Majmudar, J. speaking for the Bench clearly expressed the view that Section 69(2) cannot bar the enforcement by way of a suit by an unregistered firm in respect of a statutory right or a common law right. On the facts of that case, it was held that the right to evict a tenant upon expiry of the lease was not a right “arising from a contract” but was a common law right or a statutory right under the Transfer of Property Act. The fact that the plaint in that case referred to a lease and to its expiry, made no difference. Hence, the said suit was held not barred. It appears to us that in that case the reference to the lease in the plaint was obviously treated as a historical fact. That case is therefore directly in point. Following the said judgment, it must be held in the present case too that a suit is not barred by Section 69(2) if a statutory right or a common law right is being enforced.

10. The next question is as to the nature of the right that is being enforced in this suit. It is well settled that a *passing-off* action is a common law action based on tort. Therefore, in our opinion, a suit for perpetual injunction to restrain the defendants not to pass off the defendants’ goods as those of the plaintiffs by using the plaintiffs’ trademark and for damages is an action at common law and is not barred by Section 69(2). The decision in ***Virendra Dresses v. Varinder Garments*** [AIR 1982 Del 482] states that Section 69(2) does not apply to a passing-off action as the suit is based on tort and not on contract. In our opinion, the above decisions were correctly decided. (Special Leave Petition No. 18418 of 1999 against the latter was in fact dismissed by this Court on 28-1-2000.) The learned Senior Counsel for the appellants no doubt relied upon ***Ruby General Insurance Co. Ltd. v. Pearey Lal Kumar***. That was an arbitration case in which the words “arising out of a contract” were widely interpreted but that decision, in our view, has no relevance in interpreting the words “arising from a contract” in Section 69(2) of the Partnership Act.

11. Likewise, if the reliefs of permanent injunction or damages are being claimed on the basis of a registered trademark and its *infringement*, the suit is to be treated as one based on a statutory right under the Trade Marks Act and is, in our view, not barred by Section 69(2).

12. For the aforesaid reasons, in both these situations, the unregistered partnership in the case before us cannot be said to be enforcing any right “arising from a contract”. Point 1 is therefore decided in favour of the respondent-plaintiffs.

Point 2

13. Question however arises as to what is the scope of the words “enforcing a right arising under the contract” used in Section 69(2)? Learned Senior Counsel for the appellants repeatedly drew our attention to the allegation in the plaint at various places that it was only under the deed of dissolution dated 16-11-1974 that Moolchand, — the father of the partners of the 1st plaintiff firm and the 2nd plaintiff — became proprietor of the trademark for the whole of India (except West Bengal). That right devolved on the plaintiffs on the death of Moolchand. Therefore, it was contended that the 1st plaintiff firm was definitely seeking to enforce a right “arising from a contract”, namely, the contract of dissolution dated 16-11-1974. It was argued that the 1st plaintiff could not claim any injunction or damages unless reliance was placed on the said contract and hence the suit was barred by Section 69(2).

14. For the purpose of deciding this point, it is necessary to go into the question as to what the legislature meant when it used the words “arising from a contract” in Section 69(2).

15. In our view, it will be useful in this context to refer to the Report of the Special Committee (1930-31) which examined the Draft Bill and made recommendations to the legislature.

16. Before going into the above Report of the Special Committee which preceded the Partnership Act, 1932, it will be necessary to refer to the case in *CIT v. Jayalakshmi Rice and Oil Mills Contractor Co.* (1971) 1 SCC 280, where this Court refused to refer to this very Report for construing Section 59 of the Partnership Act. But, in our view, that decision is no longer good law as it was clearly dissented on this aspect in the judgment of the Constitution Bench in *R.S. Nayak v. A.R. Antulay* (1984) 2 SCC 183. In a number of later judgments, this Court has referred to the reports of similar committees or commissions (vide G.P. Singh’s *Interpretation of Statutes*, 7th Edn., 1999, pp. 196-97). In the latest case in *Hyderabad Industries Ltd. v. Union of India* notes on clauses were relied upon by the Constitution Bench for understanding the legislative intent. A restricted view was no doubt expressed in *P.V. Narasimha Rao v. State* (1998) 4 SCC 626 (at pp. 691-92) that such reports can be looked into for the purpose of knowing the historical basis or mischief sought to be remedied, but not for construing the provision unless there is ambiguity. Even going by this restricted view, we find that there is considerable ambiguity in Section 69(2) (unlike the English Statute of 1916 and 1985) as to what is meant by the words “arising out of a contract” inasmuch as the provision does not say whether the contract in Section 69(2) is one entered into by the firm with the defendant or with somebody else who is not a defendant, nor to whether it is a contract entered into with the defendant in business or unconnected with business. Hence, in our view, it is permissible to look into the Report even for purpose of construing Section 69(2).

17. We may state that it was on the basis of the Report of the Special Committee that the Partnership Act, 1932 was later passed by the legislature. The Committee consisted of Sir Brojendra Lal Mitter, Sir Dinshah F. Mulla, Sir Alladi Krishnaswamy Iyer and Mr Arthur

Eggar. Para 16 of the Report states that the “Bill seeks to overcome this class of difficulty by making registration optional, and by creating inducements to register which will only bear upon firms in a substantial and fairly permanent way *of business*”. Paras 17, 18 and 19 of the Report are important (see Mulla: *Partnership Act*, 1st Ed., 1934, p. 167, at pp. 176-77) reads:

“17. The outlines of the scheme are briefly as follows. The *English precedent* insofar as it makes registration compulsory and imposes a penalty for non-registration has *not been followed*, as it is considered that this step would be too drastic for a beginning in India, and would introduce all the difficulties connected with small or ephemeral undertakings. Instead, it is proposed that registration should lie entirely within the discretion of the firm or partner concerned; *but, following the English precedent*, any firm which is not registered will be unable to enforce *its claim* against third parties in the civil court; and any partner who is not registered will be unable to enforce his claims either against third parties or against fellow partners.”

It will be noticed that the above extract refers to the English precedent which is partly not followed and which is partly followed. We shall be referring to the said English precedent shortly but before we do so, we have also to refer to paras 18 and 19 of the said Report.

18. The Report states in paras 18 and 19 as follows:

18. Once registration has been effected the statement recorded in the register regarding the constitution of the firm will be conclusive proof of the facts therein contained against the partners making them and no partner whose name is on the register will be permitted to deny that he is a partner - with certain natural and proper exceptions which will be indicated later. This should afford a strong protection to persons *dealing with firms* against false denials of partnership and the evasion of liability by the substantial members of a firm.

19. ...On the other hand, a *third party* who *deals with* a firm and knows that a new partner has been introduced can either make registration of the new partner a condition for *further dealings*, or content himself with the certain security of the other partners and the chance of proving by other evidence, the partnership of the new but unregistered partner. A *third party who deals with a firm* without knowing of the addition of a new partner counts on the credit of the old partners only and will not be prejudiced by the failure of the new partner to register.

Similarly, para 23 also refers to those who *deal* with the firm.

19. The English precedent referred to in para 17, which has been not followed in part but followed in part in drafting Section 69(2) is the one contained by the Registration of Business Names Act, 1916. Section 7 of that Act refers to penalties for default in registration. As stated in the Report, the penalty part of that Act has not been introduced in India but the provisions of Section 8 creating disabilities in the way of the firm in default is adopted. Section 8 of the above English Act is relevant and it speaks of

(T)he rights of that defaulter under or arising *out of any contract* made or entered into by or on behalf of such defaulter *in relation to the business* in respect to the carrying on of which particulars were required to be furnished” (see *Halsbury Statutes*, 3rd Edn., Vol. 37, p. 867).

The above provision clearly signifies that the right that is sought to be enforced by the unregistered firm and which is barred must be a right arising out of a contract *with a third-party* defendant in respect of the firm's *business* transactions.

20. The Business Names Act, 1985 has replaced the above Act of 1916 and Section 4 of the new Act refers to the "civil remedies for breach of Section 4". It provides for dismissal of the action "to enforce a right arising out of a contract made in the *course of a business*" if the firm is not registered (see **Halsbury Statutes**, 4th Edn., Vol. 48, p. 101).

21. The above Report and provisions of the English Acts, in our view, make it clear that the purpose behind Section 69(2) was to impose a disability on the unregistered firm or its partners to enforce rights arising out of contracts *entered into by the plaintiff firm with the third-party defendants in the course of the firm's business transactions*.

22. In *Raptakos Brett and Co.* it was clarified that the contractual rights which are sought to be enforced by the plaintiff firm and which are barred under Section 69(2) are "rights arising out of the contract" and that it must be a contract entered into by the firm *with the third-party defendants*. Majmudar, J. stated as follows:

A mere look at the aforesaid provision shows that the suit filed by an unregistered firm against a third party for enforcement of any right *arising from a contract with such a third party* would be barred.... (emphasis supplied)

From the above passage it is firstly clear that a contract must be a contract by the plaintiff firm not with anybody else but with the third-party defendant.

23. The further and additional but equally important aspect which has to be made clear is that the contract by the unregistered firm referred to in Section 69(2) must not only be one entered into by the firm with the third-party defendant but must also be one entered into by the plaintiff firm in the course of the business dealings of the plaintiff firm with such third-party defendant.

24. It will also be seen that the present defendants who are sued by the plaintiff firm are third parties to the 1st plaintiff firm. Section 2(d) of the Act defines "third parties" as persons who are not partners of the firm. The defendants in the present case are also third parties to the contract of dissolution dated 16-11-1974. Their mother, Kamla Devi was no doubt a party to the contract of dissolution. The defendants are only claiming a right said to have accrued to their mother under the said contract dated 16-11-1974 and then to the defendants. In fact, the said contract of dissolution is not a contract to which even the present 1st plaintiff firm or its partners or the 2nd plaintiff were parties. Their father Moolchand was a party and his right to the trademark devolved in the plaintiffs. The real crux of the question is that the legislature, when it used the words "arising out of a contract" in Section 69(2), it is referring to a contract entered into in course of business transactions by the unregistered plaintiff firm with its defendant customers and the idea is to protect those in commerce who deal with such a partnership firm in business. Such third parties who deal with the partners ought to be enabled to know what the names of the partners of the firm are before they deal with them in business.

25. Further, Section 69(2) is not attracted to any and every contract referred to in the plaint as the source of title to an asset owned by the firm. If the plaint referred to such a

contract it could only be as a historical fact. For example, if the plaint filed by the unregistered firm refers to the source of the firm's title to a motor car and states that the plaintiff has purchased and received a motor car from a foreign buyer under a contract and that the defendant has unauthorisedly removed it from the plaintiff firm's possession, -it is clear that the relief for possession against the defendant in the suit does not arise from any contract which the defendant entered into in the course of the plaintiff firm's business with the defendant but is based on the alleged unauthorised removal of the vehicle from the plaintiff firm's custody by the defendant. In such a situation, the fact that the unregistered firm has purchased the vehicle from somebody else under a contract has absolutely no bearing on the right of the firm to sue the defendant for possession of the vehicle. Such a suit would be maintainable and Section 69(2) would not be a bar, even if the firm is unregistered on the date of suit. The position in the present case is not different.

26. In fact, the Act has not prescribed that the transactions or contracts entered into by a firm with a third party are bad in law if the firm is an unregistered firm. On the other hand, if the firm is not registered on the date of suit and the suit is to enforce a right arising out of a contract with the third-party defendant in the course of its business, then it will be open to the plaintiff to seek withdrawal of the plaint with leave and file a fresh suit after registration of the firm subject of course to the law of limitation and subject to the provisions of the Limitation Act. This is so even if the suit is dismissed for a formal defect. Section 14 of the Limitation Act will be available inasmuch as the suit has failed because the defect of non-registration falls within the words "other cause of like nature" in Section 14 of the Limitation Act, 1963. (See *Surajmal Dagduramji Shop v. Shrikisan Ramkisan.*)

27. For all the reasons given above, it is clear that the suit is based on infringement of statutory rights under the Trade Marks Act. It is also based upon the common law principles of tort applicable to passing-off actions. The suit is not for enforcement of any right arising out of a contract entered into by or on behalf of the unregistered firm with third parties in the course of the firm's business transactions. The suit is therefore not barred by Section 69(2).

28. For the aforesaid reasons, the appeal fails and is dismissed without costs. We should not be understood as having said anything on the merits of the case for we have confined ourselves to the allegations in the plaint as we are here only dealing with an application filed by the appellants under Order 7 Rule 11 CPC.

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M/S Umesh Goel v Himachal Pradesh Cooperative Housing Society Ltd.
(2016) 11 SCC 313

ISSUE:

An interesting but very important legal question arises for consideration in this appeal relating to interpretation of Section 69(3) of the Indian Partnership Act with reference to its applicability to Arbitral proceedings.

FACTS:

The respondent which is a Cooperative Group Housing Society invited tenders for construction of 102 dwelling units with basement at Plot No. 21 Sector 5, Dwarka New Delhi. The tenders were invited in May 1998. The appellant, an unregistered partnership firm submitted its bid in response to the said tender on 06.05.1998. The appellant was the successful bidder and the contract was awarded to the appellant at an estimated cost of Rs.9.80 crores. The appellant was issued a letter of intent. On 09.08.1998 the appellant submitted its first bill for the construction of the compound wall etc. The agreement for the construction of 102 dwelling units with basement was entered into between the appellant and the respondent on 02.02.1999. It is stated that there was some delay in getting the plan sanctioned, which according to the appellant, he was not responsible for the delay. A dispute arose as between the appellant and the respondent which necessitated the appellant to move the High Court of Delhi by way of an application under Section 9 of the Arbitration and Conciliation Act 1996 (for short 1996 Act) to restrain the respondent from dispossessing the appellant from the worksite till the work executed by the appellant is measured by the Commissioner to be appointed by the Court. It was filed on 22.05.2005. A Commissioner was also appointed by the High Court. The appellant filed another application under Section 9 of the 1996 Act to restrain the respondent from operating its bank accounts and from dispossessing the appellant on 29.01.2003.

With reference to the dispute which arose as between the appellant and the respondent an arbitrator/an advocate by name Smt. Sangeeta Tomar was appointed by the respondent to adjudicate the dispute between them. As the appointment came to be made on 17.03.2003 by the respondent, though, the appellant earlier moved the High Court by way of an Arbitration Application No.145 of 2003 on 09.07.2003 under Section 11(5) of the 1996 Act for appointment of an independent arbitrator, the same was subsequently withdrawn. The appellant participated in the arbitration proceedings before the arbitrator appointed by the respondent. Claims and counter claims were made by the appellant as well as the respondent before the arbitrator. The arbitrator passed the award on 05.05.2005 wherein the claim of the appellant was allowed to the extent of

Rs. 1,36,24,886.08 along with interest at the rate of 12% from 01.06.2002 till the date of the award and further interest from the date of award till its payment at the rate of 18% per annum. While resisting the claim of the appellant, the respondent did not specifically raise any plea under Section 69 of the Partnership Act.

The respondent challenged the award dated 05.05.2005 under Section 34 of the 1996 Act before the Delhi High Court which was registered as A.A. No.188 of 2005. The said application was filed on 02.08.2005. The respondents application was dismissed by the learned Single Judge by an order dated 01.09.2005. The respondent filed Review Application No.26 of 2005 which was also dismissed by the learned Single Judge by an order dated 03.10.2005. As against the orders dated 01.09.2005 and 03.10.2005, the respondent preferred appeals in FAO (OS) No.376 of 2005 on 14.11.2005. Pending disposal of the appeals, an interim order was passed on 21.07.2006 directing the respondent to deposit 50% of the decretal amount within six weeks and by subsequent order dated 18.08.2006 the time was extended by another four weeks. By the impugned order dated 20.11.2007 the Division Bench having allowed the FAO(OS) No.376 of 2005, the appellant is before us.

We heard Mr. Dhruv Mehta, learned Senior Counsel for the appellant and Mr. Amarendra Saran, learned Senior Counsel for the respondent. Mr. Dhruv Mehta, learned Senior Counsel in his submissions after drawing our attention to Section 69 and in particular Section 69(3) of the Partnership Act contended that when sub sections (1) and (2) are read in to sub section (3) of Section 69, the expression other proceedings mentioned in the said sub section (3) should be with reference to other proceedings connected with a suit in a Court and cannot be read in isolation. The learned Senior Counsel contended that if it is read in that sense the expression other proceedings in sub section (3) can have no relevance nor referable to Arbitral proceedings in isolation. The learned Senior Counsel further contended that going by the plain reading of the Statute and if the golden rule of construction is applied, an arbitrator by himself is not a court for the purpose of Section 69 of the Statute. The learned Senior Counsel then submitted that there is a vast difference between an arbitrator and the Court, that though an arbitrator may exercise judicial powers, he does not derive such powers from the State but by the agreement of the parties under a contract and, therefore, he cannot be held to be a Court for the purpose of Section 69 of the Partnership Act. While referring to Section 36 of the 1996 Act, the learned Senior Counsel submitted that it is only a statutory fiction by which for the purpose of enforcement, the award is deemed to be a decree and it cannot be enlarged to an extent to mean that by virtue of the said award to be deemed as a decree, the arbitrator can be held to be a Court. Lastly, it was contended by him that in order to invoke Section 69(3), three mandatory conditions are required to be fulfilled, namely, that (a) there should be a suit and the other proceedings should be intrinsically connected to the suit, (b) such suit should have been laid to enforce a right arising from the contract and (c) such a suit should have been filed in a Court of law.

As against the above submissions Mr. Saran, learned Senior Counsel for the respondent submitted

that the expression other proceedings will include arbitral proceedings and that the foundation for it must only be based on a right in a contract. In support of the said submission, learned senior counsel contended that this Court has held while interpreting Section 14 of the Limitation Act that arbitral proceedings are to be treated on par with civil proceedings. The learned Senior Counsel also submitted that under Section 2(a) of the Interest Act, arbitral proceedings have been equated to regular suits and, therefore, the expression other proceedings in Section 69(3) of the Partnership Act should be held to include an Arbitral Proceeding on par with a suit. The learned counsel, therefore, contended that the arbitrator should be held to be a Court and the proceedings pending before it are to be treated as a suit and consequently other proceedings. By referring to Sections 35 and 36 of the 1996 Act where an award of the arbitrator has been equated to a decree of the Court and applicability of Civil Procedure Code for the purpose of execution has been prescribed, the learned Senior Counsel contended that the arbitral proceedings should be held to be civil proceedings before a Court.

Having heard learned counsel for the appellant as well the respondent and having bestowed our serious consideration to the respective submissions, the various decisions relied upon and the provisions contained in the Partnership Act, the Interest Act, Civil Procedure Code and Arbitration Act, we are of the view that the submissions of Mr. Dhruv Mehta, learned Senior Counsel for the appellant merit acceptance.

To appreciate the respective submissions and in support of our conclusion, at the very outset Section 69 requires to be noted. Though, some of the decisions which were cited before us dealt with Section 69(3) of the Partnership Act, in the instance we wish to analyze the said sub-section along with the other components of the said Section 69. When we read sub-section (3) of Section 69 carefully, we find that as rightly contended by Mr. Dhruv Mehta, learned Senior Counsel for the appellant, the provisions of sub-sections (1) and (2) have been impliedly incorporated in sub-section (3). When the opening set of expression in sub-section (3) states that the provisions of sub-sections (1) and (2) shall apply, there is no difficulty in accepting the said submission of learned Senior Counsel for the appellant that the entirety of the said two sub-sections should be held to be bodily lifted and incorporated in sub-section (3). It is difficult to state that any one part of sub-sections (1) and (2) alone should be held to be incorporated for the purpose of sub-section (3). Therefore, we are convinced that when we read sub-section (3) it is imperative that all the ingredients contained in sub-sections (1) and (2) should be read into sub-section (3) and thereafter apply the said sub-section when such application is called for in any matter.

Once we steer clear of the said position it will be necessary to note what are the specific ingredients contained in sub-sections (1) and (2). When we read sub-section (1) of Section 69 the said sub-section primarily imposes a ban on any person as a partner of a firm from filing any suit to enforce a right arising from a contract or a right conferred under the Partnership Act in any Court by or on behalf of an unregistered firm or a person suing as a partner of a firm against the said firm or against any person alleged to be or to have been a partner in that firm. To put it in

nut-shell the ban imposed under sub-section (1) of Section 69 is on any person in his capacity as the Partner of an unregistered firm against the said firm or any of its partners, in the matter of filing a suit to enforce a right arising from a contract or conferred by the provisions of the Partnership Act. In effect, the ban is in respect of filing a suit against that unregistered firm itself or any of its partners by way of a suit under a contract or under the Partnership Act. Under sub-section (2) the very same ban is imposed on an unregistered firm or on its behalf by any of its partners against any third party by way of a suit to enforce a right arising from a contract in any Court. A close reading of sub-Sections (1) and (2) therefore shows that while under sub-section (1) the ban is as against filing a suit in a Court by any person as a partner of an unregistered firm against the firm itself or any of its partner, under sub-section (2) such a ban in the same form of a suit in the Court will also operate against any third party at the instance of such an unregistered firm. The common feature in both the sub-sections are filing of a suit, in a Court for the enforcement of a right arising from a contract or conferred by the Partnership Act either on behalf of an unregistered firm or by the firm itself or by anyone representing as partners of such an unregistered firm. While under sub-section (1) the ban imposed would operate against the firm itself or any of its partners, under sub-section (2) the ban would operate against any third party.

The question for our consideration is by virtue of sub-section (3) whether the expression other proceedings contained therein will include Arbitral proceedings and can be equated to a suit filed in a Court and thereby the ban imposed against an unregistered firm can operate in the matter of arbitral proceedings. If sub-sections (1) and (2) are virtually lifted whole hog and incorporated in sub-section (3), it must be stated that it is not the mere ban that is imposed in sub-sections (1) and (2) that alone is contemplated for the application of sub-section (3). In other words, when the whole of the ingredients contained in sub-sections (1) and (2) are wholly incorporated in sub-section (3), the resultant position would be that the ban can operate in respect of an unregistered firm even relating to a set off or other proceedings only when such claim of set off or other proceedings are intrinsically connected with the suit that is pending in a Court. To put it differently, in order to invoke sub-section (3) of Section 69 and for the ban to operate either the firm should be an unregistered one or the person who wants to sue should be a partner of an unregistered firm, that its/ his endeavour should be to file a suit in a Court, in which event even if it pertains to a claim of set off or in respect of other proceedings connected with any right arising from a contract or conferred by the Partnership Act which is sought to be enforced through a Court by way of a suit then and then alone the said sub-section can operate to its full extent.

As far as the construction of the said sub-section (3) of Section 69 is concerned, we are able to discern the above legal position without any scope of ambiguity. To be more precise, the condition precedent for the operation of ban under sub-section (3) is that the launching of a suit in a Court of law should be present and it should be by an unregistered firm or by a person claiming to be partner of an unregistered firm either to a claim for set off in the said suit or any other proceedings intrinsically connected with the said suit.

In the event of the above ingredients set out under sub-sections (1), (2) and (3) being fulfilled then and then alone the ban prescribed against an unregistered firm under Section 69(1), (2) and (3) would operate and not otherwise.

Keeping the above outcome of the legal position that can be derived from a reading of sub-sections (1), (2) and (3) of Section 69 in mind we can draw further conclusions by making specific reference to sub-clauses (a) and (b) of sub-section (3) as well as the exceptions set out in sub-clauses (a) and (b) of sub-section (4) as well. When under sub-section (3) which also relates to a ban concerning other proceedings, the law makers wanted to specifically exclude from such ban such of those proceedings which also likely to arise in a suit, but yet the imposition of ban of an unregistered firm need not be imposed. Keeping the said intent of the law makers in mind, when we read sub-clauses (a) and (b) of sub-section (3), it can be understood that even though such other proceedings may be for the enforcement of any right to sue but yet if it is for the dissolution of a firm or for accounts of a dissolved firm or any right or power to realize the property of a dissolved firm, the same can be worked out by way of a suit in a Court or by way of other proceedings in that suit and the same will not be affected by the ban imposed under sub-section (3). Similarly, any steps initiated at the instance of an official assignee, a receiver or Court under the Presidency-Towns Insolvency Act of 1909 (3 of 1909) or the Provincial Insolvency Act of 1920 (5 of 1920) to realize the property of an insolvent partner in a pending suit of a Court also stand excluded from the ban imposed under sub-section (3). The specific exclusions contained in clauses (a) and (b) of sub-section (3) therefore makes the position clear to the effect that even though such proceedings may fall under the expression other proceedings and may be intrinsically connected with a suit in a Court, yet the ban would not operate against such proceedings.

When we read sub-section (4), the ban imposed under sub-sections (1), (2) and (3) will have no application to any of those proceedings set out in sub-clauses (a) and (b) of the said sub-section (4). A specific reference to sub-clause (b) of sub-section (4) disclose that in the last part of the said sub-clause it is specifically provided that other proceedings incidental to or arising from any suit or claim of set off not exceeding Rs.100 in value under those specific statute referred to in the said sub-clause can also be launched without any ban being operated as provided under sub-sections (1), (2) and (3). The said part of sub-clause (b) of sub-section (4) thus gives a vivid picture as to the position that the other proceeding specified in the said sub-section can only relate to a pending suit in a Court and not to any other different proceeding which can be categorized as other proceedings.

We are thus able to arrive at a definite conclusion as to the scope and ambit of Section 69 in particular about Section 69(3). Having thus analyzed the provision in such minute details and its implication, we can now apply the said provision to the case on hand and find out whether Section 69(3) is attracted to the Arbitral Proceedings and the ultimate award passed therein by construing the same as falling under the expression other proceedings.

In the case on hand, the contract between the parties contained an Arbitration Clause. The respondent invoked the said clause and an Arbitrator came to be appointed. After the respondent filed its statement of claim, the appellant filed its reply and also its counter claim dated 30.08.2003. Before the Arbitrator, in the course of oral arguments, a faint attempt was made contending that, the appellant-firm being an unregistered one, by virtue of Section 69 of the Partnership Act, the proceedings insofar as the counter claim was concerned, the same was not maintainable and should be rejected. The Arbitrator took the correct view that Section 69 has no application to the proceedings of the Arbitrator and held that the objection of the respondent was not sustainable. The Arbitrator allowed the counter claim to the extent of Rs.1,36,24,886/- (Rupees One crore thirty six lacs twenty four thousand eight hundred eighty six only). When the award of the Arbitrator was challenged by the respondent under Section 34 of the Act, the very same objection was raised as a ground of attack. The learned Single Judge of the High Court also found no merit in the said contention and upheld the award of counter claim.

By the impugned judgment, the Division Bench in the appeal filed under Section 37 of the Act took a contrary view and held that the counter claim in an Arbitral Proceedings is covered by the expression other proceedings contained in Section 69(3) of the Partnership Act and the appellant being an unregistered firm at the relevant point of time was hit by the embargo contained therein and consequently the award of counter claim in the award as confirmed by the learned Judge was reversed as not justiciable by virtue of Section 69 of the Partnership Act.

Based on the close analysis of Section 69 in its different parts, we are able to discern and hold that in order to attract the said Section, first and foremost the pending proceeding must be a suit instituted in a Court and in that suit a claim of set off or other proceedings will also be barred by virtue of the provision set out in sub-sections (1) and (2) of Section 69 as specifically stipulated in sub-section (3) of the said Section. Having regard to the manner in which the expressions are couched in sub-section (3), a claim of set off or other proceedings cannot have independent existence. In other words, the foundation for the application of the said sub-section should be the initiation of a suit in which a claim of set off or other proceedings which intrinsically connected with the suit arise and not otherwise.

Under the Partnership Act, the expression Court is not defined. In Section 2(e) of the said Act though it is stated that the expressions used but not defined, the definition in the Indian Contract Act, 1872 can be applied, in the Contract Act also there is no specific definition set out for the expression Court. However, we find a definition of the Court in Section 2(1)(e) of the 1996 Act, which reads as under:

2. Definitions.-(1) In this Part, unless the context otherwise requires,-

S.2 (e) Court means the principal Civil Court of original jurisdiction in a district, and includes the High Court in exercise of its ordinary original civil jurisdiction, having jurisdiction to decide the questions forming the subject-matter of the arbitration if the same had been the subject-matter of a suit, but does not include any civil court of a grade inferior to such principal Civil Court, or any Court of Small Causes;

Mr. Amrender Saran, learned Senior Counsel for the respondent in his submissions contended that under Section 36 of the 1996 Act since it has been provided that the award of an Arbitrator can be enforced under the Code of Civil Procedure in the same manner as if it were a decree of the Court, it should be held that the role played by the Arbitrator should also be deemed to be that of a Court and on that footing hold that Arbitral Proceedings are also akin to Court proceedings before the Court by equating the Arbitral Tribunal as a Court.

Having thus noted the facts involved in the case on hand and before dealing with the contentions of Mr. Saran, learned Senior Counsel for the respondent on the interpretation of Section 69(3), we wish to note the earliest decision on this very question dealt with in Jagdish Chander Gupta v. Kajaria Traders (India) Ltd. 1964 (8) SCR 50, Justice Hidayatullah, speaking for the Bench has made a critical analysis of this very provision, namely, Section 69(3) and has stated as under in paragraphs 7 and 9:

7. Mr. Justice Naik asked the question that if all proceedings were to be excluded why was it not considered sufficient to speak of proceedings along with suits in sub-Sections (1) and (2) instead of framing a separate sub-section about proceedings and coupling other proceeding with a claim of set-off? The question is a proper one to ask but the search for the answer in the scheme of the section itself gives the clue. The section things in terms of (a) suits and (b) claims of set-off which are in a sense of the nature of suits and (c) suits and other proceedings. The section first provides for exclusion of suits in sub-sections (1) and (2). Then it says that the same ban applies to a claim of set-off and other proceeding to enforce a right arising from a contract. Next it excludes the ban in respect of the right to sue (a) for the dissolution of a firm, (b) for accounts of a dissolved firm and (c) for the realization of the property of a dissolved firm. The emphasis in each case is on dissolution of the firm. Then follows a general exclusion of the section. The fourth sub-section says that the section as a whole, is not to apply to firms or to partners and firms which have no place of business in the territories of India or whose places of business are situated in the territories of India but in areas to which Chapter VII is not to apply and to suits or claims of set-off not exceeding Rs.100 in value. Here there is no insistence on the dissolution of the firm. It is significant that in the latter part of clause (b) of that section the words are or to any proceeding in execution or other proceeding incidental to or arising from any such suit or claim and this

clearly shows that the word proceeding is not limited to a proceeding in the nature of a suit or a claim of set-off. Sub-section (4) combines suits and a claim of set-off and then speaks of any proceeding in execution and other proceeding incidental to or arising from any such suit or claim as being outside the ban of the main section. It would hardly have been necessary to be so explicit if the words other proceeding in the main section had a meaning as restricted as is suggested by the respondent. It is possible that the draftsman wishing to make exceptions of different kinds in respect of suits, claims of set-off and other proceedings grouped suits in sub-sections (1) and (2), set-off and other proceedings in sub-section

made some special exceptions in respect of them in sub-section (3) in respect of dissolved firms and then viewed them all together in sub-section (4) providing for a complete exclusion of the section in respect of suits of particular classes. For convenience of drafting this scheme was probably followed and nothing can be spelled out from the manner in which the section is subdivided.

9. In our judgment, the words other proceeding in sub-section (3) must receive their full meaning untrammelled by the words a claim of set-off. The latter words neither intend nor can be construed to cut down the generality of the words other proceeding. The sub-section provides for the application of the provisions of sub-sections (1) and (2) to claims of set-off and also to other proceedings of any kind which can properly be said to be for enforcement of any right arising from contract except those expressly mentioned as exceptions in sub-section (3) and sub-section (4). (Underlining is ours) In the first blush, when we read paragraph 7, one is likely to gain an impression as though the expression other proceedings is disjunctive of a suit as specifically prescribed in sub-sections (1) and (2) of Section 69. But on a deeper scrutiny of the judgment, we find that in the light of the special features involved in the said case, it was laid down that other proceedings would be referable to Arbitration as well. We will right now note and state as to those intricate factors which weighed with the learned Judges to state the law in such terms. First and foremost, it will have to be noted that in the said case, the Arbitral proceedings arose under the Indian Arbitration Act of 1940 and in particular in relation to a proceeding which emanated under Section 8 of the said Act. Under Section 8 of the 1940 Act, the power of Court to appoint Arbitrator or umpire is specified. Sub-sections (1)(a) to (c) and (2) of Section 8 details the situations under which the said power of appointment of Arbitrator or umpire can be made. Under Section 2(c), the expression Court is defined to mean a Civil Court having jurisdiction to decide the questions framing the subject matter of a suit excluding a Small Causes Court. Under the said definition, an exception is carved out even for a Small Causes Court to fall under the definition of Court when the said Court is called upon to exercise its jurisdiction in situations, which are set out in Section 21 of the Act.

The definition of Court under Section 2(c) read along with Sections 8 and 21 of the 1940 Act,

therefore, indicates that the proceedings initiated under the said Sections are virtually in the nature of a suit in a Civil Court having jurisdiction, though such proceedings are relating to initiation as well as superintendence of Arbitration proceedings such as appointment of an Arbitrator or umpire or inaction or neglect on the part of Arbitrator or umpire or the incapacity of the Arbitrator or umpire, death of an Arbitrator or umpire or even in situations where the agreement has not provided for or not intended to supply the vacancy or the parties or the Arbitrator fail to supply the vacancy or the parties or the Arbitrator who are required to appoint an umpire and they fail to carry out their obligation. Under Section 21 of the 1940 Act even in the absence of an agreement providing for Arbitration, by consent of all parties to any suit can seek for a reference to Arbitration before the judgment is pronounced. Equally a reference to Sections 11, 12, 14, 15, 16, 17, 18, 19, 20, 21, 23, 24,

25, 28, 29, 30, 31, 32, 33, 34, 36, 37, 38, 39, 40, 41, 43 and 47 of 1940 Act disclose that the whole

scheme of the Act in effect invested the Civil Court and under certain specified situations even with the Small Causes Court to exercise all the powers that a Civil Court having jurisdiction in a civil suit *mutatis mutandis* in relation to an Arbitration apply, unlike the Arbitration and Conciliation Act of 1996 (hereinafter called the 1996 Act).

The scope and ambit of the power and jurisdiction of Court defined under Section 2(e) of the 1996 Act is circumscribed to certain specified extent as set out in Sections 8, 9, 14, 27, 34, 36, 37, 39, 42, 43, 47, 48, 49, 50, 56, 58 and 59. A comparative consideration of the 1940 Act and 1996 Act disclose the extent of control and operation of a Court under the former Act was far more intensive and elaborate than the latter Act. The more significant distinction as between the 1940 Act and the 1996 Act is clear to the position that the former Act does not merely stop with the initiation and enforcement of an Arbitration and its award, but effectively provides for intervention at every stage of the Arbitral proceedings upto its final consideration and enforcement as if it were a regular civil suit, whereas under the 1996 Act, the scope of intervention is not that of a Civil Court as it could do in the matter of a suit. Such clear distinction could be discerned from the reading of the various provisions of both the Acts. Therefore, in the light of such distinctive features that prevail in respect of an Arbitral proceeding which emanated under the 1940 Act, this Court held in Jagdish Chander case (*supra*) to the effect that an Arbitral proceedings governed by 1940 Act would squarely fall under the category of other proceedings as specified in Section 69(3) of the Partnership Act. To be more precise, in Jagdish Chander case (*supra*), in as much the initiation of the proceedings were under Section 8 of the 1940 Act before a Civil Court having jurisdiction to decide the question forming the subject matter of suit and the respondent therein being an unregistered Partnership Firm, the ingredients set out in Section 69(1) to (3) of the Partnership Act applied in all force and consequently held that the prohibition set out in the said Section squarely applied.

We only wish to add that though in the said decision, this Court did not specifically mention as to the requirement of pendency of a proceeding in the nature of a suit in a Civil Court as the basic ingredient to be satisfied as stipulated in sub-sections (1) & (2) of Section 69 in order to extend the specific prohibition even to other proceedings under sub-section (3), this Court was fully aware of the fulfillment of those mandatory requirement having regard to the nature of proceedings that existed under the provisions of the 1940 Act. Therefore, our conclusion based on the interpretation of Section 69 on the whole as set out in paragraphs 12 to 17 are fully supported by the above decision. We have therefore no hesitation to hold that the ratio laid down in Jagdish Chander case does not in anyway conflict with the view which we have taken herein, having regard to the advent of the 1996 Act, under which the nature of Arbitration Proceedings underwent a sea change as compared to the 1940 Act, what is stated in Jagdish Chander case can have application in the special facts of that case and that it can have no application to a proceedings which emanated under the 1996 Act, for which the interpretation to be placed on Section 69(3) will have to be made independently with specific reference to the provisions of the 1996 Act, where the role of the Court is limited as noted earlier to the extent as specified in Sections 8, 9 etc. Having thus noted the distinctive features in Jagdish Chander case, we wish to refer to the subsequent decision of this Court reported in Kamal Pushp Enterprises v.D.R. Construction Co. (2000) 6 SCC 659. The judgment and the ratio in Jagdish Chander was sought to be applied in all force in Kamal Pushp Enterprises, but having noted the distinctive feature of Jagdish Chander, this Court has explained the said

judgment and held that it will have no application to a post Award situation. Some of the relevant portions of the judgment in Kamal Pushp Enterprises can be quoted to appreciate the ultimate conclusion which fully supports our view. The question posed for consideration has been noted as under:

Mr. Sanjay Parikh, learned counsel for the appellant, contended that the Courts below ought to have sustained the objection of the appellant based upon Section 69 of the Partnership Act holding the proceedings to be barred on account of the respondent being an unregistered firm. Strong reliance was placed in this regard upon the decision of this Court reported in Jagdish Chander Gupta Vs. Kajaria Traders (India) Ltd. [AIR 1964 SC 1882]; .. in addition to placing reliance upon some other decisions of the High Courts, to substantiate his claim.

This Court ultimately construed the words other proceedings in sub-section (3) of Section 69 giving them their full meaning untrammelled by the words a claim of set off, and held that the generality of the words other proceedings are not to be cut down by the latter words. The said case, being one concerning an application before Court under Section 8(2) of the Arbitration Act, 1940 in the light of the arbitration agreement, this Court finally held that since the arbitration clause formed part of the agreement constituting the partnership the proceeding under Section 8(2) was in fact to enforce a right which arose from a contract/agreement of parties.

9. The prohibition contained in Section 69 is in respect of instituting a proceeding to enforce a right arising from a contract in any Court by an unregistered firm, and it had no application to the proceedings before an Arbitrator and that too when the reference to the Arbitrator was at the instance of the appellant itself. If the said bar engrafted in Section 69 is absolute in its terms and is destructive of any and every right arising under the contract itself and not confined merely to enforcement of a right arising from a contract by an unregistered firm by instituting a suit or other proceedings in Court only, it would become a jurisdictional issue in respect of the Arbitrators power, authority and competency itself, undermining thereby the legal efficacy of the very award, and consequently furnish a ground by itself to challenge the award when it is sought to be made a rule of Court.. The Award in this case cannot either rightly or legitimately said to be vitiated on account of the prohibition contained in Section 69 of the partnership Act, 1932 since the same has no application to proceedings before an Arbitrator. At the stage of enforcement of the award by passing a decree in terms thereof what is enforced is the award itself which crystallise the rights of parties under the Indian Contract Act and the general law to be paid for the work executed and not any right arising only from the objectionable contract.. Consequently, the post award proceedings cannot be considered by any means, to be a suit or other proceedings to enforce any rights arising under a contract. All the more so when, as in this case, at all stages the respondent was only on the defence and has not itself instituted any proceedings to enforce any rights of the nature prohibited under Section 69 of the Partnership Act, before any Court as such. (Emphasis added) The above passages extracted from the case of Kamal Pushp Enterprises (supra), apart from explaining the principles laid down in Jagdish Chander case (supra), has thus held in categorical terms as to how Section 69 prohibition will have no application to the post award proceedings as they do not fall under the expression other proceedings of the said section. This Court thus having already understood and explained Jagdish Chander case (supra) and reiterated the legal position on the application of Section 69(3) to the post award proceedings, which fully supports our conclusion in the case on hand, we need not dilate much on this issue.

Having reached the above definite conclusion on the application of Section 69(3) to the post award proceedings, when we consider the submissions of Mr. Amrender Saran, learned senior counsel for the respondent, the learned counsel, in the first place, contended that for the application of Section 69(3) of the Partnership Act to Arbitral proceedings, the foundation must be only based on a right in a contract. As far as the said contention is concerned, the same has already been dealt with by this Court in Kamal Pushp Enterprises (supra) wherein it is held as under:

The Award in this case cannot either rightly or legitimately said to be vitiated on account of the prohibition contained in Section 69 of the partnership Act, 1932 since the same has no application to proceedings before an Arbitrator. At the stage of enforcement of the award by passing a decree in terms thereof what is enforced is the award itself which crystallise the rights of parties under the Indian Contract Act and the general law to be paid for the work executed and not any right

arising only from the objectionable contract.. (Emphasis added) Therefore, the said contention of the learned senior counsel for the respondent has no force.

The learned senior counsel then contended that while interpreting Section 14 of the Limitation Act, it was held that Arbitration Proceedings are to be treated on par with civil proceedings. Though, in the first blush, the submission looks more attractive, on a deeper scrutiny it must be held that it is always well settled that a judgment can be a binding precedent on a question of law, which was canvassed before it and decided. Keeping the said principle in mind when we consider the said submission, we have clearly held as to how a reading of Section 69 as a whole does not permit of any interpretation that would cover Arbitral proceedings, de hors, filing of a suit in a Court and that too in respect of a right under a contract governed by the provisions of the Indian Partnership Act, especially after the coming into force of the 1996 Act and the proceedings governed by the special features contained in the said Act. Therefore, any interpretation made under the Limitation Act while construing Section 14 to treat Arbitral proceedings on par with civil proceedings cannot be applied to the case on hand. Further, the decision of this Court in Kamal Pushp having considered the application to Section 69(3) itself to Arbitral Proceedings and held that the same will not apply to a Post Award Proceedings, we do not find any merit in the said submission. Therefore, we are not able to apply the principles laid down in the decision reported in M/s. Consolidated Engg. Enterprises (supra) and P. Sarathy (supra) relied upon by the learned senior counsel for the respondent.

The next submission of Mr. Saran, learned Senior Counsel was again by relying upon Section 2(a) of the Interest Act. Under the said definition section, Court has been defined to include a Tribunal and an Arbitrator. The learned senior counsel, therefore, contended that Arbitral Proceedings should be equated to a Court and consequently make Section 69(3), applicable to it as falling under the expression other proceedings. If such a specific provision has been incorporated in the Partnership Act, there can be no difficulty in accepting the argument of the learned senior counsel for the respondent. In the absence of such a specific provision, it will not be appropriate to import the definition clause under Section 2(a) of the Interest Act to the Partnership Act in order to apply Section 69(3) of the Partnership Act. Therefore, we do not find any scope to countenance such a submission of the learned senior counsel for the respondent.

Lastly, it was contended by Mr. Saran, learned Senior Counsel that under Section 36 of the 1996 Act, an Award of the Arbitrator has been equated to decree of the Court for the purpose of execution. Under Section 35 of the 1996 Act, an Arbitral Award will be final and binding on the parties and persons claiming under them subject to the other provisions prescribed in the said part of the Act. Under Section 36 it is provided that where the time for making an application to set aside the arbitral award under Section 34 expired, or such application having been made and referred, the award can be enforced under the Code of Civil Procedure in the same manner as if it were a decree of the Court. When we consider the submission of the learned senior counsel for the respondent, at the very outset, it must be held that by referring to Sections 35 and 36, it is

difficult to draw an inference that based on the deeming provision specifically meant for the enforcement and execution of an Award, the Arbitral Proceedings can be equated to a Civil Court proceedings. As rightly contended by Mr. Dhruv Mehta, learned senior counsel for the appellant, Section 36 only creates a statutory fiction which is limited for the purpose of enforcement of the Award. The deeming fiction is specifically restricted to treat the Award as a decree of a Court, exclusively for the purpose of execution, though as a matter of fact, it is only an Award of Arbitral proceeding. It is a settled proposition, that a statutory provision will have to be construed from the words that are expressly used and it is not for the Court to add or substitute any word to it. Therefore, going by Sections 35 and 36 it cannot be held that the entire Arbitral proceeding is a Civil Court proceedings for the purpose of applicability of Section 69(3) of the Partnership Act. In this context, we draw support from the decision of this Court reported in *Sadan K. Bormal* (supra), paragraph 25 is relevant for our purpose which reads as under:

25. So far as interpretation of a provision creating a legal fiction is concerned, it is trite that the Court must ascertain the purpose for which the fiction is created and having done so must assume all those facts and consequences which are incidental or inevitable corollaries to the giving effect to the fiction. In construing a fiction it must not be extended beyond the purpose for which it is created or beyond the language of the Section by which it is created. It cannot be extended by importing another fiction. These principles are well settled and it is not necessary for us to refer to the authorities on this subject. The principle has been succinctly stated by Lord Asquith in *East End Dwelling Co. Ltd. V. Finsbury Borough Council*, (1951) 2 ALL ER 587, when he observed :-

"If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequence and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it-. The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs". We also draw support from the decision of this Court reported in *Paramjeet Singh Patheja Vs. ICDS Ltd.* - (2006) 13 SCC 322, paragraph 42 is relevant, which reads as under:

42. The words as if demonstrate that award and decree or order are two different things. The legal fiction created is for the limited purpose of enforcement as a decree. The fiction is not intended to make it a decree for all purposes under all statutes, whether State or Central. Though the learned senior counsel for the appellant and the respondent referred to certain other decisions in support of their respective submissions, as we are fortified by our conclusion, based on the interpretation of Section 69 of the Partnership Act vis-à-vis the 1996 Act and the 1940 Act as well as supported by the decision in *Jagdish Chander* (supra) and *Kamal Pushp Enterprises* (supra), we do not find any necessity to refer to those decisions in detail. Having regard to our conclusion that Arbitral Proceedings will not come under the expression other proceedings of Section 69(3) of the

Partnership Act, the ban imposed under the said Section 69 can have no application to Arbitral proceedings as well as the Arbitration Award. Therefore, the appeal stands allowed, the impugned judgment of the Division Bench is set aside and the judgment of the learned Single Judge stands restored. No costs.

* * * * *

DISSOLUTION OF A FIRM

Saligram Ruplal Khanna v. Kanwar Rajnath

AIR 1974 SC 1094

[Partnership for a fixed term – dissolution on expiry of the term - section 42, 47]

H.R. KHANNA, J. - This appeal by special leave is directed against the judgment of a Division Bench of the Bombay High Court affirming on appeal the decision of the learned Single Judge whereby a suit for dissolution of partnership and rendition of accounts filed by the two plaintiff-appellants, Saligram Ruplal Khanna and Pessumal Atalrai Shahani, against Kanwar Rajnath defendant-respondent was dismissed. The partnership which was sought to be dissolved carried on business under the name and style of “Shri Ambernath Mills Corporation” (hereinafter referred to as SAMCO). The property which according to the appellants belonged to the partnership consisted of three mills at Ambernath. One of them was a woollen mill, the other was a silk mill and the third was an oil and leather cloth factory with land, bungalows and chawls attached thereto. In addition to that, there was a bobbin factory at Taradeo with offices at Bombay, Ahmedabad and other places. For the sake of convenience, the above property may be described, as it was done in the High Court, as “Ambernath Mills”. Although the case involves a tangled skein of facts, the points which survive for determination in appeal are rather simple.

2. The Ambernath Mills originally belonged to a company called Ahmed Abdul Karim Bros. Private Ltd. The mills were declared to be evacuee property in September, 1951 and the Custodian took over the management of the mills in pursuance of the provisions of the Administration of Evacuee Property Act, 1950. It was then decided that the mills should be managed by displaced persons who had been industrialists in Pakistan. A private limited company was formed of 31 persons for taking over the management of the mills. Rs 25,000 were contributed by each one of those persons in that connection. The appellants and the respondent too were members of the company. Appellant No. 1 and the respondent had migrated at the time of partition from Gujarat in West Punjab. The respondent was a big industrialist and left behind extensive properties in Pakistan. He held verified claim of rupees 23 lakhs in lieu of property left by him in West Pakistan. Appellant No. 1 had a verified claim of Rs 22,000 in respect of residential property left in Pakistan. In addition to that, he had a disputed claim in respect of industrial properties. Appellant No. 2 had a verified claim of about Rs 30,000. The two appellants and the respondent were associated by the Custodian with the management of the Ambemath Mills. By August, 1952 all the members of the private limited company dropped out. It was accordingly decided by the Custodian to grant a lease of the Ambernath Mills to the respondent and the two appellants. On August 30, 1952 two documents were executed. One of the documents was an agreement of partnership between the two appellants and the respondent for carrying on the business of Ambernath Mills under the lease in the name and style of Shri Ambemath Mills Corporation. The other document was the agreement of lease executed by the Custodian of Evacuee Property as lessor and the appellants and the respondent carrying on business in partnership under the name and style of SAMCO as lessees. The subject-matter of the lease was Ambernath Mills. It was stated in the

lease that the lessees had appointed the respondent as their chief representative with full powers of control, management and administration of the entire demised premises. The lease was to be for a period of five years to be computed from the date on which the possession of the demised premises was handed over to the lessees, subject to sooner determination thereof on any of the contingencies provided in Clause 21 or on the breach of any condition on the part of the lessees or in the event of any dispute among the lessees resulting in the closure of the mills. It was also provided that the lessees would purchase and the lessor would sell to the lessees at an agreed price the stocks of raw materials, unsold finished goods, consumer's stores, spare parts, cars and trucks and other moveables which had already been vested in the lessor, as well as three diesel generating sets purchased by the lessor. In the event of any difference on the question of the price, the same was to be fixed through one or more experts. The sale was to be completed within a period of three months from the date of the agreement. The lessees were authorized to take as partner one or more displaced persons who had filed claims under the Displaced Persons Claims Act, 1950 subject to the prior approval of the Government. The agreement also contained a provision for reference of any dispute arising out of the agreement of lease to arbitrators chosen by the parties by mutual consent. The annual rent payable by the lessees was fixed at Rs 6,00,000 payable in four quarterly instalments of Rs 1,50,000 each on or before 30th day of each quarter. The lessees also undertook to deposit or furnish bank guarantee in the sum of Rs 7,00,000 as security for the payment of the value of raw material, unsold finished goods, stores, spare parts and other articles.

According to the partnership agreement executed by the two appellants and the respondent on August 30, 1952, each partner has agreed to contribute a capital of Rs 1,00,000. The amount of Rs 25,000 already paid by each partner to the Custodian was regarded as part payment of the capital of rupees one lakh. Each partner had one-third share in the partnership, but it was provided that the shares would be adjusted by the respondent if fresh partners were taken in the partnership. The respondent was to be the managing partner and was entitled to assign work in the partnership to the two appellants. It was agreed that the appellants were not to interfere directly or indirectly in any manner with the management and control of the business by the respondent. The respondent was also authorised to form a limited liability company for running the business of the partnership with the consent of the Custodian and the appellants agreed to join the company as shareholders on such terms and conditions as might be agreed when such company was formed. The period of the partnership was five years "being the period of said lease".

3. The partnership took possession of Ambernath Mills on August 31, 1952. The respondent directed Appellant No. 1 to be in charge of the administration of the mills at Ambemath, while Appellant No. 2 being an engineer, was placed in charge of the properties, machinery and stores of the mills. The respondent was in overall charge of the concern.

4. It appears that the partnership made some progress in the first few months. The stocks of raw material, finished goods, stores and other moveables which were deemed to have been purchased by SAMCO under the terms of the agreement of lease were in the meantime valued by an auditor appointed by the Custodian at rupees 30 lakhs. The Custodian called upon the partnership in April, 1953 to pay a sum of rupees 7 lakhs or to furnish a bank guarantee for

the said amount as provided in the agreement of lease. This payment could not be made by the partnership. There was also difficulty in paying the sixth instalment of the rent. A cheque for Rs 1,50,000 was issued but the same was dishonoured. Subsequently, arrangements were made to pay Rs 1,00,000. An amount of Rs 50,000 out of the sixth instalment remained unpaid.

5. On February 12, 1954 the Custodian served a notice on the respondent and the two appellants to show cause why the agreement of lease should not be cancelled on account of breach of conditions in the matter of the payment of the sixth quarterly instalment of rent and the failure to deposit or furnish bank guarantee for the amount of Rs 7,00,000. A writ petition was thereupon filed by the partnership on February 16, 1954 in the Bombay High Court for quashing the notice issued by the Custodian.

6. In the meantime. Appellant No. 2 sent letter dated February 8, 1954 to the respondent suggesting that his share in the partnership be reduced to 1 anna in a rupee or to such other fraction as the respondent thought fit. A similar letter was addressed by Appellant No. 1. On February 24, 1954 the parties entered into a second agreement of partnership. It was agreed in the new partnership agreement that the share of Appellant No. 1 would be 3 annas and that of Appellant No.2, 1 anna in a rupee. The respondent was to have the remaining 12 annas share. It was also agreed that the two appellants would not have the right, title and interest in the name, capital assets and goodwill of the partnership. It was provided that the new partnership would be deemed to have been formed as from October 1, 1953. Accounts for the period from August 30, 1952 to September 30, 1953 were to be made upon the basis of the partnership agreement dated August 30, 1952 and the profits and losses for that period were to be distributed accordingly. The capital of the partnership was agreed to be arranged by the respondent and he was to be the managing partner in control of the entire affairs of the partnership. He was also to get interest at six per cent on all finances arranged by him. The appellants agreed to carry on such duties in the concern as might be assigned to them by the respondent. The period of the partnership was to be "the outstanding period of the lease".

7. The writ petition referred to above filed by the partnership to quash the notice of the Custodian was allowed by a Single Judge of the Bombay High Court on March 31, 1954. On appeal filed by the Custodian, a Division Bench of the High Court as per judgment dated April 13, 1954 set aside the order of the Single Judge and dismissed the writ petition. Certificate of fitness for appeal to this Court was granted by the High Court on May 5, 1954. Stay order was also issued on that day restraining the Custodian from dispossessing the respondent and the appellants from Ambernath Mills. Appeal against the decision of the Division Bench of Bombay High Court was then filed in this Court. The Custodian of Evacuee Property made an order on May 25, 1954 cancelling the agreement of lease of Ambernath Mills, dated August 30, 1952. The possession of the mills was voluntarily delivered by the partnership to the Custodian on June 30, 1954.

8. Representations were made on behalf of SAMCO to the Minister of Rehabilitation during the later half of 1954 for being allowed to retain Ambernath Mills. A communication was also addressed on December 14, 1954 to the Minister of Rehabilitation suggesting, inter alia, that the claim of the Custodian against the partnership in respect of arrears of rent and the value of raw material and other goods should be referred to arbitration.

13. The respondent was unable to submit to the Central Government compensation claims to the extent of Rs30,00,000 within three months of the agreement dated August 14, 1957. By April, 1959 he submitted compensation claims to the extent of Rs 20,00,000. A supplemental agreement was executed by the respondent and the President on April 29, 1959. In this agreement the President acknowledged the receipt from the respondent of the sum of Rs 20,00,000 by way of adjustment of compensation claims. The respondent undertook to pay the remaining amount of Rs 30,11,000 and Rs 18,00,000 under the award of Mr Morarji Desai, in all, Rs 48,11,000. It was agreed that the aforesaid amount would be paid by the respondent in seven annual instalments. A second supplemental agreement was executed by the President and the respondent on April 6, 1960, but we are not concerned with that. On April 21, 1960 the grant of the Ambernath Mills was made by the President to the respondent. The same day the respondent executed in favour of the President a mortgage of the Ambernath Mills for the payment of Rs 48,11,000. The sum was payable in seven equal annual instalments. On April 22, 1960 the respondent took possession of Ambernath Mills which had been lying idle for nearly six years since June 30, 1954. On May 7, 1960 the respondent sent a circular letter to all displaced persons whose compensation claims had been transferred to him informing them that possession of the mills had been handed over to him by the Central Government. They were also informed that statement of their accounts was being prepared. One such letter was sent to Appellant No. 1. He also received a statement of account and in September 1960 a cheque for Rs 204 was sent to him by way of interest.

15. It was alleged in the plaint that after the termination of the agreement of lease by the Custodian on May 25, 1954 the two appellants and the respondent assembled and orally agreed not to dissolve the partnership in spite of the termination of the lease. The agreement between the parties was further stated to be that "the partnership should be continued for the purpose of acquiring on behalf and for the benefit of the said partnership the properties Ex.1 (Ambernath Mills) hereto and to exploit the said industries". The respondent was stated to have made a representation that he was acquiring the Ambernath Mills on behalf of the partnership and that the agreement had been executed in the respondent's name because the Central Government desired to deal with only one individual. It was also stated that the respondent had admitted utilisation of a sum of Rs 2,00,000 out of the partnership fund for payment of earnest money. The respondent being a partner, according to the appellants, stood in a fiduciary character vis-a-vis the appellants and was bound to protect their interest. He could not gain for himself pecuniary advantage by entering into dealings under circumstances in which his interest were adverse to those of the appellants. The properties and profits acquired by the respondent were stated to be for the benefit of the partnership also. In the plaint, as it was initially filed, the appellants prayed for a declaration that the partnership between them and the respondent was still subsisting on the terms and conditions set out in partnership deed dated February 24, 1954 excepting the terms relating to the period of partnership. Prayer was made for a declaration that the Ambernath Mills belonged to the partnership and for rendition of the partnership accounts. By a subsequent amendment prayer was added that the partnership be dissolved from the date of the filing of the suit.

16. The respondent in his written statement denied the alleged oral agreement between the parties on or about May 25, 1954. According to the respondent, the partnership stood

dissolved on March 10, 1955 when the Central Government acquired the Ambemath Mills. According further to the respondent, the funds of the partnership were utilized for the payment of various creditors of the partnership and after those payments were made the partnership did not have sufficient funds to pay to the remaining creditors. With regard to the negotiations for the acquisition of the mills, the respondent stated that Appellant No. 1 was aware that Ambemath Mills were being acquired by the respondent for himself alone. The respondent denied that he ever told Appellant No. 1 that the amount of earnest money of Rs 2,00,000 for the purchase of the Ambemath Mills had been paid out of funds belonging to the partnership. Allegation was also made by the respondent that Appellant No. 1 had requested that he might be given some benefit in the nature of appointment of agency in the business of Ambemath Mills. The claim of the appellant for rendition of the accounts was stated to be barred by limitation. In an affidavit filed on January 11, 1961 the respondent stated that in case it was held that there was an oral agreement of partnership between the parties, the same should be taken to have been dissolved.

17. Learned trial Judge held that the appellants had failed to prove that there was an oral agreement between the parties on or about May 25, 1954. It was further held that there was no agreement, express or implied, to form a partnership for acquiring the mills and for carrying on the business thereon. The appellants were held not entitled to have the mills treated as partnership assets by invoking principles enunciated in Section 88 of the Indian Trusts Act, to which reference had been made on behalf of the appellants. The learned Judge also held the appellants' claim for rendition of accounts to be barred by limitation because in his view the partnership had stood dissolved on May 25, 1954 when the agreement of lease was cancelled. In any case, according to the learned Judge, the partnership must be deemed to have been dissolved either on January 14, 1957 when the suit filed by the two appellants and the respondent against the Custodian and the Central Government for permanent injunction was finally dismissed in appeal by a Division Bench of the Bombay High Court or on August 30, 1957 when the period of the lease came to an end.

18. In appeal before the Division Bench the following four contentions were advanced on behalf of the appellants:

(1) that on May 25, 1954 the parties expressly agreed to continue their partnership for acquiring the mills and exploiting them, that a partnership at will thus came into existence between them, and that therefore the mills acquired by the defendant or his agreement with the President of India, dated August 14, 1957 and the subsequent grant by the President of India on April 21, 1960 must be held to be an asset of the said partnership;

(2) that if such an express agreement is held not to have been proved, an implied agreement to the same effect should be inferred from the conduct of the parties and the correspondence between them;

(3) that, even supposing that there was no express or implied agreement as stated above, the rights acquired by the defendant as a result of his agreement with the President of India, dated August 14, 1957 and the subsequent Presidential grant are impressed with a trust in favour of the partnership under Section 88 of the Indian Trusts Act; and

(4) that, even if it is held that the mills are no longer an asset of the partnership, the plaintiffs are still entitled to accounts of the partnership which admittedly existed

between them and the defendant for working the mills under agreement of lease dated August 30, 1952.

The learned Judges constituting the Division Bench repelled all the contentions advanced on behalf of the appellants and substantially agreed with the findings of the trial Judge. On the question of limitation, the learned Judges held that the partnership had been dissolved at the latest on November 10, 1955 when all the attempts of the partners to get the Custodian's order dated May 25, 1954 set aside came to an end with the decision of the Supreme Court. The present suit for rendition of accounts brought on December 20, 1960 more than three years after the date of the dissolution of the partnership was held to be barred by limitation. In the result the appeal was dismissed.

19. In appeal before us Mr S.T. Desai on behalf of the appellants has frankly conceded that he is not in a position to challenge the concurrent findings of the trial Judge and the appellate Bench that the appellants had failed to prove that on May 25, 1954 the parties had expressly agreed to continue the partnership for acquiring the mills and exploiting them. Although Mr Desai indicated at the commencement of the arguments that he would challenge the finding of the Appellate Bench that the rights acquired by the respondent as per agreement dated August 14, 1957 with the President and the subsequent Presidential grant are impressed with trust in favour of the partnership under Section 88 of the Indian Trusts Act, no arguments were ultimately advanced by him on that score. Mr Desai, has, however, challenged the finding of the trial Judge and the Appellate Bench that no implied agreement as alleged by the appellants could be inferred from the material on record. The main burden of the arguments of Mr Desai, however, has been that the appellants were entitled to the accounts of the partnership which admittedly existed between the parties as per partnership agreements dated August 30, 1952 and February 24, 1954. According to Mr Desai, there had been no dissolution of the firm of the parties prior to the institution of the suit and the appellants' suit for rendition of accounts was not barred by limitation. The High Court, it is urged, was in error in holding to the contrary. The above contentions have been controverted by Mr Cooper on behalf of the respondent and, in our opinion, are not well-founded.

20. We may first deal with the question as to whether the implied agreement as alleged by the appellants can be inferred from the material on record. In this respect Mr Desai has submitted that the appellants no longer claim any interest in the ownership of Ambernath Mills which now vests in the respondent. It is, however, urged that an agreement can be inferred from the conduct of the parties that Ambernath Mills were to be run by the respondent in partnership with the appellants, even though the ownership of the same might vest in the respondent. In this connection we find that no case of such an implied agreement was set up in the trial Court, either in the plaint or otherwise, nor was such a case set up in appeal before the Division Bench. What was actually contended was that the agreement was for acquiring the mills as an asset of the partnership. The above stand of the appellants could plainly be not accepted when one keeps in view the agreement of lease dated August 30, 1952 as well as other documents on record. The said agreement of lease shows that Ambemath Mills would become the absolute property not only of the appellants and the respondent but of all persons who were to be associated with the lessees in the ownership of the proprietary interest in proportion to the total compensation payable to each of them. The agreement of

lease further contemplated that the lessee rights of the two appellants and the respondent were to be distinct from the proprietary interest in the demised premises and that the lessees were at liberty, in spite of the transfer of proprietary interest, to continue the lease for the unexpired residue of the term on the terms and conditions of the lease and payment of rent prescribed thereunder. The respondent submitted representation on August 9, 1954 on behalf of the SAMCO to the Custodian for the restart of the mills and along with it the respondent sent copies of letter of authority and particulars of verified claims of 30 displaced persons. It is implicit in the representation that in case Ambemath Mills was transferred, the same would vest in all the 30 displaced persons whose claims were submitted,

21. There are two documents which run counter to the stand taken on behalf of the appellants in this Court that there was an implied agreement that in case the respondent acquired the ownership of the mills, the mills would be worked by the respondent in partnership with the appellants. One of those documents is agreement dated September 20, 1957 which was signed by the Appellant No. 1 and the respondent a day before the respondent executed bond in favour of that appellant in view of the fact that Appellant No. 1 agreed to have his claim compensation amounting to Rs 6,994 adjusted towards the price of Ambemath Mills. It was stated in the agreement dated September 20, 1957 that the respondent was contemplating the formation of joint stock company to own, run and manage the mills and it was agreed between the parties that in the event of such company being formed, Appellant No. 1 would have the option to purchase shares of the said company to the extent of 50 per cent of the amount of the adjusted claim compensation. In case the option was exercised in favour of the purchase of the shares of the company, the respondent was to ensure that the said shares would be allotted to Appellant No. 1 at par. It was further agreed that if the shares applied for or any proportion thereof were not allotted to Appellant No. 1 by the said company, the respondent would not in any way be liable to Appellant No. 1 on that account. In the bond the respondent agreed to pay to Appellant No. 1 interest at the rate of six per cent on the amount of compensation from the date of the adjustment of the Appellant No. 1's claim compensation. Had Appellant No. 1 any interest in the Ambemath Mills which were being acquired by the respondent there could arise no occasion for the execution of the agreement dated September 20, 1957 and the bond dated September 21, 1957. All that was agreed by the respondent in those two documents was that in case he promoted a company for owning, running and managing of the Ambemath Mills, Appellant No. 1 would get a share of the value of half of his claim compensation of Rs 6,994. The said amount when compared to the price of Ambemath Mills was wholly insignificant. No question could arise of the respondent borrowing money from Appellant No. 1 for payment of price of the mills, in case the acquisition of the mills was for the benefit of the respondent as well as the appellant. It may also be stated that the interest on account of the above compensation was duly paid by the respondent to Appellant No. 1.

22. Another document which has a bearing in the above context is letter dated December 18, 1959 which was addressed by Appellant No. 1 to the Collector of Bombay in connection with the recovery of arrears of sales tax. Appellant No. 1 in that letter stated that the responsibility for the payment of such arrears of sales tax was that of the respondent and Appellant No. 1 was no more in picture. The above letter shows that Appellant No. 1

repudiated his liability for the payment of the sales tax by disclaiming his connection with the business in question.

24. We are, therefore, of the view that no inference of the implied agreement referred to by Mr Desai can be drawn from the material on record.

25. So far as the question is concerned as to whether the claim for rendition of accounts was within time, we find that according to Clause 16 of the partnership deed dated August 30, 1952 the period of partnership was fixed at five years, being the period of lease. Clause 17 of the deed of partnership dated February 24, 1954 provided that the "period of partnership shall be the outstanding period of such lease". The possession of Ambernath Mills under the agreement of lease was delivered on August 31, 1952. The period of five years of the lease was thus to expire on August 30, 1957. As the partnership was for a fixed period, the firm would in normal course dissolve on the expiry of the period of five years on August 30, 1957. No agreement between the partners to keep the firm in existence after the expiry of the fixed term of five years has been proved.

The above provision (of section 42) makes it clear that unless some contract between the partners to the contrary is proved, the firm if constituted for a fixed term would be dissolved by the expiry of that term. If the firm is constituted to carry out one or more adventures or undertakings, the firm, subject to a contract between the partners, would be dissolved by the completion of the adventures or undertakings. Clauses (c) and (d) deal with dissolution of firm on death of a partner or his being adjudicated insolvent.

26. It was indicated in the agreement of partnership that the period of partnership had been fixed at five years because that was the period of the lease of Ambernath Mills. The lease, however, ran into rough weather. On February 12, 1954 the Custodian served notice on the respondent and the two appellants to show cause why the agreement of lease should not be cancelled in accordance with the terms of that agreement on account of the breach of conditions in the matter of payment of instalment of rent and the failure of the respondent and the appellants to deposit or furnish bank guarantee for the amount of Rs 7,00,000. The respondent and the appellants challenged the validity of the above notice by means of a writ petition and, though they succeeded before a Single Judge, the Appellate Bench of the Bombay High Court upheld the validity of the notice. On May 25, 1954 the Custodian cancelled the lease of Ambernath Mills and on June 30, 1954 got possession of the mills. The respondent and the appellants assailed the decision of the Appellate Bench of the Bombay High Court in this Court, but this Court also took the view as per judgment dated November 10, 1955 that there was no legal infirmity in the notice for the termination of the lease issued by the Custodian. After the above judgment of this Court, whatever hope or expectation the partners of SAMCO had of running Ambernath Mills on lease under the agreement of lease dated August 30, 1952 came to an end and were extinguished.

27. In the meantime, as already stated earlier, the possession of Ambernath Mills was handed over by the partners of SAMCO to the Custodian on June 30, 1954. On March 10, 1955 the Central Government issued notification under Section 12 of the Displaced Persons (Compensation and Rehabilitation) Act, 1954 for acquiring the mills. The mills were then advertised for sale. The partners of SAMCO having been thwarted for good in their efforts to

get back the mills on lease now made an effort to acquire the ownership of the mills in accordance with Clauses 17 to 21 of the agreement of lease. Suit was accordingly brought by the respondent and the appellants for permanent injunction restraining the Central Government and the Custodian from selling the Ambemath Mills to any person other than the partners of SAMCO. The suit was dismissed by the City Civil Court and the appeal filed by the partners of SAMCO too was dismissed by a Division Bench of the Bombay High Court on January 14, 1957. The Division Bench held that the agreement of purchase contained in Clauses 17 to 21 of the agreement of lease was indefinite and vague and such agreement of sale was not capable of specific performance. It was further held that in view of notification dated March 10, 1955, the Central Government acquired the mills free from all encumbrances. The rights of the partners of SAMCO which were in the nature of an encumbrance were held to be no longer enforceable. No appeal was filed against the above decision of the Bombay High Court. As such, the aforesaid judgment became final. Any expectation which the partners of SAMCO could have of acquiring the ownership of Ambemath Mills under Clauses 17 to 21 of the agreement of lease was also thus dashed to the ground.

30. Reference has also been made on behalf of the appellants to the consent given by the respondent on behalf of SAMCO on November 13, 1957 to the award of Rs 18,00,000 by Mr Morarji Desai in favour of the Custodian against SAMCO. It is urged that this document would go to show that the firm of SAMCO had not been dissolved before that date. We are unable to agree. The arbitration proceedings had been started as a result of application under Section 20 of the Arbitration Act filed on April 21, 1955 when SAMCO was in existence and was a running concern. The arbitration proceedings related to a claim of the Custodian of Rs 30,00,000 on account of the price of stocks of raw material, stores and other moveables as well as about the arrears of rent. Counter-claim had also been made by SAMCO against the Custodian for a sum of Rs 17,67,080 as per written statement dated December 18, 1956 filed in arbitration proceedings. The consent which was given by the respondent on November 13, 1957 was with a view to get the dispute between SAMCO with the Custodian finally settled. This was a necessary step for the purpose of winding up the affairs of SAMCO and to complete transaction of arbitration proceedings which had been begun but remained unfinished at the time of dissolution. According to Section 47 of the Indian Partnership Act, after the dissolution of a firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise. The word "transaction" in Section 47 refers not merely to commercial transaction of purchase and sale but would include also all other matters relating to the affairs of the partnership. The completion of a transaction would cover also the taking of necessary steps in connection with the adjudication of a dispute to which a firm before its dissolution is a party. The legal position in this respect has been stated on page 251 of **Lindley on Partnership**, 13th Edn. as under:

Notwithstanding a dissolution each partner can pay, or receive payment of, a partnership debt; for it is clearly settled that payment by one of several joint debtors, or to one of several joint creditors, extinguishes the debt irrespective of any question of

partnership. So, again, it has been held that a continuing or surviving partner may issue a bankruptcy notice in the firm name in respect of a judgment obtained before the dissolution, and that notice to him of the dishonour of a bill of exchange is sufficient, and that he can withdraw a deposit or sell the partnership assets, or pledge them for the purpose of completing a transaction already commenced, or of securing a debt already incurred, or the overdraft on the partnership current account at the bank.

31. The proposition, in our opinion, cannot be disputed that after dissolution, the partnership subsists merely for the purpose of completing pending transactions, winding up the business, and adjusting the rights of the partners; and for these purposes, and these only, the authority, rights, and obligations of the partners continue (*see* page 573 of **Halsbury's Laws of England**, 3rd Edn., Vol. 28). We would, therefore, hold that the consent given by the respondent on November 13, 1957 to the award of Mr Desai would not detract from the conclusion that the firm of the parties stood dissolved on the expiry of the fixed period of partnership, viz., August 30, 1957.

32. The proposition of law referred to by Mr Desai that a dissolution does not necessarily follow because a partnership has ceased to do business would not be of any material help to the appellants because we are not basing our conclusion of the dissolution of the firm of the parties upon the fact that the partnership had ceased to do business. On the contrary, we have arrived at the above conclusion in accordance with the principle of law that a firm constituted for a fixed term shall stand dissolved, in the absence of a contract to the contrary, on the expiry of that term.

33. Our attention has also been invited to the correspondence between Appellant No. 1 and the respondent during the period from June to September, 1957. These letters reveal that Appellant No. 1 entertained hopes and expectations of deriving some benefit in case the respondent succeeded in acquiring the Ambemath Mills. The exact nature of the benefit was not, however, specified in the letters. The respondent in his replies while not belying those hopes and expectations took care not to make any commitment. After, however, the respondent succeeded in acquiring the mills, there developed a coolness in his attitude towards Appellant No. 1. This circumstance must necessarily have caused disappointment and disillusionment to Appellant No. 1. The respondent, it seems, kept some kind of carrot dangling before Appellant No. 1 during the delicate stage of his negotiations with the Government for the acquisition of the mills lest Appellant No. 1 did something to sabotage those efforts. After acquisition of the mills by the respondent his attitude changed and he gave a cold rebuff to Appellant No. 1. The above conduct of the respondent may have a bearing on the question of the award of costs, but it cannot affect our decision on the point as to whether the suit is within limitation or not.

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M/s. Juggilal Kamlatpat v. M/s. Sew Chand Bagree

AIR 1960 Cal. 463

[Dissolution of firm – No public notice under section 45(1)]

G.K. MITTER, J. - This is an application in execution of a decree on an award made by the Bengal Chamber of Commerce dated June 14, 1950 on a dispute between Juggilal Kamlatpat, the award holders, and Sew Chand Bagree, against whom the award was made. The decree was passed on May 28, 1951 for a total sum of over Rs. 31,000/-.

(2) The award was given in respect of a contract entered into between Sew Chand Bagree and Juggilal Kamlatpat on Sep. 25, 1948. The application is being opposed by Manik Chand Bagree and Moti Chand Bagree whose case is that the firm of Sew Chand Bagree was dissolved in Oct. 1945 by mutual consent of its partners and that thereafter their brother Jankidas Bagree started a new business in the name of Sew Chand Bagree with which they the other brothers had no concern. Sew Chand Bagree the individual, was the father of the three persons already mentioned. From a copy of entries in the Register of firms maintained by the Registrar of Firms, West Bengal, it appears that the business of Sew Chand Bagree was established in the year 1924, that it was formerly a joint Hindu family business and that the partnership firm was started on October 28, 1933. The three partners shown in the said record are Manik Chand Bagree, Moti Chand Bagree and Jankidas Bagree. This document does not show that there has been any change in the constitution of the firm ever since its inception. It is contended by the award holders that no change in the constitution of the firm having been notified and no public notice of the dissolution of the firm having been given under the provision of the Indian Partnership Act, all the partners continue to be liable for any act done by any of them. The award holders further do not admit that there was a dissolution of the firm in the year 1945 as alleged by the Bagrees. On the evidence adduced I must hold that there was a dissolution of the firm. On this finding the question is whether sub-section (1) of Sec. 45 of the Partnership Act is brought into play or whether the point is covered by the proviso to the said sub-section.

(8) Mr. Tiberwalla, Counsel for the Juggilal Kamlatpat, argued that it had not been established by the evidence that the firm of Sew Chand Bagree had ever been dissolved. He submitted that no attempt had been made to get any alteration in the constitution of the firm noted in the records of the Registrar of Firms up to the year 1959 although dissolution is alleged to have taken place in the year 1945. Counsel submitted that the Bagrees had not examined any disinterested third party to show that the dissolution, if any, was known to outsiders, that no advertisement of the dissolution had appeared in any newspaper, that there was no evidence of the issue of any circular with regard to it and that no broker other than Sriratan Damani had been examined. He relied strongly on the absence of the books of account of Sew Chand Bagree and contended that the same, if produced, would have established that the firm had never been wound up. There is certainly some force in these contentions, specially the comment on the non-production of the books of account. But I must hold on a consideration of the entire evidence adduced that the firm had been dissolved. The deed of agreement prepared by Messrs. Dutt and Sen and signed by the Bagree brothers, the issue of the trade license by the Corporation of Calcutta, the opening of the account with

Hindustan Commercial Bank Ltd., and the letter written to Bank of Baroda Ltd., all corroborate the oral testimony adduced on behalf of the Bagrees. The contracts of Juggilal Kamlapat with Manik Chand Bagree in a name and style other than Sew Chand Bagree tend to prove the disruption in the family. On the evidence as a whole I accept the case of the Bagrees that the firm of Sew Chand Bagree had come to an end in the year 1945.

(13) The registration of the firm under the Act is not compulsory but unless the firm is so registered it cannot file a suit to enforce a right arising out of a contract. The application for registration must comply with the provisions of Sec. 58 of the Act. Registration is effected under Sec. 59. Provision is made for recording of (a) alterations in the firm's name, (b) changes in the names and addresses of partners, (c) changes in and dissolution of the firm under Secs. 60 and 63 of the Act. Under Sec. 68 "any statement, intimation or notice recorded or noted in the Register of Firms shall, as against any person by whom or on whose behalf such statement, intimation or notice was signed, be conclusive proof of any fact therein stated." Under Sec. 72 of the Act a public notice under the Act relating to the retirement of a partner from the registered firm or to the dissolution of a registered firm etc., has to be given by notice to the Registrar of Firms and by publication in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business. For the proper interpretation of S. 45 of the Partnership Act, Mr. Tibrewalla referred me to a judgment of Garth C. J., in *Chundee Churn Dutt v. Eduljee Cowasjee Bijnee* [ILR 8 Cal 678]. This judgment turned on the interpretation of Sec. 264 of the Contract Act of 1872 which provided:

"Persons dealing with a firm will not be affected by dissolution of which no public notice has been given unless they themselves has notice of such dissolution."

(19) Section 45 sub-s. (1) of our Act without the proviso is no doubt somewhat similar to Sec. 36 sub-section (1) of the English Act but the provisions of the two Acts are not identical. Under Sec. 45 notwithstanding the dissolution of a firm the liability of the partners continues until public notice is given of the dissolution in respect of any act which would have bound the firm if done before the dissolution. But the proviso to this sub-section restricts the scope of it considerably and exempts the estate of a partner who dies or who is adjudicated an insolvent or of a partner, who not having known to the person dealing with the firm to be a partner, retires from the firm if the act is done after the date on which he ceases to be a partner. Under Sec. 36(1) of the English Act an apparent member continues to be liable to an outsider unless the latter has notice of the change in the firm. But even if there be no such notice a partner who was not known to the outsider as such ceases to be liable after his retirement under Sub-sec. (3) of Sec. 36. In the Indian Act the proviso replaces sub-sec. (3) of the English section. The only difference between Sec. 36 sub-sec. (1) of the English Act and Sec. 45 sub-sec. (1) of the Indian Act seems to be that under the former any one who is an apparent member continues liable while under the latter any one who was a member, whether apparently so or not remains liable until public notice of dissolution as given. But the proviso to the Indian Section cuts down the liability in the case of a partner who was not known as such to the person seeking to make him liable. Except for the use of the qualifying word "apparent" in sub-sec. 1 of Sec. 36 of the English Act the effect seems to be the same.

(20) "The proper function of a proviso" said Lord Macmillan in *M. and S. M. Rly. Co. v. Bazwada Municipality* [AIR 1944 PC 71]. "is to except and deal with a case which would otherwise fall within the general language of the main enactment, and its effect is confined to that case". But for the proviso the dissolution of a firm would not have affected the liability of a partner who had gone out of it or of a dormant partner until public notice of the dissolution was given. The effect of the proviso is to except the case of a partner who was not known to the person dealing with the firm to be a partner and who has retired from the firm without any public notice of dissolution being given.

(21) It was admitted by Rameshwar Agarwalla that he did not know Manik Chand Bagree and Moti Chand Bagree to be partners of Sew Chand Bagree until six months or a year ago and even this he came to know only from a copy of the entries made in the records of the Register of Firms. These persons, therefore, were not known to Juggilal Kamlapat to have been partners of the firm and they had gone out of the firm before the contract in this case was entered into. Clearly the proviso is attracted to the facts of this case and Manik Chand Bagree and Moti Chand Bagree cannot be made liable for payment of the decretal amount.

(22) Mr. Tibrewalla argued that the exception, if any, is limited to the case of a partner who "retires from the firm" and does not apply to the case of a dissolution of the firm whereby the relationship of all the partners inter se is put an end to for ever. In my view, this contention has no substance because the case of a retiring partner is expressly provided in Sec. 32 of sub-sec. (3) and the proviso to the said sub-section. It certainly would have been better if instead of the words "retires from the firm", the legislature had used the expression "severs his connection with the firm". Probably the actual words used have been taken from the English Act. Without entering into speculation of this kind it is not difficult to find out what the legislature intended. It appears to me, however, that the contingencies of death, insolvency, retirement and even expulsion of a partner having already been provided for by the Indian Act in Secs. 35, 34, 32 and 33 of the Act respectively, Sec. 36 might well have dealt with the case of a dissolution of firm simpliciter.

(23) The fact that the entries in the record of the Registrar of Firms still show that Manik Chand Bagree and Moti Chand Bagree, does not help the decree-holder in this case. If the decree-holder had adduced evidence to the effect that these records had been scrutinized by it before the transaction was entered into the position might have been different.

(25) The application will, therefore, be dismissed with costs as against Moti Chand Bagree and Manik Chand Bagree. There will be an order in terms of prayer (a) as against Jankidas Bagree.

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Sharad Vasant Kotak v. Ramniklal Mohanlal Chawda

(1998) 2 SCC 171

[Section 46]

K. VENKATASWAMI, J. - 2. This appeal by special leave has arisen under the following circumstances: The appellants are the partners of a suit firm called 'M/s Paramount Builders'. The partnership was entered into on 29-11-1979 with (seven) individuals as partners.

3. The said partnership firm was registered on 15-12-1980 under Registration No. 158675 with the Registrar of Firms. On 6-5-1986, Shri Mohanlal Hinji Chawda, a partner of the firm (Sr. No. 6 above) died and in his place, his widow Smt Jijiben Mohanlal Chawda was admitted as a partner in the firm. After the admission of the said Smt Jijiben Mohanlal Chawda, another deed of partnership was made consisting of the six old partners and the newly admitted partner Smt Jijiben Mohanlal Chawda. As a matter of fact, the induction of the new partner was not brought to the notice of the Registrar of Firms by forwarding the required particulars. It is on record that still later on 3-11-1992 another partnership deed was brought into existence consisting of the same partners. It is also on record that yet another partner Smt Hemkuber B. Kotak (S. No. 4 above) died in September 1994. The fact of death of this partner also was not intimated to the Registrar of Firms. While so, the 1st respondent gave a notice of dissolution of the firm to the appellants and also filed a suit for the dissolution of the partnership firm bearing Suit No. 5016/94 on 15-12-1994 in the High Court of Judicature at Bombay on the original side. Initially in the plaint, the constitutional validity of Section 69(2-A) of the Indian Partnership Act (hereinafter called "the Act"), as amended by the Maharashtra Act, was not raised. The 1st respondent moved a Chamber Summons No. 301 of 1997 seeking permission of the Court to carry out certain amendments to the plaint. Briefly, the amendments sought were that subsequent changes and/or modifications in the partnership deed of M/s Paramount Builders under the deed of partnership dated 20-10-1986 and also in the deed of partnership dated 3-11-1992 are merely in the nature of changes and/or modifications which do not affect registration of the said firm of M/s Paramount Builders, as required under the Act, for entitling a partner to institute a suit for reliefs against the partners on dissolution of firms and alternatively, the other amendment sought was to challenge the vires of Section 69(2-A) of the Act as in force in State of Maharashtra.

4. The amendment sought was seriously opposed by the appellants inter alia contending that the suit as filed was not maintainable and, therefore, the amendment cannot be allowed. In other words, according to the appellants on and from 20-10-1986 when a new partnership deed was made, the registration already given to the firm ceased to have validity and the partnership as at present must be deemed to be an unregistered one and, therefore, the suit was hit by Section 69(2-A). It was also contended that without impleading the State of Maharashtra and the Union of India, the vires of Section 69(2-A) in the Partnership Act cannot be challenged. The learned trial Judge accepting the objections raised by the appellants found that Section 69(2-A) of the Act creates a bar on the threshold of the filing of the suit for the relief covered in the suit and the very suit filed by the plaintiff was incompetent. That being the position, the application for amendment could not be permitted. Consequently, the application was rejected.

5. Aggrieved by the rejection of the amendment application, the first respondent preferred an appeal to the Division Bench of the High Court in Appeal No. 509 of 1997.

6. The appellate court was of the view that the registration of the firm continues to be in force notwithstanding any reconstitution of the firm and even when dissolution takes place, the registration of the firm continues. The Division Bench further held that Section 69(2-A) requires the registration of a firm and it does not require a fresh registration each time a reconstitution or dissolution of the continuing firm takes place. After finding that the suit filed by the first respondent was not hit by Section 69(2-A), the Division Bench held as follows:

The proposed amendment consists of two parts. The first part is only a factual aspect which has been sought to be introduced in order to demonstrate that the bar under Section 69(2-A) is not attracted. There is no reason as to why such an amendment should not be granted. The second part of the amendment pertains to the constitutional challenge of the validity of Section 69(2-A). As we have already taken a view that Section 69(2-A) is not attracted, the question of challenge does not survive and, therefore, it is not necessary to grant the amendment containing constitutional challenge.

7. Ultimately the appellate court allowed the appeal and permitted the amendment only regarding the factual portions and not regarding the constitutional validity of Section 69(2-A).

9. In this appeal, the following substantial question of law arises for our consideration:

Whether on the facts of this case the suit for dissolution and account of partnership is hit by Section 69(2-A) of the Act as amended in the State of Maharashtra?"

(2-A) No suit to enforce any right for the dissolution of a firm or for accounts of a dissolved firm or any right or power to realise the property of a dissolved firm shall be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner in the firm, unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm:

Provided that the requirement of registration of firm under this sub-section shall not apply to the suits or proceedings instituted by the heirs or legal representatives of the deceased partner of a firm for accounts of a dissolved firm or to realise the property of a dissolved firm.

11. Before proceeding further, we remind ourselves that we are concerned with a suit filed by a partner for dissolution and accounts. No third-party rights or liabilities are involved in the present suit filed by Respondent 1.

12. Undoubtedly counsel on both sides addressed arguments covering larger questions. But we propose to confine ourselves strictly to the facts of the case and decide the controversy without touching upon the larger issues or connected issues arising out of the pleadings because the maintainability of the suit is the sole issue based on Section 69(2-A) of the Act.

13. Section 69(2-A) (extracted above) requires two conditions before a partner can sue for dissolution of a firm and for accounts:

1. The firm must be registered.
2. The person suing is or has been shown in the register of firms as partner in the firm.

14. It is not in dispute that the partnership as entered into under a deed dated 28-11-1979 was duly registered and a certificate of registration was granted. It is also an admitted fact that the plaintiff, first respondent herein, was one of the founder partners under the deed dated 28-11-1979 and his name did find a place in the register of firms as a partner and there is nothing to show that at any point of time, his name has been removed from the register of firms. We have seen that on the death of one of the partners, his widow was inducted into the partnership and a deed was entered into on 20-10-1986, repeating almost all the clauses in the partnership deed dated 28-11-1979 except for consequential changes necessitated by the induction of a new partner in the place of the deceased partner.

15. It is the contention of the learned Senior Counsel, Mr Nariman, that when the new partner was inducted under the partnership deed dated 20-10-1986 in the place of the deceased partner, the firm registered under the partnership deed dated 28-11-1979 ceases to be on the records of Registrar of Firms and, therefore, the registration already given will not enure to the benefit of the partnership entered on 20-10-1986. If that be so, according to Mr Nariman, learned Senior Counsel, the conditions imposed by Section 69(2-A) are not satisfied and, therefore, the suit as filed was not maintainable.

16. In support of his argument, he placed strong reliance on the expression “partnership” as defined in Section 4 of the Act. It is the contention of Mr Nariman that bearing in mind the definition in Section 4 of the Act, the partners including the second respondent will collectively be a firm and that firm is not registered inasmuch as the name of the second respondent does not find a place in the register of Registrar of Firms. Therefore, the learned Single Judge was right in holding that the suit was not maintainable at the threshold. According to the learned Senior Counsel, the mere fact that the plaintiff’s name find a place in the register of Registrar of Firms is not sufficient to maintain the suit when admittedly one of the partner’s name (second respondent’s name) was not shown in the register of Registrar of Firms. He also contended that a comparison of language employed in Sections 31 and 32 of the Act will show that whenever a partner is inducted into an existing firm, the old firm ceases to exist and an altogether new firm comes into existence from the date of induction of the new partner and that new firm must get fresh registration. He also submitted that the partners entered into another deed on 3-11-1992 and they have expressly treated the firm as a reconstituted one. In other words, according to the learned Senior Counsel, the deed dated 20-10-1986 in the absence of such expression (reconstituted firm) the understanding was the old firm, ceases to be in existence and a new firm was brought into existence. For this, he also placed reliance on clauses 4 and 5 regarding “Commencement” and “Accounting Year”. He also placed reliance on a passage from **Lindley on Law of Partnership**, 15th Edn., p. 374:

Each partner is, it is true, the agent of the firm; but as pointed out before, the firm is not distinguishable from the persons from time to time composing it; and when a new member is admitted he becomes one of the firm for the future, but not as from the past, and his present connection with the firm is no evidence that he ever expressly or impliedly authorised what may have been done prior to his admission.

This is wholly consistent with the fact that after the admission of a new member, a new partnership is constituted, and thus special circumstances are required to be shown before the debts and liabilities of the old partnership are treated as having been undertaken by the new partnership.

17. Contending contrary and supporting the judgment of the Division Bench, Mr Soli J. Sorabjee, learned Senior Counsel, submitted that there is a well-recognised distinction between the legal concept of dissolution and reconstitution of a firm. In the case of an incoming or an outgoing partner in an existing firm, there is only a reconstitution of the firm and in all other respects, the existing firm continues with old and new partners. A look at Chapter V of the Act, according to him, will fortify the above contention. In other words, Chapter V deals with “Income and Outgoing Partners” while Chapter VI separately deals with “Dissolution of a Firm”. The two are totally different concepts and cannot in law be equated with each other. According to the learned Senior Counsel, the rules framed by the Maharashtra Government in 1989 and the forms prescribed under the rules in particular Forms E, G and H clearly support the said contention. It is also his contention that even when there is a dissolution of a firm, it does not cease to be a registered firm but for the purposes of Partnership Act it continues to be registered. In other words, according to the learned Senior Counsel, the registration of a firm is valid till it is cancelled in a manner known to law. Non-compliance of Sections 61, 62 and 63, as amended in Maharashtra, if at all, will attract the penalties prescribed under Section 69-A and nothing more and it is incorrect to contend that non-compliance of the said provisions will result in deregistration of the firm. As the consequence of deregistration is a drastic one, it is impermissible to hold that non-compliance with Sections 63(1) and 63(1-A) would lead to deregistration of a firm in the absence of express and clear legislative provision to that effect. He further contended that merely because another partnership deed was made on 20-10-1986, it cannot be said that there was a dissolution of the old firm and consequential formation of a new firm under the latter deed. According to the learned Senior Counsel, it is the substance of the matter that is relevant to be looked into and not the phraseology employed by the parties. In other words, the test is whether after the execution of the deed dated 20-10-1986, for all intents and purposes, the firm as reconstituted was a different unit or remained the same unit in spite of change in its constitution. Looked at from this angle, the unit remained the same as it originally was in spite of change in its constitution and the contention to the contrary, according to the learned Senior Counsel, was not correct. To support this, he pointed out the similarities between the two deeds. The alleged dissimilarities as found in clauses 4 and 5 of the document dated 20-10-1986 are really not dissimilarities but consequential and incidental changes.

19. In reply to the contention of Mr Nariman that the purpose for which Section 69(2-A) was introduced by the Maharashtra Legislature will be the last if the view projected by him is not accepted, Mr Sorabjee submitted that failure to comply with the mandatory provisions in Section 61, 62 or 63 may attract the penalties provided under Section 69-A of the Act but not the deregistration of the firm.

20. At the outset, we would like to deal with the substance of the partnership deeds in this case. As noticed earlier, the first deed of partnership was entered into on 29-11-1979 and that partnership firm was registered on 15-12-1980. One of the partners (Shri Mohanlal Hinji

Chawda) died on 6-5-1986 and in his place, his widow was inducted. The second deed of partnership was drawn on 20-10-1986. By reason of the second deed of partnership, can it be said that the existing firm dissolved or ceased. It is relevant here to note that in both the deeds it was expressly made that the death, insolvency or retirement of any partner shall not dissolve the partnership firm. On the other hand, the partner shall be entitled to carry on the partnership business on the terms and conditions mutually agreed upon by the said partners (vide clause 11). Therefore, it cannot be contended by the appellants that by reason of death of one of the partners, the existing firm stands dissolved. Can it then be said that by reason of inducting the widow of the deceased partner the existing registered firm ceased and totally a new partnership firm came into existence. According to the appellants, by reason of clauses 4 and 5 in the second deed of partnership, it must be deemed that the old partnership ceased and entirely a new partnership firm was found under the second deed. We are unable to agree with the contention of the learned Senior Counsel for the appellants on this aspect. Clauses 4 and 5 relate to commencement of the partnership and accounting year. These are minimal changes introduced in the second deed of partnership by reason of the introduction of a new partner in place of clauses 4 and 5 in the first partnership deed and in other respects, namely, the name of the partnership firm, the address and location of the firm, the business carried on and shares allotted among the partners and duration of the partnership, are identical. Moreover a careful reading of clauses 5 and 6 of the second partnership deed will give an impression that the partners have agreed to continue the existing firm. The profits or losses for the period prior to and up to the death of the deceased partner is dealt with and provided. There is no indication that the old firm was dissolved. Likewise, reliance placed on the recitals in the third deed of partnership drawn on 3-11-1992 will not come to the help of the appellants. Learned counsel for the appellants placed reliance on the term used in the third partnership deed reconstituted in the preamble portion. We are of the opinion that this does not make any substantial difference when we look into the substance of the three deeds.

22. The contention of the learned counsel for the appellants that the induction of the new partner will result in dissolution of the firm is not also acceptable. Reliance placed on the language of Sections 31 and 32 of the Act to support the said contention will be of no avail if we look into Section 17 of the Act. Section 17(a) of the Act (extracted above) suggests only reconstitution of the firm where a change occurs in the constitution of the firm. Otherwise, the old firm remains the same.

25. The next question is whether the registration given to the firm under the first partnership deed ceases when a new partner was introduced into the firm. For this, we refer to Sections 58, 59 and 63, the relevant portions have already been extracted. Rules 3, 4, 6 and 17 have also been extracted. The forms prescribed in this connection have also been extracted. A close perusal of these provisions with Forms "A", "E", "G" and "H" will show that there is a definite distinction between the Certificate of Registration given to the firm and any alterations to be entered in the *Register of Firms*. This will suggest in no uncertain terms that the changes in the constitution of the firm will not affect the registration once made. In other words, it is not required that every time a new partner is inducted, fresh registration has to be applied and obtained. However, information about changes have to be given. Failure to comply attracts penalties under Section 69-A of the Act.

27. In *Pratapchand Ramchand & Co.* [AIR 1940 Bom 257], the Bombay High Court observed as follows:

Dealing in particular with Section 63(1), that sub-section among other things provides that when a registered firm is dissolved any person who was a partner immediately before the dissolution, or the agent of any such partner or person specially authorized in this behalf, may give notice to the Registrar of such change or dissolution, specifying the date thereof, and the Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms, and shall file the notice along with the statement relating to the firm filed under Section 59. Pausing there, that section evidently contemplates in the case of a dissolution of a firm by death that notwithstanding the death the firm should still be treated for the purpose of the Act as still registered. Mr Davar has argued that by reason of the death and the dissolution of the firm the firm ceased to be registered, and in his argument he went so far as to say that the firm ought to have been registered again. No doubt it would have been logical having regard to Section 42 if the Act had so provided. But in fact it has not. The Act does contemplate notwithstanding dissolution by death that so far as registration is concerned the firm is to be deemed still to be registered, and it empowers any person who was a partner immediately before the dissolution to give notice of the change and requires the Registrar to record that notice in the entry relating to the registration of the firm and to file it along with the original statement which had been filed. The next section requiring notice is Section 69(2).

Applying that sub-section to the present case the firm was registered and in my opinion continued to be registered on the date of the institution of this suit on 26th October, 1939. There is no time-limit fixed in any of the Sections 60 to 63 as to when notice of alterations or changes should be given. Mr Davar argued that the word 'when' with which each of those sections begins involves an obligation upon the person proposing to give notice of the change to give it immediately upon the change occurring. The sections do not say so. The position therefore is this: The firm was registered at the time of the institution of the suit. The firm then consisted of Chhogamal Dhanaji and Chunilal Idanji, two of the original partners whose names were shown on the register on the date of registration and were shown on the register on the date of the institution of the suit. The fact that the firm was registered on the date of the institution of the suit and that the names of the persons suing (the firm being a compendious name for the persons suing) were shown in the register on the date of the institution of the suit appears to me to be a compliance with Section 69(2) of the Act.

It would seem that the legislature introduced the words with which that sub-section concludes, viz., 'and the persons suing are or have been shown in the register of firms as partners in the firm' advisedly. If additional partners had come into the firm as partners since the date of registration and their names had not been entered on the register in accordance with notice of a change in the constitution of the firm given to the Registrar, it may well be that the firm as then constituted could not sue, because although it was a registered firm some of the persons then suing would not

be shown in the register of firms as partners in the firm on the date of the suit. That is not this case. The partners who are suing were shown in the register originally and are still shown, and the firm according to my construction of the Act remained registered notwithstanding the death of one of the original partners.

29. In our opinion, the view taken by the Bombay High Court and followed by the other High Courts is the right view.

30. Learned counsel for the appellants placed strong reliance on the Objects and Reasons for the amendments introduced in the Maharashtra Act. According to the learned counsel, if his contention is not accepted, the object with which Section 69(2-A) was introduced will be lost. We do not think so. In this context, we wish to point out that Section 69(3)(a) of the Central Act enables the partners of both registered and unregistered firms to file a suit for dissolution and/or accounts. That being the position by introducing sub-section (2-A) in Section 69, the Maharashtra Legislature has placed certain restrictions to the extent that even the suit for dissolution of a firm or for accounts, the suit can be filed only if the firm is registered and the 'person' suing as a partner is shown in the Register of Firms as a partner in the firm. In other words, a person, who is not shown in the Register of Firms by induction after registration even though the firm is registered, cannot file a suit for dissolution or accounts. This does not in any way mean that the registration given to the firm earlier will cease. In this case, the firm was registered and there was only a reconstitution of the firm and the first respondent, the plaintiff in this case, is a person whose name is shown in the Register of Firms along with the names of the appellants and, therefore, there is compliance of Section 69(2-A). The contention to the contrary by the learned counsel for the appellants cannot be accepted.

32. We are also not impressed by the arguments of the learned counsel for the appellants that if the definition of Section 4 is applied to Section 69(2-A) then unless the names of all the partners find a place in the Register of Firms, the suit filed by the plaintiff cannot be sustained. The fact that the firm was registered and the plaintiff's name finds a place in the Register of Firms are not in dispute. The name of the newly introduced partner, of course, does not find a place in the Register of Firms. That means the person whose name does not find a place in the Register of Firms may incur certain disabilities and that will not disable the plaintiff to press the suit against the firm, which was registered against the persons whose names find a place in the Register of Firms. We are not called upon to decide what are the disabilities of the person, whose name does not find a place in the Register of Firms. For the purpose of Section 69(2-A), the partnership firm will mean the firm as found in the certificate of registration and the partners as found in the Register of Firms maintained as per rule in Form 'G'. The present suit being one for dissolution and accounts by one of the partners, whose name admittedly finds place in the Register of Firms along with the names of all the appellants, the requirements of Section 69(2-A) are satisfied. Section 4 of the Act is also complied with for this limited purpose.

33. Our conclusion is that on the induction of the second respondent, the existing firm was only reconstituted on the facts of this case and, therefore, there is no necessity to get a fresh registration. If by virtue of non-compliance of certain mandatory provisions in not informing the Registrar of Firms about the change in the constitution of the firm, certain

penalties provided in the Act alone are attracted and that will not lead to the conclusion that the registration of the firm ceased. This conclusion is based on a conjoint reading of Sections 58-63 and the forms prescribed thereunder. Further, this conclusion does not in any way militate the object of the Maharashtra Amendment introduced by Act 29 of 1984.

34. In the result, we hold that the suit in question is not hit by Section 69(2-A) of the Act and, therefore, the Division Bench is right in allowing the appeal. Consequently, the appeal is dismissed. However, there will be no order as to costs.

* * * * *

S.V. Chandra Pandian v. S.V. Sivalinga Nadar

(1993) 1 SCC 589

[*Mode of settlement of accounts - section 48(b)(iv)*]

(The four appellants and respondents 1 and 2 were brothers carrying on business in partnership in the name and style of Messers Sivalinga Nadar & Brothers and S.V.S. Oil Mills, both partnerships being registered under the Partnership Act, 1932. Most of the properties were acquired by the firm of Sivalinga Nadar & Brothers. The firm of Ms. S.V.S. Oil Mills merely had leasehold rights in the parcel of land belonging to the first-named firm on which the superstructure of the oil mill stood. Both the partnerships were of fixed durations. Disputes arose between the six brothers in regard to the business carried on in partnership in the aforesaid two names. For the resolution of these disputes the six brothers entered into an arbitration agreement dated October 8, 1981, which was as under:

“We are carrying on business in partnership together with other partners under several partnership names. We are also holding shares and managing the Public Limited Company, namely, the Madras Vanaspati Ltd., at Villupuram. Disputes have arisen among us with respect to the several business concerns, immovable and moveable properties standing in our names as well as other relatives.

We are hereby referring all our disputes, the details of which would be given by us shortly to you, namely, Sri B.B. Naidu, Sri K.R. Ramamani and Sri Seetharaman.

We agree to abide by your award as to our disputes.”

The arbitrators directed that “the firms of M/s Sivalinga Nadar & Bros. and M/s S.V.S. Oil Mills and also the joint house property Rent Account be dissolved as at the close of business on July 14, 1984.”

The arbitrators set out the properties belonging to or claimed to belong to the two firms in paras. 6 to 24 of their award. Paragraph 25 was a residuary clause which said that any asset left out or realised hereafter or any liability found due other than those reflected in the account books was to be divided and/or borne equally among the disputants. Paragraphs 26 and 27 deal with the use of the firm names. Paragraph 29 referred to the business carried on by the relatives of the disputants in the names of Sri Brahasakthi Agency and Srimagal Finance Corporation. The arbitrators had recognised the fact that even though the said business was not carried on by the disputants it was desirable to dissolve the firms also w.e.f. July 24, 1984 in the larger interest of peace and amity among the disputants and their relatives. Paragraph 30 referred to the properties standing in the name of the father of the six disputants, i.e., partners of the two firms in question. The award set out the share of the disputants.

After the award was made, O.P. No. 230 of 1984 was filed by S.V. Chandrapandian and others for a direction to the arbitrators to file their award in Court which was done. Thereupon, the applicants S.V. Chandrapandian and others filed a Miscellaneous Application No. 3503 of 1984 requesting the Court to pass a decree in terms of the award. Before orders could be passed on that application, O.P. Nos. 247 and 275 of 1984 were filed by S.V. Sivalinga Nadar and S.V. Harikrishnan respectively under Section 30 of the Arbitration Act to set aside the award. The applications came up for hearing before a learned Single Judge of the High Court. The learned Single Judge observed as under:

“The learned counsel for the respondents also contended that the award falls under Schedule I Article 12 of the Stamp Act and the allocation of properties owned by partnership firm on dissolution to the erstwhile partners is not partition of immovable properties. In this connection, learned counsel for the respondents placed reliance on the decision reported in *Addanki Narayanappa v. Bhaskara Krishtappa* which decision has been confirmed in *Addanki Narayanappa v. Bhaskara Krishnappa*. It was submitted by the learned counsel for the respondents that the contentions with regard to stamp and registration put forward by the petitioner cannot be accepted. It is to be pointed out that the award has been submitted for registration long ago on October 27, 1984 itself and it is stamped and if there is any deficiency, the registering authority could direct proper stamp to be affixed and therefore I feel there could be no impediment for the award being made a rule of the Court and a decree being passed in terms of the award as contended by the learned counsel for the respondents.”

The learned Single Judge made the final order in the following terms:

“Thus on a careful consideration of the materials available and the contentions of either side it has to be decided that Application No. 3505 of 1984 in O.P. No. 230 of 1984, filed by the petitioners therein praying for a decree in terms of the arbitration award dated July 9, 1984 has to be allowed and O.P. Nos. 247 and 275 of 1984 and the applications filed in those two petitions, i.e., Application Nos. 3474, 3476, 5030, 5031, 5032, 2827, 2828, 3773, 3762, 3874 of 1984 and 4886 and 4887 of 1985, are dismissed. The petitioner in O.P. No. 230 of 1984 and the applicants in Application No. 3505 of 1984 are directed to take steps for getting the award registered. The parties in all these proceedings are directed to bear their own costs.”

Against the judgment of the learned Single Judge, the matter was carried in appeal to a Division Bench of the High Court of Madras which reversed the finding recorded by the learned Single Judge and came to the conclusion that the award required registration under Section 17(1) of the Registration Act

In this view of the matter the Division Bench allowed the appeal and set aside the impugned judgment of the learned Single Judge and held that as the award was not registered it could not be made the rule of the Court).

A.M. AHMADI, J. - 7. Section 4 (of the Partnership Act, 1932) defines partnership as a relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all. Section 14 provides that subject to contract between the partners, the property of the firm includes all property and rights and interests in property originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business. It is also clarified that unless the contrary intention appears, property and rights and interest in property acquired with money belonging to the firm shall be deemed to have been acquired for the firm. Section 15 says that the property of the firm shall be held and used by the partners exclusively for the purposes of the business subject of course to contract between the partners. Says Section 18, subject to the provisions of the Act, a partner is the agent of the firm for the purposes of the business of the firm. Under Section 19

the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, shall bind the firm. This authority to bind the firm is termed as “implied authority”. Section 22 lays down that in order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm. Section 29 deals with the rights of transferee of a partner’s interest. Sub-section (1) thereof provides that such a transferee will not have the same rights as the transferor-partner but he would be entitled to receive the share of profits of his transferor on the account of profits agreed to by the partners. Sub-section (2) next provides that upon dissolution of the firm or upon a transferor-partner ceasing to be a partner, the transferee would be entitled against the remaining partners to receive the share of the assets of the firm to which the transferor-partner was entitled and will also be entitled to an account as from the date of dissolution. Section 30 deals with the case of a minor admitted to the benefits of partnership. Such a minor is given a right to his share of the property of the firm and also a right to share in the profits of the firm as may be agreed upon but his share is made liable for the acts of the firm though he would not be personally liable for the same. Sub-section (4), however, debars a minor from suing the partners for an account or for his share of the property or profits of the firm except when he severs his connections with the firm, in which case for determining his share the law requires a valuation of his share in the property of the firm to be made in accordance with Section 48. Sections 31 to 38 relate to incoming and outgoing partners. Section 32 deals with the consequences of retirement. Sub-sections (2) and (3) of Section 32 deal with the consequences of retirement while Sections 36 and 37 speak about the rights of an outgoing partner to carry on competing business and in certain cases to share subsequent profits. Chapter VI deals with the dissolution of a firm. Section 40 provides that a firm may be dissolved with the consent of all the partners or in accordance with the contract between the partners. Sections 41 and 42 deal with dissolution on the happening of certain events while Section 43 permits a partner to dissolve a firm by notice if it is a partnership at will. Section 44 speaks of dissolution through Court. Section 48 indicates the mode of settlement of accounts between the partners on dissolution while Section 49 posits that where there are joint debts due from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm, and, if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the debts of the firm, Chapter VII deals with the registration of firms, etc., and Chapter VIII contains the saving clause.

8. The above provisions make it clear that regardless of the character of the property brought in by the partners on the constitution of the partnership firm or that which is acquired in the course of business of the partnership, such property shall become the property of the firm and an individual partner shall only be entitled to his share of profits, if any, accruing to the partnership from the realisation of this property and upon dissolution of the partnership to a share in the money representing the value of the property. It is well settled that the firm is not a legal entity, it has no legal existence, it is merely a compendious name and hence the partnership property would vest in all the partners of the firm. Accordingly, each and every partner of the firm would have an interest in the property or asset of the firm but during its

subsistence no partner can deal with any portion of the property as belonging to him, nor can he assign his interest in any specific item thereof to anyone. By virtue of the implied authority conferred as agent of the firm his action would bind the firm if it is done to carry on, in the usual way, the business of the kind carried on by the firm but the act or instrument by which the firm is sought to be bound must be done or executed in the firm name or in any other manner expressing or implying an intention to bind the firm. His right is merely to obtain such profits, if any, as may fall to his share upon the dissolution of the firm which remain after satisfying the liabilities set out in the various sub-clauses (i) to (iv) of clause (b) of Section 48 of the Act.

9. In the present case the six brothers who were carrying on business in partnership fell out on account of disputes which they could not resolve inter se. The partnership being of fixed durations could not be dissolved by any partner by notice. As they could not resolve their disputes they decided to resort to arbitration. The three arbitrators chosen by them were men of their confidence and they after giving the partners full and complete opportunity took care to first circulate a proposed award to ascertain the reaction of the disputants therein. The letter written to the arbitrators by S.V. Sivalinga Nadar dated February 16, 1983 indicates that he was quite satisfied with the hearing given by the arbitrators. He was also by and large satisfied with the proposed award but thought it warranted certain adjustments to make it acceptable and rational. He was of the view that the award should provide for the reallocation of the shareholdings of Madras Vanaspati Ltd., whereas Brahmasakthi Tin Factory owned by his sons should be kept out of the purview of the arbitrators since it was not the subject-matter of arbitration. Then he raised some objection as to the percentage of his share and the amount found due to him. In the subsequent letter written on September 9, 1983 he has reiterated these very objections while raising certain questions regarding valuation of partnership properties. Even the application filed under Sections 30 and 33 of the Arbitration Act in the High Court the objections to the award as enumerated in paragraph 15 mainly concerned (i) the conduct of the arbitrators who, it is alleged, acted negligently, with bias and against principles of natural justice (ii) deliberate act in leaving out certain properties from consideration e.g., shareholdings of Madras Vanaspati Ltd., stock-in-trade and cash deposits, the properties of Velayudha Perumal Nadar, etc., and (iii) failure to grant him a higher share to which he was entitled. No contention was raised regarding the want of registration of the award. However, being a question of law, the learned Single Judge entertained the plea and rejected it but it found favour with the Division Bench.

The submission made in this behalf before the courts below was that the award involved a partition of immovable properties as a consequence of dissolution of the firms and since the value of the immovable properties which are the subject-matter of the award indisputably exceed the value of Rs 100, the award was compulsorily registrable in view of the mandatory nature of the language of Section 17(1) which uses the expression 'shall be registered'. On the mandatory character of the provision there is no dispute. The question which requires determination is whether on the dissolution of the partnership the distribution of the assets of the firm comprising both moveable and immovable properties after meeting its obligations on settlement of accounts amongst the partners of the firm in proportion to their respective shares amounts to a partition of immovable properties or a relinquishment or extinguishment of a

share in immovable property requiring registration under Section 17 of the Registration Act if the allocation includes immovable property of the value of Rs 100 and above? In other words the question to be considered is whether the interest of a partner in partnership assets is to be treated as moveable property or both moveable and immovable depending on the character of the property for the purposes of Section 17 of the Registration Act?

12. In *CIT v. Juggilal Kamalapat* [AIR 1967 SC 401], the facts were that three brothers and one *J* entered into a partnership business. The firm owned both moveable and immovable properties. Sometime thereafter the three brothers created a Trust with themselves as the first three trustees and simultaneously executed a deed of relinquishment relinquishing their rights in and claims to all the properties and assets of the firm in favour of *J* and of themselves in the capacity of trustees. Thereafter a new partnership firm was constituted between *J* and the Trust with specified shares. The Trust brought a sum of Rs 50,000 as its capital in the new firm. The new firm applied for registration under Section 26-A of the Income Tax Act, 1922 but the application was rejected by the authorities. The Tribunal held that the deed of relinquishment being unregistered could not legally transfer the rights and the title to the immovable properties owned by the original firm to the Trust. Since the immovable properties were not separable from the other business assets it held that there was no legal transfer of any portion of the business assets of the original firm in favour of the Trust. A reference was made to the High Court on the question whether the new partnership legally came into existence and as such should be registered under Section 26-A. The High Court held that there was no impediment to its registration. The matter was brought in appeal before this Court. This Court pointed out that the deed of relinquishment was in respect of individual interests of the three brothers in the assets of the partnership firm in favour of the Trust and consequently, did not require registration, even though the assets of the partnership included immovable property. In taking this view reliance was placed on the decision *Ajudhia Pershad* case, AIR 1947 Lah 13 as well as the decision of this Court in *Addanki Narayanappa*, AIR 1966 SC 1300.

13. Again in *CIT v. Dewas Cine Corporation* [AIR 1968 SC 676], the partnership firm was dissolved and on dissolution it was agreed between the partners that the theatres should be returned to their original owners who had brought them into the books of the partnership as its assets. In the books of accounts of the partnership the assets were shown as taken over on October 1, 1951 at the original price less depreciation, the depreciation being equally divided between the two partners. In the proceedings for the assessment year 1952-53 the firm was treated as a registered firm. The Appellate Tribunal held that restoration of the two theatres to the original owners amounted to transfer by the firm and the entries adjusting the depreciation and writing off the assets at the original value amounted to total recoupment of the entire depreciation by the partnership and on that account the second proviso to Section 10(2)(vii) of the I.T. Act, 1922 applied. The High Court in reference upheld the decision of the Tribunal and held in favour of the assessee against which the Revenue appealed to this Court. This Court after referring to Sections 46 and 48 of the Partnership Act held that on the dissolution of the partnership each theatre must be deemed to be returned to the original owner in satisfaction partially or wholly of his claim to a share in the residue of the assets after discharging the debts and other obligations. In law there was no sale or transfer by the

partnership to the individual partners in consideration of their respective share in the residue. In taking this view reliance was once again placed on the decision of this Court in *Addanki Narayanappa*.

14. In *CIT v. Bankey Lal Vaidya* [AIR 1971 SC 2270], this Court pointed out that on dissolution of partnership the assets of the firm are valued and the partner is paid a certain amount in lieu of his share of the assets, the transaction is not a sale, exchange or transfer of assets of the firm and the amount received by the partner cannot be taxed as capital gains.

15. Again in *Malabar Fisheries Co. v. CIT* [AIR 1980 SC 176], the facts were that the appellant firm which was constituted on April 1, 1959 with four partners carried on six different businesses in different names. The firm was dissolved on March 31, 1963 and under the deed of dissolution the first business concern was taken over by one of the partners, the remaining five concerns by two of the other partners and the fourth partner received his share in cash. It appears that during the assessment years 1960-61 to 1963-64 the firm had installed various items of machinery in respect of which it had received Development Rebate under Section 33 of the I.T. Act, 1961. On dissolution, the Income Tax Officer took the view that Section 34(3)(b) of the Act applied on the premiss that there was a sale or transfer of the machinery by the firm whereupon he withdrew the Development Rebate earlier allowed to the firm by amending the orders in that behalf. The appeal filed on behalf of the dissolved firm was dismissed by the Appellate Assistant Commissioner but was allowed by the Tribunal. At the instance of the Revenue a reference was made to the High Court and the High Court allowed the reference holding that there was a transfer of assets within the meaning of Section 34(3)(b). The dissolved firm approached this Court in appeal. This Court after referring to the definition of the expression 'transfer' in Section 2(47) of the Act and the case-law on the point concluded as under:

Having regard to the above discussion, it seems to us clear that a partnership firm under the Indian Partnership Act, 1932 is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm's property or firm's assets all that is meant is property or assets in which all partners have a joint or common interest. If that be the position, it is difficult to accept the contention that upon dissolution the firm's rights in the partnership assets are extinguished. The firm as such has no separate rights of its own in the partnership assets but it is the partners who own jointly in common the assets of the partnership and, therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the Act.

16. From the foregoing discussion it seems clear to us that regardless of its character the property brought into stock of the firm or acquired by the firm during its subsistence for the purposes and in the course of the business of the firm shall constitute the property of the firm unless the contract between the partners provides otherwise. On the dissolution of the firm each partner becomes entitled to his share in the profits, if any, after the accounts are settled

in accordance with Section 48 of the Partnership Act. Thus in the entire asset of the firm all the partners have an interest albeit in proportion to their share and the residue, if any, after the settlement of accounts on dissolution would have to be divided among the partners in the same proportion in which they were entitled to a share in the profit. Thus during the subsistence of the partnership a partner would be entitled to a share in the profits and after its dissolution to a share in the residue, if any, on settlement of accounts. The mode of settlement of accounts set out in Section 48 clearly indicates that the partnership asset in its entirety must be converted into money and from the pool the disbursement has to be made as set out in clause (a) and sub-clauses (i), (ii) and (iii) of clause (b) and thereafter if there is any residue that has to be divided among the partners in the proportions in which they were entitled to a share in the profits of the firm. So viewed, it becomes obvious that the residue would in the eye of law be moveable property i.e. cash, and hence distribution of the residue among the partners in proportion to their shares in the profits would not attract Section 17 of the Registration Act. Viewed from another angle it must be realised that since a partnership is not a legal entity but is only a compendious name each and every partner has a beneficial interest in the property of the firm even though he cannot lay a claim on any earmarked portion thereof as the same cannot be predicated. Therefore, when any property is allocated to him from the residue it cannot be said that he had only a definite limited interest in that property and that there is a transfer of the remaining interest in his favour within the meaning of Section 17 of the Registration Act. Each and every partner of a firm has an undefined interest in each and every property of the firm and it is not possible to say unless the accounts are settled and the residue or surplus determined what would be the extent of the interest of each partner in the property. It is, however, clear that since no partner can claim a definite or earmarked interest in one or all of the properties of the firm because the interest is a fluctuating one depending on various factors, such as, the losses incurred by the firm, the advances made by the partners as distinguished from the capital brought in the firm, etc., it cannot be said, unless the accounts are settled in the manner indicated by Section 48 of the Partnership Act, what would be the residue which would ultimately be allocable to the partners. In that residue, which becomes divisible among the partners, every partner has an interest and when a particular property is allocated to a partner in proportion to his share in the profits of the firm, there is no partition or transfer taking place nor is there any extinguishment of interest of other partners in the allocated property in the sense of a transfer or extinguishment of interest under Section 17 of the Registration Act. Therefore, viewed from this angle also it seems clear to us that when a dissolution of the partnership takes place and the residue is distributed among the partners after settlement of accounts there is no partition, transfer or extinguishment of interest attracting Section 17 of the Registration Act.

17. Strong reliance was, however, placed by the learned counsel for the respondents on two decisions of this Court, namely, (1) *Ratan Lal Sharma v. Purshottam Harit* [(1974) 1 SCC 671] and (2) *Lachhman Dass v. Ram Lal* [(1989) 3 SCC 99]. Insofar as the first-mentioned case is concerned, the facts reveal that the appellant and the respondent who had set up a partnership business in December 1962 soon fell out. The partnership had a factory and other moveable and immovable properties. On August 22, 1963, the partners entered into an agreement to refer the dispute to the arbitration of two persons and gave the arbitrators full authority to decide their dispute. The arbitrators made their award on September 10, 1963.

Under the award exclusive allotment of the partnership assets, including the factory, and liabilities, was made in favour of the appellant and it was provided that he shall be absolutely entitled to the same in consideration of a sum of Rs 17,000 plus half the amount of realisable debts of the business to the respondent. The arbitrators filed the award in the High Court on November 8, 1963. On September 10, 1964, the respondent filed an application for determining the validity of the agreement and for setting aside the award. On May 27, 1966, a learned Single Judge of the High Court dismissed the application as barred by time but declined to make the award the rule of the Court because in his view the award was void for uncertainty and created rights in favour of the appellant over immovable property worth over Rs 100 requiring registration. The Division Bench dismissed the appeal as not maintainable whereupon this Court was moved by special leave. Before this Court it was contended (i) that the award is not void for uncertainty; (ii) that the award seeks to assign the respondent's share in the partnership to the appellant and therefore does not require registration; and (iii) that under Section 17 of the Arbitration Act, the court was bound to pronounce judgment in accordance with the award. This Court while reiterating that the share of a partner in the assets of the partnership comprising even immovable properties, is moveable property and the assignment of the share does not require registration under Section 17 of the Registration Act. The legal position is thus affirmed. However, since the award did not seek to assign the share of the respondent to the appellant but on the contrary made an exclusive allotment of the partnership asset including the factory and liabilities to the appellant, thereby creating an absolute interest on payment of consideration of Rs 17,000 plus half the amount of the realisable debts, it was held to be compulsorily registrable under Section 17 of the Registration Act. The Court did not depart from the principle that the share of a partner in the asset of the partnership inclusive of immovable properties, is moveable property and the assignment of the share on dissolution of the partnership did not require registration under Section 17 of the Registration Act. The decision, therefore, turned on the interpretation of the award in regard to the nature of the assignment made in favour of the appellant. So far as the second case is concerned, we think it has no bearing since that was not a case of assignment of partnership property under a dissolution deed. In that case, the dispute was between two brothers in 2-1/2 kallas of land situate in Panipat, Haryana. The said land stood in the name of one brother - the appellant. The respondent contended that he was a benamidar and that was the dispute which was referred to arbitration. The Arbitrator made his award and applied to the Court for making it the rule of the Court. Objections were filed by the appellant raising various contentions. The award declared that half share of the ownership of the appellant shall "be now owned by Shri Ram Lal, the respondent in addition to his half share owned in those lands". Therefore, the award transferred half share of the appellant to the respondent and since the value thereof exceeded Rs 100, it was held that it required registration. It is, therefore, obvious that this case has no bearing on the point in issue herein.

18. In the present case, the Division Bench of the High Court concluded that the award required registration because of an erroneous reading of the award. The Division Bench after extensively reproducing from the Schedules 'A' to 'F' of the award proceeded to state in paragraph 39 that the allotments are exclusive to the brothers and they get independent rights of their own under the award in the properties allotted under the schedule and hence it is not a case purely of assignment of the shares in the partnership but it confers exclusive rights to the

allottees. On this line of reasoning it concluded that the award required registration. The court next pointed out in paragraph 42 of the judgment that the award also partitions certain immovable properties jointly owned by the disputants. In this connection it has placed reliance on paragraph 10(c) of the award which reads as under:

(c). Other Lands and Buildings and House properties belonging to S.V. Sivalinga Nadar & Bros. standing in the name of the firm and/or otherwise jointly owned by the disputants. These have been allotted by us to one or other or jointly to some of the disputants as per schedules annexed hereto.

The reasons which weighed with the Division Bench of the High Court in concluding that the award requires registration appear to be based on an erroneous reading of the award. We have carefully read the award and it is manifest therefrom that the Arbitrators had confined themselves to the properties belonging to the two firms in question and scrupulously avoided dealing with the properties not belonging to the firm. This is manifest from paragraphs 15 to 18 of the award. However, properties standing in the names of disputants, individually or jointly, and others as benamidars but belonging to the firm also came to be included in the distribution of the surplus partnership asset under the award. That is the purport of paragraph 10(c) extracted hereinabove. When on settlement of accounts the residue is required to be divided among the partners in proportions in which they entitled to share profits under sub-clause (iv) of clause (b) of Section 48, the properties will have to be allocated to the partners as falling to their share on the distribution of the residue and, therefore, the Arbitrators indicated in the schedules the properties falling to the share of each brother. Mere statements that a certain property will now exclusively belong to one partner or the other, as the case may be, cannot change the character of the document or the nature of assignment because that would in any case be the effect on the distribution of the residue. The property falling to the share of the partner on the distribution of the residue would naturally then belong to him exclusively but so long as in the eye of law it is money and not immovable property there is no question of registration under Section 17 of the Registration Act. Besides, as stated earlier, even if one looks at the award as allocating certain immovable property since there is no transfer, no partition or extinguishment of any right therein there is no question of application of Section 17(1) of the Registration Act. The reference to other land and buildings and house properties jointly owned by the disputants in clause (c) of paragraph 10 of the award merely indicates that certain properties belonging to the firm stood in the names of individual partners or in their joint names but they belonged to the firm and, therefore, they were taken into account for the purpose of settlement of accounts under Section 48 of the Partnership Act and distributed on the determination of the residue. The award read as a whole makes it absolutely clear that the Arbitrators had confined themselves to the properties belonging to the two firms and had scrupulously avoided other properties in regard to which they did not reach the conclusion that they belonged to the firm. On a correct reading of the award, we are satisfied that the award seeks to distribute the residue after settlement of accounts on dissolution. While distributing the residue the Arbitrators allocated the properties to the partners and showed them in the schedules appended to the award. We are, therefore, of the opinion that on a true reading of the award as a whole, there is no doubt that it essentially

deals with the distribution of the surplus properties belonging to the dissolved firms. The award, therefore, did not require registration under Section 17(1) of the Registration Act.

19. For the above reasons, we allow these appeals and set aside the impugned orders of the Division Bench and remit the matters to the Division Bench for answering the other contentions which arose in the appeal before it but which were not decided in view of its decision on the question of registration of the award. We also make it clear that the award which is pending for registration may be registered by the Sub-Registrar notwithstanding the objection raised by one of the partners, S.V. Sivalinga Nadar through his lawyer if that is the only reason for withholding registration. The appeals are allowed accordingly with costs.

* * * * *

R.D. Saxena v. Balram Prasad Sharma

(2000) 7 SCC 264

[*Papers of Clients – not goods*]

K.T. THOMAS, J. - The issue is this: has the advocate a lien for his fees on the litigation papers entrusted to him by his client?

The appellant has been practising as an advocate mostly in the courts at Bhopal, after enrolling himself as a legal practitioner with the State Bar Council of Madhya Pradesh. According to him, he was appointed as legal advisor to Madhya Pradesh State Cooperative Bank Ltd. (“the Bank”) in 1990 and the Bank continued to retain him in that capacity during the succeeding years. He was also engaged by the said Bank to conduct cases in which the Bank was a party. However, the said retainership did not last long. On 17-7-1993 the Bank terminated the retainership of the appellant and requested him to return all the case files relating to the Bank. Instead of returning the files the appellant forwarded a consolidated bill to the Bank showing an amount of Rs 97,100 as the balance payable by the Bank towards the legal remuneration to which he is entitled. He informed the Bank that the files would be returned only after settling his dues.

7. We would first examine whether an advocate has lien on the files entrusted to him by the client. Learned counsel for the appellant endeavoured to base his contention on Section 171 of the Indian Contract Act which reads thus:

“171. Bankers, factors, wharfingers, attorneys of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.”

8. Files containing copies of the records (perhaps some original documents also) cannot be equated with the “goods” referred to in the section. The advocate keeping the files cannot amount to “goods bailed”. The word “bailment” is defined in Section 148 of the Contract Act as the delivery of goods by one person to another for some purpose, upon a contract that they shall be returned or otherwise disposed of according to the directions of the person delivering them, when the purpose is accomplished. In the case of litigation papers in the hands of the advocate there is neither delivery of goods nor any contract that they shall be returned or otherwise disposed of. That apart, the word “goods” mentioned in Section 171 is to be understood in the sense in which that word is defined in the Sale of Goods Act. It must be remembered that Chapter VII of the Contract Act, comprising Sections 76 to 123, had been wholly replaced by the Sale of Goods Act, 1930. The word “goods” is defined in Section 2(7) of the Sale of Goods Act.

9. Thus understood “goods” to fall within the purview of Section 171 of the Contract Act should have marketability and the person to whom they are bailed should be in a position to

dispose of them in consideration of money. In other words the goods referred to in Section 171 of the Contract Act are saleable goods. There is no scope for converting the case files into money, nor can they be sold to any third party. Hence, the reliance placed on Section 171 of the Contract Act has no merit.

10. In England the solicitor had a right to retain any deed, paper or chattel which had come into his possession during the course of his employment. It was the position in common law and it was later recognized as the solicitor's right under the Solicitors Act, 1860. In *Halsbury's Laws of England*, it is stated thus (vide para 226 in Vol. 44):

“226. Solicitor's rights. - At common law a solicitor has two rights which are termed liens. The first is a right to retain property already in his possession until he is paid costs due to him in his professional capacity, and the second is a right to ask the court to direct that personal property recovered under a judgment obtained by his exertions stand as security for his costs of such recovery. In addition, a solicitor has by statute a right to apply to the court for a charging order on property recovered or preserved through his instrumentality in respect of his taxed costs of the suit, matter or proceeding prosecuted or defended by him.”

12. After independence the position would have continued until the enactment of the Advocates Act, 1961 which has repealed a host of enactments including the Indian Bar Council Act. When the new Bar Council of India came into existence it framed rules called the Bar Council of India Rules as empowered by the Advocates Act. Such Rules contain provisions specifically prohibiting an advocate from adjusting the fees payable to him by a client against his own personal liability to the client. As a rule an advocate shall not do anything whereby he abuses or takes advantage of the confidence reposed in him by his client (vide Rule 24). In this context a reference can be made to Rules 28 and 29 which are extracted below:

“28. After the termination of the proceeding, the advocate shall be at liberty to appropriate towards the settled fee due to him, any sum remaining unexpended out of the amount paid or sent to him for expenses, or any amount that has come into his hands in that proceeding.

29. Where the fee has been left unsettled, the advocate shall be entitled to deduct, out of any moneys of the client remaining in his hands, at the termination of the proceeding for which he had been engaged, the fee payable under the rules of the court in force for the time being, or by then settled and the balance, if any, shall be refunded to the client.”

13. Thus, even after providing a right for an advocate to deduct the fees out of any money of the client remaining in his hand at the termination of the proceeding for which the advocate was engaged, it is important to notice that no lien is provided on the litigation files kept with him. In the conditions prevailing in India with lots of illiterate people among the litigant public it may not be advisable also to permit the counsel to retain the case bundle for the fees claimed by him. Any such lien if permitted would become susceptible to great abuses and exploitation.

14. There is yet another reason which dissuades us from giving approval to any such lien. We are sure that nobody would dispute the proposition that the cause in a court/tribunal is far more important for all concerned than the right of the legal practitioner for his remuneration in respect of the services rendered for espousing the cause on behalf of the litigant. If a need arises for the litigant to change his counsel *pendente lite*, that which is more important should have its even course flow unimpeded. Retention of records for the unpaid remuneration of the advocate would impede such course and the cause pending judicial disposal would be badly impaired. If a medical practitioner is allowed a legal right to withhold the papers relating to the treatment of his patient which he thus far administered to him for securing the unpaid bill, that would lead to dangerous consequences for the uncured patient who is wanting to change his doctor. Perhaps the said illustration may be an overstatement as a necessary corollary for approving the lien claimed by the legal practitioner. Yet the illustration is not too far-fetched. No professional can be given the right to withhold the returnable records relating to the work done by him with his client's matter on the strength of any claim for unpaid remuneration. The alternative is that the professional concerned can resort to other legal remedies for such unpaid remuneration.

15. A litigant must have the freedom to change his advocate when he feels that the advocate engaged by him is not capable of espousing his cause efficiently or that his conduct is prejudicial to the interest involved in the *lis*, or for any other reason. For whatever reason, if a client does not want to continue the engagement of a particular advocate it would be a professional requirement consistent with the dignity of the profession that he should return the brief to the client. It is time to hold that such obligation is not only a legal duty but a moral imperative.

16. In civil cases, the appointment of an advocate by a party would be deemed to be in force until it is determined with the leave of the court [vide Order 3 Rule 4(1) of the Code of Civil Procedure]. In criminal cases, every person accused of an offence has the right to consult and be defended by a legal practitioner of his choice which is now made a fundamental right under Article 22(1) of the Constitution. The said right is absolute in itself and it does not depend on other laws. In this context reference can be made to the decision of this Court in *State of M.P. v. Shobharam* [AIR 1966 SC 1910]. The words "of his choice" in Article 22(1) indicate that the right of the accused to change an advocate whom he once engaged in the same case, cannot be whittled down by that advocate by withholding the case bundle on the premise that he has to get the fees for the services already rendered to the client.

17. If a party terminates the engagement of an advocate before the culmination of the proceedings that party must have the entire file with him to engage another advocate. But if the advocate who is changed midway adopts the stand that he would not return the file until the fees claimed by him are paid, the situation perhaps may turn to dangerous proportions. There may be cases when a party has no resources to pay the huge amount claimed by the advocate as his remuneration. A party in a litigation may have a version that he has already paid the legitimate fee to the advocate. At any rate if the litigation is pending the party has the right to get the papers from the advocate whom he has changed so that the new counsel can be briefed by him

effectively. In either case it is impermissible for the erstwhile counsel to retain the case bundle on the premise that fees were yet to be paid.

18. Even if there is no lien on the litigation papers of his client an advocate is not without remedies to realise the fee which he is legitimately entitled to. But if he has a duty to return the files to his client on being discharged the litigant too has a right to have the files returned to him, more so when the remaining part of the lis has to be fought in the court. This right of the litigant is to be read as the corresponding counterpart of the professional duty of the advocate.

25. We, therefore, alter the punishment to one of reprimanding the appellant. However, we make it clear that if any advocate commits this type of professional misconduct in future he would be liable to such quantum of punishment as the Bar Council will determine and the lesser punishment imposed now need not be counted as a precedent.

SETHI, J. - 31. In England also, a belief existed from the earliest times that the lawyer's fees is not a compensation to him for discharge of legal obligations but a gratuity or an honorarium which the client bestowed on him in token of his gratitude. The lawyers were considered as officers of the court, the tradition being that the law was an honorary occupation and not a means of livelihood. Early advocates were generally persons in holy orders who rendered their services to the weak and afflicted without charge and as an act of pity.

32. Under common law, the rights of a solicitor are called as liens, which are of two types namely:

(1) a "retaining lien", i.e., a right to retain property already in his possession until he has been paid costs due to him in his professional character; and

(2) a "lien on property recovered or preserved", i.e., a right to ask the court to direct that personal property recovered under a judgment obtained by his exertions stand as security for his costs of such recovery.

33. According to *Cordery on Solicitors*, 7th Edn., the retaining lien is founded on the general law of lien which springs from possession and is governed by the same rules as other cases of possessory lien. Evershed, M.R. in *Barratt v. Gough-Thomas* [(1950) 2 All ER 1048], observed:

"It is a right at common law depending, it has been said, on implied agreement. It has not the character of an encumbrance or equitable charge. It is merely passive and possessory, that is to say, the solicitor has no right of actively enforcing his demand. It confers on him merely the right to withhold possession of the documents or other personal property of his client or former client.... It is wholly derived from, and, therefore coextensive with, the right of the client to the documents or other property:"

34. According to Cordery the property upon which lien can be claimed is in the form of deeds, papers or other personal property which comes into a solicitor's possession in the course of his professional employment with the sanction of the client and/or client's property, such as bill of exchange, application of shares, share certificates, a debenture trust deed, a policy of

assurance, letters of administration or money. After referring to various authorities of English courts, the law relating to lien and its retention has been summarised in **Halsbury's Laws of England**, Vol. 44 (1), 1995 Edn., as under:

“Property affected by retaining lien.- The general rule is that the retaining lien extends to any deed, paper or personal chattel which has come into the solicitor's possession in the course of his employment and in his capacity as solicitor with the client's sanction and which is the client's property. The following may thus be subject to a retaining lien: (1) a bill of exchange; (2) a cheque; (3) a policy of assurance; (4) a share certificate; (5) an application for shares; (6) a debenture trust deed; (7) letters patent; (8) letters of administration; (9) money, including money in a client account, although only the amount due to the solicitor, and maintenance received by a solicitor if not subject to an order as to its application or bound to be applied, in effect, as trust money; or (10) documents in a drawer of which the solicitor is given the key.

The lien does not extend to (a) a client's original will; or (b) a deed in favour of the solicitor but reserving a life interest and power of revocation to the client; or (c) original court records; or (d) documents which did not come into the solicitor's hands in his capacity as solicitor for the person against whom the lien is claimed or his successor, but as mortgagee, steward of a manor or trustee. Moreover, where documents are delivered to a solicitor for a particular purpose under a special agreement which does not make express provision for a lien in favour of the solicitor, as perhaps the raising of money, or money is paid to the solicitor for a particular purpose so that he becomes a trustee of the money, no lien arises over those documents or that money unless subsequently left in the solicitor's possession for general purposes. Otherwise the lien extends to the property whatever the occasion of delivery, except that where a solicitor acts for both mortgagor and mortgagee and the mortgage is redeemed the solicitor cannot set up a lien on the deeds against the mortgagor.”

It is further stated that such a lien extends only to the solicitor's taxable costs, charges and expenses incurred on the instructions of the client against whom the lien is claimed and for which the client is personally liable including the costs of recovering the remuneration by action or upon a taxation.

35. It follows, therefore, that even under the common law no lien can be claimed with respect to the case file and such documents which are necessary for the further progress of the lis filed in the court. Even in England the right of retention has been much diluted by various exceptions created by decisions, chiefly by the courts of equity on the basis of what may be just and equitable as between the parties with conflicting interests.

39. Reference to “goods” in Section 171 of the Contract Act cannot, by any imagination, be stretched to mean the case papers, entitling their retention by the lawyer as his lien for the purposes of realising his fee. Besides the meaning attached to the “goods” under Section 2(7) of the Sale of Goods Act, under the general law the “goods” have been defined in **Bailey's Large**

Dictionary of 1732 as “merchandise” and by Johnson, who followed as the next lexicographer, it is defined to be moveables in a house; personal or immovable estates; wares, freight, merchandise. Webster defines the word “goods” thus:

“Goods, noun, plural; (1) moveables; household furniture; (2) Personal or moveable estate, as horses, cattle, utensils, etc. (3) wares; merchandise; commodities bought and sold by merchants and traders.”

40. This Court in *Union of India v. Delhi Cloth and General Mills Co. Ltd.* [AIR 1963 SC 791], held that to become “goods” an article must be something which can ordinarily come to the markets to be bought and sold. In *CCE v. Eastend Paper Industries Ltd.* [(1989) 4 SCC 244] it was stated that goods are understood to mean as identifiable articles known in the markets as goods and marketed and marketable in the market as such. Where the Act does not define “goods”, the legislature should be presumed to have used that word in its ordinary dictionary meaning i.e. to become goods it must be something which can ordinarily come to the market to be bought and sold and is known to the market as such.

41. Thus, looking from any angle, it cannot be said that the case papers entrusted by the client to his counsel are the goods in his hand upon which he can claim a retaining lien till his fee or other charges incurred are not paid. In *‘G’, a Senior Advocate of the Supreme Court, Re* [AIR 1954 SC 557], this Court observed that it was highly reprehensible for an advocate to stipulate for or receive a remuneration proportioned to the result of litigation or a claim whether in the form of a share in the subject-matter, a percentage or otherwise. An advocate is expected, at all times, to conduct himself in a manner befitting his status as an officer and a gentleman by upholding the high and honourable profession to whose privilege he has been admitted after his enrolment. If an advocate departs from the high standards which the profession has set for itself and conducts himself in a manner which is not fair, reasonable and according to law, he is liable to disciplinary action. In *M, an Advocate, Re* [AIR 1957 SC 149], this Court observed:

“As has been laid down by this Court *In the matter of ‘G’, a Senior Advocate of the Supreme Court* the Court, in dealing with cases of professional misconduct is ‘not concerned with ordinary legal rights, but with the special and rigid rules of professional conduct expected of and applied to a specially privileged class of persons who, because of their privileged status, are subject to certain disabilities which do not attach to other men and which do not attach even to them in a non-professional character... he (a legal practitioner) is bound to conduct himself in a manner befitting the high and honourable profession to whose privileges he has so long been admitted; and if he departs from the high standards which that profession has set for itself and demands of him in professional matters, he is liable to disciplinary action’. It appears to us that the fact of there being no specific rules governing the particular situation, which we are dealing with, on the facts found by us, is not any reason for accepting a less rigid standard. If any, the absence of rules increases the responsibility of the members of the profession attached to this Court as to how they should conduct themselves in such situations, having regard to the very

high privilege that an advocate of this Court now enjoys as one entitled, under the law, to practise in all the courts in India.”

42. In our country, admittedly, a social duty is cast upon the legal profession to show the people beckon (*sic* beacon) light by their conduct and actions. The poor, uneducated and exploited mass of the people need a helping hand from the legal profession, admittedly, acknowledged as a most respectable profession. No effort should be made or allowed to be made by which a litigant could be deprived of his rights, statutory as well as constitutional, by an advocate only on account of the exalted position conferred upon him under the judicial system prevalent in the country. It is true that an advocate is competent to settle the terms of his engagement and his fee by private agreement with his client but it is equally true that if such fee is not paid he has no right to retain the case papers and other documents belonging to his client. Like any other citizen, an advocate has a right to recover the fee or other amounts payable to him by the litigant by way of legal proceedings but subject to such restrictions as may be imposed by law or the rules made in that behalf. It is high time for the legal profession to join heads and evolve a code for themselves in addition to the mandate of the Advocates Act, Rules made thereunder and the Rules made by various High Courts and this Court, for strengthening the belief of the common man in the institution of the judiciary in general and in their profession in particular. Creation of such a faith and confidence would not only strengthen the rule of law but also result in reaching excellence in the profession.

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Commissioner of Sales Tax, M.P. v. M.P. Electricity Board, Jabalpur

(1969) 1 SCC 200

A.N. GROVER, J. - 5. Arguments which have been addressed by both sides have centred on question Nos. 1 and 3 which are as follows:

“(1) On the facts and circumstances of the case whether or not the Madhya Pradesh Electricity Board is a dealer within the meaning of Section 2 (c) of the C. P. and Berar Sales Tax Act, and Section 2 (d) of the Madhya Pradesh General Sales Tax Act, 1958, in respect of its activity of generation, distribution, sale and supply of electrical energy?”

(3) On the facts and circumstances of the case, whether or not steam is saleable goods and if they are saleable goods is the turnover representing the supply thereof liable to be assessed to sales tax in the hands of the assessee?”

The definition of a “dealer” is given in the two Acts substantially is that any person who carried on the business of buying, selling, supplying or distributing the goods is a “dealer” and “goods” are defined by Section 2(d) by Act XXI of 1947, as meaning all kinds of movable property other than actionable claims...and includes all material articles and commodities whether or not to be used in the construction, fitting out, improvement or repair of immovable property. The definition contained in Section 2(g) of Act II of 1959, is almost in similar terms except that certain additions are there with which we are not concerned. Reference may be made, at this stage, to the definition of “movable property” which has not been defined in the two Acts given in Section 2(24) of the Madhya Pradesh General Clauses Act. It has been defined to mean “property of every description, except immovable property”. Section 2(18) of that Act says that “immovable property” includes land, benefits to arise out of land and things attached to the earth, or permanently fastened to anything attached to the earth”.

6. The High Court went into a discussion from the point of view of mechanics relating to transmission of electric energy. It was of the view that electricity could not be regarded as an article or matter which could be possessed or moved or delivered.

7. Mr I. N. Shroff has relied on certain decisions in which the same point was involved as in the present case, namely, whether electricity is “goods” for the purpose of imposition of sales tax. In ***Kumbakonam Electric Supply Corporation Ltd. v. Joint Commercial Tax Officer, Esplanade Division, Madras*** [14 STC 600], the Madras High Court was called upon to decide whether electricity is “goods” for the purposes of the Madras General Sales Tax Act, 1959, and the Central Sales Tax Act, 1956. After referring to the definition of “goods” as given in the Sale of Goods Act, 1930, it was observed that under that definition goods must be property and it must be movable. According to the learned Madras Judge any kind of property which is movable would fall within the definition of “goods”, provided it was transmissible or transferable from hand to hand or capable of delivery which need not necessarily be in a tangible or a physical sense. Reference was also made to the definition given in the General Clauses Act which was quite wide and it was held that if electricity was property and it was movable it would be “goods”. The learned Judge found little difference between electricity and gas or water which would be

property and could be subjected to a particular process, bottled up and sold for consumption. It was observed that electricity was capable of sale as property as it was sold, purchased and consumed every where. A “dealer” was defined by the Central Sales Tax Act practically in the same way as in the Madras General Sales Tax Act and it meant a person who carried on business of buying and selling goods. In the opinion of the learned Judge the concept of dealer, goods and sale comprehended all kinds of movable property. He further relied on certain decisions which have been cited before and which will be presently noticed. A similar view was expressed by Tek Chand, J. of the Punjab and Haryana High Court in *Malerkolta Power Supply Company v. The Excise and Taxation Officer, Sangrur* [22 STC 325]. It was held that electric energy fell within the definition of “goods” in both the Punjab Sales Tax Act, 1948, and the Central Sales Tax Act, 1956. According to the learned Judge electric energy has the commonly accepted attributes of movable property. It can be stored and transmitted. It is also capable of theft. It may not be tangible in the sense that it cannot be touched without considerable danger of destruction or injury but it was perceptible both as an illuminant and a fuel and also in other energy giving forms. Electric energy may not be property in the sense of the term “movable property” as used in the Punjab and Central General Clauses Acts in contra-distinction to “immovable property” but it must fall within the ambit of “goods” even if in a sense it was intangible or invisible”. As pointed out in the Madras case the statement contained in 18 *Am. Jur.* 407 [18 AJ 407 (2 Electy)] recognises that electricity is property capable of sale and it may be the subject of larceny. In *Naini Tal Hotel v. Municipal Board* [AIR 1946 All 502], it was held that for the purpose of Article 52 of the Indian Limitation Act, electricity was property and goods. In *Erie County Natural Gas and Fuel Co. Ltd. v. Carroll* [(1911) AC 105], a question arose as to the measure of damages for a breach of contract to supply gas. Lord Atkinson delivering the judgment of the Privy Council applied the same rule which is applicable where the contract is one for sale of goods. In other words gas was treated to be “goods.”

8. The High Court, in the present case, appears to have relied on *Rash Behari v. Emperor* [AIR 1936 Cal 753], in which approval was accorded to the statement in Pollock and Mulla’s *Commentary on Sale Goods Act, 1913* that it was doubtful whether that Act was applicable to such “goods” as gas, water and electricity. The context in which this matter is discussed in the Calcutta case is altogether different and distinguishable and what was being decided there was the scope and ambit of Section 39 of the Electricity Act, 1910. As regards the entries in List II of the Seventh Schedule to the Constitution, the relevant ones may be produced:

“53. Taxes on the consumption of sale of electricity.

54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of List I.”

9. The reasoning which prevailed with the High Court was that a well-defined distinction existed between the sale or purchase of “goods” and consumption or sale of electricity otherwise there was no necessity of having Entry No. 53 but under Entry 53 taxes can be levied not only on sale of electricity but also on its consumption which could not probably have been done under

Entry 54. It is difficult to derive much assistance from the aforesaid entries. What has essentially to be seen is whether electric energy is “goods” within the meaning of the relevant provisions of the two Acts. The definition in terms is very wide according to which “goods” means all kinds of movable property. Then certain items are specifically excluded or included and electric energy or electricity is not one of them. The term “movable property” when considered with reference to “goods” as defined for the purposes of sales tax cannot be taken in a narrow sense and merely because electric energy is not tangible or cannot be moved or touched like, for instance, a piece of wood or a book it cannot cease to be movable property when it has all the attributes of such property. It is needless to repeat that it is capable of abstraction, consumption and use which, if done dishonestly, would attract punishment under Section 39 of the Indian Electricity Act, 1910. It can be transmitted, transferred, delivered, stored, possessed *etc.*, in the same way as any other movable property. Even in **Benjamin on Sale**, 8th Ed. reference has been made at p. 171 to **County of Durham Electrical, etc. Co. v. Inland Revenue** [(1909) 2 KB 604], in which electric energy was assumed to be “goods”. If there can be sale and purchase of electric energy like any other movable object, we see no difficulty in holding that electric energy was intended to be covered by the definition of “goods” in the two Acts. If that had not been the case there was no necessity of specifically exempting sale of electric energy from the payment of sales tax by making a provision for it in the schedules to the two Acts. It cannot be denied that the Electricity Board carried on principally the business of selling, supplying or distributing electric energy. It would therefore clearly fall within the meaning of the expression “dealer” in the two Acts.

10. As regards steam there has been a good deal of argument on the question whether it is liable to be assessed to sales tax in the hands of the Electricity Board. According to Mr Shroff, the Electricity Board carried on the business of selling steam to the Nepa Mills and that this has lasted for a number of years. It has been submitted that simply because the Electricity Board does not have any profit motive in supplying steam, it cannot escape payment of sales tax because the steam is nevertheless being sold as “goods”. The High Court was of the view that the water which the Nepa Mills supplied free to the Electricity Board became the property of the Board and in return for this free supply the Board agreed to give steam to Nepa Mills at a rate based solely on the coal consumed in producing steam. The mills had also agreed to reimburse the Electricity Board for the loss sustained on account of the mills not taking the “full demand of steam”. According to the High Court there was no contract for the sale of steam as such and it was only for the labour and cost involved in its supply to the mills. The High Court relied on the findings of the Tribunal on this point and held that the turnover in respect of steam was not taxable. The tribunal in its order, dated June 16, 1966, referred to certain conditions of working arrangement which was reduced to writing but which had not been properly executed as a contract which showed that the mills was supplying water free and the Electricity Board was making a prorata charge of conversion of water into steam. It seems to us that the High Court was right in coming to the conclusion, on the finding of the tribunal, that the real arrangement was for supplying steam on actual cost basis and in that sense it was more akin to a labour contract than to sale.

12. On the findings of the tribunal and the High Court, we are of the opinion that the arrangement relating to supply of steam in return for the water supplied by the mills on payment of actual cost was not one of sale but was more in the nature of a works contract. In the result, the answer of the High Court to the first question is discharged and it is held that the Electricity Board is a “dealer” within the meaning of the relevant provisions of the two Act’s in respect of its activities of generation, distribution, sale and supply of electric energy. The appeals are allowed to the extent indicated above.

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‘SALE’ AND ‘AGREEMENT TO SELL’

State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd.

1959 SCR 379

VENKATARAMA AIYAR, J. - This appeal arises out of proceedings for assessment of sales tax payable by the respondents for the year 1949-1950, and it raises a question of considerable importance on the construction of Entry 48 in List II of Schedule VII to the Government of India Act, 1935, “Taxes on the sale of goods”.

2. The respondents are a private limited company registered under the provisions of the Indian Companies Act, doing business in the construction of buildings, roads and other works and in the sale of sanitary wares and other sundry goods. Before the Sales Tax Authorities, the disputes ranged over a number of items, but we are concerned in this appeal with only two of them. One is with reference to a sum of Rs 29,51,528-7-4 representing the value of the materials used by the respondents in the execution of their works contracts, calculated in accordance with the statutory provisions applicable thereto, and the other relates to a sum of Rs 1,98,929-0-3 being the price of foodgrains supplied by the respondents to their workmen.

3. It will be convenient at this stage to refer to the provisions of the Madras General Sales Tax Act, (Mad. 9 of 1939), insofar as they are relevant for the purpose of the present appeal. Section 2(h) of the Act, as it stood when it was enacted, defined “sale” as meaning “every transfer of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration”. In 1947, the legislature of Madras enacted the Madras General Sales Tax (Amendment) Act 25 of 1947 introducing several new provisions in the Act, and it is necessary to refer to them so far as they are relevant for the purpose of the present appeal. Section 2(c) of the Act had defined “goods” as meaning “all kinds of movable property other than actionable claims, stocks and shares and securities and as including all materials, commodities and articles”, and it was amended so as to include materials “used in the construction, fitting out, improvement or repair of immovable property or in the fitting out, improvement or repair of movable property”. The definition of “sale” in Section 2(h) was enlarged so as to include “a transfer of property in goods involved in the execution of a works contract”. In the definition of “turnover” in Section 2(i), the following Explanation (1)(i) was added:

“Subject to such conditions and restrictions, if any, as may be prescribed in this behalf -
the amount for which goods are sold shall, in relation to a works contract, be deemed to be the amount payable to the dealer for carrying out such contract, *less* such portion as may be prescribed of such amount, representing the usual proportion of the cost of labour to the cost of materials used in carrying out such contract.”

A new provision was inserted in Section 2(i) defining “works contract” as meaning “any agreement for carrying out for cash or for deferred payment or other valuable consideration, the construction, fitting out, improvement or repair of any building, road, bridge or other immovable property or the fitting out, improvement or repair of any movable property”. Pursuant to the Explanation to Section 2(1)(i), a new rule, Rule 4(3), was enacted that “the amount for which goods are sold by a dealer shall, in relation to a works contract, be deemed to be the amount payable to the dealer for carrying out such contract *less* a sum not exceeding such percentage of the amount payable as may be fixed by the Board of Revenue, from time to time for different areas, representing the usual proportion in such areas of the cost of labour to the cost of materials used in carrying out such contract, subject to the following maximum percentages....”, and then follows a scale varying with the nature of the contracts.

4. It is on the authority of these provisions that the appellant seeks to include in the turnover of the respondents the sum of Rs 29,51,528-7-4 being the value of the materials used in the construction works as determined under Rule 4(3). The respondents contest this claim on the ground that the power of the Madras Legislature to impose a tax on sales under Entry 48 in List II in Schedule VII of the Government of India Act, does not extend to imposing a tax on the value of materials used in works, as there is no transaction of sale in respect of those goods, and that the provisions introduced by the Madras General Sales Tax (Amendment) Act, 1947 authorising the imposition of such tax are ultra vires. As regards the sum of Rs 1,98,929-0-3, the contention of the respondents was that they were not doing business in the sale of foodgrains, that they had supplied them to the workmen when they were engaged in construction works in out of the way places, adjusting the price therefor in the wages due to them and that the amounts so adjusted were not liable to be included in the turnover. The Sales Tax Appellate Tribunal rejected both these contentions, and held that the amounts in question were liable to be included in the taxable turnover of the respondents.

7. The sole question for determination in this appeal is whether the provisions of the Madras General Sales Tax Act are ultra vires, insofar as they seek to impose a tax on the supply of materials in execution of works contract treating it as a sale of goods by the contractor, and the answer to it must depend on the meaning to be given to the words “sale of goods” in Entry 48 in List II of Schedule VII to the Government of India Act, 1935. Now, it is to be noted that while Section 311(2) of the Act defines “goods” as including “all materials, commodities and articles”, it contains no definition of the expression “sale of goods”. It was suggested that the word “materials” in the definition of “goods” is sufficient to take in materials used in a works contract. That is so; but the question still remains whether there is a sale of those materials within the meaning of that word in Entry 48. On that, there has been sharp conflict of opinion among the several High Courts. In *Pandit Banarsi Das v. State of Madhya Pradesh* [(1955) 6 STC 93], a Bench of the Nagpur High Court held, differing from the view taken by the Madras High Court in the judgment now under appeal, that the provisions of the Act imposing a tax on the value of the materials used in a construction on the footing of a sale thereof were valid, but that they were bad insofar as they enacted an artificial rule for determination of that value by deducting out of the

total receipts a fixed percentage on account of labour charges, inasmuch as the tax might, according to that computation, conceivably fall on a portion of the labour charges and that would be ultra vires Entry 48. The entire controversy hinges on the meaning of the words “sale of goods” in Entry 48, and the point which we have now to decide is as to the correct interpretation to be put on them.

8. The contention of the appellant and of the States which have intervened is that the provisions of a Constitution which confer legislative powers should receive a liberal construction, and that, accordingly, the expression “sale of goods” in Entry 48 should be interpreted not in the narrow and technical sense in which it is used in the Indian Sale of Goods Act, 1930, but in a broad sense.

12. The contention of the appellant is well-founded that as the words “sale of goods” in Entry 48 occur in a Constitution Act and confer legislative powers on the State Legislature in respect of a topic relating to taxation, they must be interpreted not in a restricted but broad sense. And that opens up questions as to what that sense is, whether popular or legal, and what its connotation is either in the one sense or the other. Learned counsel appearing for the States and for the assesseees have relied in support of their respective contentions on the meaning given to the word “sale” in authoritative text-books, and they will now be referred to. According to Blackstone, “sale or exchange is a transmutation of property from one man to another, in consideration of some price or recompense in value”. This passage has, however, to be read distributively and so read, sale would mean transfer of property for price. That is also the definition of “sale” in **Benjamin on Sale**, 1950 Edn., p. 2. In **Halsbury’s Laws of England**, Second Edn., Vol. 29, p. 5, para 1, we have the following:

“Sale is the transfer of the ownership of a thing from one person to another for a money price. Where the consideration for the transfer consists of other goods, or some other valuable consideration, not being money, the transaction is called exchange or barter; but in certain circumstances, it may be treated as one of sale.

The law relating to contracts of exchange or barter is undeveloped, but the courts seem inclined to follow the maxim of civil law, *permutatio vicina est emptioni*, and to deal with such contracts as analogous to contracts of sale. It is clear, however, that statutes relating to sale would have no application to transactions by way of barter.”

In **Chalmer’s Sale of Goods Act**, 12th Edn., it is stated at p. 3 that “the essence of sale is the transfer of the property in a thing from one person to another for a price”, and at p. 6 it is pointed out that “where the consideration for the transfer ... consists of the delivery of goods, the contract is not a contract of sale but is a contract of exchange or barter”. In **Corpus Juris**, Vol. 55, p. 36, the law is thus stated:

“Sale” in legal nomenclature, is a term of precise legal import, both at law and in equity, and has a well defined “legal signification, and has been said to mean, at all times, a contract between parties to give and pass rights of property for money, which the buyer pays or promises to pay to the seller for the thing bought or sold.”

It is added that the word “sale” as used by the authorities “is not a word of fixed and invariable meaning, but may be given a narrow or broad meaning, according to the context”.

13. It will be seen from the foregoing that there is practical unanimity of opinion as to the import of the word “sale” in its legal sense, there being only some difference of opinion in America as to whether price should be in money or in money’s worth, and the dictionary meaning is also to the same effect. Now, it is argued by Mr Sikri, the learned Advocate-General of Punjab, that the word “sale” is, in its popular sense, of wider import than in its legal sense, and that is the meaning which should be given to that word in Entry 48, and he relies in support of this position on the observations in *Nevile Reid and Company Ltd. v. Commissioners of Inland Revenue* [(1922) 12 Tax Cas 545]. There, an agreement was entered into on April 12, 1918, for the sale of the trading stock in a brewery business and the transaction was actually completed on June 24, 1918. In between the two dates, the Finance Act, 1918, had imposed excess profits tax, and the question was whether the agreement dated April 12, 1918, amounted to a sale in which case the transaction would fall outside the operation of the Act. The Commissioners had held that as title to the goods passed only on June 24, 1918, the agreement dated April 12, 1918, was only an agreement to sell and not the sale which must be held to have taken place on June 24, 1918, and was therefore liable to be taxed. Sankey, J., agreed with this decision, but rested it on the ground that as the agreement left some matters still to be determined and was, in certain respects, modified later, it could not be held to be a sale for the purpose of the Act. In the course of the judgment, he observed that “sale” in the Finance Act should not be construed in the light of the provisions of the Sale of Goods Act, but must be understood in a commercial or business sense.

14. Now, in its popular sense, a sale is said to take place when the bargain is settled between the parties, though property in the goods may not pass at that stage, as where the contract relates to future or unascertained goods, and it is that sense that the learned Judge would appear to have had in his mind when he spoke of a commercial or business sense. But apart from the fact that these observations were *obiter*, this Court has consistently held that though the word “sale” in its popular sense is not restricted to passing of title, and has a wider connotation as meaning the transaction of sale, and that in that sense an agreement to sell would, as one of the essential ingredients of sale, furnish sufficient nexus for a State to impose a tax, such levy could, nevertheless, be made only when the transaction is one of sale, and it would be a sale only when it has resulted in the passing of property in the goods to the purchaser. It has also been held in *STO v. Messrs Budh Prakash Jai Prakash* [(1955) 1 SCR 243], that the sale contemplated by Entry 48 of the Government of India Act was a transaction in which title to the goods passes and a mere executory agreement was not a sale within that entry. We must accordingly hold that the expression “sale of goods” in Entry 48 cannot be construed in its popular sense, and that it must be interpreted in its legal sense. What its connotation in that sense is, must now be ascertained. For a correct determination thereof, it is necessary to digress somewhat into the evolution of the law relating to sale of goods.

15. The concept of sale, as it now obtains in our jurisprudence, has its roots in the Roman law. Under that law, sale, *emptio venditio*, is an agreement by which one person agrees to transfer

to another the exclusive possession (*vacuam possessionem tradere*) of something (*merx*) for consideration. In the earlier stages of its development, the law was unsettled whether the consideration for sale should be money or anything valuable. By a rescript of the Emperors Diocletian and Maximian of the year 294 A.D., it was finally decided that it should be money, and this law is embodied in the Institutes of Justinian, *vide* Title 23. *Emptio venditio* is, it may be noted, what is known in Roman law as a consensual contract. That is to say, the contract is complete when the parties agree to it, even without delivery as in contracts *re* or the observance of any formalities as in contracts *verbis* and *litteris*. The common law of England relating to sales developed very much on the lines of the Roman law in insisting on agreement between parties and price as essential elements of a contract of sale of goods. In his work on *Sale*, Benjamin observes:

“Hence it follows that, to constitute a valid sale, there must be a concurrence of the following elements viz. (1) Parties competent to contract; (2) mutual assent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer; and (4) a price in money paid or promised.”

16. Coming to the Indian law on the subject, Section 77 of the Contract Act defined “sale” as “the exchange of property for a price involving the transfer of ownership of the thing sold from the seller to the buyer”. It was suggested that under this section it was sufficient to constitute a sale that there was a transfer of ownership in the thing for a price and that a bargain between the parties was not an essential element. But the scheme of the Contract Act is that it enacts in Sections 1 to 75 provisions applicable in general to all contracts, and then deals separately with particular kinds of contract such as sale, guarantee, bailment, agency and partnership, and the scheme necessarily posits that all these transactions are based on agreements. We then come to the Indian Sale of Goods Act, 1930 (3 of 1930), which repealed Chapter 7 of the Contracts Act relating to sale of goods, and Section 4 thereof is practically in the same terms as Section 1 of the English Act. Thus, according to the law both of England and of India, in order to constitute a sale it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods which of course presupposes capacity to contract, that it must be supported by money consideration, and that as a result of the transaction property must actually pass in the goods. Unless all these elements are present, there can be no sale. Thus, if merely title to the goods passes but not as a result of any contract between the parties, express or implied, there is no sale. So also if the consideration for the transfer was not money but other valuable consideration, it may then be exchange or barter but not a sale. And if under the contract of sale, title to the goods has not passed, then there is an agreement to sell and not a completed sale.

17. Now, it is the contention of the respondents that as the expression “sale of goods” was at the time when the Government of India Act was enacted, a term of well-recognised legal import in the general law relating to sale of goods and in the legislative practice relating to that topic both in England and in India, it must be interpreted in Entry 48 as having the same meaning as in

the Sale of Goods Act, 1930, and a number of authorities were relied on in support of this contention.

21. On the basis of the authorities, the respondents contend that the true interpretation to be put on the expression “sale of goods” in Entry 48 is what it means in the Indian Sale of Goods Act, 1930, and what it has always meant in the general law relating to sale of goods. It is contended by the appellant - and quite rightly - that in interpreting the words of a Constitution the legislative practice relative thereto is not conclusive. But it is certainly valuable and might prove determinative unless there are good reasons for disregarding it, and in *STO v. Budh Prakash Jai Prakash*, it was relied on for ascertaining the meaning and true scope of the very words which are now under consideration. There, in deciding that an agreement to sell is not a sale within Entry 48, this Court referred to the provisions of the English Sale of Goods Act, 1893, the Indian Contract Act, 1872, and the Indian Sale of Goods Act, 1930, for construing the word “sale” in that Entry and observed:

“Thus, there having existed at the time of the enactment of the Government of India Act, 1935, a well-defined and well-established distinction between a sale and an agreement to sell, it would be proper to interpret the expression “sale of goods” in entry 48 in the sense in which it was used in legislation both in England and India and to hold that it authorises the imposition of a tax only when there is a completed sale involving transfer of title.”

This decision, though not decisive of the present controversy, goes far to support the contention of the respondents that the words “sale of goods” in Entry 48 must be interpreted in the sense which they bear in the Indian Sale of Goods Act, 1930.

22. The appellant and the intervening States resist this conclusion on the following grounds:

(1) The provisions of the Government of India Act, read as a whole, show that the words “sale of goods” in Entry 48 are not to be interpreted in the sense which they have in the Sale of Goods Act, 1930;

(2) The legislative practice relating to the topic of sales tax does not support the narrow construction sought to be put on the language of Entry 48;

(3) The expression “sale of goods” has in law a wider meaning than what it bears in the Sale of Goods Act, 1930, and that is the meaning which must be put on it in Entry 48; and

(4) The language of Entry 48 should be construed liberally so as to take in new concepts of sales tax.

(1) As regards the first contention, the argument is that in the Government of India Act, 1935, there are other provisions which give a clear indication that the expression “sale of goods” in Entry 48 is not to be interpreted in the sense which it bears in the Sale of Goods Act, 1930. That is an argument open to the appellant, because rules of interpretation are only aids for ascertaining the true legislative intent and must yield to the context, where the contrary clearly appears. Now, what are the indications contra? Section 311(2) of the Government of India Act defines

“agricultural income” as meaning “agricultural income as defined for the purposes of the enactments relating to Indian income tax”. It is said that if the words “sale of goods” in Entry 48 were meant to have the same meaning as those words in the Sale of Goods Act, that would have been expressly mentioned as in the case of definition of agricultural income, and that therefore that is not the meaning which should be put on them in that Entry.

In our opinion, that is not the inference to be drawn from the absence of words linking up the meaning of the word “sale” with what it might bear in the Sale of Goods Act. We think that the true legislative intent is that the expression “sale of goods” in Entry 48 should bear the precise and definite meaning it has in law, and that that meaning should not be left to fluctuate with the definition of “sale” in laws relating to sale of goods which might be in force for the time being. It was then said that in some of the Entries, for example, Entries 31 and 49, List II, the word “sale” was used in a wider sense than in the Sale of Goods Act, 1930. Entry 31 is “intoxicating liquors and narcotic drugs, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors, opium and other narcotic drugs....” The argument is that “sale” in the Entry must be interpreted as including barter, as the policy of the law cannot be to prohibit transfers of liquor only when there is money consideration therefor. But this argument proceeds on a misapprehension of the principles on which the Entries are drafted. The scheme of the drafting is that there is in the beginning of the Entry words of general import, and they are followed by words having reference to particular aspects thereof. The operation of the general words, however, is not cut down by reason of the fact that there are sub-heads dealing with specific aspects. In *Manikkasundara v. R.S. Nayudu* [(1946) FCR 67, 84], occur the following observations:

“The subsequent words and phrases are not intended to limit the ambit of the opening general term or phrase but rather to illustrate the scope and objects of the legislation envisaged as comprised in the opening term or phrase.”

A law therefore prohibiting any dealing in intoxicating liquor, whether by way of sale or barter or gift, will be intra vires the powers conferred by the opening words without resort to the words “sale and purchase”. Entry 49 in List II is “Cesses on the entry of goods into a local area for consumption, use or sale therein”. It is argued that the word “sale” here cannot be limited to transfers for money or for even consideration. The answer to this is that the words “for consumption, use or sale therein” are a composite expression meaning octroi duties, and have a precise legal connotation, and the use of the word “sale therein” can throw no light on the meaning of that word in Entry 48. We are of opinion that the provisions in the Government of India Act, 1935 relied on for the appellant are too inconclusive to support the inference that “sale” in Entry 48 was intended to be used in a sense different from that in the Sale of Goods Act.

(2) It is next urged that for determining the true meaning of the expression “Taxes on the sale of goods” in Entry 48 it would not be very material to refer to the legislative practice relating to the law in respect of sale of goods. It is argued that “sale of goods” and “taxes on sale of goods” are distinct matters, each having its own incidents, that the scope and object of legislation in

respect of the two topics are different, that while the purpose of a law relating to sale of goods is to define the rights of parties to a contract, that of a law relating to tax on sale of goods is to bring money into the coffers of the State, and that, accordingly, legislative practice with reference to either topic cannot be of much assistance with reference to the other. Now, it is true that the object and scope of the two laws are different, and if there was any difference in the legislative practice with reference to these two topics, we should, in deciding the question that is now before us, refer more appropriately to that relating to sales tax legislation rather than that relating to sale of goods. But there was, at the time when the Government of India Act was enacted, no law relating to sales tax either in England or in India. The first Sales Tax law to be enacted in India is the Madras General Sales Tax Act, 1939, and that was in exercise of the power conferred by Entry 48. In England, a purchase tax was introduced for the first time only by the Finance Act 2 of 1940. The position, therefore, is that Entry 48 introduces topic of legislation with respect to which there was no legislative practice.

(3) It is next contended by Mr Sikri that though the word “sale” has a definite sense in the Sale of Goods Act, 1930, it has a wider sense in law other than that relating to sale of goods, and that, on the principle that words conferring legislative powers should be construed in their broadest amplitude, it would be proper to attribute that sense to it in Entry 48. It is argued that in its wider sense the expression “sale of goods” means all transactions resulting in the transfer of title to goods from one person to another, that a bargain between the parties was not an essential element thereof, and that even involuntary sales would fall within its connotation. He went on to state that such sale took place when the value of the goods is paid to the owner.

The Land Acquisition Act, 1894 refers to the compulsory taking over of immovable property as acquisition. In List II of the Government of India Act, this topic is described in Entry 9 as “compulsory acquisition of land.” In the Constitution, Entry 42 in List III is “acquisition and requisition of property”. The ratio on which the opinion of Lord Morton is based has no place in the construction of Entry 48, and the law as laid down by the majority is in consonance with the view taken by this Court that bargain is an essential element in a transaction of sale.

Another contention presented from the same point of view but more limited in its sweep is that urged by the learned Solicitor-General, the Advocate-General of Madras and the other counsel appearing for the States, that even in the view that an agreement between the parties was necessary to constitute a sale, that agreement need not relate to the goods as such, and that it would be sufficient if there is an agreement between the parties and in the carrying out of that agreement there is transfer of title in movables belonging to one person to another for consideration. It is argued that Entry 48 only requires that there should be a sale, and that means transfer of title in the goods, and that to attract the operation of that Entry it is not necessary that there should also be an agreement to sell those goods. To hold that there should be an agreement to sell the goods as such is, it is contended, to add to the Entry, words which are not there.

We are unable to agree with this contention. If the words “sale of goods” have to be interpreted in their legal sense, that sense can only be what it has in the law relating to sale of

goods. The ratio of the rule of interpretation that words of legal import occurring in a statute should be construed in their legal sense is that those words have, in law, acquired a definite and precise sense, and that, accordingly, the legislature must be taken to have intended that they should be understood in that sense. In interpreting an expression used in a legal sense, therefore, we have only to ascertain the precise connotation which it possesses in law. It has been already stated that, both under the common law and the statute law relating to sale of goods in England and in India, to constitute a transaction of sale there should be an agreement, express or implied, relating to goods to be completed by passing of title in those goods. It is of the essence of this concept that both the agreement and the sale should relate to the same subject-matter. Where the goods delivered under the contract are not the goods contracted for, the purchaser has got a right to reject them, or to accept them and claim damages for breach of warranty. Under the law, therefore, there cannot be an agreement relating to one kind of property and a sale as regards another. We are accordingly of opinion that on the true interpretation of the expression "sale of goods" there must be an agreement between the parties for the sale of the very goods in which eventually property passes. In a building contract, the agreement between the parties is that the contractor should construct a building according to the specifications contained in the agreement, and in consideration therefor receive payment as provided therein, and as will presently be shown there is in such an agreement neither a contract to sell the materials used in the construction, nor does property pass therein as movables. It is therefore impossible to maintain that there is implicit in a building contract a sale of materials as understood in law.

(4) It was finally contended that the words of a Constitution conferring legislative power should be construed in such manner as to make it flexible and elastic so as to enable that power to be exercised in respect of matters which might be unknown at the time it was enacted but might come into existence with the march of time and progress in science, and that on this principle the expression "sale of goods" in Entry 48 should include not only what was understood as sales at the time of the Government of India Act, 1935 but also whatever might be regarded as sale in the times to come.

24. The principle of the decisions is that when, after the enactment of a legislation, new facts and situations arise which could not have been in its contemplation, the statutory provisions could properly be applied to them if the words thereof are in a broad sense capable of containing them. The question then would be not what the framers understood by those words, but whether those words are broad enough to include the new facts. Clearly, this principle has no application to the present case. Sales tax was not a subject which came into vogue after the Government of India Act, 1935. It was known to the framers of that statute and they made express provision for it under Entry 48. Then it becomes merely a question of interpreting the words, and on the principle, already stated, that words having known legal import should be construed in the sense which they had at the time of the enactment, the expression "sale of goods" must be construed in the sense which it has in the Sale of Goods Act.

The argument is that the definition of “sale” given in the Madras General Sales Tax Act is in conflict with that given in the Sale of Goods Act, 1930, that the sale of goods is a matter falling within Entry 10 of the Concurrent List, and that, in consequence, as the Madras General Sales Tax (Amendment) Act, 1947 under which the impugned provisions had been enacted, had not been reserved for the assent of the Governor-General as provided in Section 107 (2), its provisions are bad to the extent that they are repugnant to the definition of “sale” in the Sale of Goods Act, 1930. The short answer to this contention is that the Madras General Sales Tax Act is a law relating not to sale of goods but to tax on sale of goods, and that it is not one of the matters enumerated in the Concurrent List or over which the Dominion legislature is competent to enact a law, but is a matter within the exclusive competence of the Province under Entry 48 in List II. The only question that can arise with reference to such a law is whether it is within the purview of that Entry. If it is, no question of repugnancy under Section 107 can arise.

26. It now remains to deal with the contention pressed on us by the States that even if the supply of materials under a building contract cannot be regarded as a sale under the Sale of Goods Act, that contract is nevertheless a composite agreement under which the contractor undertakes to supply materials, contribute labour and produce the construction, and that it is open to the State in execution of its tax laws to split up that agreement into its constituent parts, single out that which relates to the supply of materials and to impose a tax thereon treating it as a sale. It is said that this is a power ancillary to the exercise of the substantive power to tax sales. The respondents contend that even if the agreement between the parties could be split up in the manner suggested for the appellant, the resultant will not be a sale in the sense of the Sale of Goods Act, as there is in a works contract neither an agreement to sell materials as such, nor does property in them pass as movables.

32. The contention that a building contract contains within it all the elements constituting a sale of the materials was sought to be established by reference to the form of the action, when the claim is in *quantum meruit*. It was argued that if a contractor is prevented by the other party to the contract from completing the construction he has, as observed by Lord Blackburn in *Appleby v. Myres* claim against that party, that the form of action in such a case is for work done and materials supplied, as appears from **Bullen and Leake's Precedents of Pleadings**, 10th Edn., at pp. 285-86, and that that showed that the concept of sale of goods was latent in a building contract. The answer to this contention is that a claim for *quantum meruit* is a claim for damages for breach of contract, and that the value of the materials is a factor relevant only as furnishing a basis for assessing the amount of compensation. That is to say, the claim is not for price of goods sold and delivered but for damages. That is also the position under Section 65 of the Indian Contract Act.

33. Another difficulty in the way of accepting the contention of the appellant as to splitting up a building contract is that the property in materials used therein does not pass to the other party to the contract as movable property. It would so pass if that was the agreement between the parties. But if there was no such agreement and the contract was only to construct a building, then the

materials used therein would become the property of the other party to the contract only on the theory of accretion. When the work to be executed is, as in the present case, a house, the construction imbedded on the land becomes an accretion to it on the principle *quicquid plantatur solo, solo cedit*, and it vests in the other party not as a result of the contract but as the owner of the land. It is argued that the maxim, what is annexed to the soil goes with the soil, has not been accepted as a correct statement of the law of this country.

The decisions are concerned with rights of persons who, not being trespassers, bona fide put up constructions on lands belonging to others, and as to such persons the authorities lay down that the maxim recognised in English law, *quicquid plantatur solo, solo cedit* has no application, and that they have the right to remove the superstructures, and that the owner of the land should pay compensation if he elects to retain them. That exception does not apply to buildings which are constructed in execution of a works contract, and the law with reference to them is that the title to the same passes to the owner of the land as an accretion thereto. Accordingly, there can be no question of title to the materials passing as movables in favour of the other party to the contract. It may be, as was suggested by Mr Sastri for the respondents, that when the thing to be produced under the contract is movable property, then any material incorporated into it might pass as a movable, and in such a case the conclusion that no taxable sale will result from the disintegration of the contract can be rested only on the ground that there was no agreement to sell the materials as such. But we are concerned here with a building contract, and in the case of such a contract, the theory that it can be broken up into its component parts and as regards one of them it can be said that there is a sale must fail both on the grounds that there is no agreement to sell materials as such, and that property in them does not pass as movables.

34. To sum up, the expression "sale of goods" in Entry 48 is a *nomen juris*, its essential ingredients being an agreement to sell movables for a price and property passing therein pursuant to that agreement. In a building contract which is, as in the present case, one, entire and indivisible - and that is its norm, there is no sale of goods, and it is not within the competence of the Provincial Legislature under Entry 48 to impose a tax on the supply of the materials used in such a contract treating it as a sale.

35. This conclusion entails that none of the legislatures constituted under the Government of India Act, 1935 was competent in the exercise of the power conferred by Section 100 to make laws with respect to the matters enumerated in the lists, to impose a tax on construction contracts and that before such a law could be enacted it would have been necessary to have had recourse to the residual powers of the Governor-General under Section 104 of the Act. And it must be conceded that a construction which leads to such a result must, if that is possible, be avoided. It is also a fact that acting on the view that Entry 48 authorises it, the States have enacted laws imposing a tax on the supply of materials in works contracts, and have been realising it, and their validity has been affirmed by several High Courts. All these laws were in the statute book when the Constitution came into force, and it is to be regretted that there is nothing in it which offers a solution to the present question. We have, no doubt, Article 248 and Entry 97 in List I conferring residual power of legislation on Parliament, but clearly it could not have been intended that the

Centre should have the power to tax with respect to works constructed in the States. In view of the fact that the State Legislatures had given to the expression "sale of goods" in Entry 48 a wider meaning than what it has in the Sale of Goods Act, that States with sovereign powers have in recent times been enacting laws imposing tax on the use of materials in the construction of buildings, and that such a power should more properly be lodged with the States rather than the Centre, the Constitution might have given an inclusive definition of "sale" in Entry 54 so as to cover the extended sense. But our duty is to interpret the law as we find it, and having anxiously considered the question, we are of opinion that there is no sale as such of materials used in a building contract, and that the Provincial Legislatures had no competence to impose a tax thereon under Entry 48.

36. To avoid misconception, it must be stated that the above conclusion has reference to works contracts, which are entire and indivisible, as the contracts of the respondents have been held by the learned Judges of the Court below to be. The several forms which such kinds of contracts can assume are set out in **Hudson on Building Contracts**, at p. 165. It is possible that the parties might enter into distinct and separate contracts, one for the transfer of materials for money consideration, and the other for payment of remuneration for services and for work done. In such a case, there are really two agreements, though there is a single instrument embodying them, and the power of the State to separate the agreement to sell, from the agreement to do work and render service and to impose a tax thereon cannot be questioned, and will stand untouched by the present judgment. In the result, the appeal fails.

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STATUTORY TRANSACTIONS

Vishnu Agencies (P) Ltd. v. Commercial Tax Officer

(1978) 1 SCC 520 : AIR 1978 SC 449

Y.V. CHANDRACHUD. J. - These appeals have been placed for hearing before a seven-Judge Bench in order to set at rest to the extent foreseeable, the controversy whether what is conveniently, though somewhat loosely, called a 'compulsory sale' is exigible to sales tax. When essential goods are in short supply, various types of orders are issued under the Essential Commodities Act, 1955 with a view to making the goods available to the consumer at a fair price. Such orders sometimes provide that a person in need of an essential commodity like cement, cotton, coal or iron and steel must apply to the prescribed authority for a permit for obtaining the commodity. Those wanting to engage in the business of supplying the commodity are also required to possess a dealer's licence. The permit-holder can obtain the supply of goods, to the extent of the quantity specified in the permit, from the named dealer only and at a controlled price. The dealer who is asked to supply the stated quantity to the particular permit holder has no option but to supply the stated quantity of goods at the controlled price. The question for our consideration, not easy to decide, is whether such a transaction amounts to a sale in the language of the law.

2. We will refer to the facts of civil appeal 724 of 1976, in which a company called M/s Vishnu Agencies (Pvt.) Ltd. is the appellant. It carries on business as an agent and distributor of cement in the State of West Bengal and is a registered dealer under the Bengal Finance (Sales Tax) Act, 1941, referred to hereinafter as the Bengal Sales Tax Act. Cement being a controlled commodity, its distribution is regulated by the West Bengal Cement Control Act, 26 of 1948, referred to hereinafter as the Cement Control Act, and by the orders made under Section 3(2) of that Act. Section 3(1) of the Cement Control Act provides, inter alia, for regulation of production, supply and distribution of cement for ensuring equitable supply and distribution thereof at a fair price. By the Cement Control Order, 1948 framed under the Cement Control Act, no sale or purchase of cement can be made, except in accordance with the conditions contained in the written order issued by the Director of Consumer Goods, West Bengal or the Regional Honorary Adviser to the Government of India at Calcutta or by officers authorised by them, at prices not exceeding the notified price.

3. The appellant is a licensed stockist of cement and is permitted to stock cement in its godown, to be supplied to persons in whose favour allotment orders are issued, at the price stipulated and in accordance with the conditions of permit issued by the authorities concerned. The authorities designated under the Cement Control Order issue permits under which a specified quantity of cement is allotted to a named permit-holder, to be delivered by a named dealer at the price mentioned in the permit. A permit is generally valid for 15 days and as soon as the price of

cement allotted in favour of an allottee is deposited with the dealer, he is bound to deliver to the former the specified quantity of cement at the specified price.

5. The appellant supplied cement to various allottees from time to time in pursuance of the allotment orders issued by appropriate authorities and in accordance with the terms of the licence obtained by it for dealing in cement. The appellant was assessed to sales tax by the first respondent, the Commercial Tax Officer, Sealdah Charge, in respect of these transactions. It paid the tax but discovered on perusal of the decision of this Court in *New India Sugar Mills Ltd. v. Commr of Sales Tax* [AIR 1963 SC 1207], that the transactions were not exigible to sales tax. Pleading that the payment was made under a mistake of law, it filed appeals against the orders of assessment passed by Respondent 1. It contended in appeals before the Assistant Commissioner of Commercial Taxes that by virtue of the provisions of the Cement Control Act and the Cement Control Order, no volition or bargaining power was left to it and since there was no element of mutual consent or agreement between it and the allottees, the transactions were not sales within the meaning of the Sales Tax Act. The appellant further contended that if the transactions were treated as sales, the definition of “sale” in the Sales Tax Act was ultra vires the legislative competency of the Provincial Legislature under the Government of India Act, 1935 and of the State Legislature under the Constitution. The appellate authority rejected the first contention and upheld the assessments. It did not, as it could not, go into the second contention regarding legislative competence. The appellant adopted the statutory remedies open to it but since the arrears of tax were mounting up and had already exceeded a sum of rupees eight lacs, it filed a writ petition in the Calcutta High Court praying that the various assessment orders referred to in the edition be quashed and a writ of prohibition be issued directing the sales tax authorities to refrain from making any further assessments for the purpose of sales tax on the transactions between the appellant and the allottees.

8. Since the crux of the appellant’s contention is that the measures adopted to control the supply of cement leave no consensual option to the parties to bargain, it is necessary first to notice the relevant provisions of law bearing on the matter. The West Bengal Cement Control Act, 26 of 1948, was enacted in order to “confer powers to control the production, supply and distribution of, and trade and commerce in, cement in West Bengal”. Section 3(1) of the Act empowers the Provincial Government to provide, by order in the Official Gazette, for regulating the supply and distribution of cement and trade and commerce therein. Section 3(2) provides by clauses (b) to (e) that an order made under sub-section (1) may provide for regulating or controlling the prices at which cement may be purchased or sold and for prescribing the conditions of sale thereof; regulating by licenses, permits or otherwise, the storage, transport, movement, possession, distribution, disposal, acquisition, use or consumption of cement; prohibiting the withholding from sale of cement ordinarily kept for sale; and for requiring any person holding stock of cement to sell the whole or specified part of the stock at such prices and to such persons or classes of persons or in such circumstances, as may be specified in the order. If any person contravenes an order made under Section 3, he is punishable under Section 6 with

imprisonment for a term which may extend to three years or with fine or with both, and if the order so provides, any Court, trying such contravention, may direct that any property in respect of which the Court is satisfied that the order has been contravened shall be forfeited to the Government.

9. In exercise of the powers conferred by Section 3(1) read with clauses (b) to (a) of Section 3(2) of the Act an order which may conveniently be called the Cement Control Order was promulgated by the Governor on August 18, 1948. The relevant clauses of that order contain the following provisions: By paragraph 1, no person shall after the commencement of the order sell or store for sale any cement unless he holds a licence and except in accordance with the conditions specified in such licence obtained from the Director of Consumer Goods, West Bengal, or any officer authorised by him in writing in this behalf. By paragraph 2, no person shall dispose of or agree to dispose of any cement except in accordance with the conditions contained in a written order of the Director of Consumer Goods, West Bengal or the authorities specified in the paragraph. By paragraph 3, no person shall acquire or agree to acquire any cement from any person except in accordance with the conditions contained in a written order of the Director of Consumer Goods, West Bengal, or the authorities specified in the paragraph. By paragraph 4, no person shall sell cement at a "higher than notified price". By paragraph 8, no person or stockist who has any stock of cement in his possession and to whom a written order has been issued under paragraph 2 shall refuse to sell the same, "at a price not exceeding the notified price", and the seller shall deliver the cement to the buyer "within a reasonable time after the payment of price" By paragraph 8A, every stockist or every person employed by him shall, if so requested by the person acquiring cement from him under a written order issued under paragraph 3, weigh the cement in his presence or in the presence of his authorised representative at the time of delivery.

11. As regards the batch of appeals from Andhra Pradesh, the levy of tax was challenged by three sets of persons, the procuring agents, the rice-millers and the retailers with the difference that the procuring agents were assessed to purchase tax, while the others to sales tax under the Andhra Pradesh General Sales Tax Act, 1957. By virtue of the provisions of the Andhra Pradesh Paddy Procurement (Levy) Orders, the paddy-growers can sell their paddy to licensed procuring agents appointed by the State Government only and at the prices fixed by the Government. The agriculturist has the choice to select his own procuring agent but he cannot sell paddy to a private purchaser. The procuring agents in their turn have to supply paddy to the rice-millers at controlled prices. The millers, after converging paddy into rice, have to declare their stocks to the Civil Supplies Department. Pursuant to the orders issued by the Department, the rice-millers have to supply a requisite quantity of rice to the wholesale or retail dealers at prices fixed by the Department. Orders for such supply by the millers are passed by the authorities under the A. P. Procurement (Levy) and Restriction on Sale Order, 1957. Under this order, every miller carrying on rice-milling operations is required to sell to the agent or officer duly authorised by the Government the minimum quantities fixed by the Government at the notified price; and no miller or other person who gets his paddy milled in any rice-mill can move or otherwise dispose of the

rice recovered by milling at such rice-mill except in accordance with the directions of the Collector. A breach of these provisions is liable to be punished under Section 7 of the Essential Commodities Act, 1955 and the goods are liable to be forfeited under Section 6A of that Act. The A. P. sales tax authorities levied purchase tax on the purchase of paddy by the procuring agents from the agriculturists and they levied sales tax on the transactions relating to the supply of rice by the millers to the wholesale and retail dealers and on the sales made by the retailers to their customers. The case as regards the sales tax imposed on the transactions between the retail dealers and the consumers stood on an altogether different footing, but the writ petitions filed by the procuring agents and rice-millers raised questions similar to those involved in the writ petition filed in the Calcutta High Court.

13. We may now notice the provisions of the Sales Tax Acts. Section 2(8) of the Bengal Finance (Sales Tax) Act, 6 of 1941, defines a "sale" to mean "any transfer of property in goods for cash or deferred payment or other valuable consideration, including a transfer of property in goods involved in the execution of a contract, but does not include a mortgage, hypothecation, charge or pledge". Section 2(1) provides that the word "turnover" used in relation to any period means "the aggregate of the sale-prices or parts of sale-prices receivable, or if a dealer so elects, actually received by the dealer". By clause (h) of Section 2, "sale-price" is defined to mean the amount payable to a dealer as valuable consideration for "the sale of any goods" By Section 4(1), every dealer whose gross turnover during the year immediately preceding the commencement of the Act exceeded the taxable quantum is liable to pay tax under the Act on all "sales" effected after the date notified by the State Government.

14. Section 2(n) of the Andhra Pradesh Central Sales Tax Act, 1957 defines a "sale" as "every transfer of the property in goods by one person to another in the course of trade or commerce, for cash, or for deferred payment or for any other valuable consideration" Section 5 of that Act is the charging section.

15. According to these definitions of 'sale' in the West Bengal and Andhra Pradesh Sales Tax Acts, transactions between the appellants on one hand and the allottees or nominees on the other are patently sales because indisputably, in one case the property in cement and in the other, property in paddy and rice was transferred for cash consideration by the appellants; and in so far as the West Bengal case is concerned, property in the goods did not pass to the transferees by way of mortgage, hypothecation, charge or pledge. But that is over-simplification. To counteract what appears on the surface plain enough, learned Counsel for the appellants have advanced a twofold contention. They contend, in the first place, that the word 'sale' in the Sales Tax Acts passed by the Provincial or State Legislatures must receive the same meaning as in the Sale of Goods Act, 1930; or else, the definition of 'sale' in these Sales Tax Acts will be beyond the legislative competence of the Provincial and State Legislatures. Secondly, the appellants contend that since under the Sale of Goods Act, there can be no sale without a contract of sale and since the parties in these matters had no volition of their own but were compelled by law to supply and receive the

goods at prices fixed under the Control Orders by the prescribed authorities, the transactions between them are not sales properly so called and therefore are not exigible to sales tax.

16. For examining the validity of the first contention, it is necessary to turn to the appropriate entries in the legislative lists of the Constitution Acts, for the contention is founded on the premise that the word 'sale' which occurs in those entries must receive the same meaning as in the Sale of Goods Act, 1930 since the expression "sale of goods" was, at the time when the Government of India Act was enacted, a term of well-recognised legal import in the general law relating to sale of goods and in the legislative practice relating to that topic both in England and in Indian Entry 48 in the Provincial List, List II of Schedule VII to the Government of India Act, 1935 relates to: "Taxes on the sale of goods". Entry 54 of List II, of the Seventh Schedule to the Constitution reads to say: "Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92A of List I". We are not concerned with Entry 92A of the Union List but we may refer to it in order to complete the picture. It refers to: "Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce".

17. The contention of the appellants that the expression "sale of goods" in Entry 48 in the Provincial List of the Act of 1935 and in Entry 54 in the State List of the Constitution must receive the same meaning as in the Sale of Goods Act is repelled on behalf of the State Governments with the argument that constitutional provisions which confer legislative powers must receive a broad and liberal construction and therefore the expression "sale of goods" in Entry 48 and its successor, Entry 54, should not be construed in the narrow sense in which that expression is used in the Sale of Goods Act, 1930 but in a broad sense. The principle that in interpreting a constituent or organic statute, that construction most beneficial to the widest possible amplitude of its powers must be adopted has been examined over the years by various Courts, including this Court, and is too firmly established to merit reconsideration. The decisions have taken the view that a Constitution must not be construed in a narrow and pedantic sense, that a broad and liberal spirit should inspire those whose duty it is to interpret it, that a Constitution of a Government is a living and organic thing which of all instruments has the greatest claim to be construed *ut res magis valeat quam pereat*, that the Legislature in selecting subjects of taxation is entitled to take things as it finds them *in rerum natura* and that it is not proper that a court should deny to such a Legislature the right of solving taxation problems unfettered by *a priori* legal categories which often derive from the exercise of legislative power in the same constitutional unit.

24. In order, therefore, to determine whether there was any agreement or consensuality between the parties, we must have regard to their conduct at or about the time when the goods changed hands. In the first place, it is not obligatory on a trader to deal in cement nor on any one to acquire it. The primary fact, therefore, is that the decision of the trader to deal in an essential commodity is volitional. Such volition carries with it the willingness to trade in the commodity strictly on the terms of Control Orders. The consumer too, who is under no legal compulsion to

acquire or possess cement, decides as a matter of his volition to obtain it on the terms of the permit or the order of allotment issued in his favour. That brings the two parties together, one of whom is willing to supply the essential commodity and the other to receive it. When the allottee presents his permit to the dealer, he signifies his willingness to obtain the commodity from the dealer on the terms stated in the permit. His conduct reflects his consent. And when, upon the presentation of the permit, the dealer acts upon it, he impliedly agrees to supply the commodity to the allottee on the terms by which he has voluntarily bound himself to trade in the commodity. His conduct too reflects his consent. Thus, though both parties are bound to comply with the legal requirements governing the transaction, they agree as between themselves to enter into the transaction on statutory terms, one agreeing to supply the commodity to the other on those terms and the other agreeing to accept it from him on the very terms. It is therefore not correct to say that the transactions between the appellant and the allottees are not consensual. They, with their free consent, agreed to enter into the transactions.

25. We are also of the opinion that though the terms of the transaction are mostly predetermined by law, it cannot be said that there is no area at all in which there is no scope for the parties to bargain. The West Bengal Cement Control Act, 1948 empowers the Government by Section 3 to regulate or control the prices at which cement may be purchased or sold. The Cement Control Order, 1948 provides by paragraph 4 that no person shall sell cement at a "higher than notified price", leaving it open to the parties to charge and pay a price which is less than the notified price, the notified price being the maximum price which may lawfully be charged. Paragraph 8 of the Order points in the same direction by providing that no dealer who has a stock of cement in his possession shall refuse to sell the same "at a price not exceeding the notified price", leaving it open to him to charge a lesser price, which the allottee would be only too agreeable to pay. Paragraph 8 further provides that the dealer shall deliver the cement "within a reasonable time" after the payment of price. Evidently, within the bounds of reasonableness, it would be open to the parties to fix the time of delivery. Paragraph 8A which confers on the allottee the right to ask for weighment of goods also shows that he may reject the goods on the ground that they are short in weight just as indeed, he would have the undoubted right to reject them on the ground that they are not of the requisite quality. The circumstance that in these areas, though minimal, the parties to the transactions have the freedom to bargain militates against the view that the transactions are not consensual.

40. The resume of cases may yet bear highlighting the true principle underlying the decisions of this Court which have taken the view that a transaction which is effected in compliance with the obligatory terms of a statute may nevertheless be a sale in the eye of a law. The Indian Contract Act which was passed in 1872 contained provisions in its seventh chapter comprising Sections 76 to 123 relating to sale of goods which were repealed on the enactment of a comprehensive law of sale of goods in 1930. The Contract Act drew inspiration from the English law of contract which is almost entirely the creation of English courts and whose growth is marked by features which are peculiar to the social and economic history of England.

Historically, the English law of contract is largely founded upon the action on the case for assumpsit, where the essence of the matter was the undertaking. The necessity for acceptance of the undertaking or the promise led the earlier writers on legal theories to lay particular emphasis on the consensual nature of contractual obligations.

43. It all began with the reliance in *Gannon Dunkerley* on the statement in the Eighth Edition (1950) of **Benjamin on Sale** that to constitute a valid sale there must be a concurrence of four elements, one of which is “mutual assent”. That statement is a reproduction of what the celebrated author had said in the second and last edition prepared by himself in 1873. The majority judgment in *New India Sugar Mills* also derives sustenance from the same passage in **Benjamin’s** eighth edition. But as observed by Hidayatullah J. in his dissenting judgment in that case, consent may be express or implied and offer and acceptance need not be in an elementary form (page 510). It is interesting that the General Editor of the 1974 edition of **Benjamin’s Sale of Goods** says in the preface that the editors decided to produce an entirely new work partly because commercial institutions, modes of transport and of payment, forms of contract, types of goods, market areas and marketing methods, and the extent of legislative and governmental regulation and intervention, had changed considerably since 1868, when the first edition of the book was published. The formulations in **Benjamin’s** second edition relating to the conditions of a valid ‘sale’ of goods, which are reproduced in the eighth edition, evidently require modification in the light of regulatory measures of social control. Hidayatullah, J., in his minority judgment referred to above struck the new path; and Bachawat J. who spoke for the Court in *Andhra Sugars* went a step ahead by declaring that “the contract is a contract of sale and purchase of cane, though the buyer is obliged to give his assent under compulsion of a statute” (page 716). The concept of freedom of contract, as observed by Hegde, J. in *Indian Steel and Wire Productions*, has undergone a great deal of change even in those countries where it was considered as one of the basic economic requirements of a democratic life (page 490). Thus, in *Ridge Nominees Ltd*, the Court of Appeal, while rejecting the argument that there was no sale because the essential element of mutual assent was lacking, held that the dissent of the shareholder was overridden by an assent which the statute imposed on him, fictional though it may be, that a sale may not always require the consensual element mentioned in **Benjamin on Sale**, and that there may in truth be a compulsory sale of property with which the owner is compelled to part for a price against his will. Decisions in cases of ‘compulsory acquisition’, where such acquisition is patent as in *Kirkness* or is inferred as in *Chhitter Mal* fall in a separate and distinct class. The observations of Lord Reid in *Kirkness* that ‘sale’ is a *nomen juris* - the name of a particular consensual contract - have therefore to be understood in the context in which they were made, namely, that compulsory acquisition cannot amount to sale. In *Gannon Dunkerley*, Venkatarama Aiyar, J. was influenced largely by these observations and by the definition of ‘sale’ in **Benjamin’s** eighth edition. *Gannon Dunkerley* involved an altogether different point and is not an authority for the proposition that there cannot at all be a contract of sale if the parties to a transaction are obliged to comply with the terms of a statute. Since we are putting in a nutshell what we have discussed earlier, we would like to reiterate in the interest of

uniformity and certainty of law that, with great deference the majority decision in *New India Sugar Mills* is not good law. The true legal position is as is stated in the minority judgment in that case and in *Indian Steel and Wire Products*, *Andhra Sugars*, *Salar Jung Sugar Mills* and *Oil and Natural Gas Commission*. To the extent to which *Cement Distributors Pvt. Ltd.* is inconsistent with these judgments, it is also, with respect, not good law.

44. The conclusion which therefore emerges is that the transactions between the appellant, M/s Vishnu Agencies (Pvt.) Ltd., and the allottees are sales within the meaning of Section 2(g) of the Bengal Finance (Sales Tax) Act, 1941. For the same reasons, transactions between the growers and procuring agents as also those between the rice-millers on one hand and the whole-sellers or retailers on the other are sales within the meaning of Section 2(n) of the Andhra Pradesh General Sales Tax Act, 1957. The turnover is accordingly exigible to sales tax or purchase tax as the case may be. The appeals are accordingly dismissed.

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Coffee Board, Karnataka v. Commissioner of Commercial Taxes

AIR 1988 SC 1487

SABYASACHI MUKHARJI, J. - These appeals by certificates are from the judgment and order of the High Court of Karnataka dated August 16, 1985. By the impugned judgment and order the writ petitions filed by the Coffee Board and others were dismissed. In order to appreciate the questions involved in the decision, it may be noted that the appellant herein — Coffee Board contended that the compulsory delivery of coffee under the Coffee Act, 1942 extinguishing all marketing rights of the growers was ‘compulsory acquisition’ and not sale or purchase to attract levy of purchase tax: it was further contended that the appellant was only a ‘trustee’ or ‘agent’ of growers not exigible to purchase tax and that all export sales were ‘in the course of export’ immune to tax under Article 286 of the Constitution.

3. The power conferred on the Board under Section 25(2) of the Coffee Act, to which we will make reference later, to reject coffee offered for delivery or even the right of a buyer analogous to Section 37 of the Sale of Goods Act showed that there was an element of consensuality in the compulsory sales regulated by the Act. The amount paid by the Board to the grower under the Act was the value or price of coffee in conformity with the detailed accounting done thereto under the Act. It was further held by the High Court that the amount paid to the grower was neither compensation nor dividend. The payment of price to the grower was an important element to determine the consensuality test to find out whether there was sale under Section 4(1) of the Sale of Goods Act. The Act also ensures periodical payments of price to the growers. The Rules provide for advancing loans to growers. Therefore, according to the Division Bench of the Karnataka High Court without any shadow of doubt these elements indicated that in the compulsory sale of coffee, there was an element of consensuality. When once the Board was held to be a ‘dealer’ it also followed from the same that there was sale by the grower, purchase by the Board and then a sale by the Board. The purchases and the exports if any made by the Board thereafter on any principle would not be ‘local sales’ within the State of Karnataka. Explanation 3(2)(ii) to Section 2(1) of the Karnataka Sales Tax Act had hardly any relevance to hold that the later export sales were ‘local sales’ to avoid liability under Section 6 of the Karnataka Sales Tax Act. The direct export sales made by the appellant for the period in challenge were not ‘in the course of export’ and they did not qualify for exemption from purchase tax under Section 6 of the Karnataka Sales Tax Act. The levy of sales tax on coffee, it was held by the High Court fell, under entry 43 of the Second Schedule of the Act and it was governed by Section 5(3)(a) of the Act and not by Section 5(1) of the Act. It was further held that under Section 5 of the Central Sales Tax Act, 1956 purchases and exports made by the Coffee Board are ‘for export’ and not ‘in the course of export’ and thus did not qualify for exemption under Article 286 of the Constitution of India. It was observed by the High Court that the Board did not purchase or take delivery of any specific coffee or goods of any grower and exported the same under prior contracts of sale. The Board did not purchase any specific coffee of any specific grower for purposes of direct

exports at all. The purchases made and exports made would be 'for export' only and not 'in the course of export' to earn exemption under Article 286 of the Constitution of India. It was further held that Sections 11 and 12 of the Act which regulate the levy and payment of customs and excise duties when closely examined really established according to the High Court that what was grown by the growers and delivered to the Board was not at all compulsory acquisition but was sale. If it was compulsory acquisition and there was payment of compensation, then these provisions would not have found their places in the Coffee Act at all, according to the High Court. Levy of customs and excise duties on compensation was something unheard of, an incongruity and an anachronism in compulsory acquisition, according to the High Court.

11. The question involved in these appeals and the writ petitions is the exigibility of tax on sale if there be any, by the growers of the coffee to the Board. Basically, it must depend upon what is sale in the general context as also in the context of the relevant provisions of the Act namely, the Karnataka Sales Tax Act, 1957, as amended from time to time, ('the Karnataka Act') and the Central Sales Tax Act, 1956, ('the Central Act'). We must, however, examine these in the context of general law, namely, the Sale of Goods Act, 1930 and the concept of sale in general.

12. The essential object of the contract of sale is the exchange of property for a money price. There must be a transfer of property, or an agreement to transfer it, from one party, the seller, to the other, the buyer, in consideration of a money payment or a promise thereof by the buyer. Lord Denning, M.R., in *C.E.B. Draper & Sons Ltd. v. Edward Turner & Sons Ltd.* [(1964) 3 All ER 148], observed as follows:

“I know that often times a contract for sale is spoken of as a sale. But the word 'sale' properly connotes the transfer of the absolute or general property in a thing for a price in money [see Benjamin on Sale, 2nd edn. (1873), p. 1, quoted in *Kirkness v. John Hudson & Co.*, 1955 AC 696, 708, 719]. In this Act of 1926 I think that 'sale' is used in its proper sense to denote the transfer of property in the goods. The sale takes place at the time when the property passes from the seller to the buyer and it takes place at the place where the goods are at that time.”

Lord Denning was speaking for the English Act of 1926 for the Sale of Goods Act.

13. In the Sale of Goods Act, 1930, ('Sale of Goods Act') contract of sale of goods is defined under Section 4(1) as a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. It also stipulates by sub-section (4) of Section 4 that an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

14. **Benjamin's Sale of Goods** (2nd Edn.) states that leaving aside the battle of forms, sale is a transfer of property in the goods by one, the seller, to the other, the buyer.

15. Under the Karnataka Sales Tax Act, sale is defined under Section 2(t) as:

“‘Sale’ with all its grammatical variations and cognate expressions means every transfer of the property in goods by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration, but does not include a mortgage, hypothecation, charge or pledge.”

16. The Central Act defines “sale” as under in Section 2(g):

“ ‘Sale’, with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or for deferred payment or for any other valuable consideration, and includes a transfer of goods on the hire-purchase or other system of payment by instalments, but does not include a mortgage or hypothecation of or a charge or pledge on goods.”

17. Coffee Board is a ‘dealer’ duly registered as such under the Sales Tax Acts of all the States in which it holds auctions/maintains depots/runs coffee houses. The Board is also registered as a ‘dealer’ under the Central Sales Tax Act. The Board collects and remits sales tax on all the coffee sold by it for domestic consumption to the State in which the sale takes place. Coffee is sold through auctions held in the States of Karnataka, Tamil Nadu and Andhra Pradesh, and also through the Board’s own depots located in nine States. Sale is also effected by way of allotments to cooperative societies. The Board directly exports coffee and also sells coffee to registered exporters through separate export auctions. It may be mentioned that over 50 per cent of the coffee is produced in Karnataka and most of the Robusta variety of coffee is produced in Kerala. All the coffee produced in these States cannot be sold within the State where the coffee is produced. Coffee meant for export has also to be stored at convenient places. The Board, therefore, transfers coffee from one State to another. Sales tax is not payable or paid on the transfer of such coffee. In order to appreciate the actual controversy and the point at issue in the instant case, it is vital to appreciate the real nature of the transaction.

18. In 1966 this Court in the case of *State of Kerala v. Bhavani Tea Produce Co.* [AIR 1966 SC 677], which arose under the Madras Plantations Agricultural Income Tax Act, 1955, held that when growers delivered coffee under Section 25 of the Act to the Board all their rights therein were extinguished and the coffee vested exclusively in the Board. This Court observed that when growers delivered coffee to the Board, though the grower “does not actually sell” the coffee to the Board, there was a ‘sale’ by operation of law. This was in connection with Section 25 of the Act. The court, however, did not hold that there was a taxable ‘sale’ by the grower to the Board in the year in question. The sale, according to this Court in that case took place in earlier years in which the Agricultural Income Tax Act did not operate. All the States in which coffee is grown and all the persons concerned with the coffee industry, it is asserted on behalf of the Additional Solicitor General, understood this decision as laying down that the ‘sale by operation of law’ mentioned therein only meant the ‘compulsory acquisition’ of the coffee by the Coffee Board.

19. We are, however, bound by the clear ratio of this decision. The Court considered this question: “was there a sale to the Coffee Board?” at page 99 of the Report and after discussing

clearly said the answer must be in the affirmative. It was rightly argued, in our opinion, by Dr Chitale on behalf of the respondents that the question whether there was sale or not or whether the Coffee Board was a trustee or an agent could not have been determined by this Court, as it was done in this case unless the question was specifically raised and determined. We cannot also by-pass this decision by the argument of the learned Additional Solicitor General that Section 10 of the Act had not been considered or how it was understood by some. This decision in our opinion concludes all the issues in the instant appeal.

20. In 1970 purchase tax was introduced. The Karnataka Sales Tax Act was amended by Karnataka Act 9 of 1970 and Section 6 was substituted. The new Section 6 provided for the levy of purchase tax on every dealer who in the course of his business purchased any taxable goods in circumstances in which no tax under Section 5 was leviable and, inter alia, despatched these to a place outside the State, at the same rate at which tax would have been leviable on the sale price of such goods under Section 5 of the Karnataka Act. The delivery of coffee by the coffee growers to the Coffee Board not being treated a purchase by the Board, the State did not demand any tax from the Board in respect of such deliveries. Demands were raised for the first time in 1983. Assessments for the years up to 1975 were completed without any demand for purchase tax being raised.

21. This Court on or about April 15, 1980 in the case of *Consolidated Coffee Ltd. v. Coffee Board, Bangalore* [AIR 1980 SC 1468], held that sale of coffee at export auctions were sales which preceded the actual export and thus exempt from sales tax under Section 5(3) of the Central Sales Tax Act. The court also directed the State Governments to refund the amounts collected as sales tax on such sales and set a time limit for effecting such refunds. The Karnataka Government, as a consequence, became liable to refund to the Coffee Board about Rs 7 crores which amount in turn was to be refunded by the Board to the exporters. In 1981 the Commissioner of Sales Tax, Karnataka informed the Board by a letter that the mandatory delivery of coffee to the Board by the grower would be regarded as 'sale' and that the Board should pay purchase tax as the coffee growers, being agriculturists are not 'dealers'. It is the case of the Coffee Board that no such claim had been made at any time in the past in any of the States in India. The Commissioner issued a show cause notice proposing to reopen the assessment for the year 1974-75. In June 1982 pre-assessment notice was sent by the authorities proposing to assess the Board to purchase tax for the assessment year 1975-76 and a sum of Rs 3.5 crores was demanded as purchase tax on the coffee transferred from Karnataka to outside the State either as stock transfers or as exports directly to buyers abroad.

22. In August 1982 the Coffee Board along with two coffee growers filed writ petitions being Writ Petition Nos. 15536 to 15540 of 1982 in the High Court of Karnataka praying for a declaration that the mandatory delivery of coffee under Section 25(1) of the Act was not sale and that Section 2(t) of the Karnataka Sales Tax Act required to be struck down if the same encompassed compulsory acquisition also. The show cause notice and the pre-assessment notice were also challenged and prayers were made for quashing the same. The High Court granted

interim stay. In the meantime on or about February 3, 1983 Constitution (Forty-Sixth Amendment) Act, 1983 came into force and the definition of "Tax on sale or purchase of goods" was added by insertion of clause (29-A) in Article 366. This definition is prospective in operation. Subsequent to February 3, 1983, the Karnataka Sales Tax Act was amended by Act 10 of 1983, Act 23 of 1983 and Act 8 of 1984. The definition of 'sale' in Section 2(t), however, was not amended. That definition was amended with effect from August 1, 1985 by the Karnataka Act 27 of 1985. After hearing the State Government, the High Court made absolute the stay of further proceedings pursuant to the show cause notice of the Commissioner proposing to reopen the assessment for the year 1974-75. The court modified the stay order regarding the pre-assessment notice and permitted the completion of assessment reserving liberty to the Coffee Board to move the High Court after the assessment was completed. On May 31, 1983 assessment order was made for the year 1975-76. On or about June 17, 1983 demand for Rs 3.5 crores as arrears of tax for the assessment year 1975-76 was issued to the Coffee Board. On July 2, 1983, the High Court stayed the assessment demand for purchase tax for the assessment year 1975-76. On or about June 18, 1983 the assessment order was issued for the year 1976-77. The Board was assessed on a taxable turnover of Rs 92.99 crores and Rs 10.18 crores was assessed as tax. Of this sum, Rs 8.06 crores is the demand on account of purchase tax. Thereafter notice demanding payment of Rs 8.06 crores as arrears of tax for the assessment year 1976-77 was issued. The Coffee Board filed a writ petition in August 1983 being Writ Petition No. 13981 of 1983 challenging the assessment and the demand for the purchase tax for the assessment year 1976-77. Rule was issued and the assessment as also demand for purchase tax was stayed. In the meantime, notice of demand for Rs 8.08 crores as arrears of tax for the assessment year 1977-78 was issued. In September 1983 Writ Petition No. 17071 of 1983 was filed by the Coffee Board for the assessment year 1977-78. Rule was issued. Assessment and demand for purchase tax was stayed. Similarly, Writ Petition No. 17072 of 1983 was filed by the Coffee Board regarding assessment year 1978-79. Rule was issued. Assessment and demand for purchase tax was stayed. In the meantime in October 1983, there was another Writ Petition No. 19285 of 1983 filed challenging the demand for the purchase tax for the year 1979-80. Rule was issued. Assessment and demand was stayed. Writ Petition No. 19118 of 1983 was filed challenging the demand of purchase tax for the year 1980-81. Rule was issued. Assessment and demand for purchase tax was stayed.

23. All these writ petitions in January 1984 were referred to the Division Bench for hearing and disposal. It may be mentioned here that in or about May 1984 the Coffee Board started for the first time to collect contingency deposits to cover purchase tax liability, if any, for the period February 3, 1983 onwards subsequent to the Forty-Sixth Amendment to a limited extent. This was by a circular. It is stated that the Board withheld about Rs 6.8 crores from the pool payment to growers for the season 1982-83 for meeting in part the liability, if any, for the purchase tax for the period subsequent to February 3, 1983. The court however, in 1985 directed the appellant-Coffee Board to remit to the State Government Rs 6.8 crores. The High Court also directed the Board to remit to the State Government Rs 1.5 crores collected by the Board as contingency deposits between May and December 1984. The State Government undertook to return these

monies with interest, in the event of the writ petitions being allowed. By the judgment delivered on August 16, 1985, the High Court dismissed the writ petitions by a common judgment and various sums of money for the various years became payable as purchase tax. The said judgment is reported in Indian Law Reports, Karnataka, Vol. 36 at page 1365. These appeals challenge the said decision.

24. In view of the decision of the High Court several questions were canvassed in these appeals. The questions were: (i) Was there transfer of coffee to the Board from the coffee growers or acquisition? (ii) Was there any element of sale involved? (iii) Was the Coffee Board trustee or agent for the coffee growers for sale to the export market, and (iv) if it is sale, is it in the course of export of the goods to the territory outside India? The first and the basic question that requires to be considered in these appeals is whether the acquisition of coffee by the Board is compulsory acquisition or is it purchase or sale? As mentioned all the questions were answered by this Court in *Bhavani Tea Produce Co.* case against the appellant. We were, however, invited to compare the transaction in question with transactions in *Peanut Board v. Rockhampton Harbour Board* [(1932-33) 48 CLR 266]. Was there any mutuality? In this connection it is necessary to analyse and compare the decision of this Court in *Vishnu Agencies (Pvt.) Ltd. v. CTO* and to what extent the principles enunciated in the said decision affect the position. In order to address ourselves to the problem posed before this Court, we must bear in mind the history and the provisions of the Coffee Market Expansion Act, 1942, under which the Board was constituted, which we have already noted.

25. The control of marketing of farm produce for the economic benefit of the producers and to bring about collective marketing of the produce is a recognised feature of governments of several countries, particularly, United States of America, Britain and Australia. The object was to prevent unhealthy competition between the producers, to secure the best price for the produce in the local market, to conserve for local consumption as much produce as was needed and to make available the surplus for export outside the States and also to foreign markets. The method usually adopted to achieve the object is to establish a marketing board with power to control the price, to obtain possession of the produce and to pool it with a view to collective marketing. The legislation in this behalf is compendiously described as “pooling legislation” and is based on the fundamental idea that the collectivist economy is superior to individualistic economy. There are therefore, different marketing boards for different kinds of produce, such as sugar, dairy produce, wheat, lime fruit, apples, pears and so on. The Indian Coffee Market Expansion Act was modelled somewhat on the lines which obtained in other countries and was intended to control the development of the coffee industry and to regulate the export and sale of coffee. If, however, the transaction amounts to sale or purchase under the relevant Act then that is the end of the matter.

26. All parties drew our attention to the decision in the case of *Vishnu Agencies Pvt. Ltd.* [AIR 1978 SC 449]. There the court was concerned with the Cement Control Order and the transactions taking place under the provisions of that control order. The Cement Control Order

was promulgated under the West Bengal Cement Control Act, 1948 which prohibited storage for sale and sale by a seller and purchase by a consumer of cement except in accordance with the conditions specified in licence issued by a designated officer. It also provided that no person should sell cement at a higher price than the notified price and no person to whom a written order had been issued shall refuse to sell cement "at a price not exceeding the notified price". Any contravention of the order became punishable with imprisonment or fine or both. Under the A. P. Procurement (Levy and Restriction on Sale) Order, 1967, (CA Nos. 2488 to 2497 of 1972) every miller carrying on rice milling operation was required to sell to the agent or an officer duly authorised by the government, minimum quantities of rice fixed by the government at the notified price, and no miller or other person who gets his paddy milled in any rice mill can move or otherwise dispose of the rice recovered by milling at such rice mill except in accordance with the directions of the Collector. Breach of these provisions became punishable. It was held dismissing the appeals that sale of cement in the former case by the allottees to the permit-holders and the transactions between the growers and procuring agents as well as those between the rice millers on the one hand and the wholesalers or retailers on the other, in the latter case, were sales exigible to sales tax in the respective States. It was observed by Beg, C.J. that the transactions in those cases were sales and were exigible to tax on the ratio of *Indian Steel and Wire Products Ltd.* [AIR 1968 SC 478], *Andhra Sugars Ltd.* [AIR 1968 SC 599] and *Karam Chand Thapar* [AIR 1969 SC 343]. In cases like *New India Sugar Mills* [AIR 1963 SC 1207], the substance of the concept of a sale itself disappeared because the transaction was nothing more than the execution of an order. The Chief Justice emphasised that deprivation of property for a compensation called price did not amount to a sale when all that was done was to carry out an order so that the transaction was substantially a compulsory acquisition. On the other hand, a merely regulatory law, even if it circumscribed the area of free choice, did not take away the basic character or core of sale from the transaction. Such a law which governs a class obliges a seller to deal only with parties holding licences who may buy particular or allotted quantities of goods at specified prices, but an essential element of choice was still left to, the parties between whom agreements took place. The agreement, despite considerable compulsive elements regulating or restricting the area of his choice, might still retain the basic character of a transaction of sale. In the former type of cases, the binding character of the transaction arose from the order directed to particular parties asking them to deliver specified goods and not from a general order or law applicable to a class. In the latter type of cases, the legal tie which binds the parties to perform their obligations remains contractual. The regulatory law merely adds other obligations, such as the one to enter into such a tie between the parties. Although the regulatory law might specify the terms, such as price, the regulation is subsidiary to the essential character of the transaction which is consensual and contractual.

The parties to the contract must agree upon the same thing in the same sense. Agreement on mutuality of consideration, ordinarily arising from an offer and acceptance, imports to it enforceability in courts of law. Mere regulation or restriction of the field of choice does not take away the contractual or essentially consensual binding core or character of the transaction.

Analysing the Act, it was observed that according to the definition of “sale” in the two Acts the transactions between the appellants in that case and the allottees or nominees, as the case may be, were patently sales because in one case the property in the cement and in the other property in the paddy and rice was transferred for cash consideration by the appellants. When the essential goods are in short supply, various types of orders are issued under the Essential Commodities Act, 1955 with a view to making the goods available to the consumer at a fair price. Such orders sometimes provide that a person in need of an essential commodity like cement, cotton, coal or iron and steel must apply to the prescribed authority for a permit for obtaining the commodity. Those wanting to engage in the business of supplying the commodity are also required to possess a dealer’s licence. The permit-holder can obtain the supply of goods, to the extent of the quantity specified in the permit and from the named dealer only and at a controlled price. The dealer who is asked to supply the stated quantity to the particular permit-holder has no option but to supply the stated quantity of goods at the controlled price. Then the decisions in *State of Madras v. Gannon Dunkerley & Co. Ltd.* [AIR 1958 SC 560] and *New India Sugar Mills v. CST*, were discussed and the correctness of the view taken in the former case was doubted and the majority opinion in the latter case was overruled.

27. It was submitted by the learned Additional Solicitor General that these cases, namely, *Bhavani Tea Estate* and *Vishnu Agencies*’ would have no application within the set up of the Coffee Act because the provisions of the statute expressly provide that there could be no sale or contract of sale, yet the High Court had for purposes of sales tax assumed (notwithstanding the statutory prohibition) that the transaction contemplated by the statute in the present case, the mandatory delivery, would be a sale. It was submitted that where a statute prohibited a registered owner from selling or contracting to sell coffee from any registered estate, there could be no implication of any purchase on the part of the Coffee Board of the coffee delivered pursuant to the mandatory provisions of Section 25(1) of the Act. It was urged that Section 17 of the Coffee Act read with Sections 25 and 47 enacts what since 1944 is a total prohibition against the sale of coffee by growers and corresponding purchase of coffee from growers. In view of Section 17 read with Section 25, purchase by the Coffee Board of coffee delivered under Section 25(1) was also impliedly prohibited. It is in view of this express prohibition of sale and corresponding implied prohibition of purchase that the Act provided the only method of disposal of coffee, viz., by the delivery of all coffee to the Coffee Board with no rights attached on such delivery, save and except the statutory right under Section 34. It was also argued that the legislature has made a conscious difference between acquisition of coffee by compulsory delivery by the growers under Section 25(1) of the Act and purchase of coffee by the Board under Section 26(2) and, as such, compulsory delivery of coffee under Section 25(1) cannot constitute a sale transaction as known to law between the growers and the Coffee Board. We are, however, unable to accept the submissions of the learned Additional Solicitor General. All the four essential elements of sale - (1) parties competent to contract, (2) mutual consent - though minimal, by growing coffee under the conditions imposed by the Act, (3) transfer of property in the goods and (4) payment of price though deferred, - are present in the transaction in question. As regards the provisions under

Section 26(2) empowering the Coffee Board to purchase additional coffee not delivered for inclusion in the surplus pool, it is only a supplementary provision enabling the Coffee Board to have a second avenue of purchase, the first avenue being the right to purchase coffee under the compulsory delivery system formulated under Section 25(1) of the Act. The scheme of the Act is to provide for a single channel for sale of coffee grown in the registered estates. Hence, the Act directs the entire coffee produced except the quantity allotted for internal sale quota, if any, to be sold to the Coffee Board through the modality of compulsory delivery and imposes a corresponding obligation on the Coffee Board to compulsorily purchase the coffee delivered to the pool, except:

- (1) where the coffee delivered is found to be unfit for human consumption: and
- (2) where the coffee estate is situated in a far off and remote place or the coffee grown in an estate is so negligible as to make the sale or coffee through compulsory delivery an arduous task and an uneconomical provision.

28. Since all persons including the Coffee Board are prohibited from purchasing/selling coffee in law, there could be no sale or purchase to attract the imposition of sales/purchase tax it was urged. Even if there was compulsion there would be a sale as was the position in *Vishnu Agencies*". This Court therein approved the minority opinion of Hidayatullah, J. in *New India Sugar Mills v. CST*. In the nature of the transactions contemplated under the Act mutual assent either express or implied is not totally absent in this case in the transactions under the Act. Coffee growers have a volition or option, though minimal or nominal to enter into the coffee growing trade. Coffee growing was not compulsory. If anyone decides to grow coffee or continue to grow coffee, he must transact in terms of the regulation imposed for the benefit of the coffee growing industry. Section 25 of the Act provides the Board with the right to reject coffee if it is not up to the standard. Value to be paid as contemplated by the Act is the price of the coffee. Fixation of price is regulation but is a matter of dealing between the parties. There is no time fixed for delivery of coffee either to the Board or the curer. These indicate consensuality which is not totally absent in the transaction.

29. It was urged that regard having been to the sovereign nature of the power exercised by the Coffee Board and the scheme of the Coffee Act, the ratio of *Vishnu Agencies* will not apply to the acquisition of coffee under Section 25(1) by the Coffee Act. It is in this connection appropriate to refer to the question of compulsory acquisition and this naturally leads to the problem of exercising eminent domain by the State. It is trite knowledge that eminent domain is an essential attribute of sovereignty of every state and authorities are universal in support of the definition of eminent domain as the power of the sovereign to take property for public use without the owner's consent upon making just compensation. Nichols on *Eminent Domain* (1950 edn.) a classic authority on the subject, defines 'eminent domain' as 'the power of the sovereign to take property for public use without the owner's consent'; see para 1.11 page 2 of Vol. 1 which elaborates the same in these words:

“This definition expresses the meaning of the power in its irreducible terms: (a) Power to take, (b) Without the owner’s consent, (c) For the public use.

All else that may be found in the numerous definitions which have received judicial recognition is merely by way of limitation or qualification of the power. As a matter of pure logic it might be argued that inclusion of the term ‘for the public use’ is also by way of limitation. In this connection, however, it should be pointed out that from the very beginning of the exercise of the power the concept of the ‘public use’ has been so inextricably related to a proper exercise of the power that such element must be considered as essential in any statement of its meaning. The ‘public use’ element is set forth in some definitions as the ‘general welfare’, the ‘welfare of the public’, the ‘public good’, the ‘public benefit’ or ‘public utility or necessity’.

It must be admitted, despite the logical accuracy of the foregoing definition and despite the fact that the payment of compensation is not an essential element of the meaning of eminent domain, that it is an essential element of the valid exercise of such power. Courts have defined eminent domain so as to include this universal limitation as an essential constituent of its meaning. It is much too late in the historical development of this principle to find fault with such judicial utterances. The relationship between the individual’s right to compensation and the sovereign’s power to condemn is discussed in Thayer’s *Cases on Constitutional Law*. ‘But while obligation (to make compensation) is thus well established and clear let it be particularly noticed upon what ground it stands, viz. upon the natural rights of the individual. On the other hand, the right of the State to take springs from a different source, viz. a necessity of government. These two, therefore, have not the same origin; they do not come, for instance, from any implied contract between the State and the individual, that the former shall have the property, if it will make compensation; the right is no mere right of pre-emption, and it has no condition of compensation annexed to it, either precedent or subsequent. But, there is a right to take, and attach to it as an incident, an obligation to make compensation; this latter, morally speaking, follows the other, indeed like a shadow, but it is yet distinct from it, and flows from another source.

30. It is concluded thus:

Accordingly, it is now generally considered that the power of eminent domain is not a property right, or an exercise by the state of an ultimate ownership in the soil, but that it is based upon the sovereignty of the state. As the sovereign power of the State is broad enough to cover the enactment of any law affecting persons or property within its jurisdiction which is not prohibited by some clause of the Constitution of the United States, and as the taking of property within the jurisdiction of a state for the public use upon payment of compensation is not prohibited by the Constitution of the United States, it necessarily follows that it is within the sovereign power of a state, and it needs no additional justification.

31. Cooley in his treatise on the *Constitutional Limitations* Chapter XV expressed the same view at page 524 of the book in these words:

“More accurately, it is the rightful authority which must rest in every sovereignty to control and regulate those rights of a public nature which pertain to its citizens in common and to appropriate and control individual property for the public benefit, as the public safety, convenience or necessity may demand.”

33. This Court in the *State of Karnataka v. Ranganatha Ready* [AIR 1978 SC 215], held that the power of acquisition could be exercised both in respect of immovable and movable properties.

34. While conceding the power of acquisition of coffee in exercise of eminent domain, the scheme contemplated under the Act was not an exercise of eminent domain power. The Act was to regulate the development of coffee industry in the country. The object was not to acquire coffee grown and vest the same in the Board. The Board is only an instrument to implement the Act.

39. We accept the submission of the learned Additional Solicitor General that it is not necessary that every member of the public should benefit from property that is compulsorily acquired. But in essence the scheme envisaged is sale - and not compulsory acquisition.

40. It has also to be borne in mind that the terms ‘sale’ and ‘purchase’ have been used in some of the provisions and that is indicative that no compulsory acquisition was intended.

41. Section 34 of the Act reads as follows:

“34.(1) The Board shall at such times as it thinks fit make to registered owners who have delivered coffee for inclusion in the surplus pool such payments out of the pool fund as it may think proper.

(2) The sum of all payments made under sub-section (1) to any one registered owner shall bear to the sum of the payments made to all registered owners the same proportion as the value of the coffee delivered by him out of the year’s crop to the surplus pool bears to the value of all coffee delivered to the surplus pool out of that year’s crop.

42. The High Court has referred to the provisions of Section 34(2) of the Act and observed that the said provisions ensure periodical payments of price to the growers. The rules provide for advancing loans to the growers. Without a shadow of doubt these elements indicate, according to the High Court, that in the compulsory sale of coffee, there was an element of consensuality. We are in agreement that there is consensuality in the scheme of the section. The High Court has referred to Section 25(2) of the Coffee Act and observed that the power conferred by Section 25(2) of the Coffee Act must be read subject to the very requirement of that and all other provisions of the Act. When a grower sells coffee that has become totally unfit for human consumption for one or the other valid reason, such a grower cannot compel the Board to purchase such coffee on the ground that it was coffee and thus endanger public safety and also pay its value or price. In the very nature of things, these things cannot be foreseen or enumerated

exhaustively. The High Court was of the view that if a grower delivered coffee to the Board, the Coffee Act extinguished his title and absolutely vested the same in the Board, however, preserving his right for payment of its value or its price in accordance with the provisions of that Act. According to the High Court the amount paid by the Board to the grower under the Act is the value or price of coffee in conformity with the detailed accounting done thereto under the Coffee Act. The High Court was right. The High Court went on to observe that the amount paid to the grower was neither compensation nor dividend. The payment of price to the grower is an important element to determine the consensuality in the sale and the sale itself is under Section 4(1) of the Sale of Goods Act. Therefore, the High Court was of the view that neither Section 25(2) read with Section 17 nor the provisions for payment of compensation indicate that coffee becomes the property of the Coffee Board not by consent but by the operation of law.

43. The levy of duties of excise and customs under Sections 11 and 12 of the Coffee Act are inconsistent with the concept of compulsory acquisition. Section 13(4) of the Coffee Act clearly fixes the liability for payment of duty of excise on the registered owner of the estate producing coffee. The Board is required to deduct the amount of duty payable by such owner from the payment to the grower under Section 34 of the Act. The duty payable by the grower is a first charge on such Pool payment becoming due to the grower from the Board. Section 11 of the Act provides for levy of duty of customs on coffee exported out of India. This duty is payable to the customs authorities at the time of actual export. The levy and collection of this duty is not unrelated to the delivery of the coffee by the growers to the Board or the pool payments made by the Board to the growers. The duty of excise as also the duty of customs are duties levied by Parliament in exercise of its powers of taxation. It is not a levy imposed by the Board. It is a fact that the revenue realised from the levy of these duties form part of the Consolidated Fund of India and can be utilised for any purpose. It may be utilised for the purpose of the Coffee Act only if Parliament by appropriation made by law in this regard so provides. The true principle or basis in *Vishnu Agencies* case applies to this case. Offer and acceptance need not always be in an elementary form, nor does the law or contract or of sale of goods require that consent to a contract must be express. Offer and acceptance can be spelt out from the conduct of the parties which cover not only their acts but omissions as well. The limitations imposed by the Control Order on the normal right of the dealers and consumers to supply and obtain goods, the obligations imposed on the parties and the penalties prescribed by the order do not militate against the position that eventually, the parties must be deemed to have completed the transaction under an agreement by which one party binds itself to supply the stated quantity of goods to the other at a price not higher than the notified price and the other party consents to accept the goods on the terms and conditions mentioned in the permit or the order of allotment issued in its favour by the concerned authority.

44. A contract whether express or implied between the parties for the transfer of the property in the goods for a price paid or promised is an essential requirement for a 'sale'. In the absence of a contract whether express or implied, it is true, there cannot be any sale in the eyes of law.

However, as we see the position and the scheme of the Act, in the instant case, there was contract as contemplated between the growers and the Coffee Board. This Court applied in *Vishnu Agencies* case the consensual test laid down in the earlier decision of this Court in the *State of Madras v. Gannon Dunkerley* in this regard. In law there cannot be a sale whether or not compulsory, in the absence of a contract express or implied. The position of the Coffee Board so far as sale is concerned is explained by the Madras High Court very lucidly in *Indian Coffee Board, Batlagundu v. State of Madras*, where the High Court expressed the view that the Indian Coffee Board which derived its existence from the Coffee Market Expansion Act is a dealer within the meaning of Section 2 (b) of the Madras General Sales Tax Act, 1939, and is therefore, liable to sales tax on its turnover. The High Court held that the Board was not a constituted representative of the producer and it did not hold the goods on behalf of the producer. After the goods enter the pool after delivery, they become the absolute property of the Board and the producer, a registered owner, has no right or claim to the goods except to a share in the sale proceeds after the goods are sold in accordance with the provisions of the Act.

45. It was said by the learned Additional Solicitor General that the cultivation of coffee in India was over a century old and numerous plantations existed long prior to the enactment of the Coffee Act. There was no act of volition on the part of the growers in taking to coffee cultivation and subjecting themselves to the provisions of the Act by taking up such cultivation. The cultivation of coffee can be carried on only in certain types of soil and in high elevations. The land suited for coffee cultivation cannot be used for growing other crops on a similar scale. Coffee is a perennial crop. The growers have no choice in growing coffee one year and then changing to a different crop in the following year. Coffee plants have a life ranging from 30 to 70 years, the average life of the plant being 40 years. Coffee estates require constant attention and expenses have to be incurred for manuring, cultural operations, application of pesticides, etc. at regular intervals. Removal of old and diseased plants and replanting them with superior disease-resistant varieties is also necessary and is done each year. The coffee grower has thus no choice at all in continuing to be a coffee cultivator, it was argued. The cultivation of coffee is not in any way comparable to the cultivation of sugarcane, the cultivation of which can be discontinued at will. Such practical difficulties, however, do not in essence make any difference.

47. The coffee growers being agriculturists are not dealers and therefore are not liable to pay any sales tax or purchase tax, it was submitted. The demand for purchase tax is in effect a demand on the growers who were exempt from such levy, as the monies required for paying the tax if the same is lawful has necessarily to come out of the monies otherwise payable to the growers. The object of the pool marketing system is not to deprive the growers of a fair compensation for their produce by making them suffer a tax which they would not otherwise be required to suffer. An analysis of the different provisions of the Coffee Act makes it clear that there was no sale to attract exigibility to duty, it was submitted. We are unable to accept these submissions. Section 6 of the Karnataka Sales Tax Act, 1957 meets the situation created by such circumstances. This was examined by this Court in *State of Tamil Nadu v. M.K. Kandaswami* [AIR 1975 SC 1871],

which examined Section 7-A of Tamil Nadu General Sales Tax Act, 1959 - which was in pari materia with Section 6 of the Karnataka Sales Tax Act. In that view of the matter Section 6 of the Karnataka Act would be attracted.

48. The alternative submission of the appellant was that the Coffee Board was a trustee or agent of the growers'. We are unable to accept this submission either. There is no trust created in the scheme of the Act in the Coffee Board: it is a statutory obligation imposed on the Coffee Board and does not make it a trustee in any event. It is also not possible to accept the submission that the Central Sales Tax Act will not be applicable to any sale by the Coffee Board because it was an export sale by the Coffee Board.

50. In the aforesaid view of the matter, we are of the opinion that the imposition of tax in the manner done by the sales tax authorities which has been upheld by the High Court is correct and the High Court was right. The appeals fail and are dismissed.

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CONTRACT FOR WORKS/LABOUR

Commr. of Commercial Taxes v. Hindustan Aeronautics Ltd.

(1972) 1 SCC 395 : AIR 1972 SC 744

S. M. SIKRI, C. J. - In this appeal by certificate granted by the High Court of Mysore the only question involved is whether the delivery by the respondent -Hindustan Aeronautics Ltd. (the assessee) to the Railway Board of railway coaches model 407,408 and 411 is liable to sales-tax under the Central Sales Tax Act.

2. The Commercial Tax Officer, by assessment order, dated March 28, 1964, in respect of the assessment year 1958-59, included the turnover in respect of the supply of these coaches. The Sales Tax Officer rejected the contention of the assessee that there was no sale involved in the execution of the works-contract.

3. In appeal, the Deputy Commissioner of Commercial Taxes confirmed the order. In revision the Commissioner of Commercial Taxes also came to the same conclusion. He, therefore, confirmed the appellate order of the Deputy Commissioner.

4. The assessee then took an appeal to the High Court of Mysore under Section 24(1) of the Mysore Sales Tax Act, read with Section 9(3) of the Central Sales Tax Act. The High Court was not satisfied with the material on record and directed that a report be sent on three points, viz:

“(i) Whether and if so to what extent the assessee has drawn advance payment from the Railway Board in respect of the material utilised for completing the contracts in question;

(ii) Whether any material, in respect of which no advance have been drawn, has been utilised by the assessee for completing the contracts; and

(iii) Whether the assessee has used for completing the contracts any material not specifically procured for the purposes of completing the contracts.”

5. The Commercial Tax Officer submitted his report, and certain extracts may be reproduced below:

“My findings revealed that as and when they purchased materials, they sent to the Railway Board “an invoice” accompanied by a list of the details regarding the materials purchased. 90 per cent. of the value of these materials was then paid to the company after inspection of the materials by the Board’s representative.

Invoice No. 31009 of October 15, 1956, is obtained as a sample. This invoice shows that materials for the value of Rs 2,60,374-12-0 were purchased by the company for 407 model coaches. The details of the materials are given in list attached to the invoice. The invoice and the list were sent to the Board with a covering letter, dated October 15, 1956, asking payment of Rs 2,34,517-4-0 being 90 per cent of the invoice amount. The amount

of this invoice is included in the Board's remittance note No. 1290 of October 30, 1956, and a cheque was issued to the company for the total of several such invoices. The amount of the cheque received on October 30, 1956, was Rs 22,90,719-0-0."

He concluded:

"(1) It is not possible to specify the exact amount received from the Board as advance payments. It is said that the construction was spread out more than one year and a running account was maintained showing the debits and credits for this coaches.

(2) It is said that no materials, for which advance was not drawn, was utilised for building the coaches.

(3) It is not possible to find out whether any materials not specifically procured for the construction of coaches were used. But it is said that there is no possibility of any other materials being used for this construction. The constructions are said to be done at particular shed which is separately located. No other work is undertaken in this section. All the materials procured for construction of coaches are said to be kept separately in this section alone. Materials not connected with this work are not mixed up with the materials in this section. Separate stock registers are maintained for this section. Receipts and issues of materials for the constructions of coaches are being accounted for in this register under code numbers."

6. The High Court allowed the appeal and set aside the order including the turnover relating to the construction of railway coaches, models 407, 408 and 411. Facts found by the High Court and as they appear to us are as follows.

7. On February 3, 1955, the Ministry of Railways wrote to the Hindustan Aircraft Ltd. regarding the coaching programme 1955-56.

8. After discussions and settlement of terms between officers of the Government of India and of the assessee, the Railway Board placed orders with the assessee. The terms agreed between the parties are found stated in a letter of the Government of India, Ministry of Railways (Railway Board) No. 57/142/RE(163), dated May 4, 1957. This relates to the first of the models 407.

9. There is an indemnity bond in respect of this contract.

12. On these facts we have to decide whether there has been any sale of the coaches within the meaning of the Central Sales Tax Act. We were referred to a number of cases of this Court and the High Courts, but it seems to us that the answer must depend upon the terms of the contract. The answer to the question whether it is a works contract or it is a contract of sale depends, upon the construction of the terms of the contract in the light of the surrounding circumstances. In this case the salient features of the contract are as follows:

(1) The Railway books capacity of the assessee for the purpose of construction of railway coaches.

(2) Advance on account is made to the extent of 90% of the value of the material on the production of a certificate by the inspecting authority.

(3) The material used for the construction of coaches before its use is the property of the Railway. This is quite clear from para 1 of the Idemnity Bond set out above. No other meaning can be given to the words in the bond to the effect that “the Hindustan Aircraft Ltd. hereby undertake to hold at their works at Bangalore for and on behalf of the President of the Union of India and as his property in trust for him the Stores and articles in respect of which advances are made to them”.

It seems to us clear that the property in the materials which are used for the construction of the coaches becomes the property of the President before it is used.

(4) It seems that there is no possibility of any other material being used for the construction as is borne out from the report written by the Commercial Tax Officer.

(5) As far as the coaches of models 407 and 408 are concerned, the wheelsets and underframes are supplied free of cost.

(6) In the order the words used are “manufacture and supply of the following coaches”.

(7)The material and wage escalator and adjustments which are mentioned in the contract are natural factors.

13. On these facts it seems to us that it is a pure works contract. We are unable to agree that when all the material used in the construction of a coach belongs to the Railways there can be any sale of the coach itself. The difference between the price of a coach and the cost of material can only be the cost of services rendered by the assessee. If it is necessary to refer to a case which is close to the facts of this case, then this case is more in line with the decision of this Court in *State of Gujarat v. Kailash Engineering Co.* [19 STC 13] than any other case.

14. The only difference as far as coach model No. 411 is concerned is that in that case the wheelsets and underframes are not supplied free of cost but otherwise there is no essential difference in the terms. This does not make any difference to the result.

15. In the result the appeal fails and is dismissed with costs.

* * * * *

Sentinel Rolling Shutters and Engg. Co. (P) Ltd. v. CST

(1978) 4 SCC 260 : AIR 1978 SC 545

P.N. BHAGWATI, J. - This appeal by special leave raises the vexed question whether a particular contract is a contract of sale or a contract of work and labour. This has always been a difficult question, because most of the cases which come before the Court are border line cases and the decisions given by courts are by no means uniform. But so far as the present case is concerned, it does not present any serious difficulty and is comparatively free from complexity or doubt, for there is a decision of this Court which is directly applicable and is determinative of the controversy between the parties.

2. The assessee who is the appellant before us is a private limited company carrying on business as engineers, contractors, manufacturers and fabricators and in the course of its business, it entered into a contract dated June 28, 1972 with M/s C.M. Shah & Co. (P) Ltd. (hereinafter referred to as the Company) for fabrication, supply, erection and installation of Sentinels Pull and Push Type and Reduction Gear Type Rolling Shutters in shed Nos. 3 and 4 of the Sidheswar Sahakari Sakar Karkhana belonging to the company. The detailed specifications of the rolling shutters were given in the contract and the price was stipulated to be Rs 7 per sq. ft. and rt. for Pull and Push Type Rolling Shutters and Rs 9 per sq. rt. and ft. for the Reduction Gear Type Rolling Shutters, the price in both cases being inclusive of "erection at site". The contract was expressed to be subject to the terms and conditions set out in a printed form and there were also certain special terms and conditions which were specifically written out in the contract. Since considerable reliance was placed on behalf of the Revenue on some of the printed terms and conditions of the contract, we shall set them out in extenso:

2. Once the delivery of the goods is effected, rejection claims cannot be entertained.

4. All erection work shall be carried out at-customer's own risk and no claim for incidental structural breakages, damages to the property of the customers or others shall be entertained. All masonry works required before and or after erection shall be carried out by customers at own cost.

10. All payment shall be on overall measurements only. Customer desiring to check the correctness of the overall measurements shall notify their intention in advance and shall get the measurements checked before installation. No dispute on this ground shall be entertained once the erection is completed.

12. Terms of Business: 50 per cent advance with the order and the balance against delivery of the goods ex-work prior to erection, or against through Banks.

The special terms and conditions provided that the actual transportation charges would be in addition to the price stipulated in the contract and the delivery would be 6/8 weeks ex-works from the date of receipt of the final confirmation of the order. The terms of payment also formed part of the special terms and conditions and they provided "25 per cent advance, 65 per cent against delivery and remaining 10 per cent after completion of erection and handing over of shutters to

the satisfaction” of the Company. The assessee carried out its part of the contract and manufactured the two types of rolling shutters according to the specifications provided in the contract and erected and installed them in sheds Nos. 3 and 4 of the Sidheswar Sahakari Sakar Karkhana. It does not appear from the record as to when the bill relating to the contract was submitted by the assessee to the Company, but it was dated August 19, 1972 and presumably it was sent by the assessee after the fabrication of the two types of rolling shutters was completed, but before they were erected and installed at the premises of the Company. Since the assessee entertained doubt as to whether the contract was a contract for sale or a contract for work and labour, the assessee made an application dated September 16, 1972 to the Commissioner of Sales Tax for determining this question, for on the answer to it, depended the taxability of the amount to be received by the assessee against fulfilment of the contract. The Deputy Commissioner of Sales Tax, who heard the application, took the view that the contract was a contract for sale of the two types of rolling shutters and the work of erection and installation was merely incidental to the sale and the assessee was, therefore, liable to pay sales tax on 95 per cent of the amount receivable by it under the contract. Since that represented the sale price of the rolling shutters, the remaining 5 per cent being attributable to the work and labour involved in erection and installation. The assessee, being aggrieved by the order passed by the Deputy Commissioner of Sales Tax preferred an appeal to the Sales Tax Tribunal, but the Sales Tax Tribunal also took the same view and held that the transaction of supply of the two types of rolling shutters embodied in the contract amounted to a sale but so far as the price was concerned, the Sales Tax Tribunal observed that since 90 per cent of the amount under the contract was payable at the stage of delivery, that should be taken to be the sale price and the balance of 10 per cent should be held to be “the charges for the work”. The contract was thus held by the Sales Tax Tribunal to be a composite contract consisting of two parts, one for sale of the two types of rolling shutters and the other for execution of the work of erection and installation. This led to an application for a reference by the assessee and on the application, the following question of law was referred for the opinion of the High Court:

Whether having regard to the facts and circumstances of the case the Tribunal was justified in law in coming to the conclusion that the contract in question essentially consisted of two contracts, one for supply of materials for money consideration and the other for service and labour done?

The High Court made a detailed and exhaustive review of the decided cases and held, agreeing with the Sales Tax Tribunal, that the contract between the assessee and the Company “was a divisible contract which essentially consisted of two contracts, one for the supply of shutters of the aforesaid two types for money and the other for service and labour”, and accordingly answered the question in favour of the Revenue and against the assessee. The assessee thereupon brought the present appeal with special leave obtained from this Court.

3. Now the question whether a particular contract is a contract for sale or for work and labour is always a difficult question and it is not surprising to find the taxing authorities divided on it.

The difficulty, however, lies not in the formulation of the tests for determining when a contract can be said to be a contract for sale or a contract for work and labour, but in the application of the tests to the facts of the case before the Court. The distinction between a contract for sale and a contract for work and labour has been pointed out by this Court in a number of decisions and some tests have also been indicated by this Court, but it is necessary to point out that these tests are not exhaustive and do not lay down any rigid or inflexible rule applicable alike to all transactions. They do not give any magic formula by the application of which we can say in every case whether a contract is a contract for sale or a contract for work and labour. They merely focus on one or the other aspect of the transaction and afford some guidance in determining the question, but basically and primarily, whether a particular contract is one for sale of goods or for work and labour depends upon the main object of the parties gathered from the terms of the contract, the circumstances of the transaction and the custom of the trade.

4. It may be pointed out that a contract where not only work is to be done but the execution of such work requires goods to be used may take one of three forms. The contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price; it may be a contract for work in which the use of materials is accessory or incidental to the execution of the work; or it may be a contract for supply of goods where some work is required to be done as incidental to the sale. Where a contract is of the first type, it is a composite contract consisting essentially of two contracts, one for the sale of goods and the other for work and labour. The second type of contract is clearly a contract for work and labour not involving sale of goods, while the third type is a contract for sale where the goods sold are chattels and some work is undoubtedly done, but it is done only as incidental to the sale. No difficulty arises where a contract is of the first type because it is divisible and the contract for sale can be separated from the contract for work and labour and the amount payable under the composite contract can be apportioned between the two. The real difficulty arises where the contract is of the second or third type, because in such a case it is always a difficult and intriguing problem to decide in which category the contract falls. The dividing line between the two types of contracts is somewhat hazy and "thin partitions do their bounds divide". But even so the distinction is there and it is very much real and the Court has to perform at times the ingenious exercise of distinguishing one from the other.

5. The distinction between a contract for sale and a contract for work and labour has been pointed out in **Halsbury's Laws of England**, Third Edition, Volume 34, Article 3. The primary test is *whether the contract is one whose main object is transfer of property in a chattel as a chattel to the buyer, though some work may be required to be done under the contract as ancillary or incidental to the sale or it is carrying out of work by bestowal of labour and service and materials are used in execution of such work*. A clear case of the former category would be a contract for supply of airconditioner where the contract may provide that the supplier will fix up the airconditioner in the premises. Ordinarily a separate charge is provided in such contract for the work of fixing up but in a given case it may be included in the total price. Such a contract

would plainly be a contract for sale because the work of fixing up the airconditioner would be incidental to the sale. Then take a contract for constructing a building where considerable quantity of materials is required to be used in the execution of the work. This would clearly be a contract for work and labour and fall within the latter category. But, as we pointed out earlier, there may be and indeed as the decided cases show, there are a large number of cases which are on the border line and it is here that difficulty is often experienced in the application of this primary test. To resolve this difficulty, the courts have evolved some subsidiary tests. One such test is that formulated by this Court in *Commissioner of M.P. v. Purshottam Premji* [(1970) 2 SCC 287], where it has been said:

The primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing work or rendering service no property in the thing produced as a whole In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it, at some time before delivery, and the property therein passes only under the contract relating thereto to the other party for price.

This was the test applied by this Court in the *State of Rajasthan v. Man Industrial Corporation* [(1969) 1 SCC 567], for holding that a contract for providing and fixing four different types of windows of certain sizes according to “specifications, designs, drawings and instructions” set out in the contract was a contract for work and labour and not a contract for sale.

6. Now, it is clear that the contract is for fabrication, supply, erection and installation of two types of rolling shutters and not only are the rolling shutters to be manufactured according to the specifications, designs, drawings and instructions provided in the contract, but they are also to be erected and installed at the premises of the Company. The price stipulated in the contract is inclusive of erection and installation charges and the contract does not recognise any dichotomy between fabrication and supply of the rolling shutters and their erection and installation so far as the price is concerned. The erection and installation of the rolling shutters is as much an essential part of the contract as the fabrication and supply and it is only on the erection and installation of the rolling shutters that the contract would be fully executed. It is necessary, in order to understand the true nature of the contract, to know what is a rolling shutter and how it is erected and installed in the premises. It is clear from the statement Ex. C to the petition for special leave, which statement was submitted before the Sales Tax Tribunal and the correctness of which was at no time disputed before us, that a rolling shutter consists of five component parts, namely, two brackets welded with ‘U’ type clamps, one pipe shafting with high tension springs, shutter screen made out of 20G/18G/thickness of metal as required by the customer, side guides or guide channels welded with iron clamps to the bottom with provision of locking arrangements with welded handles and top cover. These component parts fabricated by the manufacturer and taken to the site and fixed on the premises and then comes into existence a Rolling Shutter as an identifiable commercial article. The method of fixing the component parts in position in the premises so as to bring into existence the commercial article known as a rolling shutter is fully

described in the statement Ext. C. First of all, certain masonry work is required to be done by the customer and that has to be carried out by the customer at his own cost. Then the brackets are fixed on either side on the top portion of the opening by grouting holes on the masonry walls and inserting the bolts. Thereafter the holes are filled with cement and the pipe shafting with high tension springs is inserted into the 'IT clamps of the brackets. Then the iron curtain of the rolling shutter is hosted over the high tension springs and tightened by means of nut bolts and guide channels are then fixed by grouting masonry walls where side guide clamps are to be fixed. After fixing the clamps to the grouted portion of the wall, the same is plastered and then the iron curtain of the shutter is lowered through the guide channels to operate the shutter manually up and down. The rolling shutter is then 'born' and it becomes a permanent fixture to the premises. The Indian Standards Specification Book for Metal Rolling Shutters and Rolling Grills also gives a similar procedure for fixing the component parts of the Rolling Shutter on the premises. It clearly shows that a rolling shutter consists of curtain, lock plates, guide channels, bracket plates, rollers, hood covers, gears, worms, fixing bolts, safety devices, anchoring rods, central hasp and staple. Each guide channel has to be provided with a minimum of three fixing cleats or supports for attachment to the walls or column by means of bolts or screws. The guide channels are further attached to the jambs, plumbed either in the overlapping fashion, projecting fashion or embedded in grooves, depending on the method of fixing. All these operations take place at the site after despatch of the component parts of the rolling shutter. Hood cover is fixed in a neat manner and supported at the top at suitable intervals. This also has to be done at the site. Item 11.1 of the specification shows that the rolling shutter curtain and bottom lock plate are interlocked together and rolled in one piece, but the other parts like guide channels, bracket plates, rollers, etc., are despatched separately. Item 12.1 shows that "all the rolling shutters are erected by the manufacturer or his authorised representative in a sound manner, so as to afford trouble-free and easy operation, long life and neat appearance". It will, thus, be seen that the component parts do not constitute a rolling shutter until they are fixed and erected on the premises. It is only when the component parts are fixed on the premises and fitted into one another that they constitute a rolling shutter as a commercial article and till then they are merely component parts and cannot be said to constitute a rolling shutter. The erection and installation of the rolling shutter cannot, therefore, be said to be incidental to its manufacture and supply. It is a fundamental and integral part of the contract because without it the rolling shutter does not come into being. The manufacturer would undoubtedly be the owner of the component parts when he fabricates them, but at no stage does he become the owner of the rolling shutter as a unit so as to transfer the property in it to the customer. The rolling shutter comes into existence as a unit when the component parts are fixed in position on the premises and it becomes the property of the customer as soon as it comes into being. There is no transfer of property in the rolling shutter by the manufacturer to the customer as a chattel. It is essentially a transaction for fabricating component parts and fixing them on the premises so as to constitute a rolling shutter. The contract is thus clearly and indisputably a contract for work and labour and not a contract for sale.

7. The Revenue leaned heavily on the provision in the contract that the delivery of the goods shall be ex-works and once the delivery of the goods is effected, no claim for rejection shall be entertained and relying on this provision, the Revenue contended that under the contract the rolling shutters were to be delivered by the assessee to the company ex-works, that is, at the works of the assessee and the property in the rolling shutters passed to the company as soon as they were delivered and hence it was a contract for sale. We do not think this contention of the Revenue has any force and it must be rejected. It is clear from the above discussion that a rolling shutter as a complete unit is not fabricated by the manufacturer in his factory but he manufactures only the component parts and it is only when the component parts are fitted into position and fixed on the premises that a rolling shutter comes into being as a commercial article and, therefore, when the contract provides that the delivery of the goods shall be ex-works, what is obviously meant is that the component parts shall be delivered to the company at the works of the assessee and once they are delivered, they shall not be liable to be rejected by the company. But that does not mean that as soon as the component parts are delivered to the company, the contract is fully executed. The component parts do not constitute a rolling shutter and it is the obligation of the assessee under the contract to fix the component parts in position on the premises and erect and install a rolling shutter. The execution of the contract is not completed until the assessee carries out this obligation imposed upon it under the contract and a rolling shutter is erected and installed at the premises. It is true that clause (12) of the printed terms and conditions provides that 50 per cent of the amount under the contract shall be paid as advance and the balance against delivery of the goods ex-works but this clause is clearly overridden by the special term specifically written out in the contract that 25 per cent of the amount shall be paid by way of advance, 65 per cent against delivery and the remaining 10 per cent after completion of erection and handing over of the rolling shutters to the satisfaction of the company. This provision undoubtedly stipulates that 90 per cent of the amount due under the contract would be paid before erection and installation of the rolling shutters has commenced, but that would not make it a contract for sale of rolling shutters. The true nature of the contract cannot depend on the mode of payment of the amount provided in the contract. The parties may provide by mutual agreement that the amount stipulated in the contract may be paid at different stages of the execution of the contract, but that cannot make the contract one for sale of goods if it is otherwise a contract for work and labour. It may be noted that the contract in *State of Madras v. Richardson of Cruddas Ltd* [(1968) 21 STC 245 (SC)] contained a provision that the full amount due under the contract shall be paid in advance even before the execution of the work has started and yet the Madras High Court held, and that view affirmed by this Court, that the contract was a works contract. The payment of the amount due under the contract may be spread over the entire period of the execution of the contract with a view either to put the manufacturer or contractor in possession of funds for the execution of the contract or to secure him against any risk of non-payment by the customer. That cannot have any bearing on the determination of the question whether the contract is one for sale or for work and labour.

8. Here the last portion of the special terms in regard to payment of the amount due under the contract also makes it clear that it is only when the component parts are fitted into position in the premises that a rolling shutter would be complete and this rolling shutter has to be to the satisfaction of the company and it is then to be handed over by the assessee to the company and then, and then alone, would the remaining 10 per cent be payable by the company to the assessee. It is, therefore, clear that the contract is one single and indivisible contract and the erection and installation of the rolling shutter is as much a fundamental part of the contract as the fabrication and supply. We must, in the circumstances, hold, driven by the compulsion of this logic, that the contract was a contract for work and labour and not a contract for sale. This view which we are taking is completely supported by the decision of this Court in *Vanguard Rolling Shutters of Steel Works v. Commissioner of Sales Tax, U.P.* [(1977) 2 SCC 250] to which one of us (Bhagwati, J.) was a party.

9. We accordingly allow the appeal, set aside the judgment of the High Court and hold that the contract in the present case was a contract for work and labour and not a contract for sale.

Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi

(1978) 4 SCC 36 & (1980) 2 SCR 650

R.S. PATHAK J. - This and the connected appeal are directed against the judgment of the High Court of Delhi disposing of a reference made to it under Section 21(3) of the Bengal Finance (Sales Tax) Act, 1941 as extended to the Union territory of Delhi on the following question:

Whether the service of meals to casual visitors in the Restaurant is taxable as a sale—

(i) when the charges are lump sum per meal or

(ii) when they are calculated per dish? The High Court has answered the question in the affirmative.

2. The appellant runs a hotel in which lodging and meals are provided on “inclusive terms” to residents. Meals are served to non-residents also in the restaurant located in the hotel. In the assessment proceedings for the assessment years 1957-58 and 1958-59 under the Bengal Finance (Sales Tax) Act, 1941, the appellant contended that the service of meals to residents and non-residents could not be regarded as a sale and therefore sales tax could not be levied in respect thereof. The contention was rejected by the Sales Tax authorities, who treated a portion of the receipts from the residents and non-residents as representing the price of the foodstuff’s served. At the instance of the appellant, the High Court called for a statement of the case on two questions. One was whether the supply of meals to residents, who paid a single all-inclusive charge for all services in the hotel, including board was exigible to sales tax. The second was the question set forth above. The High Court answered the first question in favour of the appellant and the second against it. And now these appeals by special leave.

3. Tax is payable by a dealer under Section 4 of the Bengal Finance (Sales Tax) Act, 1941 on sales effected by him, and the expression “sale” has been defined by Section 2(g) of the Act to mean “any transfer of property in goods for cash or deferred payment or other valuable consideration including a transfer of property in goods involved in the execution of a contract” The question is whether in the case of non-residents the service of meals by the appellant in the restaurant constitutes a sale of foodstuff’s.

4. This is a case where the origin and historical development of an institution has profoundly influenced the nature and incidents it possesses in law. In the case of an hotelier this Court proceeded on the footing that his position in law was assimilable to that of an innkeeper. At common law an innkeeper was a person who received travellers and provided lodging and necessaries for them and their attendants and employed servants for this purpose and for the protection of travellers lodging in his inn and of their goods [Halsbury’s Laws of England, 3rd Edn., Vol. 21, p. 442, para 932]. It was hospitality that he offered, and the many facilities that constituted the components of that hospitality determined the legal character of the transactions flowing from them. Long ago, in *Crisp v. Pratt* [(1939) 79 ER 1072], it was pointed out that innkeepers do not get their living by buying and selling, and that although they buy provision;, to

be spent in their house, they do not sell them but what they do is to “utter” them. “Their gain”, it was added “is not only by uttering of their commodities, but for the attendance of their servants, and for the furniture of their house, rooms, and lodgings, for their guests” In *Newton v. Tries* [91 ER 100], Holt, C.J. defined the true status of an innkeeper by reference to the services afforded by him, that he was an “hospitator”, and was “not paid upon the account of the intrinsic value of his provisions, but for other reasons: the recompence he receives, is for care and pains, and for protection and security ... but the end of an innkeeper in his buying, is not to sell, but only a part of the accommodation he is bound to prepare for his guests.”

5. Having proper regard to those particular considerations, it is not surprising that the principle was extended in England to the service of food at eating places or restaurants. The keeper of an eating house, or victualler, was regarded fundamentally as providing sustenance to those who ordered food to eat in the premises. Like the hotelier, a restaurateur provides many services in addition to the supply of food. He provides furniture and furnishings, linen, crockery and cutlery, and in the eating places of today he may add music and a specially provided area for floor dancing and in some cases a floor show. The view taken by the English law found acceptance on American soil, and after some desultory dissent initially in certain states it very soon became firmly established as the general view of the law. The first addition of *American Jurisprudence*, Vol. 46, p. 207, para 13, sets forth the statement of the law in that regard, but we may go to the case itself, *Electa B. Merrill v. James W. Hodson* [1915-B LRA 481], from which the statement has been derived. Holding that the supply of food or drink to customers did not partake of the character of a sale of goods the Court commented:

The essence of it is not an agreement for the transfer of the general property of the food or drink placed at the command of the customer for the satisfaction of his desires, or actually appropriated by him in the process of appeasing his appetite or thirst. The customer does not become the owner of the food set before him, or of that portion which is carved for his use, or of that which finds a place upon his plate, or in side dishes set about it. No designated portion becomes his. He is privileged to eat, and that is all. The uneaten food is not his. He cannot do what he pleases with it. That which is set before him or placed at his command is provided to enable him to satisfy his immediate wants, and for no other purpose. He may satisfy those wants; but there he must stop. He may not turn over unconsumed portions to others at his pleasure, or carry away such portions. The true essence of the transaction is service in the satisfaction of a human need or desire,—ministry to a bodily want. A necessary incident of this service or ministry is the consumption of the food required. This consumption involves destruction, and nothing remains of what is consumed to which the right of property can be said to attach. Before consumption title does not pass; after consumption there remains nothing to become the subject of title. What the customer pays for is a right to satisfy his appetite by the process of destruction. What he thus pays for includes more than the price of the food as such. It includes all that enters into the conception of service, and with it no small factor of direct

personal service. It does not contemplate the transfer of the general property in the food applied as a factor in the service rendered.

The position was radically altered in the United States by the enactment of the Uniform Commercial Code, which provides in effect that the serving for value of food or drink to be consumed either on the premises or elsewhere constitutes a sale.

6. It has already been noticed that in regard to hotels this Court has in *M/s. Associated Hotels of India Ltd.* adopted the concept of the English law that there is no sale when food and drink are supplied to guests residing in the hotel. The Court pointed out that the supply of meals was essentially in the nature of a service provided to them and could not be identified as a transaction of sale. The Court declined to accept the proposition that the Revenue was entitled to split up the transaction into two parts, one of service and the other of sale of foodstuff's. If that be true in respect of hotels, a similar approach seems to be called for on principle in the case of restaurants. No reason has been shown to us for preferring any other. The classical legal view being that a number of services are concomitantly provided by way of hospitality, the supply of meals must be regarded as ministering to a bodily want or to the satisfaction of a human need. What has been said in *Elects B. Merrill* appears to be as much applicable to restaurants in India as it does elsewhere. It has not been proved that any different view should be taken, either at common law, in usage or under statute.

7. It was urged for the respondent that in *Associated Hotels of India Ltd.*, this Court drew a distinction between the case of meals supplied to a resident in a hotel and those served to a customer in a restaurant. We are unable to find any proposition of law laid down by the court there which could lead to that inference.

8. In the result, we hold that the service of meals to visitors in the restaurant of the appellant is not taxable under the Bengal Finance (Sales Tax) Act, 1941, as extended to the Union territory of Delhi, and this is so whether a charge is imposed for the meal as a whole or according to the dishes separately ordered.

* * * * *

State of Karnataka v. Udipikrishna Bhavan

(1981) 3 SCC 76

GUPTA, J. - These two appeals arise out of two revision petitions dismissed by the Karnataka High Court which were preferred by the State of Karnataka under Section 8(4) of the Karnataka Appellate Tribunal (Amendment) Act, 1976 read with Section 23 of the Karnataka Sales Tax Act, 1957. The revision petitions were directed against a common order of the Karnataka Appellate Tribunal by which the Tribunal allowed two appeals preferred by the assessee relating to the assessment for the years ended March 31, 1976 and March 31, 1977 respectively. Following the decision of this Court in ***Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi*** [(1979) 1 SCR 557], the Tribunal had held that the supply of refreshments to the visitors of the two hotels owned by the respondent before us was “part of a social service and not a sale”. The High Court taking the same view dismissed the revision petitions. The finding of the Appellate Tribunal, as summarised by the High Court, on which its decision rests is: “The assessee runs a hotel wherein food and drinks are served to the visitors.” We do not think that this finding only is sufficient to justify the conclusion reached by the Tribunal and the High Court. It appears that the attention of the High Court was drawn to the judgment of this Court disposing of a review petition in the ***Northern India Caterers*** case (1980) 2 SCR 650. The following extract from that judgment to which the High Court itself has referred is relevant:

Indeed, we have no hesitation in saying that where food is supplied in an eating-house or restaurant, and it is established upon the facts that the substance of the transaction, evidenced by its dominant object, is a sale of food and the rendering of services is merely incidental, the transaction would undoubtedly be exigible to sales tax. In every case it would be for the taxing authority to ascertain the facts when making an assessment under the relevant sales tax law and to determine upon those facts whether a sale of the food supplied is intended...

Clearly therefore the only finding recorded in this case that the assessee runs a hotel wherein food and drinks are served to the visitors is not sufficient.

2. We set aside the impugned order and send the case back to the Sales Tax Officer concerned for a fresh assessment according to law following the guidelines appearing in the judgment of this Court disposing of the review petition in the ***Northern India Caterers*** case.

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M/s. Larsen & Toubro Limited V. State of Karnataka
(2014) 1 SCC 708

2. Does the two-Judge Bench decision of this Court in Raheja Development[1] lay down the correct legal position? It is to consider this question that in Larsen and Toubro[2] a two-Judge Bench of this Court has referred the matter for consideration by the larger Bench. In the referral order dated 19.8.2008, the two-Judge Bench after noticing the relevant provisions of the Karnataka Sales Tax Act, 1957 and the distinction between a contract of sale and a works contract made the reference to the larger Bench by observing as follows :

“We have prima facie some difficulty in accepting the proposition laid down in Para 20 quoted above. Firstly, in our view, prima facie, M/s Larsen & Toubro - petitioner herein, being a developer had undertaken the contract to develop the property of Dinesh Ranka. Secondly, the Show Cause Notice proceeds only on the basis that Tripartite Agreement is the works contract. Thirdly, in the Show Cause Notice there is no allegation made by the Department that there is monetary consideration involved in the first contract which is the Development Agreement.

Be that as it may, apart from the disputes in hand, the point which we have to examine is whether the ratio of the judgment of the Division Bench in the case of Raheja Development Corporation (supra) as enunciated in Para 20, is correct. If the Development Agreement is not a works contract could the Department rely upon the second contract, which is the Tripartite Agreement and interpret it to be a works contract, as defined under the 1957 Act. The Department has relied upon only the judgment of this Court in Raheja Development Corporation(supra) case because para 20 does assist the Department. However, we are of the view that if the ratio of Raheja Development case is to be accepted then there would be no difference between works contract and a contract for sale of chattel as a chattel. Lastly, could it be said that petitioner - Company was the contractor for prospective flat purchaser. Under the definition of the term "works contract" as quoted above the contractor must have undertaken the work of construction for and on behalf of the contractor (sic.) for cash, deferred or any other valuable consideration. According to the Department, Development Agreement is not works contract but the Tripartite Agreement is works contract which, prima facie, appears to be fallacious. There is no allegation that the Tripartite Agreement is sham or bogus.

For the aforestated reasons, we direct the Office to place this matter before the Hon'ble Chief Justice for appropriate directions in this regard, as we are of the view that the judgment of Division Bench in the case of Raheja Development (supra) needs re-consideration by the larger Bench.”

3. Of the 26 appeals under consideration before us, 14 are from Karnataka and 12 from Maharashtra. Insofar as Karnataka appeals are concerned, it is appropriate that we take the facts from the leading case being Larsen and Toubro. The ECC division of Larsen and Toubro (for short, “L&T”) is engaged in property development along with the owners of vacant sites. On

19.10.1995, L&T entered into a development agreement with Dinesh Ranka, owner of the land bearing survey numbers 90/1, 91, 92 (Part), 94, 95 and 96/1 (Part) together measuring 34 acres all situated at Kothanur Village, Begur Hobli, Bangalore South Taluk, Bangalore, for construction of a multi-storeyed apartment complex. The owner was to contribute his land and L&T was to construct the apartment complex. After development, 25% of the total space was to belong to the owner and 75% to L&T. A power of attorney was executed by the owner of the land in favour of L&T to enable it to negotiate and book orders from the prospective purchasers for allotment of built up area. Accordingly, L&T entered into agreements of sale with intended purchasers. The agreements provided that on completion of the construction, the apartments would be handed over to the purchasers who will get an undivided interest in the land also. Sale deeds, thus, were executed in favour of the intended purchasers by L&T and the owner.

4. On 12.07.2005, the business premises of L&T were inspected by the Deputy Commissioner of Commercial Taxes (Intelligence-1) South Zone, Koramangala, Bangalore (hereinafter referred to as the 'Deputy Commissioner') and a detailed statement of the Finance Manager was recorded.

5. On 21.12.2005, the Deputy Commissioner called upon L&T to furnish the details of development project. L&T furnished details on 24.07.2005 and 26.09.2005.

6. On 04.10.2005, the Deputy Commissioner served a show cause notice on L&T stating that it was liable to tax as per the decision of this Court in *Raheja Development*¹. L&T responded to the show cause notice and submitted preliminary objections on 10.10.2005. By a further communication dated 10.11.2005, L&T objected to the assessment of tax for development of projects by it. The L&T *inter alia* submitted that the development agreement was not a works contract *per se* on account of the reasons: (a) the agreement was to develop and market flats to customers; (b) the intent and purpose of the agreement was to develop property by the petitioners on the one hand and the land owner on the other; (c) the construction and development of the said land involved no monetary consideration; and (d) the only consideration was that upon the completion of the entire project, L&T would be entitled to 75 per cent of the same.

7. Again on 04.01.2006, the business premises of L&T were inspected and certain documents like agreement copies and other documents relating to the transactions of the sale of flats were seized for the purposes of further investigation and verification.

8. On 02.02.2006, the Deputy Commissioner served upon L&T a further notice proposing to tax the sale of materials used in the construction of flats on the ground that it was entitled to 75 per cent of the share of the projects. L&T filed detailed objections to this notice as well.

9. On 03.07.2006, the Deputy Commissioner issued provisional assessment orders under Section 28(6) of the Karnataka Sales Tax Act, 1957 (for short, 'KST Act') for the years 2000-01 to 2004-05. Along with the provisional orders, the Deputy Commissioner also issued demand notices raising a total demand of Rs. 3,99,28,636/-.

10. Initially, L&T preferred a writ petition before this Court challenging the above demands but that writ petition was withdrawn and a writ petition under Article 226 of the Constitution of India was filed before the Karnataka High Court.

11. The Single Judge of the Karnataka High Court noted that the controversy raised by the L&T was covered by the decision of this Court in *Raheja Development* and, accordingly, dismissed the writ petition on 10.07.2007 by observing as follows:

“From the aforesaid observations of the Apex Court it is very much clear that as the petitioner No. 1 had entered into an agreement to carry out construction activity on behalf of someone else for cash or for deferred payment or for any other valuable construction, it would be carrying out works contract and therefore would become liable to pay turnover tax on the transfer involved in such work contracts. It is also not in dispute in this matter that the agreement of sale is entered into between the first petitioner and the buyers of the flat even prior to completion of the construction of the building. Under such circumstances, as has been held by the Apex Court in the RAHEJA DEVELOPMENT CORPORATION's Case, the petitioners are liable to pay the turnover tax on the transfer of goods involved in such 'works contract'. In view of the dictum laid down by the recent judgment cited supra, this Court does not find any merit in this writ petition.”

12. L&T preferred an intra-court appeal. The Division Bench of that Court concurred with the Single Judge and dismissed the writ appeal by expressing its opinion as follows:

“In our view, so far as the definition of 'work contract' in almost similar situation as in the present case has been well considered by the Hon'ble Supreme Court in the case of K. RAHEJA DEVELOPMENT CORPORATION(supra).The question as to whether that judgment as per Article 141 of the Constitution of India is the law of the land binding on all the Courts in the Country. *Prima facie*, we find that the facts and circumstances in that case are almost similar to the present case and as such, the ratio laid down in the RAHEJA's Case and relied upon by the learned Single Judge is, in our view, just and proper. So far as the other pronouncements are concerned, if the appellant feels that it is necessary to get the pronouncement in RAHEJA's Case reviewed, it is open for him to approach the Apex Court and this Court cannot substitute its own findings on the questions since the same has already been decided by the Apex Court in RAHEJA's case.”

17.Mr. Rohinton F. Nariman, learned senior counsel for L&T led the arguments on behalf of the appellants. His submission is that *Raheja Development* does not lay down correct law. He submits that insertion of clause 29-A (b) in Article 366 following the 61st Law Commission

Report is intended to separate the goods component from the labour and services component of a composite works contract. The amendment does not in any manner undo *Gannon Dunkerley-I*³ insofar as that decision defines what a works contract is. In this regard, learned senior counsel extensively referred to the decisions of this Court in *Builders' Association*⁴ and *Bharat Sanchar*⁵. It is argued by him that in *Raheja Development I* it was incorrectly assumed that the definition of works contract was wide although the definition of works contract in KST Act and Madras General Sales Tax Act which was under consideration in *Gannon Dunkerley-I*³ was identical.

18. Alternatively, it is argued by Mr. Rohinton F. Nariman that if it is accepted that the definition of 'works contract' in KST Act is wide which takes within its fold the contracts that are not commonly understood as works contract then this would be outside Entry 54 List II of the Seventh Schedule of the Constitution for the reason that "works contract" as understood in *Gannon Dunkerley-I*³ has not in any manner been upset by the constitutional amendment and would have to mean "works contract" as commonly understood.

19. Criticizing the conclusions drawn in paragraph 20 of the judgment in *Raheja Development I*, it is argued by Mr. Rohinton F. Nariman that these conclusions are incorrect for, (a) the well known tests to determine as to whether a particular contract is a "works contract" or "contract of sale" have not been adverted to; (b) the contract is not read as a whole. Its substance and the main object has not been looked at and one phrase is torn out of context without adverting to any other part of the contract and based on this reasoning the contract is said to be a works contract; (c) though it is noticed that construction/development is to be on payment of a price in various installments but does not draw any conclusion from it; (d) it is noticed that developer has a lien on the property but incorrectly states that the lien is because they are not owners. The lien is obviously so that if monies are not recovered from the prospective flat purchasers, the lien can be exercised, showing thereby that the contract is a contract of an agreement to sell immovable property; (e) after noticing that developer can terminate the agreement if any one installment is not paid and can forfeit 10% of the amount that has been paid and can ultimately resell the flat, it is held that the presence of such a clause does not mean that the agreement ceases to be a "works contract" without appreciating that such a clause would have no place in a works contract and can only be consistent with the contract for the sale of immovable property inasmuch as termination can take place if the entire consideration for the immovable property is not paid; (f) it is stated that if there is termination but there is no re-sale, there would be no works contract only to that extent which is again wholly incorrect because post termination what happens to a particular flat is of no relevance inasmuch as the prospective flat purchaser goes out of the picture; and (g) the distinction between a flat being constructed and a flat under construction is a distinction without a difference for the reason that the

judgment notices that if the agreement is entered into after the flat is already constructed, there would be no 'sale' and no 'works contract'. This is obviously for the reason that the flat has already been developed by the developer using his material and his plan and is sold as such to a purchaser.

21. Based on the various clauses of the tripartite agreement, it is argued that the main object of the agreement read as a whole and the substance of the agreement is to sell and convey fraction of the land together with a fully constructed flat only when all installments have been fully paid. The work undertaken is for the joint development of the project as a whole, i.e., work is undertaken by the developer for himself and for the owner. The construction is not carried out for and on behalf of the purchaser, but it is carried out entirely by the owner/developer in order to exploit or get the best price for the land and the structure built thereon from various flat purchasers. The flat is to be sold as a flat and not an aggregate of its component parts. No work is carried out for the purchaser who gets title to the property only after all work is complete. Learned senior counsel argued that the ultimate test would be: if a suit for specific performance is filed by the flat purchaser against the owner/developer, such suit would invariably be for the conveyance of title and not for the construction of a building. Conversely a suit by an owner/developer against the flat purchaser would be for payment of consideration of a flat/fractional interest in the land. Such suit would never be for payment of work done at the behest of the flat purchaser and payment of consideration therefor. It is, thus, submitted that the judgment in *Raheja Development^I* does not lay down good law and deserves to be overruled.

39. In the counter arguments advanced on behalf of the two States – Karnataka and Maharashtra - *Raheja Development^I* has been stoutly defended. Mr. K.N. Bhat, learned senior counsel for Karnataka submits that view taken in *Raheja Development^I* is correct and needs no reconsideration – both on merits as well as on the basis of binding precedents on the principles governing reconsideration of an earlier decision. He submits that Article 366(29-A) uses the phraseology employed in Entry 54 of List II that reads, “taxes on sale or purchase of goods” For the purpose of Entry 54 List II, “taxes on the sale or purchase of goods” includes “tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract”. Transfer of property in goods is the essence of definition of 'sale' in Section 4 of the Sale of Goods Act. Article 366(29-A)(b) can be rephrased as “a tax on the sale of goods involved in the execution of a works contract” and in any case by the deeming fiction incorporated in the above provision, it shall be deemed to be a sale of those goods by the person making the transfer and a purchase by a person to whom such transfer is made. The taxable event is the deemed sale of goods involved in the execution of works contract. Article 366 (29-A) has been inserted to remedy the situation arising from the decision in the *Gannon Dunkerley-I* where attempt to levy sales tax on the sale of goods involved in the

execution of works contract was held to be unconstitutional. This was on the basis that a works contract could not be dissected into contract for “works and services” and contract for “sale of goods”. Mr. K.N. Bhat submits, relying upon para 41 in *Builders’ Association* that definition of ‘works contract’ KST Act does not go beyond what is contemplated in the Constitution.

52. Prior to Forty-sixth Amendment in the Constitution, levy of sales tax on the sale of goods involved in the execution of the works contract was held to be unconstitutional in *Gannon Dunkerley-I*³. That was a case where the assessee (Gannon Dunkerley) was carrying on business as engineers and contractors. Its business consisted mainly of execution of contracts for construction of buildings, bridges, dams, roads and structural contracts of all kinds. During the assessment year under consideration, the return filed by the assessee showed as many as 47 contracts most of which were building contracts which were executed by it. From the total of the amount which the assessee received in respect of sanitary contracts and other contracts 20 per cent and 30 per cent respectively were deducted for labour and the balance was taken as the turnover of the assessee for the assessment year in question. Sales tax was levied on the said balance treating it as taxable turnover under the Madras General Sales Tax Act, 1939. Assessee questioned the levy of sales tax on the ground that there was no sale of goods as understood in India and, therefore, no sales tax could be levied on any portion of the amount which was received by the assessee from the persons for whose benefit it had constructed buildings. The Madras High Court concluded that the transactions in question were not contracts for sale of goods as defined under the provisions of the Sale of Goods Act, 1930 which was in force on the date on which the Constitution came into force and, therefore, the assessee was not liable to pay sales tax on the amounts received by it from the persons for whom it had constructed buildings during the year of assessment. It is from this judgment that the matter reached this Court. The Constitution Bench of this Court held that in a building contract where the agreement between the parties was that the contractor should construct the building according to the specifications contained in the agreement and in consideration received payment as provided therein, there was neither a contract to sell the materials used in the construction nor the property passed therein as movables. It was held that in a building contract which was one (entire and indivisible) there was no sale of goods and it was not within the competence of the Provincial State Legislature to impose tax on the supply of the materials used in such a contract treating it as a sale. The Constitution Bench said, “.....when the work to be executed is, as in the present case, a house, the construction imbedded on the land becomes an accretion to it on the principle *quicquid plantatur solo, solo cedit*, and it vests in the other party not as a result of the contract but as the owner of the land. Vide *Hudson on Building Contracts*, 7th Edn., p. 386.....” It was further stated, “.....that exception does not apply to buildings which are constructed in execution of a works contract, and the law with reference to them is that the title to the same passes to the owner of the land as an accretion thereto. Accordingly, there can

be no question of title to the materials passing as movables in favour of the other party to the contract.....”

53. In *Gannon Dunkerley-I*³, this Court held that in a building contract which was one, entirely indivisible, there was no sale of goods and it was not within the competence of the provincial State legislature to impose tax on the supply of materials used in such a contract treating it as a sale. The above statement was founded on the premise that the works contract was a composite contract which is inseparable and indivisible. Entry 48 of List II of Schedule Seven of the Government of India Act, 1935 was under consideration before this Court in *Gannon Dunkerley-I*³. It is observed that the expression “sale of goods” in that entry has the same meaning as the said expression had in the Sale of Goods Act, 1930. In other words, the essential ingredients of sale of goods are (i) an agreement to sell movables for a price and (ii) property passing therein pursuant to that agreement.

54. The problems connected with powers of States to levy tax, *inter alia*, on goods involved in execution of works contract following *Gannon Dunkerley-I*³ was elaborately examined by the Law Commission of India. In its 61st Report, Chapter 1A, the Law Commission specifically examined the taxability of works contract. The Law Commission noted the essential nature and features of the building contracts and the difference between contract of works and contract for sale. It examined the question whether the power to tax indivisible contracts of works should be conferred on the States. The Law Commission suggested three alternatives (a) amendment in the State List, Entry 54, or (b) adding a fresh entry in the State List, or (c) insertion in Article 366 a wide definition of “sale” so as to include works contract. It preferred the last one, as, in its opinion, this would avoid multiple amendments.

55. Having regard to the above recommendation of the Law Commission, the Constitution Bill No.52 of 1981 was introduced in the Parliament.

56. The Parliament then enacted the Constitution (Forty-sixth Amendment) Act, 1982 which received the assent of the President on 02.02.1983. Accordingly, clause 29-A was inserted in Article 366 of the Constitution which is set out as below.

- (ii) the transfer of property in goods involved in the execution of a works contract;
- (iii) delivery of goods on hire-purchase or any system of payment by instalments;
- (iv) transfer of the right to use any goods for any purpose for cash, deferred payment or other valuable consideration;
- (v) the supply of goods by an unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(vi) the supply, by way of or as part of any service, of food or any drink for cash, deferred payment or other valuable consideration.

12. Clause (3) of article 286 is proposed to be amended to enable Parliament to specify, by law, restrictions and conditions in regard to the system of levy, rates and other incidents of the tax on the transfer of goods involved in the execution of a works contract, on the delivery of goods on hire-purchase or any system of payment by instalments and on the right to use any goods.

13. The proposed amendments would help in the augmentation of the State revenues to a considerable extent. Clause 6 of the Bill seeks to validate laws levying tax on the supply of food or drink for consideration and also the collection or recoveries made by way of tax under any such law. However, no sales tax will be payable on food or drink supplied by a hotelier to a person lodged in the hotel during the period from the date of the judgment in the Associated Hotels of India case and the commencement of the present Amendment Act if the conditions mentioned in sub-clause (2) of clause 6 of the Bill are satisfied. In the case of food or drink supplied by restaurants this relief will be available only in respect of the period after the date of judgment in the Northern India Caterers (India) Limited case and the commencement of the present Amendment Act.”

(29-A) “tax on the sale or purchase of goods” includes—

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hire-purchase or any system of payment by instalments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any ‘other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;’.

57. Following the above amendment in the Constitution, the sales tax legislations in various States were amended and provisions were made for imposition of sales tax in relation to works contract. The constitutional validity of the Forty-sixth Amendment by which the

legislatures of the States were empowered to levy sales tax on certain transactions described in clauses (a) to (f) of clause 29-A of Article 366 of the Constitution as well as the amendments made in the State legislations were challenged in *Builders' Association*. The Constitution Bench of this Court upheld the constitutionality of the Forty-sixth Amendment. The Court observed that the object of the new definition introduced in clause 29-A of Article 366 of the Constitution was to enlarge the scope of the expression "tax of sale or purchase of goods" wherever it occurs in the Constitution so that it may include within its scope any transfer, delivery or supply of goods that may take place under any of the transactions referred to in sub-clauses (a) to (f). The Constitution Bench explained that clause 29-A refers to a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The emphasis is on the transfer of property in goods – whether as goods or in some other form. A transfer of property in goods under sub-clause (b) of clause 29-A is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and a purchase of those goods by a person to whom such transfer was made.

58. Article 286 puts certain restrictions upon the power of the State to enact laws concerning imposition of sales tax. It lays down that no law of a State shall impose or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place (a) outside the State, or (b) in the course of import of the goods into, or export of the goods out of the territory of India. Sub-clause (2) of Article 286 enables the Parliament to enact law formulating principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in clause (1). As regards inter-state trade and commerce, clause (3) puts two restrictions. It provides that any law of a State shall, insofar as it imposes, or authorises the imposition of (a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-state trade or commerce; (b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) and sub-clause

(d) of clause 29-A of Article 366, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of tax as the Parliament may by law specify. Clause (3) was substituted by Constitution Forty-sixth Amendment Act, 1982 with effect from 02.02.1983.

59. Clause 29-A was inserted in Article 366 by the Forty-sixth Amendment with effect from 02.02.1983. Entry 54 of List II (State List) -enables the State to make laws relating to taxes on the sale or purchase of goods other than the newspapers, subject to the provisions of Entry 92-A of List I. Entry 63 of List II enables the States to provide rates of stamp duty in respect of documents other than those specified in provisions of List I with regard to the rates of stamp duty. Entry 92-A of List I deals with taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade

or commerce. Entry 6 of List III deals with the subjects, “transfer of property other than the agricultural land; registration of deeds and documents”.

60. It is important to ascertain the meaning of sub-clause (b) of clause 29-A of Article 366 of the Constitution. As the very title of Article 366 shows, it is the definition clause. It starts by saying that in the Constitution unless the context otherwise requires the expressions defined in that article shall have the meanings respectively assigned to them in the article. The definition of expression “tax on sale or purchase of the goods” is contained in clause (29-A). If the first part of clause 29-A is read with sub-clause (b) along with latter part of this clause, it reads like this: tax on the sale or purchaser of the goods” includes a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made. The definition of “goods” in clause 12 is inclusive. It includes all materials, commodities and articles. The expression, ‘goods’ has a broader meaning than merchandise. Chattels or movables are goods within the meaning of clause 12. Sub-clause (b) refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression “in some other form” in the bracket is of utmost significance as by this expression the ordinary understanding of the term ‘goods’ has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of ‘tax on the sale or purchase of goods’ includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.

61. Viewed thus, a transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

62. The States have now been conferred with the power to tax indivisible contracts of works. This has been done by enlarging the scope of “tax on sale or purchase of goods” wherever it occurs in the Constitution. Accordingly, the expression “tax on the sale or purchase of goods” in Entry 54 of List II of Seventh Schedule when read with the definition clause 29-A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.

63. *Gannon Dunkerley-I* and few other decisions following *Gannon Dunkerley-I* wherein the expression “sale” was given restricted meaning by adopting the definition of the word “sale” contained in the Sale of Goods Act has been undone by the Forty-sixth Constitutional Amendment so as to include works contract. The meaning of sub-clause (b) of clause 29-A of Article 366 of the Constitution also stands settled by the Constitution Bench of this Court in *Builders’ Association*⁴. As a result of clause 29-A of Article 366, tax on the sale or purchase of goods may include a tax on the transfer in goods as goods or in a form other than goods involved in the execution of the works contract. It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract.

64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract. The view taken by a two-Judge Bench of this Court in *Rainbow Colour Lab*¹⁶ that the division of the contract after Forty-sixth Amendment can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer of property takes place as an incident of contract of service is no longer good law, *Rainbow Colour Lab* has been expressly overruled by a three-Judge Bench in *Associated Cement*

65. Although, in *Bharat Sanchar* the Court was concerned with sub-clause (d) of clause 29-A of Article 366 but while dealing with the question as to whether the nature of transaction by which mobile phone connections are enjoyed is a sale or service or both, the three-Judge Bench did consider the scope of definition in clause 29-A of Article 366.

With reference to sub-clause (b) it said: “..... sub-clause (b) covers cases relating to works contract. This was the particular fact situation which the Court was faced with in *Gannon Dunkerley-I* and which the Court had held was not a sale. The effect in law of a transfer of property in goods involved in the execution of the works contract was by this amendment deemed to be a sale. To that extent the decision in *Gannon Dunkerley-I* was directly overcome”. It then went on to say that all the sub-clauses of Article 366(29-A) serve to bring transactions where essential ingredients of a ‘sale’ as defined in the Sale of Goods Act, 1930 are absent, within the ambit of purchase or sale for the purposes of levy of sales tax.

66. It then clarified that *Gannon Dunkerley-I* survived the Forty-sixth Constitutional Amendment in two respects. First, with regard to the definition of “sale” for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29-A) operate and second, the dominant nature test would be confined to a composite transaction not covered by Article 366 (29-A). In other words, in *Bharat Sanchar*⁵, this Court reiterated what was stated by this Court in *Associated Cement*¹⁵ that dominant nature test has no application to a composite transaction covered by the clauses of Article 366(29-A). Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six sub-clauses of clause 29-A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.

67. In view of the statement of law in *Associated Cement* and *Bharat Sanchar* the argument advanced on behalf of the appellants that dominant nature test must be applied to find out the true nature of transaction as to whether there is a contract for sale of goods or the contract of service in a composite transaction covered by the clauses of Article 366 (29-A) has no merit and the same is rejected.

68. In *Gannon Dunkerley-II*¹¹, this Court, *inter alia*, established the five following propositions : (i) as a result of Forty-sixth Amendment the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and the other for supply of labour and service and as a result of such contract which was single and indivisible has been brought on par with a contract containing two separate agreements; (ii) if the legal fiction introduced by Article 366 (29-A)(b) is carried to its logical end, it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services; (iii) in view of sub-clause (b) of clause 29-A of Article 366, the State legislatures are competent to impose tax on the transfer of property in goods involved in the execution of works contract. Under Article 286(3)(b), Parliament has been empowered to make a law specifying restrictions and conditions in regard to the system of levy, rates or incidents of such tax. This does not mean that the legislative power of the State cannot be exercised till the enactment of the law under Article 286(3)(b) by the Parliament. It only means that in the event of law having been made by Parliament under Article 286(3)(b), the exercise of the legislative power of the State under Entry 54 in List II to impose tax of the nature referred to in sub-clauses (b), (c) and (d) of clause (29-A) of Article 366 would be subject to restrictions and conditions in regard to the system of levy, rates and other incidents of tax contained in the said law; (iv) while enacting law imposing a tax on sale or purchase of goods under Entry 54

of the State List read with Article 366 (29-A)(b), it is permissible for the State legislature to make a law imposing tax on such a deemed sale which constitutes a sale in the course of the inter-state trade or commerce under Section 3 of the Central Sales Tax Act or outside under Section 4 of the Central Sales Tax Act or sale in the course of import or export under Section 5 of the Central Sales Tax Act; and (v) measure for the levy of tax contemplated by Article 366 (29-A)(b) is the value of the goods involved in the execution of a works contract. Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. Since, the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.

69. In *Gannon Dunkerley-II*, sub-section (3) of Section 5 of the Rajasthan Sales Tax Act and Rule 29(2)(1) of the Rajasthan Sales Tax Rules were declared as unconstitutional and void. It was so declared because the Court found that Section 5(3) transgressed the limits of the legislative power conferred on the State legislature under Entry 54 of the State List. However, insofar as legal position after Forty-sixth Amendment is concerned, *Gannon Dunkerley-II*¹¹ holds unambiguously that the States have now legislative power to impose tax on transfer of property in goods as goods or in some other form in the execution of works contract.

70. The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, clause 29-A of Article 366 empowers the States to levy tax on the deemed sale.

71. Now, if by legal fiction provided in clause (29-A)(b) of Article 366, the works contract becomes separable and divisible, one for the materials and the other for services and for the work done, whatever has been said by this Court in *Gannon Dunkerley-I* with regard to the definition of works contract in Section 2(i) of the Madras General Sales Tax Act pales into insignificance insofar as ambit and scope of the term “works contract” within the meaning of Article 366(29-A) is concerned. To say that insertion of clause (29-A) in Article 366 has not undone *Gannon Dunkerley-I* in any manner, in our view, is not correct. The narrow meaning given to the term “works contract” in *Gannon Dunkerley-I* now no longer survives.

72. There is no doubt that to attract Article 366(29-A)(b) there has to be a works contract but then what is its meaning. The term “works contract” needs to be understood in a manner that the Parliament had in its view at the time of Forty-sixth Amendment and which is more appropriate to Article 366(29-A)(b).

76. In our opinion, the term ‘works contract’ in Article 366(29-A)(b) is amply wide and cannot be confined to a particular understanding of the term or to a particular form. The term encompasses a wide range and many varieties of contract. The Parliament had such wide meaning of “works contract” in its view at the time of Forty-sixth Amendment. The object of insertion of clause 29-A in Article 366 was to enlarge the scope of the expression “tax of sale or purchase of goods” and overcome *Gannon Dunkerley-I*. Seen thus, even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract. The additional obligations in the contract would not alter the nature of contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. Once the characteristics or elements of works contract are satisfied in a contract then irrespective of additional obligations, such contract would be covered by the term ‘works contract’. Nothing in Article 366(29-A)(b) limits the term “works contract” to contract for labour and service only.

The Parliament had all genre of works contract in view when clause 29-A was inserted in Article 366.

77. The difference between a contract for work (or service) and a contract for sale (of goods) has come up for consideration before this Court on more than one occasion. Before we consider some of the decisions of this Court in this regard, it is of interest to refer to two old decisions of English courts. In *Lee* it was laid down that if a contract would result in the transaction of property in goods from one party to another then it must be a contract of sale.

78. However, the statement of law in *Lee* did not find favour in *Robinson* where it was held that if the substance of the contract required skill and labour for the production of the articles then it would not make any difference that there would pass some materials in addition to the skill.

79. In *Chandra Bhan Gosain* this Court explicated that for finding out whether a contract is one of work done and materials found or one for sale of goods depends on its essence. If not of its essence that a chattel should be produced and transferred as a chattel, then it may be a contract for work done and materials found and not a contract for sale of goods.

80. In *Purshottam Premji*, the difference between a contract for work and a contract for sale was explained like this: The primary difference between a contract for work or service and a contract for sale of goods is that in the former there is in the person performing work or rendering service no property in the thing produced as a whole notwithstanding that a part or even the whole of the materials used by him may have been its property. In a case of contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it at some time before delivery and the property therein passes only under the contract relating thereto to other party for price. Mere transfer of property in goods used in the performance of the contract is not sufficient; to constitute a sale there must be an agreement express or implied relating to the sale of goods and completion of the agreement by passing of title in the very goods contracted to be sold. Ultimately the true effect of an accretion made pursuant to a contract has to be judged, not by an artificial rule that the accretion may be presumed to have become by virtue of affixing to a chattel of part of that chattel but from the intention of the parties to the contract.

81. The factors highlighted in *Purshottam Premji* which distinguish a contract for work from a contract for sale are relevant but not exhaustive. It is not correct to say that these factors should be considered as the only factors to differentiate a works contract and a contract for sale. In our view, there are not and there cannot be absolute tests to distinguish a sale and works contract.

82. This Court in *Associated Hotels* stated that the determination as to whether the contract involved in a transaction constitutes a contract of sale or a contract of work or service depends in each case upon its facts and circumstances. Mere passing of property in article or commodity during the course of the performance of the transaction does not render it a transaction of sale. For even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work and property in such cases articles or materials were passed to the other party. That would not necessarily convert the contract into one of sale of those materials. It is stated in *Associated Hotels* that in every case the Court will have to find out what is the primary object of the transaction and the intention of the parties while entering upon it. It has been clarified that in some cases it may be that even while entering into a contract of work or even service, parties might enter into separate agreements, one of work and service and the other of sale and purchase of materials to be used in the course of executing the work or performing the service. But, then in such cases the transaction will not be one and indivisible but will fall into the two separate agreements one of work or service and the other of sale.

85. In *Hindustan Aeronautics*²⁶, the Court noted the difference between contract for service and contract for sale of goods in these words:

“13. It is well settled that the difference between contract of service and contract for sale of goods, is, that in the former, there is in the person performing work or rendering service no property in the things produced as a whole notwithstanding that a part or even the whole of materials used by him had been his property. In the case of a contract for sale, the thing produced as a whole has individual existence as the sole property of the party who produced it sometime before delivery and the property therein passed only under the contract relating thereto to the other party for price. It is necessary, whether in essence there was any agreement to work for a stipulated consideration.....”

86. The Court went on to say further in *Hindustan Aeronautics* as follows;

“18. It cannot be said as a general proposition that in every case of works contract, there is necessarily implied the sale of the component parts which go to make up the repair. That question would naturally depend upon the facts and circumstances of each case. Mere passing of property in an article or commodity during the course of performance of the therefore, in every case for the courts to find out transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of works or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials.....”

7. In *Kone Elevators*²⁷, the Court again highlighted the tests to distinguish a works contract and a contract for sale of goods. The Court said;

“5. It can be treated as well settled that there is no standard formula by which one can distinguish a “contract for sale” from a “works contract”. The question is largely one of fact depending upon the terms of the contract including the nature of the obligations to be discharged thereunder and the surrounding circumstances. If the intention is to transfer for a price a chattel in which the transferee had no previous property, then the contract is a contract for sale. Ultimately, the true effect of an accretion made pursuant to a contract has to be judged not by artificial rules but from the intention of the parties to the contract. In a “contract of sale”, the main object is the transfer of property and delivery of possession of the property, whereas the main object in a “contract for work” is not the transfer of the property but it is one for work and labour. Another test often to be applied is: when and how the property of the dealer in such a transaction passes to the customer: is it by transfer at the time of delivery of the finished article as a chattel or by accession during the procession of work on fusion to the movable property of the customer? If it is the former, it is a “sale”; if it is the latter, it is a “works contract”. Therefore, in judging whether the contract is for a “sale” or for “work and labour”, the essence of the contract or the reality of the transaction as a whole has to be taken into consideration. The predominant object of the contract, the circumstances of the case and the custom of the trade provide a guide in deciding whether transaction is a “sale” or a “works contract”. Essentially, the question is of interpretation of the “contract”. It is

settled law that the substance and not the form of the contract is material in determining the nature of transaction. No definite rule can be formulated to determine the question as to whether a particular given contract is a contract for sale of goods or is a works contract. Ultimately, the terms of a given contract would be determinative of the nature of the transaction, whether it is a “sale” or a “works contract”. Therefore, this question has to be ascertained on facts of each case, on proper construction of terms and conditions of the contract between the parties.”

92. It seems to us (and that is the view taken in some of the decisions) that a contract may involve both a contract of work and labour and a contract of sale of goods. In our opinion, the distinction between contract for sale of goods and contract for work (or service) has almost diminished in the matters of composite contract involving both (a contract of work/labour and a contract for sale for the purposes of Article 366 (29-A)(b). Now by legal fiction under Article 366(29-A)(b), it is permissible to make such contract divisible by separating the transfer of property in goods as goods or in some other form from the contract of work and

labour. A transfer of property in goods under clause 29(A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. For this reason, the traditional decisions which hold that the substance of the contract must be seen have lost their significance. What was viewed traditionally has to be now understood in light of the philosophy of Article 366(29-A).

93. The question is: Whether taxing sale of goods in an agreement for sale of flat which is to be constructed by the developer/promoter is permissible under the Constitution? When the agreement between the promoter/developer and the flat purchaser is to construct a flat and eventually sell the flat with the fraction of land, it is obvious that such transaction involves the activity of construction inasmuch as it is only when the flat is constructed then it can be conveyed. We, therefore, think that there is no reason why such activity of construction is not covered by the term “works contract”. After all, the term “works contract” is nothing but a contract in which one of the parties is obliged to undertake or to execute works. Such activity of construction has all the characteristics or elements of works contract. The ultimate transaction between the parties may be sale of flat but it cannot be said that the characteristics of works contract are not involved in that transaction. When the transaction involves the activity of construction, the factors such as, the flat purchaser has no control over the type and standard of the material to be used in the construction of building or he does not get any right to monitor or supervise the construction activity or he has no say in the designing or lay-out of the building, in

our view, are not of much significance and in any case these factors do not detract the contract being works contract insofar as construction part is concerned.

94. For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, in our opinion, three conditions must be fulfilled: (i) there must be a works contract, (ii) the goods should have been involved in the execution of a works contract, and (iii) the property in those goods must be transferred to a third party either as goods or in some other form. In a building contract or any contract to do construction, the above three things are fully met. In a contract to build a flat there will necessarily be a sale of goods element. Works contracts also include building contracts and therefore without any fear of contradiction it can be stated that building contracts are species of the works contract.

95. Ordinarily in the case of a works contract the property in the goods used in the construction of the building passes to the owner of the land on which the building is constructed when the goods and materials used are incorporated in the building. But there may be contract to the contrary or a statute may provide otherwise. Therefore, it cannot be said to be an absolute proposition in law that the ownership of the goods must pass by way of accretion or exertion to the owner of the immovable property to which they are affixed or upon which the building is built.

96. Value addition as a concept after Forty-sixth Amendment to the Constitution has been accepted by this Court in *P.N.C. Construction*. While dealing with this concept, the Court said that value addition was important concept which had arisen after the Forty-sixth Amendment by insertion of sub-clause (b) of clause (29-A) in Article 366. It has now become possible for the States to levy sales tax on the value of the goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods in a building contract. On account of the Forty-sixth Amendment in the Constitution the State Governments are empowered to levy sales tax on the contract value which earlier was not possible

97. Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. Article 366(29-A)(b) does contemplate a situation where the goods may not be transferred in the form of goods but may be transferred in some other form which may even be in the form of immovable property.

100. We have no doubt that the State legislatures lack legislative power to levy tax on the transfer of immovable property under Entry 54 of List II of the Seventh Schedule. However, the States do have competence to levy sales tax on the sale of goods in an agreement of sale of flat which also has a component of a deemed sale of goods. Aspects theory though does not allow the State legislature to entrench upon the Union List and tax services by including the cost of such service in the value of goods but that does not detract the State to tax the sale of goods element involved in the execution of works contract in a composite contract like

contract for construction of building and sale of a flat therein. In para 88 of *Bharat Sanchar*⁵, the Court stated: “the aspects theory does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods. Even in those composite contracts which are by legal fiction deemed to be divisible under Article 366(29-A), the value of the goods involved in the execution of the whole transaction cannot be assessed to sales tax”. Having said that, the Court also stated that the States were not competent to include the cost of service in the value of the goods sold (i.e. the sim card) nor the Parliament could include the value of the sim card in the cost of services. But the statement in para 92(C) of the Report is clear that it is upto the States to tax the sale of goods element in a composite contract of sale and service. *Bharat Sanchar*⁵ thus supports the view that taxation of different aspects of the same transaction as separate taxable events is permissible.

101. In light of the above discussion, we may summarise the legal position, as follows:

(i) For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, three conditions must be fulfilled: (one) there must be a works contract, (two) the goods should have been involved in the execution of a works contract and (three) the property in those goods must be transferred to a third party either as goods or in some other form.

(ii) For the purposes of Article 366(29-A)(b), in a building contract or any contract to do construction, if the developer has received or is entitled to receive valuable consideration, the above three things are fully met. It is so because in the performance of a contract for construction of building, the goods (chattels) like cement, concrete, steel, bricks etc. are intended to be incorporated in the structure and even though they lost their identity as goods but this factor does not prevent them from being goods.

(iii) Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. The term “works contract” in Article 366 (29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. Nothing in Article 366(29-A)(b) limits the term “works contract”.

(iv) Building contracts are species of the works contract.

(v) A contract may involve both a contract of work and labour and a contract for sale. In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.

(vi) The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A). Even if the dominant intention of the contract is not to transfer the property in goods and rather it is rendering of

service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if such contract otherwise has elements of works contract. The enforceability test is also not determinative.

(vii) A transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

(viii) Even in a single and indivisible works contract, by virtue of the legal fiction introduced by Article 366(29-A)(b), there is a deemed sale of goods which are involved in the execution of the works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for the sale of goods and the other for supply of labour and services. In other words, the single and indivisible contract, now by Forty-sixth Amendment has been brought on par with a contract containing two separate agreements and States have now power to levy sales tax on the value of the material in the execution of works contract.

(ix) The expression “tax on the sale or purchase of goods” in Entry 54 in List II of Seventh Schedule when read with the definition clause 29-A of Article 366 includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract.

(x) Article 366(29-A)(b) serves to bring transactions where essential ingredients of ‘sale’ defined in the Sale of Goods Act, 1930 are absent within the ambit of sale or purchase for the purposes of levy of sales tax. In other words, transfer of movable property in a works contract is deemed to be sale even though it may not be sale within the meaning of the Sale of Goods Act.

(xi) Taxing the sale of goods element in a works contract under Article 366(29-A)(b) read with Entry 54 List II is permissible even after incorporation of goods provided tax is directed to the value of goods and does not purport to tax the transfer of immovable property. The value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works even though property passes as between the developer and the flat purchaser after incorporation of goods.

102. The crucial question would now remain: whether the view taken in *Raheja Development*¹ with reference to definition of “works contract” in KST Act is legally unjustified? The following definition of “works contract” was under consideration before this Court in *Raheja Development* “works contract” includes any agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any moveable or immovable property”.

103. The Court also noticed the definition of “dealer” and “taxable turn over”.

104. The broad facts in *Raheja Development* were these:

Raheja Development carried on the business of real estate development and allied contracts;

Raheja Development entered into development agreements with the owners of land;

Raheja Development entered into agreements of sale with intended purchasers. The agreements provided that on completion of the construction, the residential apartments or the commercial complexes would be handed over to the purchasers who would get an undivided interest in the land also;

The owners of the land would then transfer the ownership directly to the society formed under the Karnataka Ownership Flat (Regulation of the Promotion of Construction, Sale, Management and Transfer) Act, 1972 (for short, 'KOFA').

105. In light of the above facts and the definition of "works contract", the question before this Court was whether Raheja Development were liable to pay turnover tax on the value of goods involved in the execution of the works contract.

106. Section 5-B of the KST Act provides for levy of tax on transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract.

107. On consideration of the arguments that were put forth by the parties, the Court in *Raheja Development*¹ held as under:

- (i) The definition of the term "works contract" in the Act is an inclusive definition.
- (ii) It is a wide definition which includes "any agreement" for carrying out building or construction activity for cash, deferred payment or other valuable consideration.
- (iii) The definition of works contract does not make a distinction based on who carries on the construction activity. Even an owner of the property may be said to be carrying on a works contract if he enters into an agreement to construct for cash, deferred payment or other valuable consideration.
- (iv) The developers had undertaken to build for the prospective purchaser.
- (v) Such construction/development was to be on payment of a price in various installments set out in the agreement.
- (vi) The developers were not the owners. They claimed lien on the property. They had right to terminate the agreement and dispose of the unit if a breach was committed by the purchaser. A clause like this does not mean that the agreement ceases to be "works contract". So long as there is no termination, the construction is for and on behalf of the purchaser and it remains a "works contract".
- (vii) If there is a termination and a particular unit is not resold but retained by the developer, there would be no works contract to that extent.

(viii) If the agreement is entered into after the flat or unit is already constructed then there would be no works contract. But, so long as the agreement is entered into before the construction is complete it would be works contract.

108. The correctness of the view taken in *Raheja Development* has been doubted in the referral order principally for the reasons: (a) the developer had undertaken the contract to develop the property of the owner. It is not alleged by the department that there is monetary consideration involved in the development agreement. If the development agreement is not a works contract, could the department rely upon the second contract which is the tripartite agreement and interpret it to be a works contract; (b) if the ratio in *Raheja Development* is to be accepted then there would be no difference between works contract and a contract for sale of chattel as a chattel and (c) from the definition of works contract, the contractor must have undertaken the work of construction for and on behalf of the flat purchaser for cash, deferred or any other valuable consideration but could it be said that developer was contractor for the prospective flat purchaser.

109. In *Raheja Development*¹, the Court on consideration of the clauses (q) and (r) of the recitals and clauses (1), 5(c) and (vii) of the agreement between the flat purchaser, developer and owner of the land observed that the agreement had an element for carrying out building and construction activity for cash, deferred payment or other valuable consideration. The developer had undertaken to build for the prospective purchaser. Having regard to the various clauses of the recitals and also the clauses of the agreement, the Court was of the view that such agreement was a typical agreement and so long as there was no termination of the contract, the construction is for and on behalf of the purchaser and it remains a “works contract”.

114. In Article 366(29-A)(b), the term ‘works contract’ covers all genre of works contract and it is not limited to one specie of the contract. In *Raheja Development*¹, the definition of “works contract” in KST Act was under consideration. That definition of “works contract” is inclusive and refers to building contracts and diverse construction activities for monetary consideration viz; for cash, deferred payment or other valuable consideration as works contract. Having regard to the factual position, *inter alia*, *Raheja Development*¹ entered into development agreements with the owners of the land and it also entered into agreements for sale with the flat purchasers, the consideration being payment in installments and also the clauses of the agreement the Court held that developer had undertaken to build for the flat purchaser and so long as there was no termination of the contract, the construction is for and on behalf of the purchaser and it remains a “works contract”. The legal position summarized by us and the foregoing discussion would justify the view taken by the two Judge Bench in *Raheja Development*¹.

115. It may, however, be clarified that activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government.

116. The reasons stated in the referral order for reconsideration of *Raheja Development*¹ do not make out any good ground for taking a view different from what has been taken by this Court in *Raheja Development*. We are in agreement with the submission of Mr. K.N. Bhat that since *Raheja Development* in May, 2005 almost all States have modified their laws in line with *Raheja Development* and there is no justification for change in the position settled after the decision of this Court in *Raheja Development*.

18. We are clearly of the view that *Raheja Development*¹ lays down the correct legal position and we approve the same. 120. Clause (24) of Section 2 defines sale to mean a sale of goods made within the State for cash or deferred payment or other valuable consideration but does not include a mortgage, hypothecation, charge of pledge; and the words “sell”, “buy” and “purchase”, with all their grammatical variations and cognate expressions. An explanation is appended to this clause. Clause (b) of the explanation to Section 2(24) defines what would be a sale for the purpose of the clause and brought in its ambit the transactions mentioned therein. Explanation (b)(ii) was amended with effect from 20.06.2006 by inserting the following words after the words “works contract”: “including, an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property”.

121. There is no doubt in our mind that the amendment in explanation b(ii) to Section 2(24) was brought because of the judgment of this Court in *Raheja Development*. We have already held that *Raheja Development* lays down the correct legal position.

125. Once we have held that *Raheja Development* lays down the correct law, in our opinion, nothing turns on the circular dated 07.02.2007 and the notification dated 09.07.2010. The circular is a trade circular which is clarificatory in nature only. The notification enables the registered dealer to opt for a composition scheme. The High Court has dealt with the circular and notification. We do not find any error in the view of the High Court in this regard.

State of Karnataka and Ors. v. Pro Lab and Ors.

AIR 2015 SC 1098

Constitutional validity of Entry 25 of Schedule VI to the Karnataka Sales Tax Act, 1957 (hereinafter referred to as the 'Act') is the subject matter of the present appeal. It is the third endeavour to resurrect this entry, when on the first two occasions, the steps taken by the State were declared as impermissible. Even this time, the High Court has dumped the amendment as unconstitutional. However, the reasons advanced by the High Court in all three rounds are different. While traversing through the historical facts leading to the issue at hand, we shall be referring to the same for clear understanding of the controversy involved.

2.This entry was inserted in the said Act by an amendment which came into effect from 01.07.1989, thereby providing levy of tax for processing and supply of photographs, photo prints and photo negatives. The validity of this entry was challenged by means of a writ petition filed in the High Court of Karnataka. The High Court in that case titled ***M/s Keshoram Surindranath Photo – Bag (P) Ltd. and others v. Asstt.Commissioner of Commercial Taxes (LR), City Division, Bangalore and others*** declared the said Entry to be unconstitutional. State of Karnataka had challenged that judgment by filing special leave petition in this Court. This special leave petition was dismissed vide order dated 20.04.2000, following its earlier judgment in the case of ***Rainbow Colour Lab and Another v. State of Madhya Pradesh and others***². The reason for holding Entry 25 as unconstitutional was that the contract of processing and supplying of photographs, photo frames and photo negatives was predominantly a service contract with negligible component of goods/material and, therefore, it was beyond the competence of State Legislature given in Entry 25 of List II of Schedule VII of the Constitution to impose sales tax on such a contract.

3.It so happened that within one year of the judgment in *Rainbow Colour Lab's case*, three Judges Bench of this Court rendered another judgment in the case of ***ACC Ltd. v. Commissioner of Customs*** wherein it expressed its doubts about the correctness of the law laid down in *Rainbow*. We may point out at this stage itself that during the course of hearing of the present appeal, there was a hot debate on the question as to whether judgment in *Rainbow Colour Lab's case* was over-ruled in the case of *ACC Ltd.* case or not. This aspect will be gone into by us at the appropriate stage.

4.After the judgment in *ACC Ltd.* case, a circular instruction was issued by the Commissioner of Commercial Taxes to the assessing authorities to proceed with the assessments as per Entry 25. This became the subject matter of challenge before the High Court of Karnataka in the case of ***M/s Golden Colour Labs and Studio and others v. The Commissioner of Commercial Taxes***. The High Court allowed the writ petition vide judgment dated 30.07.2003 holding that a provision once declared unconstitutional

could not be brought to life by mere administrative instructions. However, at the same time, the Court observed that Entry 25, Schedule VI to the Act, declared *ultra vires* the Constitution in *Keshoram's* case, cannot be revived automatically, unless there is re-enactment made by the State Legislature to that effect.

5. The appropriate procedure indicated in the aforesaid judgment emboldened the State to come out with the required legislative amendment. This paved way for the enactment of the Karnataka State Laws Act, 2004 by the State Legislature that came into force with effect from 29.01.2004. Section 2(3) of the said amendment re-introduced Entry 25 in identical terms, as it appeared earlier, and that too with retrospective effect that is w.e.f. 01.07.1989, when this provision was inserted by the amendment made in the year 1989 for the first time.

6. As was expected, this amendment was again challenged before the Karnataka High Court by the respondent herein as well as many others. Vide impugned judgment dated 19.08.2005, the High Court has again declared the said amendment as unconstitutional. It would be pertinent to mention that the High Court has not taken into consideration the events that followed after *Rainbow Colour Lab's* case, namely, over-ruling of the said judgment in *ACC Ltd.* Since the basis of *Keshoram's* case decided in the first calm by the High Court was same as given in *Rainbow Colour Lab*, obviously *Keshoram* also no longer remains a good law. However, the reason given by the High Court, this time, is that the ratio laid down in *Keshoram's* case continues to be binding on the State of Karnataka. As per the High Court, “the re-enactment of the said provision is possible in the event of a subsequent declaration made by the Hon'ble Supreme Court re-considering or pronouncing a similar question in terms of the findings in para 23 of the *Golden Colour Lab's* case. This is, thus, the chequered history of the litigation amply demonstrating as to how the State of Karnataka is making desperate attempts to ensure that provision in the form of Entry 25 in the said Act survives, empowering the State Government to levy sales tax for processing and supply of photographs, photo prints and photo negatives.

8. We may also record at this point itself that legislative competence of the State to insert the aforesaid Entry is primarily challenged on the ground that the State Government is not empowered to levy sales tax on the processing and supplying of photographs which is predominantly in the nature of “service” and the element of “goods” therein was minimal. The respondents argue that the State Legislature does not have any power to impose tax on “services” inasmuch as the sales tax can be levied only on “sale of goods” as permitted under Article 366 (29-A) of the Constitution of India. Challenge is also laid on the retrospective effect given to the said Entry by arguing that such a move is violative of Article 265 of the Constitution of India as subjecting the assesseees to such a tax from retrospective effect is confiscatory in nature and, therefore, unconstitutional.

9. We have projected, in nutshell, the chequered history of the litigation by referring to the judgments of this Court pronounced from time to time which have a direct bearing on the outcome of this appeal. Therefore, we are simply required to do a diagnostic of the sorts in revisiting these judgments.

10. In order to ensure that we avoid unnecessary burdening of judgments with the earlier case laws, it is safe to charter the journey by initiating discussion about the Constitution Bench judgment in the case of *Gannon Dunkerley and Co. and others v. State of Rajasthan and others*. That case pertained to the execution of the Works Contracts. Question involved was as to whether there could be levy of sales tax on the sale of goods involved in the execution of such Works Contracts. The assessee, viz. Gannon Dunkerley, was carrying on business as Engineering Contractors and executing the contracts pertaining to construction of building projects, dams, roads and structural contracts of all kinds. In respect of sanitary contracts, 20 per cent was deducted for labour and balance was taken as a turnover of the assessee for the purposes of levying sales tax by the assessing authority. Likewise, in respect of other contracts, 30 per cent was deducted for labour and on balance amount, sales tax was levied treating it as turnover of the assessee under the Madras General Sales Tax Act, 1939. The question which arose for consideration was as to whether there was any sale of goods. The Constitution Bench held that building contract was in the nature of Works Contract and there was no element of sale of goods in such a contract. In its opinion, in a building contract where the agreement between the parties was that the contractor should construct the building according to the specifications contained in the agreement and in consideration received payment as provided therein, there was neither a contract to sell the materials used in the construction nor the property passed therein as movables. It was held that in a building contract, which was one entire and indivisible, there was no sale of goods and it was not within the competence of the Provincial State Legislature to impose tax on the supply of the materials used in such a contract treating it as a sale. The Court, thus, proceeded on the basis that a building contract was indivisible and composite wherein there was no sale of goods and, therefore, the State Legislature was not competent to impose sales tax on the supply of material used in such a contract treating it as a sale. Since, Entry 48 of the List II of Schedule VII in the Government of India Act, 1935 was under consideration that empowers State Government to levy tax “sale of goods”, the Court held that the expression “sale of goods” in the said Entry is to be given the same meaning as given under the Sale of Goods Act, 1930. That would mean that it would be sale of goods only if the two essential ingredients, namely: (i) an agreement to sell movables for a price, and (ii) property passing therein pursuant to that agreement, are satisfied.

11. After the aforesaid Constitution Bench judgment, the Parliament amended the Constitution of India by the Constitution (46th Amendment) Act, 1982 which received the assent of the President of India on 02.02.1983. By this amendment, clause (29-A) was inserted in Article 366 of the Constitution, which reads as under:

“(29A) “tax on the sale or purchase of goods” includes -

- a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

- a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
- a tax on the delivery of goods on hire-
- purchase or any system of payment by instalments;
- a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
- a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration; and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;]”

12. The challenge laid to the aforesaid amendment was repelled by this Court in the case of *Builders Association of India and others v. Union of India and others*⁶. In this judgment, the Constitution Bench specifically noted that the purport and object of the aforesaid amendment was to enlarge the scope of the expression “tax of sale for purchase of goods” wherever it occurs in the Constitution so that it may include within its ambit any transfer, delivery or supply of goods that may take place under any of the transactions referred to in sub-clauses (a) to (f). To put it tersely, with the aforesaid amendment, the States are empowered to make the Works Contract divisible and tax “sale of goods” component. It clearly follows therefrom that the restricted meaning which was assigned to the expression “sale of goods” in Gannon Dunkerley's case is undone by the aforesaid amendment. The interpretation which is to be assigned to clause 29-A of Article 366 is stated with remarkable clarity in *M/s Larsen Toubro and another v. State of Karnataka and another*⁷, by a three Judge Bench in the following words:

“60. It is important to ascertain The meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution. As the very title of Article 366 shows, it is the definition clause. It starts by saying that in the Constitution unless the context otherwise requires the expressions defined in that article shall have the meanings respectively assigned to them in the article. The definition of expression "tax on sale or purchase of the goods" is contained in Clause (29A). If the first part of Clause 29A is read with Sub-clause

(b) along with latter part of this clause, it reads like this: tax on the sale or purchaser of the goods" includes a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the

person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made. The definition of "goods" in Clause 12 is inclusive. It includes all materials, commodities and articles. The expression, 'goods' has a broader meaning than merchandise. Chattels or movables are goods within the meaning of Clause 12. Sub-clause (b) refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression "in some other form" in the bracket is of utmost significance as by this expression the ordinary understanding of the term 'goods' has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of 'tax on the sale or purchase of goods' includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.

61. Viewed thus, a transfer of property in goods under Clause 29A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

62. The States have now been conferred with the power to tax indivisible contracts of works. This has been done by enlarging the scope of "tax on sale or purchase of goods" wherever it occurs in the Constitution. Accordingly, the expression "tax on the sale or purchase of goods" in Entry 54 of List II of Seventh Schedule when read with the definition Clause 29A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.

63. *Gannon Dunkerley-I (supra)* and few other decisions following *Gannon Dunkerley-I (supra)* wherein the expression "sale" was given restricted meaning by adopting the definition of the word "sale" contained in the Sale of Goods Act has been undone by the Forty-sixth Constitutional Amendment so as to include works contract. The meaning of Sub-clause (b) of Clause 29A of Article 366 of the Constitution also stands settled by the Constitution Bench of this Court in *Builders' Association (supra)*. As a result of Clause 29A of Article 366, tax on the sale or purchase of goods may include a tax on the transfer in goods as goods or in a form other than goods involved in the execution of the works contract. It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract."

13. Notwithstanding some clear and pertinent observations made in by the Constitution Bench in *Builders Association's case*, while upholding the Constitutional validity of 46th Amendment, there was some ambiguity in the judicial thought on one particular

aspect which was also one of the basis of judgment in *Gannon Dunkerley's* case. In *Gannon Dunkerley's* case, the Constitution Bench had laid down “dominant intention test” to find out as to whether a particular contract involved transfer of property in goods. The Court was of the opinion that if the dominant intention of a contract was not to transfer the property in goods, but it was Works Contract, or for that matter, a contract in the nature of rendering of services, even if a part of it related to the transfer of goods, that would be immaterial and no sales tax on the said part could be levied, going by the principle of dominant intention behind such a contract, which was in the nature of Works Contract in the contract relating to construction of buildings.

14. As pointed out above, in *Gannon Drunkerley's* case, the Court also held that such a contract was indivisible. No doubt, insofar as indivisibility facet of the contract is concerned, the same was done away by 46th Constitutional Amendment. However, in subsequent cases, the Court grappled with the issue as to whether the principle of dominant intention still prevailed. This very aspect came up for discussion before two Judge Bench of this Court in *Rainbow Colour Lab's case*. The Court held the view that the division of contract after 46th Amendment can be made only if the Works Contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. This aspect is highlighted by the said Bench in the following manner:

“10. Since this was a judgment rendered prior to the coming into force of the 46th Constitutional Amendment, we will have to consider whether the said Amendment has brought about any change so as to doubt the legal position enunciated in the above case. It is true that by the 46th Constitutional Amendment by incorporating Clause 29A(b) in Article 366, the definition of the words "sale" and "works contract" have been enlarged. The State of Madhya Pradesh has also brought about a consequent change in the definition of the word 'sale' in Section of its Sales Tax Act but it is to be noticed that in the said State Act the expression 'works contract' has not been specifically defined.

11. Prior to the Amendment of Article 366, in view of the judgment of this Court In *State of Madras v Gannon Dunkerley and Co.*, the State could not levy sales-tax on sale of goods involved in a work's contract because the contract was indivisible. All that has happened In law after the 46th Amendment and the judgment of this Court in *Builders case* (supra) is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction (i) contract for sale of goods involved in the said works contract and (it) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. The Amendment, referred to above, has not empowered the State to indulge in microscopic division of contracts involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a

service contract or otherwise, may involve the use of some material or the other in execution of the said contract. State is not empowered by the amended law to impose sales-tax on such incidental materials used in such contracts. This is clear from the judgment of this Court in *Hindustan Aeronautics Ltd. v. State of Karnataka* [1984]2SCR248, where it was held thus: Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of sale of those materials. In every case, the Court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it....”

15. While considering the validity of Entry 25 in Schedule VI of the Act and holding it to be unconstitutional, as beyond the powers of the State Legislature, the High Court of Karnataka in *Keshoram's case* examined in detail the business which was carried out by the petitioner in the said case and the process that was involved in processing and supplying of photographs, photoframes or photonegatives. By that time, 46th Constitutional Amendment had already been effected which was also taken note of by the High Court. However, the High Court took the view that the main object of the work undertaken by the petitioner in that case was not the transfer of a chattle as a chattle and, in fact, it was a contract of work and labour and there was no sale of goods involved.

16. It is manifest from the above that the rationale behind the judgment was to look into the main object of the work undertaken by the assessee and concluding that since it was essentially a

Works Contract and transfer of photopaper upon which the positive prints were taken were simply incidental and ancilliary to the main transactions, that was in the nature of service contract, and, therefore, Entry 25 was beyond the scope of Article 366 of the Constitution of India. Apparently, the High Court applied dominant intention test while holding Entry 25 as unconstitutional. By the time, Special Leave Petition against this judgment came up for consideration before this Court on 20.04.2000, the judgment in the case of *Rainbow Colour Lab's case* had just been rendered observing that dominant intention test was still valid notwithstanding insertion of clause 29-A in Article 366 of the Constitution by 46th Amendment. Following this judgment, SLP was dismissed.

17. Within one year of the said judgment, this very issue again cropped up for discussion and decision before a three Judge Bench in *ACC Ltd. case*. The issue arose under the Customs Act, 1962 viz. whether the drawings, designs etc. relating to machinery or industrial technology were goods which were leviable to duty of customs on their transaction value at the time of their report. However, since the issue related to meaning that has to be given to the expression “goods”, the case law on this aspect including *Gannon Dunkerley & Kame's case* were specifically taken note of and discussed. The Court also noticed the effect of 46th Amendment and in the process commented upon the

judgment in the *Rainbow Colour Lab's case*. The Court specifically remarked that *Gannon Dunkerley & Kame's* judgments were of pre 46th Amendment era which had no relevance after the said Constitutional amendment. It can be discerned from the following discussion contained therein:

"21. All the aforesaid decisions related to the period prior to the Forty-sixth Amendment of the Constitution when Article 366(29A) was inserted. At that time in the case of a works contract it was held that the same could not be split and State Legislature had no legislative right to seek to levy sales tax on a transaction which was not a sale simpliciter of goods. *Rainbow Colour Lab & Anr. Vs. State of M.P. and Others*, (2000) 2 SCC 385 was, however, a case relating to the definition of the word "sale" in the M.P. General Sales Tax Act, 1958 after its amendment consequent to the insertion of Article 366(29A). The question there was whether the job rendered by a photographer in taking photographs, developing and printing films would amount to works contract for the purpose of levy of sales tax. This Court held that the work done by the photographer was only a service contract and there was no element of sale involved. After referring to earlier decisions of this Court, it was observed at page 391 as follows:

"15. Thus, it is clear that unless there is sale and purchase of goods, either in fact or deemed, and which sale is primarily intended and not incidental to the contract, the State cannot impose sales tax on a works contract simpliciter in the guise of the expanded definition found in Article 366(29A)(b) read with Section 2(n) of the State Act. On facts as we have noticed that the work done by the photographer which as held by this Court in *Kame* case is only in the nature of a service contract not involving any sale of goods, we are of the opinion that the stand taken by the respondent State cannot be sustained."

22. Even though in our opinion the decisions relating to levy of sales tax would have, for reasons to which we shall presently mention, no application to the case of levy of customs duty, the decision in *Rainbow Colour Lab case* (supra) requires consideration. As a result of the Forty-sixth Amendment, sub-article 29A of Article 366 was inserted as a result whereof tax on the sale or purchase of goods was to include a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Taking note of this amendment this Court in *Rainbow Colour Lab* at page 388-389 observed as follows:

"11. Prior to the amendment of Article 366, in view of the judgment of this Court in *State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd.* the States could not levy sales tax on sale of goods involved in a works contract because the contract was indivisible. All that has happened in law after the 46th Amendment and the judgment of this Court in '*Builders*' case is that it is now open to the States to divide the works contract into two separate contracts by a legal fiction: (i) contract for sale of goods involved in the said works contract, and (ii) for supply of labour and service. This division of contract under the amended law can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer in property takes place as an incident of contract of service. The amendment, referred to above, has not empowered the State to indulge in a microscopic division of contracts

involving the value of materials used incidentally in such contracts. What is pertinent to ascertain in this connection is what was the dominant intention of the contract. Every contract, be it a service contract or otherwise, may involve the use of some material or the other in execution of the said contract. The State is not empowered by the amended law to impose sales tax on such incidental materials used in such contracts.."

23. In arriving at the aforesaid conclusion the Court referred to the decision of this Court in *Hindustan Aeronautics Ltd. vs. State of Karnataka* (1984) a SCC 706 and *Everest Copier* (supra). But both these cases related to pre-Forty-sixth Amendment era where in a works contract the State had no jurisdiction to bifurcate the contract and impose sales tax on the transfer of property in goods involved in the execution of a works contract. The Forty-sixth Amendment was made precisely with a view to empower the State to bifurcate the contract and to levy sales tax on the value of the material involved in the execution of the works contract, notwithstanding that the value may represent a small percentage of the amount paid for the execution of the works contract. Even if the dominant intention of the contract is the rendering of a service, which will amount to a works contract, after the Forty-sixth Amendment the State would now be empowered to levy sales tax on the material used in such contract. The conclusion arrived at in *Rainbow Colour Lab* case, in our opinion, runs counter to the express provision contained in Article 366 (29A) as also of the Constitution Bench decision of this Court in *Builders' Association of India and Others vs. Union of India and Others* (1989) 2 SCC 645." [emphasis supplied]

18. It is amply clear from the above and hardly needs clarification Bench judgment in *Rainbow Colour Lab's case* did not lay down the correct law as it referred to pre 46th Amendment judgments in arriving at its conclusions which had lost their validity. The Court also specifically commented that after 46th Amendment, State is empowered to levy sales tax on the material used even in those contracts where "the dominant intention of the contract is the rendering of a service, which will amount to a Works Contract".

19. In view of the above, the argument of the respondent assesseees that *ACC Ltd.* case did not over-rule *Rainbow Colour Lab's case* is, therefore, clearly misconceived. In fact, we are not saying so for the first time as a three member Bench of this Court in *M/s Larsen and Toubro* has already stated that *ACC Ltd.* had expressly over-ruled *Rainbow Colour Lab* while holding that dominant intention test was no longer good test after 46th Constitutional Amendment. We may point out that learned counsel for the respondent assesseees took courage to advance such an argument emboldened by certain observations made by two member Bench in the case of *C.K. Jidheesh v. Union of India*⁸, wherein the Court has remarked that the observations in *ACC Ltd.* were merely obiter. In *Jidheesh*, however, the Court did not notice that this very argument had been rejected earlier in *Bharat Sanchar Nigam Ltd. v. Union of India*⁹.

20. In *M/s Larsen and Toubro*, the Court, after extensive and elaborate discussion, once again specifically negated the argument predicated on dominant intention test having regard to the statement of law delineated in *ACC Ltd.* and *Bharat Sanchar Nigam Ltd.* cases. The reading of following passages from the said judgment is indicative of providing complete answer to the arguments of the respondent assessee herein:

“64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract. The view taken by a two-Judge Bench of this Court in *Rainbow Colour Lab (supra)* that the division of the contract after Forty-sixth Amendment can be made only if the works contract involved a dominant intention to transfer the property in goods and not in contracts where the transfer of property takes place as an incident of contract of service is no longer good law, *Rainbow Colour Lab (supra)* has been expressly overruled by a three-Judge Bench in *Associated Cement*.

65. Although, in *Bharat Sanchar*, the Court was concerned with Sub-clause (d) of Clause 29A of Article 366 but while dealing with the question as to whether the nature of transaction by which mobile phone connections are enjoyed is a sale or service or both, the three-Judge Bench did consider the scope of definition in Clause 29A of Article 366. With reference to Sub-clause (b) it said: "Sub-clause (b) covers cases relating to works contract. This was the particular fact situation which the Court was faced with in *Gannon Dunkerley-I* and which the Court had held was not a sale. The effect in law of a transfer of property in goods involved in the execution of the works contract was by this amendment deemed to be a sale. To that extent the decision in *Gannon Dunkerley-I* was directly overcome". It then went on to say that all the Sub-clauses of Article 366 (29A) serve to bring transactions where essential ingredients of a 'sale' as defined in the Sale of Goods Act, 1930 are absent, within the ambit of purchase or sale for the purposes of levy of sales tax.

66. It then clarified that *Gannon Dunkerley-I* survived the Forty-sixth Constitutional Amendment in two respects. First, with regard to the definition of "sale" for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Article 366(29A) operate and second, the dominant nature test would be confined to a composite transaction not covered by Article 366(29A). In other words, in *Bharat Sanchar*, this Court reiterated what was stated by this Court in *Associated Cement* that dominant nature test has no application to a composite transaction covered by the clauses of Article 366(29A). Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six Sub-clauses of Clause 29A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.

67. In view of the statement of law in *Associated Cement and Bharat Sanchar*, the argument advanced on behalf of the Appellants that dominant nature test must be applied to find out the true nature of transaction as to whether there is a contract for sale of goods or the contract of service in a composite transaction covered by the clauses of Article 366(29A) has no merit and the same is rejected.

68. In *Gannon Dunkerley-II*, this Court, inter alia, established the five following propositions:

(i) as a result of Forty-sixth Amendment the contract which was single and indivisible has been altered by a legal fiction into a contract which is divisible into one for sale of goods and the other for supply of labour and service and as a result of such contract which was single and indivisible has been brought on par with a contract containing two separate agreements;

(ii) if the legal fiction introduced by Article 366(29A)(b) is carried to its logical end, it follows that even in a single and indivisible works contract there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for sale of goods and the other for supply of labour and services;

(iii) in view of Sub-clause (b) of Clause 29A of Article 366, the State legislatures are competent to impose tax on the transfer of property in goods involved in the execution of works contract. Under Article 286(3)(b), Parliament has been empowered to make a law specifying restrictions and conditions in regard to the system of levy, rates or incidents of such tax. This does not mean that the legislative power of the State cannot be exercised till the enactment of the law under Article 286(3)(b) by the Parliament. It only means that in the event of law having been made by Parliament under Article 286(3)(b), the exercise of the legislative power of the State under Entry 54 in List II to impose tax of the nature referred to in Sub-clauses (b), (c) and (d) of Clause (29A) of Article 366 would be subject to restrictions and conditions in regard to the system of levy, rates and other incidents of tax contained in the said law; (iv) while enacting law imposing a tax on sale or purchase of goods under Entry 54 of the

State List read with Article 366(29A)(b), it is permissible for the State legislature to make a law imposing tax on such a deemed sale which constitutes a sale in the course of the inter-state trade or commerce under Section 3 of the Central Sales Tax Act or outside under Section 4 of the Central Sales Tax Act or sale in the course of import or export under Section 5 of the Central Sales Tax Act; and (v) measure for the levy of tax contemplated by Article 366(29A)(b) is the value of the goods involved in the execution of a works contract. Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the value of the goods involved in the execution of a works contract. Since, the taxable event is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, the value of the goods which can constitute the measure for the levy of the tax

has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.

69. In *Gannon Dunkerley-II*, Sub-section (3) of Section 5 of the Rajasthan Sales Tax Act and Rule 29(2)(1) of the Rajasthan Sales Tax Rules were declared as unconstitutional and void. It was so declared because the Court found that Section 5(3) transgressed the limits of the legislative power conferred on the State legislature under Entry 54 of the State List. However, insofar as legal position after Forty-sixth Amendment is concerned, *Gannon Dunkerley-II* holds unambiguously that the States have now legislative power to impose tax on transfer of property in goods as goods or in some other form in the execution of works contract.

70. The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, Clause 29A of Article 366 empowers the States to levy tax on the deemed sale.”

21. To sum up, it follows from the reading of the aforesaid judgment that after insertion of clause 29-A in Article 366, the Works Contract which was indivisible one by legal fiction, altered into a contract, is permitted to be bifurcated into two: one for “sale of goods” and other for “services”, thereby making goods component of the contract exigible to sales tax. Further, while going into this exercise of divisibility, dominant intention behind such a contract, namely, whether it was for sale of goods or for services, is rendered otiose or immaterial. It follows, as a sequitur, that by virtue of clause 29-A of Article 366, the State Legislature is now empowered to segregate the goods part of the Works Contract and impose sales tax thereupon. It may be noted that Entry 54, List II of the Constitution of India empowers the State Legislature to enact a law taxing sale of goods. Sales tax, being a subject-matter into the State List, the State Legislature has the competency to legislate over the subject.

22. Keeping in mind the aforesaid principle of law, the obvious conclusion would be that Entry 25 of Schedule VI to the Act which makes that part of processing and supplying of photographs, photo prints and photo negatives, which have “goods” component exigible to sales tax is constitutionally valid.

23. For being classified as Works Contract the transaction under consideration has to be a composite transaction involving both goods and services. If a transaction involves only service i.e. work and labour then the same cannot be treated as Works Contract. It was contended that processing of photography was a contract for service simpliciter with no elements of goods at all and, therefore, Entry 25 could not be saved by taking shelter under clause 29-A of Article 366 of the Constitution. For this proposition, umbrage under the judgment in *B.C. Kame's* case was sought to be taken wherein this Court held that the work involving taking a photograph, developing the negative or doing other photographic work could not be treated as contract for sale of goods. Our attention was drawn to that portion of the judgment where the Court held that such a contract is for use of skill and labour by the photographer to bring about desired results inasmuch as a good photograph reveals not only the aesthetic sense and

artistic faculty of the photographer, it also reflects his skill and labour. Such an argument also has to be rejected for more than one reasons. In the first instance, it needs to be pointed out that the judgment in *Kame's* case was rendered before the 46th Constitutional Amendment. Keeping this in mind, the second aspect which needs to be noted is that the dispute therein was whether there is a contract of sale of goods or a contract for service. This matter was examined in the light of law prevailing at that time, as declared in *Dunkerley's* case as per which dominant intention of the contract was to be seen and further that such a contract was treated as not divisible. It is for this reason in *BSNL and M/s Larsen and Toubro* cases, this Court specifically pointed out that *Kame's* case would not provide an answer to the issue at hand. On the contrary, legal position stands settled by the Constitution Bench of this Court in *Kone Elevator India Pvt. Ltd. v. State of Tamil Nadu and Ors.*¹⁰ Following observations in that case are apt for this purpose:

“On the basis of the aforesaid elucidation, it has been deduced that a transfer of property in goods under Clause (29A)(b) of Article 366 is deemed to be a sale of goods involved in the execution of a Works Contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made. One thing is significant to note that in *Larsen and Toubro* (supra), it has been stated that after the constitutional amendment, the narrow meaning given to the term “works contract” in *Gannon Dunkerley-I* (supra) no longer survives at present. It has been observed in the said case that even if in a contract, besides the obligations of supply of goods and materials and performance of labour and services, some additional obligations are imposed, such contract does not cease to be works contract, for the additional obligations in the contract would not alter the nature of the contract so long as the contract provides for a contract for works and satisfies the primary description of works contract. It has been further held that once the characteristics or elements of works contract are satisfied in a contract, then irrespective of additional obligations, such contract would be covered by the term “works contract” because nothing in Article 366(29A)(b) limits the term works contract” to contract for labour and service only.”

24. Another attack on the insertion of Entry 25 pertained to retrospectivity given to this provision. It was sought to be argued that amendment to the Act was made by Karnataka State Laws Act, 2004 which came into force w.e.f. 29.01.2004 and insertion of Entry 25 with retrospective effect i.e. w.e.f. 01.07.1989 was not permissible. To put it otherwise, the argument was that even if Entry 25 is held to be valid, it should be made prospective i.e., w.e.f. 29.01.2004.

25. We are afraid, even this argument does not cut any ice. The first thing in this regard which is to be kept in mind is that Entry 25 was inserted for the first time by amendment of the Act w.e.f. 01.07.1989. This amendment was post 46th Constitutional Amendment. However, the High Court of Karnataka declared the said Entry to be unconstitutional and the SLP was also dismissed. Undoubtedly, it was because of the judgment in *Rainbow Colour Lab*, which judgment was declared as not a good law in

ACC Ltd. (which position is repeated in *BSNL* as well as *M/s Larsen and Toubro* cases). Thus, the very basis on which Entry 25 of Schedule VI was declared as unconstitutional, has been found to be erroneous. In such circumstances, the legislature will be justified in enacting the law from the date when such a law was passed originally and that date is 01.07.1989 in the instant case. We have to keep in mind the fact that on the basis of this amendment, there have been assessments made by the assessing authorities. This was admitted by the learned counsel for the respondents at bar at the time of the arguments.

27. We would also like to refer to the case of *Hiralal Ratanlal v. State of U.P.*¹⁵, wherein it was observed “the source of the legislative power to levy sales or purchase tax on goods is Entry 54 of the List II of the Constitution. It is well settled that subject to Constitutional restrictions a power to legislate includes a power to legislate prospectively as well as retrospectively. In this regard legislative power to impose tax also includes within itself the power to tax retrospectively.”

28. We would like to point out at this stage that the High Court in the impugned judgment has not dealt with the matter in its correct perspective. The reason given by the High Court in invalidating Entry 25 is that this provision was already held unconstitutional by the said High Court in *Keshoram's* case against which the SLP was also dismissed and in view of that decision, it was not permissible for the legislature to re-enact the said Entry by applying a different legal principle. According to us, this was clearly an erroneous approach to deal with the issue and the judgment of the High Court is clearly unsustainable. The High Court did not even deal with various facets of the issue in their correct perspective, in the light of subsequent judgments of this Court with specific rulings that *Rainbow Colour Lab* is no longer a good law.

29. The impugned judgment of the High Court is accordingly set aside, the present appeal is allowed and as a result thereof, the writ petitions filed by the respondents in the High Court are dismissed holding that Entry 25 of Schedule VI of the Act is constitutionally valid. There shall, however, be no order as to costs.

* * * * *

British Paints (India) Ltd. v. Union of India

AIR 1971 CAL. 393

The Union of India invited tenders for the supply of paints of the description compound recolouring Olive Green Scamic 314 for faded tents to Specification Ind/32/7037. The plaintiff offered a tender. The laboratory did not consider the sample to be up to the mark, but the higher authorities of the Defence Department accepted this tender, and placed an order with the plaintiff for supply of 500 Cwt. of this article and the price was fixed at Rs. 256/- F.O.R. Calcutta per Cwt. According to the contract the goods were to be inspected by the Inspector at Calcutta, and if he was satisfied that these were up to the mark, then the same could be dispatched by the plaintiff on receipt of the inspection notes. The original date of delivery was fixed on 15th of October, 1952, but the plaintiff stated that it might not be in a position to do so as it had to indent some of the ingredients from U.K., and on their successive applications for extension of time, time for supply was finally extended up to the 30th of April 1953. 9 Cwt. of this article was inspected on the 16th October 1952 and accepted and dispatched on the 5th December 1952. The second lot consisting of 59½ Cwt. was inspected on the 16th March 1953, and was rejected on the 22nd April 1953, and again offered after some reconditioning on the 30th April 1953, and rejected on the 19th May 1953. The third lot of 150 Cwt. was inspected on the 30th March 1953 and accepted and dispatched on the 17th April 1953. The fourth lot consisting of 188 Cwt. was inspected on the 13th April 1953, and was rejected on the 7th May 1953. The last lot consisting of 93½ Cwt. together with 59½ Cwt. constituting the second lot, were inspected on the 30th April 1953, and rejected on the 19th May 1953. Therefore, the defendant had accepted 159 Cwt., and the balance of 341 Cwt. constitutes the disputed item. The defendant terminated this contract on the ground that the delivery was not made by the 30th April by its letter dated the 1st of May 1953. Before the receipt of this letter, Mr. Bogh the Technical Director of the plaintiff company went over to Kanpur to find out how the test was carried on there and he was given every opportunity to see that on the 1st of May 1953. On his coming back, the letter of cancellation of the contract was gone into, and the plaintiff requested the Kanpur authorities where the tests were to be done, to enable its chemist Mr. Ghosh to come and see for himself why the goods were rejected. Mr. Ghosh came there in the third week of May 1953, and with the help of Drs. Ranganathan and Balakrishnan he saw how the test was carried on. The reconditioned sample which he had brought was tested by the authorities at Kanpur, at the request of the plaintiff by its letter the 22nd May 1953, and on the 30th May the Kanpur authorities wrote to the Inspector in Calcutta, with copy to the plaintiff, that his reconditioned sample was "found to conform to the quoted particulars in all respects and is therefore acceptable." There was further correspondence between the plaintiff and the defendant re: the acceptance of the goods but the defendant by its letter dated the 30th September 1953 intimated that its decision as conveyed by its letter dated the 1st of May 1953 was final and cannot be altered and further that the stores offered by the plaintiff "were not in accordance with the terms of the Contract for quality." Thereafter the plaintiff served the usual notices on the defendant and the matter had also been referred to arbitration. The Arbitrators however found that under the terms of the contract, the Inspector's decision was to be final and binding on the parties, and, as such, held that they had no jurisdiction to enter into this question of the rejection of the supplies on

the ground that this did not conform to the required specification. The main ground of the plaintiff is that the test made by the Kanpur authorities was not in accordance with the agreement inasmuch as they “were carrying out the test by comparing the supplied material with a tinted slip prepared some months ago with the paint from the said sample No. 30/100” and not in the same manner and at the same time as provided for in the Agreement. It was further alleged that the Inspector carried out the inspection capriciously and not in accordance with the said specification. The plaintiff further alleged that the materials were specially manufactured for the purpose of this tender and could not be resold in the market and claimed a sum of Rupees 88,496/- as damages inclusive of storing charges on the basis of the price at which the plaintiff agreed to supply together with a sum of Rs. 5,228/- by way of interest. The total claim was thus laid at Rs. 93,724/-. The Union of India contested the suit alleging that time was of the essence of the contract and further that the tests at Kanpur were carried on in accordance with the rules, and that the Inspector’s reports were not at all arbitrary, and that the supplies were not accepted as the same were not of the requisite quality. The learned Subordinate Judge at Alipore held in favour of the defendant on all the points involved and dismissed the suit. Hence this appeal.

S.K. CHAKRAVARTI, J. – 2. Now under the terms of the Agreement “the Inspector’s decision as regards rejections aforesaid shall be final and binding on the parties.” In this case, as we have already pointed out, the Inspector’s reports are to the effect that the articles are not according to the specification and the shade is lighter than the sample of 30/100” and “did not match also the standard olive green scamic 314.” Prima facie, therefore, the plaintiff will be bound by it and its claim to damages cannot be entertained. Mr. Rabindra Mohan Mukherjee learned Advocate appearing on behalf of the appellant submits that the Inspector did not apply his mind to the point and merely dittoed what was written by the authorities at Kanpur and, as such his Reports are perverse and arbitrary and cannot bind the parties. In the next place, it has also been urged that the tests which had been urged that the tests which had been made at Kanpur were not in accordance with the Contract, in view of the facts that the tests were not carried on with reference to the accepted sample 30/100 at the time of examination of the contents of the further supplies, but with tints made at a distant time. It has also been urged that the sample 30/100 had already been destroyed.

3. Now, if the contentions or either of them are accepted, then it must be held that the Inspector’s reports would be arbitrary, and it would be open to the plaintiff to challenge the order of rejection prima facie passed on that basis, and the order of rejection would not stand.

4. The Inspector in question, Colonel Pillay has been examined in this case and his evidence would disclose that he did apply his mind. He waited for 3 to 4 days to make up his mind after obtaining the reports from Kanpur and appears to have taken other factors also into consideration. There is no reason to disbelieve his testimony in this respect. There were not proper facilities for testing in Calcutta, and the procedure appears to be to send the same to Kanpur for testing, and on getting their reports, the Inspector in Calcutta was to decide whether the goods were to be accepted or not. Moreover, the tests at Kanpur were carried on by experts namely, Dr. Ranganathan and Dr. Balakrishnan and if the Inspector acted on the basis of such reports, it cannot be said that he did not apply his mind thereto. In the circumstances, we must overrule the contention of Mr. Mukherjee in this respect.

5. As regards the tests at Kanpur it would appear from the evidence of Dr. Ranganathan and Dr. Balakrishnan and specially of the latter that every time a sample of the supply came, they carried on the tests with reference to the sample 30/100 and that they did so even in the case of these three rejected supplies. They have emphatically denied that the sample 30/100 had been destroyed. Mr. Bogh who called on them on the 1st of May 1953 did not at all ask them as to whether that sample 30/100 had been destroyed or not. He only wanted to see how the test was done and it was not necessary therefore, to bring out the sample 30/100 which was kept in safe custody, so to say to show the method of testing. Mr. Bogh in his cross-examination had stated that that sample had been destroyed. As a matter of fact no such complaint in writing was made to the authorities concerned. Mr. I.B. Ghosh the Chief Chemist of the plaintiff firm of course states that he was told that the sample had been destroyed. This fact has been denied by Drs. Ranganathan and Balakrishnan, and the learned Judge appears to have preferred the testimony of the latter gentleman, to that of Mr. Ghosh. We see no reasons to differ from him in the assessment of his evidence. They are responsible Officers and under the rules so long as the Contract is alive they are bound to keep it and it is only when much later they came to know that the Contract had been cancelled they destroyed the sample. As a matter of fact, when Mr. Ghosh called on the Kanpur authorities in May 1953 he took with himself a reconditioned sample. It would appear from the evidence that some amount of black carbon was put in to make the colour a bit darker and thereafter that passed the test. When the second batch of 59½ Cwt. had been rejected, the plaintiff wrote to the authorities concerned that they would supply these things after reconditioning. This fact would also disclose that the supplies which had been made and rejected did not conform to the required specification. It would further appear from the evidence of Mr. Bogh and Mr. Ghosh that they did not carry on the tests in their own laboratories with any cotton Dosuti. As a matter of fact, Mr. Bogh was not aware what cotton Dosuti was, and he asked for a sample of that from the Kanpur authorities. Therefore, the fact that according to the plaintiff's own technical men, these three supplies in question were up to the specification, cannot override the opinion of the Kanpur authorities. Under the terms of the Contract, the test is to be made by applying the sample "to a piece of cotton dosootie or sheeting used in the manufacture of tents." That was not done at all by the plaintiff. Mr. Mukherjee has also made grievance of the fact that the Kanpur authorities had carried on the test with a piece of scoured cotton dosootie and not an unscoured one. The evidence of Dr. Balakrishnan would show that they always carry on the test on scoured cotton dosootie and it is cotton dosootie which is mostly used in the manufacturing of tents. Scoured cotton dosootie is also cotton dosootie, and in the circumstances it cannot be said that the test carried on by the Kanpur authorities on scoured cotton dosootie would be inconsistent with the terms of the contract.

6. Mr. Mukherjee has laid stress on the fact that the plaintiff had also got the rejected supplies tested by an expert Mr. Monk and his report and evidence would disclose that the rejected articles were of the same quality as the tender sample 30/100, a duplicate of which had been kept in the plaintiff firm. Mr. Monk carried on his test in the absence of the defendant. He did so also more than three years after the articles had been made and his own evidence would disclose that the articles were not exactly of the same quality as before something having already evaporated. He also did not apply the same to any scoured cotton dosootie or any sheeting used in the manufacture of tents. What is worse, he took samples

from each of the rejected barrels and made a hotchpot of the same, and then made the comparison. The plaintiff had already written to the defendant to offer the 59½ Cwt. after reconditioning and it is quite likely that it was so done. Therefore, we cannot accept the evidence of Mr. Monk in this respect. What is more, as we have already pointed out, the Kanpur authorities had made the tests in accordance with the rules, and found the quality not up to the mark, and the Inspector's report is based on that and the Inspector also applied his mind to it, and the Inspector's report in this connection is final and conclusive, and cannot be overruled by Mr. Monk's opinion.

7. It has further been urged by Mr. Mukherjee that the delivery has been made in time and that the defendant had voluntarily or involuntarily waived the quality and therefore was not competent to reject the supplies. It would appear that Mr. Ghosh went to Kanpur with the reconditioned sample and the Kanpur authorities found it acceptable. Mr. Mukherjee, therefore, submits that the defendant was not therefore right in cancelling the Contract and in refusing to give them any further time to recondition the rejected goods in accordance with the approved sample. Now, the Contract was cancelled on the 1st of May 1953 and the Contract had been made with the Director-General of Supply. The Kanpur authorities cannot extend the time of delivery, and therefore, this point also fails. At no stage was there any waiver of the quality.

8. In this connection Mr. P.K. Sengupta learned Government Advocate points out that the plaintiff did not give sufficient time for inspection even. It would appear from Section 17(2) of the Indian Sale of Goods Act that if the purchase was being made on the basis of a sample, some reasonable time must be given to the purchaser to find out if the goods offered were in accordance with the sample. It would further appear from the evidence that after the goods were manufactured, the plaintiff was to send an intimation to the Inspector in Calcutta and he would take samples and then send the same to Kanpur and there it must be tested and the test alone would take at least three days. All these were within the knowledge of the plaintiff. The plaintiff, however, offered the reconditioned second supply and the 4th and 5th instalments on the 30th April by its letter dated the 29th and the delivery date being the 30th April there was not sufficient time to inspect.

9. Mr. Mukherjee has very strenuously contended that time was not of the essence of the contract and that the respondent was not entitled therefore to cancel the Contract on the 1st of May on the alleged default to make delivery of the goods by the 30th April. It would appear from the Contract itself that time was specifically made of the essence of the Contract. Mr. Mukherjee submits that inasmuch as the time had been extended from time to time, it would appear therefrom that the Union of India did not consider the fixed time to be a condition it was a warranty and nothing more and the action of the Union of India in cancelling the Contract unilaterally was an anticipatory breach, and would entitle the plaintiff to damages. In *Gomathi Nayagam v. Palaniswami* [AIR 1967 SC 868], it has been laid down that "Intention to make time of the essence of the contract may be evidenced by either express stipulations or by circumstances which are sufficiently strong to displace the ordinary presumption that in a contract of sale of land stipulations as to the time are not of the essence." In this particular case, as we have already pointed out, there was an express stipulation that time would be of the essence of the Contract. It is no doubt a fact that the

original time for delivery in the Contract namely 15th of October 1952 was extended from time to time or the application express or implied of the plaintiff up to the 30th of April 1953. In its telegram as also letter dated the 2/3rd March 1953 the defendant made it quite clear that there would be no further extension of time. In *Md. Habidullah v. Bird and Co.* [AIR 1922 PC 178], it has been held by the Privy Council that when after the seller of goods has failed to deliver them at the agreed time the buyer has agreed to an extension of time for delivery, the effect of Section 55 of the Indian Contract Act is that the buyer is entitled to damages computed in the ordinary way, if the seller fails to delivery within the extended time. Mr. Mukherjee, with his usual fairness, has placed before us the aforesaid two decisions and has also relied on *Burn & Co. v. Morvi State* [AIR 1925 PC 188] and more particularly on *Hindusthan Construction Co. v. State of Bihar* [AIR 1963 Pat 254]. In *Burn & Co.* case, the Privy Council, on an interpretation of the terms of the Contract came to the conclusion that the intention of the parties when the Contract was made, was that time should be of the essence of the Contract. In the *Hindustan Construction Co.*, the court, on an analysis of the terms and specially in view of the facts, that there was a provision for daily damages after the default is made, and the State of Bihar which had the option of determining the Contract did not avail itself of the option, held that time was not of the essence of the Contract. The facts in that case are entirely different from the facts, of the present case wherein the plaintiff had asked for extension of time again and again and the defendant had reluctantly to agree thereto. Even, in this decision it has also been laid down that an intention to make time of the essence of the Contract must be expressed in explicit and unmistakable language in the agreement itself and if by any means such an intention is not explicit, it may be inferred from the antecedent conduct of the parties and surrounding circumstances but not from the subsequent conduct of the parties after the Contract was made. We are therefore, of opinion that in this particular case time was of the essence of the Contract and this time would also include the extended time as agreed upon by both the parties. This term in the agreement was a condition precedent and not a mere warranty.

10. Mr. Mukherjee has also relied on Section 23 of the Sale of Goods Act and submits that as in the month of May the Kanpur authorities found the reconditioned sample to be acceptable, Section 23 would apply. In this case the Contract was cancelled originally by letter dated the 1st of May 1953 as the goods were not delivered by the 30th of September 1953. In that letter it has been stated that the stores offered by the plaintiff were not in accordance with the terms of the Contract for quality and were therefore, rejected. At one stage of the arguments, it was urged on behalf of the appellant that as the Inspector's reports regarding the goods were not available on the 1st May 1953, the authorities had no materials before it under which it would cancel the Contract. In *Nune Siwayya v. Maddu* [(1935) 62 IA 89, 98 (PC)], it has been held by the Privy Council that in a suit for damages for breach by repudiation of the Contract for the sale of goods, the defendant can rely upon any grounds for repudiation which existed when he repudiated; he is not confined to the ground which he then stated. After the Inspector's reports were made available and showed that the goods were not in accordance with the tender, it was up to the Union of India to take up that ground as well. Mr. Sengupta in this connection has already drawn our attention to Ext. 3-C the condition of Contract. Now the term "delivery" as defined therein means "Delivery by the dates specified in the acceptance of tender of stores which are found acceptable by the Inspector and not the

submission of stores which are not to the required standard or which are not delivered by due dates.” In this particular case, the goods were not properly delivered by the 30th of April 1953. The goods were not up to the standard, and there was no sufficient time given to Union of India for inspecting the same, as we have already pointed out.

11. Mr. Mukherjee has also submitted that as the defendant also claimed liquidated damages, the defendant was not entitled to cancel the Contract. We are not in a position to accept this contention. In Ext. 3-C it has been specifically laid down that if any stores are rejected, the Secretary shall be at liberty to (a) to allow the Contractor to resubmit the stores within a time specified by himself, (b) buy the quantity of the stores rejected by others of a similar nature elsewhere at the risk and cost of the contract etc. or (c) terminate the contract and recover from the contractor the loss the purchaser thereby incurs. Therefore, it was within the rights of the defendant to terminate the contract. The defendant has not made any attempt to recover the loss if any, he has suffered for the default of the plaintiff. By Ext. 20 the defendant while cancelling the Contract for the supply of the further materials had merely asked the plaintiff to note that right to recover liquidated damages for delayed supply was reserved. There was no claim actually made for liquidated damages. In the subsequent letter (Ext. 51) no such claim was even referred to. In the circumstances, this objection must be overruled.

12. The result, therefore, is that we find that in this case time was of the essence of the contract and that the time was extended up to the 30th of April 1953 by the mutual consent of the parties and that the goods had not been offered or delivered in time, and were also not of the requisite quality. The defendant, therefore, was within its rights to repudiate the contract for the supply of the remaining portion of the goods, and this appeal therefore, must fail.

13. At the same time we must note that we do not find that there has been any deliberate negligence on the part of the plaintiff. They had difficulties of their own, inasmuch as they had to import some of the ingredients, and the defendant itself was also responsible for some delay, inasmuch as, in the month of January it suddenly directed the defendant to supply the goods in galvanized sheets. If the plaintiff’s men had gone over to Kanpur by the 30th April on getting the rejection slip of the second lot, then further troubles might have been avoided. Unfortunately however, its representatives went to Kanpur after the cancellation of the Contract, and it is quite clear from the evidence, that the goods were required very urgently for Military purposes and it was not possible for the defendant to wait any further, We, therefore, dismiss this appeal, but direct that each party will bear its own costs.

* * * * *

DOCTRINE OF CAVEAT EMPTOR

Jones v. Just

(1868) 3 Q.B. 197

MELLOR, J. – In this case, it appeared that the plaintiffs, through Messrs. Beneke & Co., their brokers, entered into a contract with the defendant for the purchase of a quantity of Manilla hemp, to arrive.... The shipping documents were duly delivered to the plaintiffs, and the price was paid. All the vessels named in the contract arrived in due course, with the respective numbers of bales of hemp having marks corresponding to those specified in the contract on board; and the bales were delivered to the plaintiffs. On examination of the bales it was found that the whole of those marked J.H.V. were in such a state as to afford strong evidence that they had at some time, probably from a shipwreck when on the voyage from Manilla to Singapore, been wetted through with salt water had afterwards been unpacked and dried, and then repacked in the bales which were afterwards shipped at Singapore.

Manilla hemp is divided into several qualities. The hemp in the bales in question, if in good condition, would have been what is called “fair current Manilla hemp”, which is not the lowest quality; but in all the bales the hemp was damaged to some extent, though not so far as to make it lose the character of hemp. After some correspondence between the parties, the hemp was sold by auction by the plaintiffs’ orders as “Manilla hemp, with all faults”, and at the auction it realised about 75 per cent of the price which similar hemp would have fetched if undamaged. The price of hemp had risen considerably since the contract, so that the proceeds of the sale were very nearly equal to the invoice price. There was no attempt to shew that the defendant knew of the state in which the hemp had been shipped at Singapore.

At the close of the plaintiffs’ case, Mr. Brett, for the defendant, contended that, in point of law, under this written contract, there was no further condition or warranty than that the bales on their arrival should answer the description of bales of Manilla hemp, which they did, as was proved by the fact that the hemp, though sold with a stigma upon it, fetched a price only 25 per cent, below that of sound hemp; and that as to quality or condition there was no warranty; that consequently the maxim *caveat emptor* applied.

The learned judge expressed an opinion adverse to this view. He said: “I think that the question is for the jury, whether what was supplied under this contract was, when shipped at Singapore, such as to answer the description of *reasonably merchantable* Manilla hemp, that being the warranty which, I think, the law implies in a contract to supply, as this is: though it would be different in a sale of specific things which the purchaser might examine, or of things sold by sample. And I think the question whether it is fairly and reasonably merchantable, is a question of more or less, which must be left to the jury as reasonable men to determine.” The judge then reserved leave to move to enter the verdict for the defendant, if there was no evidence to go to the jury of a breach of warranty.

Upon this intimation of opinion, the counsel addressed the jury, and the case was left to them substantially to the effect above stated; and the jury were further told that if they found

for the plaintiffs, the damages should be measured by the rate which the hemp was worth when it arrived compared with the rate which the same hemp would have realised, had it been shipped in the state in which it ought to have been shipped: thus, in effect, giving the plaintiffs the benefit of the rise in the market.

Mr. Brett, in the ensuing Term, obtained a rule to enter the verdict for the defendant, pursuant to the leave reserved; or for a new trial, on the ground of misdirection as to the measure of damages, which he contended ought at most to have been the difference between the value of the article actually delivered, viz., fair average Manilla hemp in a damaged state, and the value of sound Manilla hemp of the lowest quality which might have been supplied at Singapore under this contract. The other objections to the direction were substantially only varied modes of putting the point reserved.

We thought that if the contract had the effect which the direction stated it to have, the true measure of the damages was given, as it put the plaintiffs in the position in which they would have been if the contract had been fulfilled; but we took time to consider the question as to what the contract really was, which is no doubt one of importance and difficulty.

After careful consideration, we are of opinion that Blackburn, J.'s direction was substantially correct. On the argument before us, it was contended that the contract was performed on the part of the defendant by the shipping at Singapore of an article which answered the description of "Manilla hemp", although at that time it was so damaged as to have become unmerchantable. It was said that there being no fraud on the part of the vendor, and both parties being equally ignorant of the past history and actual condition of the article contracted for, and neither of them having had the opportunity of inspecting it, it was the duty of the vendees to have stipulated for a merchantable article, if that was what they intended to contract for. In other words, it was said that the maxim, *caveat emptor*, applied in such a case, in the same way as on a sale of a specific article by a person not being the manufacturer or producer, even though the defect was latent and not discoverable upon examination.

We are of opinion that there is a great distinction between the present case and the sale of goods *in esse*, which the buyer may inspect, and in which a latent defect may exist, although not discoverable on inspection.

The cases which bear upon the subject do not appear to be in conflict, when the circumstances of each are considered. They may, we think, be classified as follows:

First, where goods are *in esse*, and may be inspected by the buyer, and there is no fraud on the part of the seller, the maxim *caveat emptor* applies, even though the defect which exists in them is latent, and not discoverable on examination, at least where the seller is neither the grower nor the manufacturer: *Parkinson v. Lee* [2 East, 314]. The buyer in such a case has the opportunity of exercising his judgment upon the matter; and if the result of the inspection be unsatisfactory, or if he distrusts his own judgment he may if he chooses require a warranty. In such a case, it is not an implied term of the contract of sale that the goods are of any particular quality or are merchantable. So in the case of the sale in a market of meat, which the buyer had inspected, but which was in fact diseased, and unfit for food, although that fact was not apparent on examination, and the seller was not aware of it, it was held that

there was no implied warranty that it was fit for food, and that the maxim caveat emptor applied: *Emmerton v. Mathews* [31 L.J. (Ex.) 139].

Secondly, where there is a sale of a definite existing chattel specifically described, the actual condition of which is capable of being ascertained by either party, there is no implied warranty: *Barr v. Gibson* [3 M. & W. 390].

Thirdly, where a known described and defined article is ordered of a manufacturer, although it is stated to be required by the purchaser for a particular purpose, still if the known, described, and defined thing be actually supplied, there is no warranty that it shall answer the particular purpose intended by the buyer: *Chanter v. Hopkins* [4 M. & W. 399].

Fourthly, where a manufacturer or a dealer contracts to supply an article which he manufactures or produces, or in which he deals, to be applied to a particular purpose, so that the buyer necessarily trusts to the judgment or skill of the manufacturer or dealer, there is in that case an implied term or warranty that it shall be reasonably fit for the purpose to which it is to be applied: *Brown v. Edgington* [2 Man. & G. 279]. In such a case the buyer trusts to the manufacturer or dealer, and relies upon his judgment and not upon his own.

Fifthly, where a manufacturer undertakes to supply goods, manufactured by himself, or in which he deals, but which the vendee has not had the opportunity of inspecting, it is an implied term in the contract that he shall supply a merchantable article: *Laing v. Fidgeon* [4 Camp. 169]. And this doctrine has been held to apply to the sale by the builder of an existing barge, which was afloat but not completely rigged and furnished; there, inasmuch as the buyer had only seen it when built, and not during the course of the building, he was considered as having relied on the judgment and skill of the builder that the barge was reasonably fit for use: *Shepherd v. Pybus* [3 Man. & G. 868].

If, therefore, it must be taken as established that, on the sale of goods by a manufacturer or dealer to be applied to a particular purpose, it is a term in the contract that they shall reasonably answer that purpose, and that on the sale of an article by a manufacturer to a vendee who has not had the opportunity of inspecting it during the manufacture, that it shall be reasonably fit for use, or shall be merchantable, as the case may be, it is difficult to understand why a similar term is not to be implied on a sale by a merchant to a merchant or dealer who has had *no* opportunity of inspection. Accordingly in the case *Bigge v. Parkinson* [31 L.J. (Ex. 301)] upon a contract to supply provisions and stores to a ship guaranteed to pass the survey of the East India Company's officers, it was held by the Court of Exchequer Chamber that there was an implied term in the contract, that the stores should be reasonably fit for the purpose for which they were to be supplied, notwithstanding that the vendor had specially contracted that they should pass the survey of the East India Company's officers.

We are aware of no case in which the maxim, caveat emptor, has been applied where there has been no opportunity of inspection, or where that opportunity had not been waived. The case of *Gardiner v. Gray* [4 Camp. 144, 145], appears strongly in point to the present. The contract was for the sale of twelve bales of waste silk imported from the continent, and before it was landed samples were shewn to plaintiff's agent, and the bargain was then made, but without reference to the sample. It was purchased in London, and sent to Manchester, and on its arrival there was found to be of a quality not saleable under the denomination of "waste

silk". Lord Ellenborough expressed his opinion that "the purchaser under such circumstances had a right to expect a saleable article answering the description in the contract. Without any particular warranty, this is an implied term in every such contract. Where there is no opportunity to inspect the commodity the maxim, *caveat emptor*, does not apply."

In general, on the sale of goods by a particular description, whether the vendee is able to inspect them or not, it is an implied term of the contract that they shall reasonably answer such description, and if they do not, it is unnecessary to put any other question to the jury; thus, in *Wieler v. Schilizzi* [25 L.J. (C.P.) 89], and in *Josling v. Kingsford* [32 L.J. (C.P.) 94], the substantial question put to the jury was, did the goods delivered reasonably answer the description in the contract? And the answer of the jury being that they did not, that answer sufficed to determine each case. In one of those cases there was no opportunity to inspect, in the other there was. So in the case of *Nichol v. Godts* [10 Ex. 191], where the contract was for the sale of "foreign refined rape oil, warranted only equal to sample", it was held in an action for not accepting the article tendered, that it was necessary for the vendor to establish that it was not only equal to the sample as to quality, but that it was in fact such an article as answered, the description of foreign refined rape oil. In *Wieler v. Schilizzi*, in which there was no opportunity to inspect, and no express stipulation as to quality, it would have been necessary, had the finding of the jury affirmed that the article delivered did in fact answer the description of "Calcutta linseed", to determine whether the judge ought not to have put the further question, was it reasonably merchantable? It certainly was not determined that such a question would have been wrong, though perhaps the words "tale quale" in that contract might have the effect of excluding any such warranty; and Willes, J., in his judgment [17 C.B. at p. 624], said that the purchaser in that case "had a right to expect, not a perfect article, but an article which would be *saleable* in the market as Calcutta linseed."

It appears to us that, in every contract to supply goods of a specified description which the buyer has no opportunity to inspect, the goods must not only in fact answer the specific description, but must also be saleable or merchantable under that description. In the words of Lord Ellenborough in *Gardiner v. Gray* [4 Camp. 145], "without any particular warranty this is an implied term in every such contract." In the present case the question appears to be, was the article as delivered at Singapore merchantable or saleable in the market under the description of "Manilla hemp?" Blackburn, J., appears to have divided that question into two, viz.: Was the article, in fact, Manilla hemp? Secondly, was it merchantable? The precise mode of submitting the question is not material, provided the substantial direction was correct, as we think it was.

The counsel for the defendant relied upon a case of *Turner v. Mucklow* [8 Jur. (N.S.) 870], tried before Mellor, J., in the year 1862, at Liverpool. In that case the plaintiffs were calico printers, and had contracted to sell to the defendant, who was a drysalter and dye extract manufacturer, a boat-load of "spent madder." The defendant, not finding the spent madder supplied suitable for his purpose, repudiated the contract, and refused to pay for it. It appeared that the plaintiffs, in their trade as calico printers, used large quantities of madder roots, having extracted from which the finer colouring matter by chemical processes they placed the refuse or spent madder in a large heap in their yard. They occasionally used portions of it, and by the application of other chemical processes extracted from it a colouring

matter called garancine, but they did not manufacture spent madder for sale. On a previous occasion they had sold to the defendants, who was a manufacturer of garancine, a small quantity of spent madder from their accumulation; and on the occasion in question the defendant, by letter, bargained with the plaintiffs for a quantity of their spent madder, which he did not inspect before delivery, and upon a portion of it being used by the defendant for the purpose of manufacturing garancine, it turned out that the garancine produced by it was of very inferior quality and unmarketable. The jury were directed that if the article supplied fairly and reasonably answered the description of "spent madder", there was no implied warranty that it was of any particular quality or fitness for any particular use, and upon that direction the jury found a verdict for the plaintiffs; and upon the argument on a rule which was obtained for a new trial, on the ground of misdirection, the Court of Exchequer held the direction to be right; Martin B., declaring his opinion to be "that no direction was ever more correct."

In that case it is to be observed that the defendant had the opportunity, if he had chosen to avail himself of it, to inspect the heap of spent madder; he knew that it was the refuse madder after it had gone through the plaintiffs' processes, and that it was not manufactured for sale. These circumstances entirely distinguish that case from the present.

The counsel for the defendant also relied upon the statute 19 & 20 Vict. c. 60, s. 50 [19 & 20 Vict. c. 60, s. 5]: "Where goods shall after the passing of this act be sold, the seller, if at the time of the sale he was without knowledge that the same were defective or of bad quality, shall not be held to have warranted their quality or sufficiency, but the goods with all faults shall be at the risk of the purchaser, unless the seller shall have given an express warranty of the quality or sufficiency of such goods, or unless the goods have been expressly sold for a specified and particular purpose, in which case the seller shall be considered without such warranty to warrant that the same are fit for such purpose." [This statute applies only to Scotland], as a sort of implied legislative declaration of the law of England upon that subject in favour of his argument; but, upon examining the section referred to, it does not appear to bear out that view, for all that it declares is, that a seller of goods, without knowledge that they are defective or of bad quality, shall not be held to have warranted their quality or sufficiency.

It has already appeared that there is not in general, on the sale of goods in England to be supplied, an implied warranty that they shall be of any particular quality or sufficiency for any particular purpose, but merely that they shall be merchantable goods of the description bargained for. The present case depends on the distinction between a sale of particular articles and a contract to supply articles of a particular kind.

The authority of Chancellor Kent [*Kent's Commentaries*, vol. II; p. 479 of the 6th ed., the last by the author himself. 11th ed., pp. 633-635] was also appealed to; but as the American cases which he cites are generally adverse to his opinion, it can at most be said that the opinion of an eminent writer is opposed to the authority of the cases which he cites.

It appears to us, in the result of this case, that the maxim of caveat emptor cannot apply, and that it must be assumed that the buyer and seller both contemplated a dealing in an article which was merchantable. The buyer bought for the purpose of sale, and the seller could not

on any other supposition than that the article was merchantable have found a customer for his goods, and the buyer must be taken to have trusted to the judgment, knowledge, and information of the seller, as it is clear that he could *exercise no judgment of his own*; and this appears to us to be at the root of the doctrine of implied warranty, and that in this view it makes no difference, whether the sale is of goods specially appropriated to a particular contract, or to goods purchased as answering a particular description.

It was contended further by the defendant's counsel that the shippers at Singapore were the persons who selected the goods in question, and that the defendant, who merely sold them to arrive, was as little aware of their true condition when shipped as the plaintiffs; but it is clear that the defendant, if not directly connected with the shippers as his correspondents, must at least have purchased from them, and had recourse against them for not supplying an article reasonably merchantable.

The remarks of Cockburn, C.J., on the argument in *Bigge v. Parkinson* [H. 7 & N. at p. 959], though not in terms repeated by him in delivering the judgment of the Court of Exchequer Chamber, are really involved in it, and are very closely in point here.

We are therefore of opinion that Blackburn, J.'s direction was right, and that this rule must be discharged.

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Richard Thorold Grant v. Australian Knitting Mills, Ltd.

AIR 1936 PC 34

[*Section 16 - Reliance by buyer on seller's skill*]

The appellant was a fully qualified medical man practising at Adelaide in South Australia. He brought his action against the respondent, claiming damages on the ground that he had contracted dermatitis by reason of the improper condition of underwear purchased by him from the respondents, John Martin & Co., Ltd., and manufactured by the respondents, the Australian Knitting Mills, Limited; the case was tried by Sir George Murray, Chief Justice of South Australia, who after a trial lasting for 20 days gave judgment against both respondents for the appellant for £2,450 and costs. On appeal the High Court of Australia set aside that judgment by a majority. Evatt, J., dissented, and agreed with the Chief Justice. Of the majority, the reasoning of Dixon, J., with whom McTiernan, J., concurred, was in effect that the evidence was not sufficient to make it safe to find for the appellant. Starke, J., who accepted substantially all the detailed findings of the Chief Justice, differed from him on his general conclusions of liability based on these findings. The appellant's claim was that the disease was caused by the presence in the cuffs or ankle ends of the underpants which he purchased and wore, of an irritating chemical, viz., free sulphite, the presence of which was due to negligence in manufacture, and also involved on the part of the respondents, John Martin & Co., Ltd., a breach of the relevant implied conditions under the Sale of Goods Act.

The underwear, consisting of two pairs of underpants and two singlets, was bought by the appellant at the shop of the respondents, John Martin & Co., Ltd., who dealt in such goods and who will be hereafter referred to as the retailers, on 3rd June 1931; the retailers had in ordinary course at some previous date purchased them with other stock from the respondents, the Australian Knitting Mills, Ltd., who will be referred to as the manufacturers; the garments were of that class of the manufacturers' make known as Golden Fleece. The appellant put on one suit on the morning of Sunday, 28th June 1931; by the evening of that day he felt itching on the ankles but no objective symptoms appeared until the next day, when a redness appeared on each ankle in front over an area of about 2½ inches by 1½ inches. The appellant treated himself with calomine lotion, but the irritation was such that he scratched the places till he bled. On Sunday, the 5th July, he changed his underwear and put on the other set which he had purchased from the retailers; the first set was washed and when the appellant changed his garments again on the following Sunday he put on the washed set and sent the others to the wash; he changed again on 12th July. Though his skin trouble was getting worse he did not attribute it to the underwear, but on the 13th July he consulted a dermatologist, Dr. Upton, who advised him to discard the underwear, which he did, returning the garments to the retailers with the intimation that they had given him dermatitis; by that time one set had been washed twice and the other set once. The appellant's condition got worse and worse; he was confined to bed from 21st July for 17 weeks; the rash became generalised and very acute. In November, he became convalescent and went to New Zealand to recuperate. He returned in the following February and felt sufficiently recovered to resume his practice, but soon had a relapse and by March his condition was so serious that he went in April into hospital where he remained until July. Meantime in April 1932, he commenced this action, which was tried in and after November of that year. Dr. Upton was his medical attendant throughout and

explained in detail at the trial the course of the illness and the treatment he adopted. Dr. de Crespigny also attended the appellant from and after 22nd July 1931, and gave evidence at the trial. The illness was most severe, involving acute suffering and at times Dr. Upton feared that his patient might die.

LORD WRIGHT, J. – It is impossible here to examine in detail the minute and conflicting evidence of fact and of expert opinion given at the trial: all that evidence was meticulously discussed at the hearing of the appeal before the Board. It is only possible to state briefly the conclusions at which their Lordships after careful consideration have arrived. In the first place, their Lordships are of opinion that the disease was of external origin. Much of the medical evidence was directed to supporting or refuting the contention strenuously advanced on behalf of the respondents that the dermatitis was initially produced and was of the type described as herpeticiformis, which is generally regarded as of internal origin. That contention may now be taken to have failed: it has been rejected by the Chief Justice at the trial and in the High Court, by Starke and Evatt, JJ., and, in effect also, by Dixon and McTiernan, JJ. The evidence as to the symptoms and course of the disease given by the two doctors who attended the appellant is decisive: dermatitis herpeticiformis is an uncommon disease, of a type generally not so severe as that suffered by the appellant, and presenting in general certain characteristic features, in particular, bullae or blisters and symmetrical grouping of the inflammatory features, which were never present in the appellant. Dr. Wigley, a very eminent dermatologist, who examined the appellant, and as an expert gave evidence in support of the doctors who actually attended him, expressed his opinion that all dermatitis had no external origin, but whether he was right in this or not, he was confident that in the appellant's case the origin of the disease was external and on all the evidence their Lordships accept this view.

But then it was said that the disease may have been contracted by the appellant from some external irritant the presence of which argued no imperfection in the garments but which only did harm because of the appellant's peculiar susceptibility. Thus the disease might have been initiated by the mechanical irritation of the wool itself or if it was due to some chemical ingredient in the garments, that might have been something in itself harmless, either because of its character or because of the actual quantity in which it was present, so that the mischief was attributable to the appellant's own physical defect and not to any defect in the garments; the respondents, it was said, could not be held responsible for anything in the garments which would not be harmful in normal use. Two issues were thus involved: one, was the appellant's skin normal, and the other, was there in the garments or any part of them a detrimental quantity of any mischievous chemical? The Chief Justice held that the appellant's skin was normal. He had habitually up to the material time worn woolen undergarments without inconvenience; that he was not sensitive to the mechanical effects of wool seemed to be proved by an experiment of his doctors who placed a piece of scoured wool on a clear area on his skin and found that after a sufficient interval no trace of irritation being produced. It was said that he had suffered from tuberculosis some years before and that the disease had merely been arrested, not eliminated, and it was then said that tuberculosis made the patient more susceptible to skin disease, because it weakens the resistance of the skin and lowers the patient's vitality. But this contention did not appear to be established. It was admitted that the appellant's skin had by reason of his illness become what is denominated "allergic," that

is, unduly sensitised to the particular irritant from which he had suffered; but that could throw no light on the original skin condition. A point was made that a skin ordinarily normal might transiently and unexpectedly show a peculiar sensitivity, but that remained a mere possibility which was not developed and may be ignored. In the result there does not seem any reason to differ from the Chief Justice's finding that the appellant's skin was normal.

What then caused this terrible outbreak of dermatitis? The place and time of the original infection would seem to point to the cause being something in the garments, and in particular to something in the ankle ends of the underpants, because the inflammation began at the front of the shins where the skin is drawn tight over the bone, and where the cuff of the pants presses tightly under the socks against the skin, and began about nine or ten hours after the pants were first put on: the subsequent virulence and extension of the disease may be explained by the toxins produced by the inflammation getting into the blood stream. But the coincidence, it was pointed out, was not sufficient proof in itself that the pants were the cause. The appellant then relied on the fact that it was admitted in the respondents' Answers to Interrogatories that the garments when delivered to the retailer by the manufacturers contained sulphur dioxide, and on the fact that the presence of sulphur dioxide indicated the presence of free sulphites in the garment. If there were in a garment worn continuously all day next the skin free sulphites in sufficient quantities, a powerful irritant would be set in operation. Sweat is being slowly and continuously secreted by the skin, and combines with the free sulphites to form successively sulphur dioxide, sulphurous acid and sulphuric acid: sulphuric acid is an irritant which would produce dermatitis in a normal skin if applied in garments under the conditions existing when the appellant wore the underpants. It is a fair deduction from the Answers and from the evidence that free sulphites were present in quantities not to be described as small, but that still left the question whether they were present in quantities sufficient to account for the disease. It is impossible now and was impossible at any time after the garments were washed to prove what quantities were present when the garments were sold. That can only be inferred from various considerations. The garments were in July 1931 handed back to the retailers and by them sent back to the manufacturers. In November 1931 Mr. Anderson, of Victoria an analytical chemist, on the instructions of the manufacturers analysed one half of one of the pants to ascertain what quantity of water soluble salts they contained and found certain quantities of sulphates but sulphates would not irritate the skin. In the following May, Mr. Anderson made a further analysis of the other three garments and of the remaining half of the pair of pants: he was testing for sulphites, which he expressed in terms of sulphur dioxide percentage by weight. In one singlet he found a nil return, in the other 0.0070; in the pants he found 0.0082 in one and 0.0201 in the other. There was some debate whether these figures were of free sulphites, or of sulphites adherent to the wool molecule, and not soluble by sweat. Their Lordships, after careful consideration and for a variety of reasons do not differ from the conclusion of the Chief Justice that these results proved the presence of free sulphite. But the results were not such as to show quantities likely to cause irritation. On the other hand, a very eminent scientist, Professor Hicks, called by the appellant, gave his opinion that the garments before washing must have had sulphites in considerably greater quantity: and these tests of Mr. Anderson were of each garment as a whole, whereas it was clear that the relevant parts in

each pair of pants were the ankle ends since the disease was initiated at that point in each leg. It is clear that no further light could be thrown by fresh analysis of the actual garments.

Evidence was given on behalf of the manufacturers as to the processes used in the manufacture of these garments. The webs of wool were put through six different processes: of these the second, third and fourth, were the most significant for this case. The second was for shrinking and involved treatment of the web with a solution of calcium hypochloride and hydrochloric acid. The third process was to remove these chemicals by a solution of bisulphite of soda, and the fourth process was to neutralise the bisulphite by means of bicarbonate of soda; the fifth process was for washing and the sixth was a drying and finishing process. If the fourth process did not neutralise the added bisulphite, free sulphites would remain, which the subsequent washing might not entirely remove. The manufacturers' evidence was that the process was properly applied to the wool from which these garments were made and if properly applied was bound to be effective. The foreman scourer Smith was not called at the trial, where his absence was made matter of comment, but Ashworth, one of the scourers, gave evidence and among other things said that they had to be very careful that there was no excess of one chemical or the other. If there were an excess of some sort or the other, it would be bound to be somebody's fault. The washing off was to clear out as much of the traces of the previous process as possible. But something might go wrong, someone might be negligent and as a result some bisulphite of soda which had been introduced might not have been got rid of. The cuffs of the pants were ribbed and were made of a different web separately treated. The appellant's advisers had at the trial no independent information as to the actual process adopted in respect of these garments or even when they were made and, by petition, they asked for leave to adduce further evidence which would go to show, as they suggested, that the process deposed to was not adopted by the manufacturers until after 3rd June 1931. Their Lordships however feel themselves in a position to dispose of the appeal on the evidence as it stands taking due account of the fact that the manufacturers' secretary was called and deposed that in the previous six years the manufacturers had treated by a similar process 4,737,600 of these garments, which they had sold to drapers throughout Australia and he had no recollection of any complaints, which if made would in ordinary course have come under his notice. Dr. Hargreaves, an analytical chemist, on the instructions of the manufacturers analysed specimen garments, subjecting them to tests which would extract any sulphur adherent to the wool as well as free sulphites, if any were present, and found only negligible quantities. Against this evidence was that of Professor Hicks who agitated in unheated water for two minutes a singlet of the manufacturers' Golden Fleece make, purchased in November 1932, and found that the aqueous extract contained a percentage by weight of sulphite of 0.11 which in his opinion was free in the fabric and readily soluble in cold water. The significance of this experiment seems to be that however well designed the manufacturers' proved systems may be to eliminate deleterious substances it may not invariably work according to plan. Some employee may blunder.

Mr. Greene for the respondents quite rightly emphasised how crucial it would have been for the appellant's case to prove by positive evidence that in fact the garments which the appellant wore, contained an excess of free sulphites. He contended that the appellant's case involved arguing in a circle; his argument, he said, was that the garments must have caused

the dermatitis because they contained excess sulphites, and must have caused the disease: but nought, he said, added to nought still is no more than nought. This, however, does not do justice either to the process of reasoning by way of probable inference which has to do so much in human affairs or to the nature of circumstantial evidence in law Courts. Mathematical, or strict logical demonstration is generally impossible: juries are in practice told that they must act on such reasonable balance of probabilities as would suffice to determine a reasonable man to take a decision in the grave affairs of life. Pieces of evidence, each by itself insufficient, may together constitute a significant whole, and justify by their combined effect a conclusion. Dixon, J., in the judgment in which he dissented from that of the Chief Justice, does not seem to suggest that there was no evidence for a decision in the appellant's favour but merely that it was not safe so to decide. But the coincidences of time and place and the absence of any other explanation than the presence of free sulphite in the garments, point strongly in favour of the appellant's case: it is admitted as has been said above that some sulphites were present in the garments, and there is nothing to exclude the possibility of a quantity sufficient to do the harm. On the whole there does not seem adequate reason to upset the judgment on the facts of the Chief Justice. No doubt, this case depends in the last resort (be-inference to be drawn from retailers evidence, though on much of the circumstances and evidence the trial judge had) by the advantage of seeing and hearing the witnesses. The plaintiff must prove his case but there is an onus on a defendant who, on appeal, contends that a judgment should be upset: he has to show that it is wrong. Their Lordships are not satisfied in this case that the Chief Justice was wrong.

That conclusion means that the disease contracted and the damage suffered by the appellant were caused by the defective condition of the garments which the retailers sold to him and which the manufacturers made and put forth for retail and indiscriminate sale. The Chief Justice gave judgment against both respondents, against the retailers on the contract of sale and against the manufacturers in tort, on the basis of the decision in the House of Lords in 1932 AC 562(1). The liability of each respondent depends on a different cause of action, though it is for the same damage. It is not claimed that the appellant should recover his damage twice over; no objection is raised on the part of the respondents to the form of the judgment which was against both respondents for a single amount. So far as concerns the retailers, Mr. Greene contends that if it were held that the garments contained improper chemicals and caused the disease, the retailers were liable for breach of implied warranty, or rather condition under S. 14. South Australia Sale of Goods Act, 1895, which is identical with S. 14, English Sale of Goods Act, 1893. The section is in the following terms:

“14. Subject to the provisions of this Act, and of any Statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows:

I. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he be the manufacturer or not), there is an implied condition that the goods shall be reasonably fit for such

purpose: provided that in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose:

II. Where the goods are bought by description who deals in goods of that description (whether he be manufacturer or not), there is implied condition that the goods shall be of merchantable quality; provided that if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed;

III. An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade;

IV. An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith."

He limited his admission to liability under exception (ii), but their Lordships are of opinion that liability is made out under both exception (i) and exception (ii) to S. 14, and feel that they should so state out of deference to the views expressed in the Court below. S. 14 begins by a general enunciation of the old rule of caveat emptor and proceeds to state by way of exception the two implied conditions by which it has been said the old rule has been changed to rule of caveat vendor; the change has been rendered necessary by the conditions of modern commerce and trade. There are numerous cases on the section, but as these were cited below it is not necessary to detail them again. The first exception, if its terms are satisfied, entitles the buyer to the benefit of an implied condition that the goods are reasonably fit for the purpose for which the goods are supplied but only if that purpose is made known to the seller "so as to show that the buyer relies on the seller's skill or judgment." It is clear that the reliance must be brought home to the mind of the seller, expressly or by implication. The reliance will seldom be express; it will usually arise by implication from the circumstances; thus to take a case like that in question of a purpose from a retailer the reliance will be in general inferred from the fact that a buyer goes to the shop in the confidence that the tradesman has selected his stock with skill and judgment; the retailer need know nothing about the process of manufacture; it is immaterial whether he be manufacturer or not; the main inducement to deal with a good retail shop is the expectation that the tradesman will have brought the right goods of a good make; the goods sold must be, as they were in case goods of a description which it is in the course of the seller's business to supply; there is no need to specify in terms the particular purpose for which the buyer requires the goods; which is nonetheless the particular purpose within the meaning of the section because it is the only purpose for which anyone would ordinarily want the goods. In this case the garments were naturally intended and only intended to be worn next the skin. The proviso does not apply to a case like the sale of Golden Fleece make such as is here in question, because Golden Fleece is rather a patent or trade name within the meaning of the proviso to Excep. (i). With great deference to Dixon, J. their Lordships think that the requirements of Excep. (i) were complied with. The conversation at the shop in which the appellant discussed questions of price and of

the different makes did not affect the fact that he was substantially relying on the retailers to supply him with a correct article.

The second exception in a case like this in truth overlaps in its application the first exception; whatever else merchantable may mean it does mean that the article sold, if only meant for one particular use in ordinary course, is fit for that use; merchantable does not mean that the thing is saleable in the market simply because it looks all right. It is not merchantable in that event if it has defects unfitting it for its only proper use but not apparent on ordinary examination: that is clear from the proviso, which shows that the implied condition only applies to defects not reasonably discoverable to the buyer on such examination as he made or could make. The appellant was satisfied by the appearance of the underpants; he could not detect and had no reason to suspect the hidden presence of the sulphites; the garments were saleable in the sense that the appellant or anyone similarly situated and who did not know of their defect, would readily buy them but they were not merchantable in the statutory sense because their defect rendered them unfit to be worn next the skin. The proviso to Excep. (ii) does not apply where, as in this case, no examination that the buyer could or would normally have made would have revealed the defect. In effect the implied condition of being fit for the particular purpose for which they are required and implied condition of being merchantable produce in cases of this type the same result. It may also be pointed out that there is a sale by description even though the buyer is buying something displayed before him on the counter: a thing is sold by description, though it is specific, so long as it is sold not merely as the specific thing but as a thing corresponding to a description, e.g., woolen under garments, a hot water bottle, a second-hand reaping machine, to select a few obvious illustrations.

The retailers accordingly in their Lordships' judgment are liable in contract: so far as they are concerned, no question of negligence is relevant to the liability in contract. But when the position of the manufacturers is considered, different questions arise: there is no privity of contract between the appellant and the manufacturers: between them the liability, if any, must be in tort, and the gist of the cause of action is negligence. The facts set out in the foregoing show in their Lordships' judgment negligence in manufacture. According to the evidence, the method of manufacture was correct; the danger of excess sulphites being left was recognised and was guarded against: the process was intended to be fool proof. If excess sulphites were let in the garment, that could only be because someone was at fault. The appellant is not required to lay his finger on the exact person in all the chain who was responsible or to specify what he did wrong. Negligence is found as a matter of inference from the existence of the defects taken in connexion with all the known circumstances: even if the manufacturers could by apt evidence have rebutted that inference they have not done so.

On this basis, the damage suffered by the appellant was caused in fact (because the interposition of the retailers may for this purpose in the circumstances of the case be disregarded) by the negligent or improper way in which the manufacturers made the garments. But this mere sequence of cause and effect is not enough in law to constitute a cause of action in negligence, which is a complex concept, involving a duty as between the parties to take care, as well as a breach of that duty and resulting damage. It might be said that here was no relationship between the parties at all: the manufacturers, it might be said, parted once and for all with the garments when they sold them to the retailers and were

therefore not concerned with their future history, except in so far as under their contract with the retailers they might come under some liability: at no time, it might be said, had they any knowledge of the existence of the appellant: the only peg on which it might be sought to support a relationship of duty was the fact that the appellant had actually worn the garments, but he had done so because he had acquired them by a purchase from the retailers, who were at that time the owners of the goods, by a sale which had vested the property in the retailers and divested both property and control from the manufacturers. It was said there could be no legal relationships in the matter save those under the two contracts, between the respective parties of those contracts, the one between the manufacturers and the retailers and the other between the retailers and the appellant. These contractual relationships (it might be said) covered the whole field and excluded any question of tort liability: there was no duty other than the contractual duties. This argument was based on the contention that the present case fell outside the decision of the House of Lords in 1932 AC 562 (1). Their Lordships, like the Judges in the Courts in Australia, will follow that decision, and the only question here can be what that authority decides and whether this case comes within its principles. In 1932 AC 562 (1) the defendants were manufacturers of ginger beer which they bottled: the pursuer had been given one of their bottles by a friend who had purchased it from a retailer who in turn had purchased from the defenders. There was no relationship between pursuer and defenders except that arising from the fact that she consumed the ginger beer they had made and bottled. The bottle was opaque so that it was impossible to see that it contained the decomposed remains of a snail: it was sealed and stoppered so that it could not be tampered with until it was opened in order to be drunk. The House of Lords held these facts established in law a duty to take care as between the defenders and the pursuer. Their Lordships think that the principle of the decision is summed up in the words of Lord Atkin at p. 599:

A manufacturer of products, which he sells in such a form as to show that he intends them to reach the ultimate consumer in the form in which they left him with no reasonable possibility of intermediate examination, and with the knowledge that the absence of reasonable care in the preparation or putting up of the products will result in an injury to the consumer's life or property, owes a duty to the consumer to take that reasonable care.

This statement is in accord with the opinions expressed by Lord Thankerton and Lord Macmillan, who in principle agreed with Lord Atkin. In order to ascertain whether the principle applies to the present case, it is necessary to define what the decision involves and consider the points of distinction relied upon before their Lordships. It is clear that the decision treats negligence, where there is a duty to take care, as a specific tort in itself, and not simply as an element in some more complex relationship or in some specialised breach of duty, and still less as having any dependence on contract. All that is necessary as a step to establish the tort of actionable negligence is to define the precise relationship from which the duty to take care is to be deduced. It is however essential in English law that the duty should be established: the mere fact that a man is injured by another's act gives in itself no cause of action: if the act is deliberate, the party injured will have no claim in law even though the injury is intentional, so long as the other party is merely exercising a legal right: if the act involves lack of due care, again no case of actionable negligence will arise unless the duty to

be careful exists. In 1932 AC 562, the duty was deduced simply from the facts relied on, viz., that the injured party was one of a class for whose use, in the contemplation and intention of the makers, the article was issued to the world, and the article was used by that party in the state in which it was prepared and issued without it being changed in any way and without there being any warning of, or means of detecting, the hidden danger: there was, it is true, no personal intercourse between the maker and the user; but though the duty is personal, because it is *inter partes*, it needs no interchange of words, spoken or written, or signs of offer or assent; it is thus different in character from any contractual relationship; no question of consideration between the parties is relevant: for these reasons the use of the word “privity” in this connexion is apt to mislead because of the suggestion of some overt relationship like that in contract, and the word “proximity” is open to the same objection; if the term proximity is to be applied at all, it can only be in the sense that the want of care and the injury are in essence directly and intimately connected; though there may be intervening transactions of sale and purchase and intervening handling between these two events, the events are themselves unaffected by what happened between them; proximity can only properly be used to exclude any element of remoteness, or of some interfering complication between the want of care and the injury, and like “privity” may mislead by introducing alien ideas. Equally also may the word “control” embarrass, though it is conveniently used in the opinions in 1932 AC 562(1) to emphasise the essential factor that the consumer must use the article exactly as it left the maker, that is in all material features, and use it as it was intended to be used.

In that sense the maker may be said to control the thing until it is used. But that again is an artificial use, because, in the natural sense of the word, the makers parted with all control when they sold the article and divested themselves of possession and property. An argument used in the present case based on the word “control” will be noticed later. It is obvious that the principles thus laid down involve a duty based on the simple facts detailed above, a duty quite unaffected by any contracts dealing with the thing, for instance, of sale by maker to retailer, and again by retailer to consumer or to the consumer’s friend. It may be said that the duty is difficult to define, because when the act of negligence in manufacture occurs there was no specific person towards whom the duty could be said to exist: the thing might never be used: it might be destroyed by accident or it might be scrapped, or in many ways fail to come into use in the normal way: in other words the duty cannot at the time of manufacture be other than potential or contingent and only can become vested by the fact of actual use by a particular person.

One further point may be noted. The principle of (1932) AC 562 can only be applied where the defect is hidden and unknown to the consumer, otherwise the directness of cause and effect is absent: the man who consumes or uses a thing which he knows to be noxious cannot complain in respect of whatever mischief follows because it follows from his own conscious volition in choosing to incur the risk or certainty of mischance. If the foregoing are the essential features of (1932) AC 562, they are also to be found, in their Lordships’ judgment, in the present case. The presence of the deleterious chemical in the pants, due to negligence in manufacture, was a hidden and latent defect, just as much as were the remains of the snail in the opaque bottle; it could not be detected by any examination that could reasonably be made. Nothing happened between the making of the garments and their being

worn to change their condition. The garments were made by the manufacturers for the purpose of being worn exactly as they were worn in fact by the appellant: it was not contemplated that they should be first washed. It is immaterial that the appellant has a claim in contract against the retailers, because that is a quite independent cause of action, based on different considerations, even though the damage may be the same. Equally irrelevant is any question of liability between the retailers and the manufacturers on the contract of sale between them. The tort liability is independent of any question of contract.

It was argued, but not perhaps very strongly, that (1932) AC 562 was a case of food or drink to be consumed internally, whereas the pants here were to be worn externally. No distinction, however can be logically drawn for this purpose between a noxious thing taken internally and a noxious thing applied externally: the garments were made to be worn next the skin: indeed Lord Atkin specifically puts as examples of what is covered by the principle he is enunciating things operating externally, such as “an ointment, a soap, a cleaning fluid or cleaning powder.” Mr. Greene, however sought to distinguish (1932) AC 562 from the present on the ground that in the former the makers of the ginger beer had retained “control” over it in the sense that they had placed it in stoppered and sealed bottles, so that it would not be tampered with until it was opened to be drunk, whereas the garments in question were merely put into paper packets, each containing six sets, which in ordinary course would be taken down by the shopkeeper and opened and the contents handled and disposed of separately so that they would be exposed to the air. He contended that though there was no reason to think that the garments when sold to the appellant were in any other condition, least of all as regards sulphur contents, that when sold to the retailers by the manufacturers, still the mere possibility and not the fact of their condition having been changed was sufficient to distinguish (1932) AC 562: there was no “control” because nothing was done by the manufacturers to exclude the possibility of any tampering while the goods were on their way to the user. Their Lordships do not accept that contention. The decision in (1932) AC 562 did not depend on the bottle being stoppered and sealed: the essential point in this regard was that the article should reach the consumer or user subject to the same defect as it had when it left the manufacturer. That this was true of the garment is in their Lordships’ opinion beyond question. At most there might in other cases be a greater difficulty of proof of the fact.

Mr. Greene further contended on behalf of the manufacturers that if the decision in (1932) AC 562 were extended even a hairsbreadth, no line could be drawn and a manufacturer’s liability would be extended indefinitely. He put as an illustration the case of a foundry which had cast a rudder to be fitted on a liner: he assumed that it was fitted and the steamer sailed the seas for some years: but the rudder had a latent defect due to faulty and negligent casting and one day it broke, with the result that the vessel was wrecked, with great loss of life and damage to property. He argued that if (1932) AC 562 were extended beyond its precise facts, the maker of the rudder would be held liable for damages of an indefinite amount, after an indefinite time and to claimants indeterminate until the event. But it is clear that such a state of things would involve many considerations far removed from the simple facts of this case. So many contingencies must have intervened between the lack of care on the part of the makers and the casualty that it may be that the law would apply, as it does in proper cases, not always according to strict logic, the rule that cause and effect must not be too remote: in any

case the element of directness would obviously be lacking. Lord Atkin deals with that sort of question in (1932) AC 562, 591, where he quotes the common sense opinion of Mathew, LJ:

It is impossible to accept such a wide proposition, and, indeed, it is difficult to see how, if it were the law, trade could be carried on.

In their Lordships' opinion it is enough for them to decide this case on its actual facts. No doubt many difficult problems will arise before the precise limits of the principle are defined: many qualifying conditions and many complications of fact may in the future come before the Courts for decision. It is enough now to say that their Lordships hold the present case to come within the principle of (1932) AC 562 and they think that the judgment of the Chief Justice was right and should be restored as against both respondents and that the appeal should be allowed with costs here and in the Courts below, and that the appellant's petition for leave to adduce further evidence should be dismissed without costs. They will humbly so advise His Majesty.

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EFFECTS OF THE CONTRACT

Passing of Property

CIT v. Mysore Chromite Ltd.

(1955) 1 SCR 849 : AIR 1955 SC 98

S.R. DAS, J. - This is an appeal from the judgment pronounced by the High Court of Judicature at Madras on 29th March, 1951 on a consolidated reference by the Income Tax Appellate Tribunal under Section 66(1) of the Income Tax Act whereby the High Court answered in the affirmative both the referred questions which were expressed in the following terms:

“(1) Whether on the facts and in the circumstances of the case the profits derived by the assessee company from sales made to European and American buyers arose outside British India?

(2) Whether on the facts and in the circumstances of the case the profits derived by the assessee company from sales made to European and American buyers were received outside British India?”

3. The assessee company is a private limited company registered in the Mysore State under the Mysore Company Regulations and has its registered office at Sinduvalli in Mysore State. The management and control of the assessee company was vested in Messrs Oakley Bowden & Co. (Madras) Ltd., another private limited company incorporated under the Indian Companies Act, having its registered office at No. 15, Armenian Street, Madras. The assessee company owns chromite mines in Mysore State. Chrome ores are extracted from the mines and converted into a merchantable product and then sold to buyers mostly outside India. A very small proportion of the total sales is effected in India and for the purposes of this case may be left out of consideration. The sales are mostly to buyers in America and Europe. The sales to the purchasers in Europe are put through in London by Bowden Oakley & Co. Ltd., London, which is the agent of the assessee company in Europe holding a power of attorney from the assessee company. The contracts for sale to European purchasers are signed by Bowden Oakley & Co. Ltd., in London. The sales to purchasers in America are effected through Messrs W.R. Grace & Co., who buy for undisclosed principals. The contracts for sale to American purchasers are signed by W.R. Grace & Co., presumably in America and by Oakley Bowden & Co. (Madras) Ltd., in Madras. Specimen forms of contracts with European purchasers and those with American purchasers are set out in the order of the Tribunal dated 22nd January, 1948 out of which the present reference arises. Under both forms of contracts the price was F.O.B. Madras or Marmagoa. A very small quantity of goods was sold F.O.B. Marmagoa and the same need not be considered here. Provision was made for weighing, sampling and assay of goods at destination.

4. The course of dealing as found by the Appellate Tribunal was as follows: Before the goods were actually shipped, the buyers used to open a confirmed irrevocable Bankers' credit with some first class bank in London. Being informed of the opening of such credit the Eastern Bank Ltd., London sent intimation to the Eastern Bank Ltd., Madras, and the latter in

its turn used to pass on the intimation by letter addressed to the assessee company. A specimen of such letter is also set out in the order of the Appellate Tribunal. In such communication the Eastern Bank Ltd., Madras, informed the assessee company that "in accordance with advices received by letter from our London Office, a confirmed and irrevocable credit has been opened in your favour by Messrs Morgan Grenfell & Co., Ltd., London, for account of Messrs W.R. Grace & Co., New York, for a sum not exceeding £ 7300 (seven thousand three hundred pounds sterling) in all, available by delivery to us on or before 15th January, 1940 of the following documents..." Towards the end of the letter the Eastern Bank Ltd., Madras used to write that they were "prepared in our options as customary to negotiate drafts drawn in terms of the arrangement provided that the documents as abovementioned appear to us to be in order". The letter concluded with a warning that the advice was "given for your guidance and without involving any responsibility on the part of this Bank". On receipt of such intimation the assessee company placed the contracted goods on board the steamer at Madras and obtained A bill of lading in its own name. As already mentioned, the shipments were made principally at Madras Port. Thereafter the assessee company used to make out a provisional invoice on the basis of the bill of lading weight and contract price for 48 per cent Cr. 203 and used to draw a bill of exchange on the buyers' Bank, where the letter of credit had been opened, for 90 per cent of the amount of the provisional invoice payable at sight in the case of European contracts and 80 per cent of the amount of the provisional invoice at 90 days' sight in the case of American contracts and in either case the bills of exchange used to be drawn in favour of the Eastern Bank Ltd., London. The bill of exchange together with the relative bill of lading endorsed in blank by the assessee company and the provisional invoice was then negotiated with the Eastern Bank Ltd., Madras, the bankers of the assessee company, who used to credit the assessee company with the amount of the bill of exchange. The Eastern Bank Ltd., Madras, then forwarded the documents to the Eastern Bank Ltd., London, who used to present the bill of exchange to the buyers' Bank in London and upon the bill of exchange being accepted the Eastern Bank Ltd., London, used to deliver the bill of lading and the invoice to the buyers' Bank. The buyers' Bank in due course used to pay the amount of the bill of exchange to the Eastern Bank Ltd., London. Thereafter, on arrival of the goods and after weighment and assay, the sale price was ascertained and the balance of price, after deducting the payments made against the bill of exchange, used to be paid to the Eastern Bank Ltd., London, which was the assessee company's agent and banker in London.

7. Learned Solicitor-General appearing in support of this appeal contends that having regard to the terms of the contracts the sales must be regarded as having taken place in British India. The facts strongly relied on by him are (i) that the price and delivery of goods were on F.O.B. terms, (ii) that in the European contracts the insurance, if any, was to be the concern of the buyers and (iii) that payment of the 80 per cent or 90 per cent as the case may be was made in Madras by the Eastern Bank Ltd., Madras, to the assessee company on the delivery of the documents. All these facts taken together indicate, according to his submission, that the property in the goods passed at Madras and the sales accordingly were completed in British India. We are unable to accept this line of reasoning. According to Section 4 of the Indian Sale of Goods Act a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price and where under a contract of

sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell. By sub-section (4) of that section an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. Section 18 of the Act clearly indicates that in the case of sale of unascertained goods no property in the goods is transferred to the buyer unless and until the goods, are ascertained. In the present case, the contracts were always for sale of unascertained goods. Skipping over Sections 19 to 22 which deal with contract of sale of specific goods we come to Section 23 which lays down that where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. It is suggested that as soon as the assessee company placed the goods on board the steamer named by the buyer at the Madras Port the goods became ascertained and the property in the goods passed immediately to the buyer. This argument, however, overlooks the important word “unconditionally” used in the section. The requirement of the section is not only that there shall be appropriation of the goods to the contract but that such appropriation must be made unconditionally. This is further elaborated by Section 25 which provides that where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation reserve the right of disposal of the goods until certain conditions are fulfilled. In such a case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled. The question in this case, therefore, is: was there an unconditional appropriation of the goods by merely placing them on the ship? It is true that the price and delivery was F.O.B., Madras but the contracts themselves clearly required the buyers to open a confirmed irrevocable Bankers’ credit for the requisite percentage of the invoice value to be available against documents. This clearly indicated that the buyers would not be entitled to the documents that is, the bill of lading and the provisional invoice, until payment of the requisite percentage was made upon the bill of exchange.

The bill of lading is the document of title to the goods and by this term the assessee company clearly reserved the right of disposal of the goods until the bill of exchange was paid. Placing of the goods on board the steamer named by the buyer under a F.O.B. contract clearly discharges the contractual liability of the seller as seller and the delivery to the buyer is complete and the goods may thenceforward be also at the risk of the buyer against which he may cover himself by taking out an insurance. Prima facie such delivery of the goods to the buyer and the passing of the risk in respect of the goods from the seller to the buyer are strong indications as to the passing also of the property in the goods to the buyer but they are not decisive and may be negated, for under Section 25 the seller may yet reserve to himself the right of disposal of the goods until the fulfilment of certain conditions and thereby prevent the passing of property in the goods from him to the buyer. The facts found in this case are that the assessee company shipped the goods under bill of lading issued in its own name. Under the contract it was not obliged to part with the bill of lading which is the document of title to

the goods until the bill of exchange drawn by it on the buyers' Bank where the irrevocable letter of credit was opened was honoured. It is urged that under the provision in the contract for weighment and assay, which was ultimately to fix the price unless the buyer rightly rejected the goods as not being in terms of the contract, the passing of property in the goods could not take place until the buyer accepted the goods and the price was fully ascertained after weighment and assay. It is submitted that being the position, the property in the goods passed and the sales were concluded outside British India, for the weighment, sampling, assay and the final fixation of the price could only take place under all these contracts outside British India. It is not necessary for us to express any opinion on this extreme contention. Suffice it to say, for the purposes of this case, that in any event upon the terms of the contracts in question and the course of dealings between the parties the property in the goods could not have passed to the buyer earlier than the date when the bill of exchange was accepted by the buyers' Bank in London and the documents were delivered by the assessee company's agent, the Eastern Bank Ltd., London, to the buyers Bank. This admittedly, and as found by the Appellate Tribunal, always took place in London. It must, therefore, follow that at the earliest the property in the goods passed in London where the bill of lading was handed over to the buyers' Bank against the acceptance of the relative bill of exchange. In the premises, the Appellate Tribunal as well as the High Court were quite correct in holding that the sales took place outside British India and, *ex hypothesi*, the profits derived from such sales arose outside British India.

8. As to the second question, the learned Solicitor-General contends that irrespective of the place where the sale may have taken place the profits derived from such sales were received in Madras. It is recalled that after shipment the assessee company, through its managing agent in Madras, prepared provisional invoices and drew bills of exchange for 80 per cent or 90 per cent, as the case may be, of the amount of such invoices and handed over the same to the Eastern Bank Ltd., Madras, and received the amount of the bill of exchange from them in Madras. He contends that the receipt of this payment by the assessee company was really the receipt of the price of the goods and amounted to receipt of profits in Madras. He draws our attention to the terms of payment in the European contract and to the letter of intimation of the opening of the credit sent by the Eastern Bank Ltd. Madras, to the assessee company which have been quoted in part in the earlier part of this judgment. He relies on the words "through the Eastern Bank Ltd", appearing in the contract and the words "available by delivery to us" appearing in the letter. We do not think that those words support the contention of the learned Solicitor-General. The words "through the Eastern Bank Ltd.," appear to us to go with the preceding words "to be advised to sellers" which are put within brackets which seem to have been wrongly closed after the word "sellers" instead of after the words "the Eastern Bank Ltd." Ordinarily, the buyer opens a letter of credit with his Bank in favour of the seller and the words "through the Eastern Bank Ltd." would be meaningless unless it was intended to mean that the irrevocable credit which was in favour of the assessee company was to be operated upon by the latter through the Eastern Bank Ltd. If that were the true meaning, then that certainly does not make the Eastern Bank Ltd. the agent of the buyers. The words "available by delivery to us" occurring in the letter of the Eastern Bank Ltd., Madras, do not appear to us to indicate that this was any part of the terms of the letter of credit. This was an intimation in accordance with the advice received by the Eastern Bank

Ltd., Madras, from the Eastern Bank Ltd., London, that the assessee company might avail itself of the letter of credit by delivery of the documents to the Eastern Bank Ltd., Madras. This is made further clear by the latter part of the letter where the Eastern Bank Ltd., Madras, expressed their willingness at their option to negotiate the drafts drawn in terms of the arrangement provided that the documents were in order. The concluding sentence of that letter whereby the Eastern Bank Ltd., Madras, disown any responsibility in respect of the advice clearly militates against the suggestion of the learned Solicitor-General. It is, in these circumstances, impossible to accede to the argument that the payment of 80 per cent or 90 per cent, as the case may be, of the amount of the provisional invoice by the Eastern Bank Ltd., Madras, was a payment on account of the price. Normally, price is paid by or on behalf of the buyer. In this case the fact found is that the Eastern Bank Ltd., Madras, and the Eastern Bank Ltd. London, were agents of the assessee company. Neither of them had any relation with the buyers. Therefore, a payment by them cannot be regarded as a payment of the price. The true position is very clearly put by Lord Sumner in *The Prinz Adalbert* [LR (1917) AC 586, 589]:

“When a shipper takes his draft, not as yet accepted, but accompanied by a bill of lading indorsed in this way, and discounts it with a banker, he makes himself liable on the instrument as drawer, and further makes the goods, which the bill of lading represents, security for its payment. If, in turn, the discounting banker surrenders the bill of lading to the acceptor against his acceptance, the inference is that he is satisfied to part with his security in consideration of getting this further party’s liability on the bill, and that in so doing he acts with the permission and by the mandate of the shipper and drawer.”

This payment by the Eastern Bank Ltd., Madras, therefore, is nothing but an advance made by them to their own customer on the security of the goods covered by the bill of lading reinforced by the benefit of the liability taken up by the assessee company as drawer of the bill which in its turn is backed by the confirmed and irrevocable credit of the buyers’ London Bank. If this payment was on account of the price, why should the assessee company, as the seller, undertake any liability to the Eastern Bank Ltd., as the drawer of the bill of exchange? The truth of the matter is that the price was paid on behalf of the buyers by their respective London Banks in London to the Eastern Bank Ltd., London which was the agent of the assessee company. The first receipt of the price, therefore, as pointed out by the High Court, was by the Eastern Bank Ltd., London, on behalf of the sellers. There is no dispute that the balance of the price ascertained after weighment and assay and deducting the amount paid on the bill of exchange was similarly received in London by the Eastern Bank Ltd., London, on behalf of the assessee company. The subsequent adjustment made in the books of the Eastern Bank Ltd., London did not operate as a receipt of profits in British India. In our opinion the High Court correctly answered the second question also in favour of the assessee company.

9. For reasons stated above, this appeal must stand dismissed.

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P.S.N.S. Ambalavana Chettiar v. Express Newspapers Ltd.

(1968) 2 SCR 239 : AIR 1968 SC 741

R. S. BACHAWAT, J. - The dispute arises out of a contract between the appellants and the respondent entered into on November 13, 1951. The terms of this contract were recorded in writing in the form of a letter written by the respondent to Appellant 1 and set out below:

“Messrs. P.S.N.S. Ambalavana Chettiar and Company Ltd., 260, Angappa Naicken Street, Madras.

Dear Sirs,

We confirm having purchased from you and the Madras Paper Marketing Company, Madras, 500 tons of Russian Newsprint as per the following description:

About 70 per cent in reels of 34 inches width.

“15 per cent in reels of 22 inches width; 15 per cent in reels of 36 inches width” at annas 9 per lb. ex-wharf Bombay duty, etc., paid. The buyers are to take delivery within four days of the offer of delivery. Any wharfage, etc., up to the fourth day of the offer of delivery will be on seller's account and thereafter on buyer's account.

We have also sold you about 415 tons of Russian newsprint in sheets in size of about 30" x 42" (760 mm X 1085 mm) ex-godown, Madras at Re. 0-9-6 per lb. We will keep the stock of sheets in our godown on your account free of rent. We shall advance you moneys against this newsprint at annas 8 per lb. This advance will carry interest at 5 per cent per annum. We will also charge you the exact amount of insurance which we pay to our Insurance Company against the goods.

We shall pay Rs 5,60,000 to your Bankers in Bombay and take delivery of the 500 tons of newsprint from the harbour in Bombay. Accounts will be made on the basis of the above arrangement and whatever one party is liable to pay to the other will be adjusted subsequently.”.

2. The document shows that the respondent agreed to buy from the appellants 500 tons of Russian newsprint in reels at 9 annas per lb., ex-wharf, Bombay and to take delivery of the goods on payment of Rs 5,60,000. At the same time, the appellants agreed to buy from the Respondent 415 tons of Russian newsprint in sheets then lying in a godown in Madras at 9 annas 6 pies per lb. upon the term that the appellants would pay the insurance charge and also interest at 5 per cent per annum on an amount equivalent to the price of the goods calculated at 8 annas per lb. The understanding was that the appellants would within a reasonable time take delivery of the goods bought by them in instalments and the accounts would be finally adjusted on the completion of the deliveries. It may be mentioned that Appellant 2 carried on business under the name and style of Madras Paper Marketing Company.

3. On November 26, 1951, the parties orally agreed that instead of 500 tons the respondent would buy 300 tons of newsprint in reels and that instead of 415 tons the appellants would buy 300 tons of newsprint in sheets and the terms of the contract dated November 13, 1951 would stand varied accordingly.

4. On December 5, 1951, the respondent took delivery of 300 tons of newsprint in reels on payment of Rs 3,18,706-9-10 and a sum of Rs 57,816-13-2 remained due to the appellants

on account of the price of these goods. From November 29, 1951 up to February 27, 1952, the appellants took delivery of 122324 lbs. of newsprint in sheets on payment of Rs 63,032-15-9 to the respondent. Subsequently, the appellants refused to take delivery of the balance 547501 lbs. of newsprint in sheets. Counsel for the parties agreed before us that March 29, 1952 was the date when the appellants repudiated the contract. On April 21, 1952 after giving notice to the appellants the respondent resold the balance goods to one G.R. Lala at 6½ annas per lb.

5. On April 18, 1952, the appellants filed in the High Court of Madras C.S. No. 175 of 1952 claiming from the respondent Rs 57,816-13-2 on account of the balance price of 300 tons of newsprint in reels and interest thereon. The respondent admitted the claim for the balance price. On July 30, 1952, the respondent filed in the High Court of Madras C.S. No. 262 of 1952 claiming a decree for Rs 62,266-13-2 on account of the balance price of 122324 lbs., the deficiency on resale of 547501 lbs. of the newsprint in sheets, interest and insurance charges after setting off the sum of Rs 57,816-13-2 due to the appellants. The principal defence of the appellants was that the contract with regard to 415 tons of newsprint in sheets was cancelled in November, 1951 and that Appellant 2 was not a party to this contract. The appellants also denied the factum and validity of the resale. The two suits were tried by Rajagopala Ayyangar, J. He dismissed C.S. No. 175 of 1952 and decreed C.S. No. 262 of 1952. From these two decrees, the appellants filed two appeals in the High Court of Madras. A Division Bench of the High Court dismissed the two appeals. The present appeals have been filed on certificates granted by the High Court.

6. The two courts concurrently found that (1) Appellant 2 was a party to the contract of purchase of 415 tons of newsprint in sheets, (2) on November 26, 1951 the parties orally agreed that instead of 415 tons the appellants would buy 300 tons of the newsprint and (3) there was no cancellation of the contract as alleged by the appellants. These findings are not challenged. The two Courts concurrently found that the resale held on April 21, 1952 was genuine and was effected at a proper price on due notice and after proper advertisement. Mr Gupte attempted to challenge these findings, but we see no reason to interfere with them. The principal argument advanced by Mr Gupte was that the property in the goods resold on April 21, 1952 had not passed to the appellants and the resale was consequently invalid. We are inclined to accept this argument.

7. It is to be noticed that the contract did not envisage any loan of money by the respondent to the appellants on the security of the newsprint in sheets. The payment of Rs 3,18,706-9-10 was made by the respondent towards part discharge of its liability for the price of the newsprint in reels. No doubt, the contract stated: "We shall advance you moneys against this newsprint at annas 8 per lb. This advance will carry interest at 5 per cent per annum." But the real import of this clause was that the appellants would pay interest at 5 per cent per annum on an amount equivalent to the price of the newsprint in sheets calculated at 8 annas per lb. The respondent was not a pledge of the newsprint in sheets and had no right to sell the goods under Section 176 of the Indian Contract Act, 1872. The real question is whether the respondent had the right to resell the goods under Section 54(2) of the Sale of Goods Act, 1930.

8. The seller can claim as damages the difference between the contract price and the amount realised on resale of the goods where he has the right of resale under Section 54(2) of

the Sale of Goods Act. The statutory power of resale under Section 54(2) arises if the property in the goods has passed to the buyer subject to the lien of the unpaid seller. Where the property in the goods has not passed to the buyer, the seller has no right of resale under Section 54(2). The question is whether the property in the 300 tons of newsprint in sheets had passed to the appellants before the resale.

9. On November 13, 1951, the respondent agreed to sell to the appellants the stock of 415 tons of newsprint in sheets then lying in the respondent's godown in Madras. There was an unconditional contract for the sale of specific goods in a deliverable state and the property in the goods then passed to the appellants. But on November 26, 1951, the contract was varied in a material particular. The parties agreed that the appellants would buy only 300 tons of the stock of 415 tons of newsprint then lying in the respondent's godown. The result was that in place of the original contract for sale of specific goods a contract for sale of unascertained goods was substituted.

10. Rajagopala Ayyangar, J., held that the effect of the variation of the contract on November 26, 1951 was that the appellants and the respondent became joint owners of the stock 415 tons. In our opinion, this was not the correct legal position. The parties did not intend that the appellants would buy undivided share in 415 tons of newsprint. On November 26, 1951 the bargain between the parties was that the appellants would buy and the respondent would sell 300 tons out of the larger stock of 415 tons.

11. The appellate court held that the property in the entire 415 tons passed to the appellants who were subsequently relieved from their liability to take 115 tons and that the respondent could resell any 300 tons out of the larger stock of 415 tons. We are unable to accept this line of reasoning. It is true that originally the property in the entire 415 tons had passed to the appellants. But the result of the variation of the contract was to annul the passing of property in the goods. The effect of the bargain on November 26, 1951 was that the respondent would sell and deliver to the appellants any 300 tons out of the larger stock of 415 tons. As from November 26, 1951, the property in the entire stock of 415 tons belonged to the respondent. The parties did not intend that as from November 26, 1951 the property in any individual portion of the stock of 415 tons would remain vested in the appellants.

12. Section 18 of the Sale of Goods Act provides that where there is a contract for the sale of unascertained goods no property in the goods is transferred to the buyer unless and until the goods are ascertained. It is a condition precedent to the passing of property under a contract of sale that the goods are ascertained. The condition is not fulfilled where there is a contract for sale of a portion of a specified larger stock. Till the portion is identified and appropriated to the contract, no property passes to the buyer. In *Gillett v. Hill* [149 ER 871, 873] Bayley, B. said:

“Where there is a bargain for a certain quantity extra greater quantity, and there is power of selection in the vendor to deliver which he thinks fit, then the right to them does not pass to the vendee until the vendor has made his selection, and trover is not maintainable before that is done. If I agree to deliver a certain quantity of oil as ten out of eighteen tons, no one can say which part of the whole quantity I have agreed to deliver until a selection is made. There is no individuality until it has been divided.”

13. No portion of 415 tons of the newsprint lying in the respondent's godown was appropriated to the contract by the respondent with the appellants's consent before the resale. On the date of the resale, property in the goods had not passed to the buyer. Consequently, the respondent had no right to resell the goods under Section 54(2). The claim to recover the deficiency on resale is not sustainable.

14. The respondent is entitled to claim as damages the difference between the contract price and the market price on the date of the breach. Where no time is fixed under the contract of sale for acceptance of the goods, the measure of damages is prima facie the difference between the contract price and the market price on the date of the refusal by the buyer to accept the goods, see Illustration (c) to Section 73 of the Indian Contract Act. In the present case, no time was fixed in the contract for acceptance of the goods. On March 29, 1952, the appellants refused to accept the goods. The respondent is entitled to the difference between the contract price and the market price on March 29, 1952. Counsel for both parties requested us that instead of remanding the matter we should assess the damages on this basis and finally dispose of the matter. We have gone through the materials on the record and with the assistance of counsel, we assess the market price of the Russian newsprint in sheets on March 29, 1952 at 8 annas per lb. Counsel on both sides agreed to this assessment. The claim of the respondent for Rs 6,798-5-1 on account of interest and Rs 1119-6-0 for insurance charges is admitted before us by Mr Gupte

15. In the result, Civil Appeal No. 165 of 1965 is allowed in part, the decrees passed by the courts below are varied by substituting therefore a decree in favour of the respondent against the appellants for a sum of Rs 10,980-12-8 with interest thereon at 6 per cent per annum from July 30, 1952. Civil Appeal No. 166 of 1965 is dismissed.

* * * * *

Agricultural Market Committee v. Shalimar Chemical Works Ltd.

(1997) 5 SCC 516 : AIR 1997 SC 2502

S. SAGHIR AHMAD, J. - 2. Agricultural Market Committee (“the Committee”) which is the appellant before us is a statutory body created under the Andhra Pradesh (Agricultural Produce and Livestock) Markets Act, 1966 (“the Act”) while the respondent is a licensed trader dealing in “copra” (dried coconut kernel) which it imports from various places in the State of Kerala for manufacturing coconut oil.

3. “Copra” is a notified agricultural produce and, therefore, the Committee has a right to levy and realise the market fee on all transactions of purchase and sale provided the transactions take place within the notified area of the Committee.

4. By orders dated 2-3-1989 and 28-3-1989, the Assessing Authority who is also the Secretary of the Committee levied the market fee on the respondent who challenged those orders in appeals filed under Section 12-E but the appeals were dismissed on the technical ground of non-compliance with Section 12-E(2) under which the whole amount of market fee had to be deposited before filing the appeal.

6. In order to levy market fee on the transaction of sale and purchase by the respondent, the Assessing Authority had relied upon Rule 74(2) of the Andhra Pradesh (Agricultural Produce and Livestock) Market Rules, 1969 (for short “the Rules”) and Explanation to Bye-law 24(5) of the Bye-laws of the Committee which contained a statutory presumption that if a notified agricultural produce was weighed or measured within the notified area of the Committee, it shall be deemed to have been purchased or sold within that area. The appellate as also the revisional authorities had also relied upon this provision and had held that since “copra” which was imported from the State of Kerala was, admittedly, weighed at Hyderabad, it shall be deemed to have been sold to the respondent at Hyderabad and, consequently, the respondent was liable to pay market fee on all the transactions of sale/purchase of “copra” during the period in question.

29. Let us now consider the next question relating to the nature of transaction relating to sale/purchase of “copra” by the respondent from various dealers in the State of Kerala.

30. It is contended by the learned counsel for the appellant that if an order was placed with a dealer in Kerala in pursuance of which goods were despatched by lorry to Hyderabad where the respondent, after making payment to and receiving documents from the bank, obtained delivery of goods, and that too, after weighment, the transaction cannot but be treated as sale at Hyderabad and not in the State of Kerala.

31. During the pendency of the proceedings before the Appellate Authority, statement of Shri Somnath Bhattacharya, Director of the respondent Company was recorded. He stated that the “copra” was brought into the State of Andhra Pradesh from outside. It was unloaded at the premises of the appellant where it was crushed and coconut oil was extracted. He further stated as under:

“After the material comes to Hyderabad, we will weigh the same for the purpose of verification regarding the quantity despatched by the Kerala dealers. We have a running account with the dealers in Kerala State. The account of the dealers will be settled sometimes monthly and sometimes within two or three months from the date of despatch.... Very rarely it is found on weighment at Hyderabad that the quantity

despatched by the dealer at Kerala is less than the quantity mentioned in the invoice concerned and in such cases, the Hyderabad unit will send a report to our Head Office and the Head Office raises a debit note against the dealer for the shortage of copra.”

32. The above statement has been considered by the High Court which came to the conclusion that the weighment was done only for the satisfaction of the buyer and was not a condition of contract. The High Court also took into consideration the contents of the invoice and Form X and observed as under:

“The appellate authority has referred to a copy of Invoice No. 357 dated 16-5-1985 for arriving at the conclusion that the purchase was effected by the appellant in Hyderabad. This invoice dated 16-5-1985 shows that one Abdul Hameed despatched 200 bags of ‘copra’ through Lorry No. MSQ 3971 from Alleppey in Kerala to Hyderabad and the demand draft for Rs 1,39,000 was forwarded to bank. The note to the invoice says that the despatch of the goods is made solely at the risk and responsibility of M/s Shalimar Chemical Works, the appellant herein, and that Abdul Hameed takes ‘no responsibility or liability as to delayed despatches, losses due to theft, pilferage, rain or damage, leakage, wear and tear etc.’ Column 1 of the accompanying Form X mentions the name of the person consigning the goods as Abdul Hameed. Clause 5 of Form X is in the following terms:

‘If the consignor is transporting goods in pursuance of a sale for the purpose of delivery to the buyer, the name and address of the person to whom the goods are sold, his registration certificate no. under the Andhra Pradesh General Sales Tax Act, 1957. If he is a dealer furnish bill number and date relating in the sale.’

Against this Column No. 5, it is mentioned that the appellant herein is the person to whom the goods are sold. The consignor’s name is mentioned in Column No. 6 as Abdul Hameed of Alleppey. Column No. 7 is in the following terms:

‘7. If the consignor is transporting the goods from one of his shops or godowns to an agent for sale or from one of his shops or godowns to another for the purpose of storage, the address of the agent or of the shop or godown to which the transports are made.’

Against this column, it was written ‘For Sale’. Because it was written in Column No. 7 as ‘for sale’, the appellate authority held that this evidenced that the transport of ‘copra’ was only to enable the appellant to purchase the same and that the same was not sold in Alleppey.

The view taken by the appellate authority is totally unsustainable.”

33. The High Court further observed as under:

“One significant aspect to be noticed in this case is that after the stocks were loaded into the trucks, the sellers in Kerala had absolutely no liability with regard to any future losses. That is the reason why the goods were insured and the insurance premia were paid by the appellant. Where goods have been delivered to a common carrier to be sent to the person, by whom they have been ordered, the carrier becomes the agent of the vendee and such a delivery amounts to delivery to the vendee under Section 23(2) of the Sale of Goods Act. There was thus completed sale in Kerala State and no purchase in the State of Andhra Pradesh.”

34. On the basis of material placed on record, the High Court came to the conclusion that the sale of “copra” took place in the State of Kerala and not at Hyderabad.

35. We may, at this stage, consider certain provisions of the Sale of Goods Act, 1930, specially as the Andhra Pradesh (Agricultural Produce and Livestock) Markets Act, 1966 does not contain any definition of sale or purchase. [Sections 19 and 20 of the Sale of Goods Act were quoted by the court].

36. We may, before analysing the provisions of Sections 19 and 20, observe that the Indian Sale of Goods Act is based largely upon the English and American Acts. Under these Acts, namely, the English Sale of Goods Act, the American Uniform Sales Act and the Indian Sale of Goods Act, the relevant factor for determining where the sale takes place, is the intention of the parties. A contract of sale, like any other contract, is a consensual act inasmuch as parties are at liberty to settle, amongst themselves, any terms they may choose.

37. Section 19 attempts to give effect to the elementary principle of the Law of Contract that the parties may fix the time when the property in the goods shall be treated to have passed. It may be the time of delivery, or the time of payment of price or even the time of the making of contract. It all depends upon the intention of the parties. It is, therefore, the duty of the court to ascertain the intention of the parties and in doing so, they have to be guided by the principles laid down in Section 19(2) which provides that for ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

38. Section 20 indicates that in case of unconditional contract of sale in respect of specified goods in a deliverable state, the property in the goods passes to the buyer at such time as the parties intend it to be transferred. Section 19(3) provides that Sections 20 to 24 contain the rules for ascertaining the intention of the parties as to the time at which the property in the goods shall be treated to have passed to the buyer. Both Sections 19 and 20 apply to the sale of “specific” or “ascertained” goods.

39. Section 20, which contains the first rule for ascertaining the intention of the parties, provides that where there is an unconditional contract for the sale of “specific goods” in a “deliverable state”, the property in the goods passes to the buyer when the contract is made. This indicates that as soon as a contract is made in respect of specific goods which are in a deliverable state, the title in the goods passes to the purchaser. The passing of the title is not dependent upon the payment of price or the time of delivery of the goods. If the time for payment of price or the time for delivery of goods, or both, is postponed, it would not affect the passing of the title in the goods so purchased.

40. In order that Section 20 is attracted, two conditions have to be fulfilled: (i) the contract of sale is for specific goods which are in a deliverable state; and (ii) the contract is an unconditional contract. If these two conditions are satisfied, Section 20 becomes applicable immediately and it is at this stage that it has to be seen whether there is anything either in the terms of the contract or in the conduct of the parties or in the circumstances of the case which indicates a contrary intention. This exercise has to be done to give effect to the opening words, namely, “Unless a different intention appears” occurring in Section 19(3). In *Hoe Kim Seing v. Maung Ba Chit* [AIR 1935 PC 182], it was held that intention of the parties was the decisive factor as to when the property in goods passes to the purchaser. If the contract is silent, intention has to be gathered from the conduct and circumstances of the case.

41. This Court in *Consolidated Coffee Ltd. v. Coffee Board* [AIR 1980 SC 1468], has held that in an auction-sale of chattels, property passes to the purchaser on the acceptance of his bid. This occurs not because of Section 64(2) but because of the rule contained in Section 20.

42. In the instant case, the goods which were the subject-matter of sale were ascertained goods. They were also in a deliverable state. On the order being placed by the respondent, the seller in the State of Kerala, loaded the goods on the lorry and despatched the same to Hyderabad. It is at this stage that the conduct of the parties becomes extremely relevant. It was one of the terms of the contract between the parties that the seller would not be liable for any future loss of goods and that the goods were being despatched at the risk of the respondent. The respondent had also obtained insurance of the goods and had paid the policy premium. He, therefore, intended the goods to be treated as his own so that if there was any loss of goods in transit, he could validly claim the insurance money. The weighing of the goods at Hyderabad or the collection of documents from the bank or payment of price through the bank at Hyderabad were immaterial, inasmuch as the property in the goods had already passed at Kerala and it was not dependent upon the payment of price or the delivery of goods to the respondent.

43. We are in full agreement with the view expressed by the High Court and are also of the opinion that having regard to the evidence on record which indicated that on the order placed by the respondent, the stocks were loaded into the trucks for despatch to Hyderabad with the clear stipulation that the despatch was at the risk of the purchaser and that the seller had no liability with regard to any future losses and that the stock was insured and the insurance premium was paid by the respondent, the sale took place in the State of Kerala and not at Hyderabad.

44. In view of the above, the appeal has no merit and is dismissed.

* * * * *

Pearson v. Rose & Young, Ltd.

(1950) 2 Ch. D. 1027

[Mercantile agent in possession of motor car with the consent of the owner but registration book obtained by trick. The right of innocent buyer]

The plaintiff gave possession of his motor car to H., a motor car dealer and a mercantile agent within the Factors Act, 1889, s. 2(1), for the purpose of inviting offers to purchase it. By means of a trick H, induced the plaintiff to hand him the registration book relating to the car. Later the same day H., acting without the authority or knowledge of the plaintiff, sold the car and handed the registration book to the fourth party who acted in good faith without notice of any absence of authority. The fourth party subsequently sold the car to the third party, and the third party sold it to the defendants. In an action by the plaintiff against the defendants claiming damages for the conversion of the car.

Held: Though the plaintiff consented to H's having possession of the car as a mercantile agent, within the meaning of s. 2(1), he did not consent to his possession in that capacity of the registration book; the sale of a car without the registration book relating to it was not a sale of goods "in the ordinary course of business" within s. 2(1), and the consent necessary to pass a good title to a purchaser under s. 2(1) was a consent to possession of both the car and the registration book; and, therefore, H. was unable to pass a good title to the fourth party.

SOMERVELL, LJ. – This is an appeal from a decision of DEVLIN, J., who decided against the plaintiff. There is a third and a fourth party. The claim is for damages for the conversion of a motor car, which admittedly up to Mar. 17, 1949, was the property of the plaintiff. The car came into the possession of a Mr. Hunt, admittedly a mercantile agent. The fourth party bought it from Mr. Hunt and claims a good title under s. 2(1) of the Factors Act, 1889, which is as follows:

“(1) Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same.”

The fourth party sold the car to the third party, who sold it to the defendants. The sole issue in the appeal is whether the fourth party did or did not get a good title under the Factors Act, 1889. On these findings counsel for the plaintiff submitted that the only possible conclusion was that the car was obtained by larceny by a trick. On that basis there are conflicting opinions whether s. 2(1) of the Factors Act, 1889, can or cannot apply. Counsel for the plaintiff submitted it could not. I will refer to this later because I have come to the conclusion that the appeal succeeds on the judge's findings irrespective of that point. It is, I think, clear that on the sale of a second-hand car the vendor will ordinarily deliver and the

purchaser require the delivery of the registration, or “log”, book. Counsel for the plaintiff stated, and I accept it, that he did not contend that cars could not be sold without their log books, but the price would be substantially reduced thereby. This shows, and I so hold, that a sale of a car without its log book would not be a sale “in the ordinary course of business.” The findings of DEVLIN, J., as to Mr. Hunt’s reasons for getting hold of the log book support this view.

The transaction which the fourth party seeks to uphold is the sale of a car with its log book, a more valuable subject-matter than a car without its log book. Mr. Hunt, it seems to me, was never in possession of the log book with the consent of the plaintiff. One can test it in this way. If immediately after the plaintiff had left the building he had been asked: “Did you mean to leave your car?” he would have answered “Yes.” If he had been asked “Did you mean to leave your log book?” He would have answered “No”, and would have gone back and collected it. The ostensible authority which enabled Mr. Hunt to effect a sale “in the ordinary course of business” arose because of his possession of the log book without the consent of the owner. The relationship of the log book, which is, of course, not a document of title, to a motor car is one to which no useful analogy has occurred to me. I am, however, of opinion that on the conclusions as set out above the fourth party cannot claim the protection of the Factors Act, 1889. In cases of larceny by a trick, the person defrauded does in one sense consent to the possession of the thief, but, so far as the log book is concerned, for the reasons I have given, the plaintiff never consented to Mr. Hunt’s having possession of it.

The issue with regard to larceny by a trick was fully argued before us. I will deal with it because, if there was larceny by a trick of the goods sold, and this prevents the Factors Act applying, the appeal would succeed in any event. I accept the submission of counsel for the plaintiff that, on the findings of DEVLIN, J., there is only one possible conclusion – that the possession of the car was obtained by larceny by a trick. The law as to larceny by a trick is fully set out in the judgment of BANKES, L.J., in *Folkes v. King* [(1923) 1 K.B. 291 to 293]. It seems to me clear that Mr. Hunt had an *animus furandi* at the time he got possession of the car and that the other conditions are fulfilled. The plaintiff clearly did not intend to pass the property, nor on the judge’s findings did he authorise Mr. Hunt to conclude a sale.

The question whether this necessarily excludes a purchaser from the protection of the Factors Act has been considered in more than one case, but there is not clear decision on the point. In *Folkes v. King* BANKES, L.J. and SCRUTTON, L.J. considered the point. BANKERS, L.J. said:

“The question is whether, assuming that Hudson was guilty of larceny of the car, that fact renders it impossible that anyone can have obtained a title to the car from Hudson under the Factors Act; the argument being that no one can under those circumstances prove the owner’s consent to the car being in Hudson’s possession. The argument against this view was admirably put by Mr. J.A. Hamilton (as he then was) in *Oppenheimer v. Frazer & Wyatt* [(1907) 1 K.B. 519], but it was expressly rejected by every member of the court. The view taken by the court in that case as to the want of *bonafides* on the part of the purchaser of the goods rendered it unnecessary to decide the point, and the opinions of the members of the court are

therefore, I think, strictly speaking *obiter* and not binding upon us. They deserve however to be treated with the greatest respect, and it is only because I am unable after full consideration to agree with them that I venture to differ from the conclusion at which they arrived.”

In *Oppenheimer v. Frazer & Wyatt*, FLETCHER MOULTON, L.J., said:

“A mercantile agent is as capable of stealing as any other man, and, if he has stolen the goods, there can be no question, in my opinion, that he must be taken to hold possession of them without the consent of the owner. One of the recognized methods of stealing at common law is distinguished from other types of larceny, and called larceny by a trick, but it is in the eye of the law pure stealing.”

With regard to the consent required for the Factors Acts, BANKES, L.J., in *Folkes v. King* said:

“What the section refers to is the consent of the owner. To establish a consent it is no doubt necessary to consider what the state of mind of the owner of the goods was with reference to the possession of them by the mercantile agent.”

SCRUTTON, L.J., after referring to the earlier cases, said:

“First on the question whether to prove larceny by a trick is a defence to the Factors Act as excluding consent of the true owner. I can understand that where by a trick there is error in the person there is no true consent and the Factors Act is excluded. But where there is agreement on the person and the true owner intends to give him possession, it does not seem to me that the fact that the person apparently agreeing to accept an agency really means to disregard the agency, and act for his own benefit, destroys the consent of the true owner under the Factors Act. That Act intended to protect a purchaser in good faith carrying out an ordinary mercantile transaction with a person in the position of a mercantile agent. It does not do so completely, for it requires the purchaser to prove that the goods were in possession of the mercantile agent ‘with the consent of the owner.’ But it does not require the purchaser in addition to prove that the mercantile agent agreed both openly and secretly, ostensibly and really, to the terms on which the owner transferred possession to the mercantile agent. It appears to me to be enough to show that the true owner did intentionally deposit in the hands of the mercantile agent the goods in question. It is admitted that if he was induced to deposit the goods by a fraudulent misrepresentation as to external facts, he has yet consented to give possession, and the Factors Act applies, but it is argued that if he deposits the goods in the possession of an agent who secretly intends to break his contract of agency the Factors Act does not apply. I do not think Parliament had any intention of applying the artificial distinctions of the criminal law to a commercial transaction, defeating it if there were larceny by a trick, but not if there were only larceny by a bailee, or possession obtained by false pretences.”

I have set out these passages at some length because I agree with the conclusion and the reasons given for it and do not desire to add to them. As the issue was fully argued before us,

and as opinions have already been expressed, I thought it right to set out the conclusion to which I have come. For the reasons given above I think the appeal succeeds.

DENNING, L.J. – In the early days of the common law the governing principle of our law of property was that no person could give a better title than he himself had got, but the needs of commerce have led to a progressive modification of this principle so as to protect innocent purchasers. We have had cases in this court recently about sales in market overt and sales by a sheriff, and now we have the present case about sales by a mercantile agent. The cases show how difficult it is to strike the right balance between the claims of true owners and the claims of innocent purchasers. The way that Parliament has done it in the case of mercantile agents is this. Parliament has protected the true owner by making it clear that he does not lose his right to goods when they are taken from him without his consent, as, for instance, when they have been stolen from his house by a burglar who has handed them over to a mercantile agent. In that case the true owner can claim them back from any person into whose hands they come, even from an innocent purchaser who has brought from a mercantile agent. Parliament has not protected the true owner if he has himself consented to a mercantile agent having possession of them, because, by leaving them in the agent's possession, he has clothed the agent with apparent authority to sell them, and he should not, therefore, be allowed to claim them back from an innocent purchaser.

The critical question, therefore, in every case is whether the true owner consented to the mercantile agent having possession of the goods. This is often a very difficult question to decide. There are three points of principle which arise for consideration in the present case.

(i) If the goods are stolen from the true owner by the mercantile agent, does that mean that the owner does not consent to the mercantile agent having possession of them? At first sight the answer seems to be obvious. No man ever consents to the theft of his goods, but therein lurks a fallacy. There are many cases of larceny where the true owner consents to the thief having possession of the goods, but not to his stealing them. For instance, if the true owner allows the agent to have the goods on hire or for repair, and the agent later on makes up his mind to steal them and does so, either by breaking bulk (common law), or by converting them to his own use (statute), the agent is guilty of larceny as a bailee, but the true owner undoubtedly consented to his having possession of them. Take the same instance where the owner lets the agent have the goods on hire or for repair, but, with this difference, that the agent from the very beginning intended to steal the goods, then on all the authorities the agent is guilty of larceny by a trick, but the owner undoubtedly consented to his having possession of them. His state of mind is the same in both instances. He consented to possession, but not to the theft of the goods. In my opinion, therefore, the fact that the agent is guilty of larceny by a trick does not prevent the operation of the Factors Act any more than the fact that he has been guilty of larceny as a bailee. I find myself in full agreement with the judgments of BANKES, L.J., and SCRUTTON, L.J., in *Folkes v. King*, and I see nothing to the contrary in the opinion of VISCOUNT SUMNER in *Lake v. Simmons* [(1927) A.C. 510, 511].

(ii) If the true owner was induced to part with the goods by some fraud on the part of the mercantile agent, does that mean that he did not consent to the mercantile

agent having possession of them? Again the answer at first sight seems obvious. A consent obtained by fraud is no consent at all, because fraud negatives consent. The effect of fraud, however, in this, as in other parts of the law, is as a rule only to make the transaction voidable and not void, and if, therefore, an innocent purchaser has bought the goods before the transaction is avoided the true owner cannot claim them back. For instance, if a mercantile agent should induce the owner to pass the property to him by some false pretence, as by giving him a worthless cheque, or should induce the owner to entrust the property to him for display purposes, by falsely pretending that he was in a large way of business when he was not, then the owner cannot claim the goods back from an innocent purchaser who has bought them in good faith from the mercantile agent. The agent's offence may in some cases be obtaining goods by false pretences, or in other cases larceny by a trick, the difference depending on whether as a result of the fraud the owner intended to pass to the agent the property or the power to pass the property (false pretences), or only to pass the possession (larceny by trick). In each case, whether the owner intended to pass the property or not, at any rate he consented to the agent having possession. The consent may have been obtained by fraud but, until avoided, it is a consent which enables the Factors Act to operate.

(iii) If the true owner consents to the mercantile agent having the goods for repair but not for sale, is that a consent which enables the Factors Act to operate? The answer would seem at first sight to be "Yes", because it is undoubtedly a consent to the agent having possession, but this needs testing. Suppose, for instance, that the owner of furniture leaves it with a repairer for repair and that the repairer happens to be a dealer as well. Does that mean that the repairer can deprive the true owner of his goods by selling them to a buyer? Clearly not, if the owner did not know the repairer to be a dealer, and, even if he did, why should that incidental knowledge deprive the true owner of his goods? Such considerations have led the courts to the conclusion that the consent, which is to enable the Factors Act to operate, must be a consent to be possession of the goods by a mercantile agent as mercantile agent: That means that the owner must consent to the agent having them for a purpose which is in some way or other connected with his business as a mercantile agent. It may not actually be for sale. It may be for display or to get offers, or merely to put the goods in his showroom, but there must be a consent to something of that kind before the owner can be deprived of his goods.

If it were right to apply these considerations to the car taken by itself, without the registration book, I should find myself in full agreement with the judgment of DEVLIN, J. Hunt was a mercantile agent who got possession of the car with the consent of the plaintiff. It is true that Hunt was probably guilty of larceny by a trick. The plaintiff did not intend to pass the property to him or even to give him the power to pass the property, and Hunt had the *animus furandi* from the beginning. That does not alter the fact that the plaintiff consented to his having possession of it. It is also true that he intended Hunt to repair it, but the plaintiff also intended that Hunt should act in some respects as a dealer by receiving offers from

prospective purchasers. He did, therefore, consent to his having possession of the car as a mercantile agent.

Where I do not agree with DEVLIN, J. is that he put the registration book on one side as if it was of no significance in law. He seems to have thought the Factors Act operated if the mercantile agent had possession of the car with the consent of the true owner, even though he did not have possession of the registration book. I cannot share that view. This court has recently had to consider the position of the registration book, or, as it is more commonly called, the “log book”, of a car: It is not a document of title, but it is the best evidence of title. Everyone who buys or sells a second-hand car knows that a clean title cannot be given or obtained without the log book. The instructions on every log book tell the owner to “keep this book in a safe place, not on the vehicle” and that “on transferring the vehicle to another person you must hand over this book to the person acquiring the vehicle.” All sensible owners pay heed to these instructions. If the seller can produce the book showing that his title is in order, he will receive the proper market price, but no wise buyer pays his money except against delivery, not only of the car, but also of the log book. If the seller cannot produce it, he will receive as a rule only a fraction of the proper price, because its absence is of itself notice of a defect of title. This state of affairs was foreseen by SCRUTTON, L.J., twenty-seven years ago. In *Folkes v. King*, he said:

“If the production of the book, or if it was said to be lost, of a new one, was required by every purchaser, it would be very difficult to find a market for the cars which have lately been stolen in such large numbers; and the courts may have to take adverse notice of the conduct of a purchaser who does not require the production of the book of registry.”

The courts have adopted that suggestion, and now view with suspicion any dealing in a second-hand car without a log book.

When the significance of the log book is realised, it becomes plain that the consent of the owner, which is necessary for the Factors Act to operate, is a consent to the possession by the mercantile agent, not only of the car, but also of the log book that goes with it. So long as the owner retains the log book, the mercantile agent cannot dispose of the car in the ordinary course of his business, because it is not in the ordinary course of anyone’s business to dispose of a second-hand car without a log book. The retention by the owner of the log book, therefore, effectually prevents the Factors Act from operating. The handing over of the log book with the car enables the Act to operate. The owner then clothes the agent with apparent authority to dispose of the car, and the agent is enabled to dispose of it in the ordinary course of his business, and the Factors Act operates to give a good title to an innocent purchaser. To put it shortly, in the case of a car, “goods” in the Act means the car together with the log book.

This brings me to the critical question in this case: Did the plaintiff consent to Hunt having possession of the log book as well as the car? On the findings of fact by DEVLIN, J., the answer is clearly “No.” On March 18, 1949, the plaintiff simply let Hunt have the log book in his hands to inspect if for a few moments. The plaintiff gave Hunt the barest physical custody of it while he was still there himself. He never consented to Hunt having possession

of it. Then Hunt, by a trick, managed to get the plaintiff called away while he, Hunt, still held the book. Armed thus with the log book, Hunt was able to sell the car on the very same day to an innocent purchaser, which, without it, he could not have done. On those facts the plaintiff no more consented to Hunt having possession of the log book than if Hunt had stolen it from his pocket. The Factors Act does not operate, therefore, to give a good title to the dealer who bought from Hunt, nor to the buyers in succession from him.

I confess that I come to this conclusion with some reluctance, because I recognise that the legislature intended the courts to make every reasonable presumption in favour of the innocent purchaser: see s. 2(4) of the Act, but my reluctance is tempered by the reflection that in this case the buyer, Mr. Marshall, was himself a motor car dealer, who bought the car from Hunt on March 18, 1949, for £450 and sold it on March 21, 1949, for £620. A dealer whose business enables him to make quick and large profits of that kind must not be surprised if he occasionally gets his fingers burnt. In my opinion, therefore, the appeal should be allowed.

VAISEY, J. – Where there are two innocent parties of whom one has to suffer for the criminal act of a third, no decision can be said to be satisfactory. This example of that familiar problem presents to my mind considerable difficulty. On the whole, having had the advantage of reading the judgments of my Lords which have just been delivered, I share their view that this appeal should succeed. What the relationship between a motor car and its registration book or log book really is, I find it extremely difficult to define. For many purposes the book ought not to be regarded as a part of the car in the same sense as one of the car's four wheels can be so regarded. What strikes me as decisive of the present case is the fact, already pointed out by my Lords, that a dealer in cars, being a mercantile agent, cannot be said to be "acting in the ordinary course of" his business as such when selling a car without its log book, any more, in my judgment, that he would be so acting if he sold a car with only three wheels. Suppose that a car with only three of its wheels had come into the dealer's possession with the owner's consent, and that the dealer had proceeded to steal the fourth wheel from the owner's garage, had placed it on the car, and had then sold the car. In such a case, I do not think that the totality of the four-wheeled vehicle could be said to have come into the dealer's possession with the owner's consent, so as to bring into operation s. 2(1) of the Factors Act, 1889. When once it is admitted that the sale of a car without a log book is not an ordinary, but a quite extraordinary, transaction on the part of a dealer in cars, I think it must follow that the transaction here is not within the protection of the sub-section. In suggesting the imaginary case of the stolen wheel, I am well aware of the danger of analogies, and mine may be no better than most. That Act does modify and form an exception to the general law of property by conferring a title upon strangers in derogation of the rights of the true owner, and for myself I would be reluctant to extend its operation further than its terms necessitate. The appeal appears to me to be well-founded, and I have nothing further to add.

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***Mysore Sugar Co. Ltd., Bangalore v. Manohar Metal Industries,
Chikpet, Bangalore***

AIR 1982 Kant. 283

[Section 54 - Right of an un-paid seller]

The Mysore Sugar Company, the plaintiff in the suit, advertised for sale of certain items like copper ingots, copper scraps as well as brass tubes available with the company at Mandya by its notification dated 27th July, 1966. The defendant offered to purchase the same by his letter dated 30-6-1966. The plaintiff accepted the offer of the defendant to purchase the various items and, thereafter, the defendant lifted certain items on part-payment and when it came to lifting of copper ingots, he sought for time to pay the balance and to remove the same separating it from other things with which it was mixed up. The defendant had to lift 2,000 K.Gs. of copper scrap and 2,000 K.Gs. of copper ingots valued at Rs. 48,503-96. He wrote to the plaintiff on 28-4-1966 raising objections regarding percentage of copper contents in the articles. The plaintiff intimated to the defendant on 12-9-1966 stating that no certificate for purity of the metal would be given and the material was sold on "as is and where is" condition. In spite of repeated reminders and demands, the defendant did not take delivery of the remaining goods and remit the value. The letter dated 22-11-1966 to the defendant also did not meet with favourable response. Therefore, the plaintiff resold copper tubes and copper ingots through an advertisement dated 30th December, 1966 to M/s. Karnataka Hardware, Avenue Road, Bangalore. By the said resale, the plaintiff incurred loss of Rs. 8,643-96. The plaintiff got issued a legal notice to the defendant to make good the loss. The defendant did not. Hence, the plaintiff instituted the suit for recovery of Rs. 8,643-96 less Rs. 500/- being the initial deposit by the defendant. The plaintiff claimed, in all, Rs. 8,143-96 ps. from the defendant along with costs and interest.

The defendant contended that the suit was not tenable. According to him, what was offered was copper scraps and copper ingots in the advertisement and what was found at the spot was alloy and not pure copper. Therefore, he contended that the plaintiff committed breach of contract. He further contended that the plaintiff did not have right to re-sell and that compensation, if any, could only be recovered under the general principles contained in S. 73 of the Indian Contract Act, 1872 (hereinafter referred to as the 'Act'). According to him, Section 54 of the Sale of Goods Act, 1930 was not applicable. The defendant, according to him, was not liable to pay any damages. On the other hand, he claimed compensation of Rs. 1,000/-.

G.N. SABHAHIT, J. – 8. The points, therefore, that arise for my consideration in this appeal are:

- (1) Whether the Courts below were justified in holding that the defendant committed breach of contract?
- (2) Whether the learned Civil Judge was justified in dismissing the suit for damages?

9. It is true that in the advertisement given by the plaintiff, it is specifically mentioned that what was offered for sale was copper scraps and copper ingots. It is further true that there was no clause in the tender stating that the goods were sold on "as is and where is" condition. It is also on record that the parties were not allowed to inspect the goods before

offering their tender. The fact, however, remains that after the tender of the defendant was accepted he had occasion to inspect the goods and he lifted part of the goods and when he came to lifting of copper scraps and copper ingots, instead of raising any protest, he prayed for extension of time to make payment and to lift the goods. That would clearly show that the defendant knew that what was offered was the material on "as is and where is" condition. Hence, the Courts below have rightly rejected the contention of the defendant that he was not offered copper scraps and copper ingots of cent per cent purity and as such the plaintiff committed the breach of contract. I have no reason to differ.

10. It is no doubt true that it is the plaintiff who has come to the Court claiming damages. The first question that would arise for my consideration is whether, under Section 54(2) of the Sale of Goods Act, the goods had already passed on to the ownership of the buyer.

11. Thus we have to find out whether the seller exercised his right of lien or stoppage in transit on the facts of this case. (The court re-produced sections 19 and 20 of the Act.)

12-A. Thus by reading Ss. 19 and 20 of the said Act, it becomes obvious that in this case an offer was made by advertising to sell all the articles in question. Thereafter, a tender was given by the defendant and his tender was accepted. Therefore, there is an unconditional contract of sale and there were, no doubt, stipulations for payment of price and delivery of goods subsequently. In such a case, the property in the goods passes on to the buyer and hence Section 54 of the Act comes into play. It is on record that the plaintiff issued a notice to the defendant as per Ex. D-10 on 22-11-1966 making his intention clear that the buyer must lift the goods on payment as otherwise he will have to resell the goods and the defendant shall be liable for any loss caused. That satisfied the condition mentioned in Section 54(2) of the Act. Thereafter, however, it was made clear by a notice to the defendant that if he did not lift the goods within three days, his contract would be treated as cancelled. That is by Ex. D-8 dated 12-9-1966. Therefore, since the goods were not lifted by the defendant, the contract came to an end on or about 15-9-1966. Within a reasonable time thereafter the company should have resold the goods by advertising it. But the evidence on record shows that the advertisement was inserted only on 30-12-1966, i.e., after nearly three months.

13. The learned Advocate appearing for the respondent-defendant urged before me that this was not re-sale within a reasonable time as contemplated under S. 54(2) of the Act. It is all the more so, according to him, because P.W. 2, the person who purchased the goods in the re-sale has clearly stated in his evidence that the prices were more three months prior to his giving the tender for resale, and, thereafter, the prices came down. Therefore it is clear from the evidence on record that the prices were falling from August 1966 and the plaintiff-company delayed for three months therefrom to give the advertisement, knowing fully well that the prices were falling; for P.W. 2 has stated that the prices were a little low at the time when he gave his tender and that the prices were a little more earlier. P.W. 2 is witness examined by the plaintiff. Making allowance for his interestedness, it is obvious that the prices were more in about September 1966 when the breach of contract occurred.

14. It is needless for me to point out that a duty lay on the plaintiff to mitigate the damages. Even in view of S. 54(2), it was the duty of the plaintiff to see that re-sale was effected within a reasonable time especially so, when the prices were falling for the relevant material. Three months delay, therefore, on the facts of this case, is certainly inordinate and

re-sale has not taken place within a reasonable time as contemplated in Section 54(2). It is relevant to mention in this context that what was the ruling price in about September 1966 is not brought on record by the plaintiff though P.W. 2, as stated above, admitted that the prices were more at that time. The difference claimed as damages on the facts of this case, is also not much. That being so, the learned Civil Judge having regard to the probabilities has observed that if the goods were re-sold in September 1966 within a reasonable time, the plaintiff would not have incurred any loss whatsoever. At any rate, since the burden of proving the damages was on the plaintiff and he has not placed any evidence on record in that behalf, the learned Civil Judge has rightly proceeded to disallow the suit for damages.

16. As explained above, there has been unreasonable delay in re-selling, on the facts of the present case, when the market price was falling. Hence, the value realised on re-sale does not afford a good ground to fix the damages. There is no evidence on record placed by the plaintiff to show the ruling price of the commodity at the time when there was breach of contract. The plaintiff has come to Court. The burden is on him to prove the alleged damages and since he has not placed any material evidence to show that he has suffered damages, he has to fail and the learned Civil Judge has rightly held so. I have no reason to differ.

17. The learned counsel appearing for the respondent-defendant submitted that S. 54(2) of the Sale of Goods Act should be read with Section 73 of the Act. It may be stated in this context that Section 73 contains the general principle with regard to fixing up of damages, whereas Section 54 speaks of specific case of moveable property sold. Section 54 is more specific whereas Section 73 is general in nature. Therefore, Section 54 prevails over Section 73 though both the sections are based on the same general principle.

18. In the result, therefore, I am constrained to hold that the appeal is devoid of merits and is liable to be dismissed and I dismiss the same.

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