

(1950) 04 MAD CK 0022

In the Madras High Court

Case No : Second Appeal No. 1165 of 1946

S.N.T. Kumaraswami Chettiar and Others

APPELLANT

Vs

M.S.M. Chinnathambi Chettiar and Others

RESPONDENT

Date of Decision : 14-04-1950

Acts Referred:

Companies Act, 1913 — Section 4
Limitation Act, 1908 — Article 62, 23

Citation : AIR 1951 Mad 291 : (1951) ILR (Mad) 593 : (1942) 55 LW 889 : (1950) 2 MLJ 453

Hon'ble Judges : Ajamannar, C.J;Balkrishna Ayyar, J

Bench : Division Bench

Advocate : K. Bhashyam, for T.V. Ramanatha Aiyar, for the Appellant; S. Amudachari and M.R. Narayanaswami for S. Ramaswami Aiyangar, for the Respondent

Final Decision : Dismissed

Judgement

Rajamannar, C.J.—This second appeal has been posted before a Bench, because Govinda Menon J. considered that the points raised in it

are of sufficient importance to be heard by a Bench.

2. The facts which led up to the suit filed by the appellants are stated clearly and fully in the judgment of the District Munsif, Tiruchirapalli, who

disposed of the case in the first instance. It is sufficient to mention only the material facts necessary for a discussion of the points of law which arise

in this appeal. There were two partnership businesses carried on under the name and style of Sri Krishna & Co., (Boiler) and Krishna & Co. (Bice

Mill). The former was started on 25-6-1923 with 60 persons owning the business in 40 shares with a share capital of Rs. 600 per share. The latter

was started on 6-9-1923 and consisted of 37 persons owning 20 shares with a

share capital of Rs. 600 per share. Some of the persons had shares in both the partnerships. There were changes in the partners from time to time. Though the two concerns were distinct, it is common ground that the profits of both the businesses were pooled together and divided among the total number of share-holders. Plaintiff 1 and his paternal-grand-uncle Narayanan Chettiar were members of an undivided Hindu family which contributed a total capital of Rs. 1800 to the two businesses and owned three shares therein. The total number of shares was 69 out of which the joint family owned three. At a partition between plaintiff 1 and his granduncle, plaintiff 1 got 1 1/2 shares and his grand-uncle got 1 1/2 shares. The grand uncle Narayanan Chetty died in 1935 leaving behind him three daughters plaintiffs 2 to 4 who became entitled to his shares. The plaintiff's suit is based upon the ownership of three out of 59 shares in the two businesses. In 1929 one of the share-holders filed a suit for a dissolution of the partnerships and for an account, but it was dismissed on 28-10-1930 on the ground that the partnership was an illegal association and that the suit was not maintainable. Nevertheless, the business continued to be carried on till 1941 when on account of certain misunderstandings between plaintiff 1 and the persons who were in management of the business, plaintiff 1 filed a complaint on 26-2-1941 u/s 4 Clause (5), Companies Act. Though the complaint was filed in February 1941 the case was eventually taken up by the Magistrate and the trial commenced only on 14-10-1941. Meanwhile, on 11-10-1941, the share-holders resolved at a meeting to dissolve the two concerns. Simultaneously a private limited company was formed under the name and style of the Manaohanallur Sri Krishna Rice Mills Ltd. (defendant; A in the case) with a share capital of RS. 5000 divided into 200 shares of RS. 25 each with the object of acquiring and taking over as a going concern the two businesses. The company was duly incorporated on 16-10-1941. It was resolved at the meeting of the partners of the two businesses held on 11-10-1941 that the properties of the partnerships shall be sold to the company which was being formed for a total consideration of RS. 5000 and two persons V. P. Marudayya Chettiar and P.M. Kumaraswami Chettiar, were empowered to carry out the transaction. It was further resolved that the sale amount shall be divided among the partners according

to their respective proportionate shares. There is evidence that 191 shares in the new company were actually allotted and some of the partners of the two dissolved partnerships took up shares in the new company while some others were paid the sums due to them for their capital. Some who were not members of the old partnership also took up shares in the new company. The criminal prosecution ended in a nominal sentence of a fine of one rupee or in default simple imprisonment for two days (vide order Ex. P- 21 dated 2-12-1941). There is also evidence of purchase by the new company of the machinery and superstructures of the old businesses from Marudayya and Kumaraswami abovementioned (Exs. D-38, D-39, D-40 and D-41). The sales were in October and December 1941. On 18-6-1942 the plaintiffs filed a suit out of which this second appeal arises against the new limited company as defendant 4 and against defendant 1, one P.K. Narayanan Chetti, and defendants 2 and 3 as the legal representatives of one Muthuveeran Chetti on the ground that defendant 1 and Muthuveeran Chetti were the persons who managed the businesses from 1935 onwards. Pending the suit, defendant 1 died and defendants 5 to 8 were added as his legal representatives. The suit was for the following reliefs:

- (1) a declaration that the plaintiffs are entitled to three out of fifty-nine shares in the assets and properties of Sri Krishna & Co. (Boiler) and the Krishna & Co. (Rice Mill) now vesting in defendant 4 and are entitled to a proportionate allotment of shares in defendant 4 company;
- (2) a permanent injunction directing defendant 4 company to issue shares in favour of the plaintiffs in respect of 3/59 of its assets and account for the dividends accrued or accruing on such shares and if that be not possible directing payment on the market-value of the 8/59th share on the assets with interest thereon;
- (3) a direction to defendants 2, 3 and 5 to 8 as legal representatives of Muthuveeran Chettiar to account for the plaintiffs' share in the company now incorporated as defendant 4 company. The suit was dismissed against all the defendants by both the District Munsif of Tiruchirapalli and on appeal by the Subordinate Judge of Tiruchirapalli on the ground that the plaintiffs could have no remedy against the members of the old partnerships which were illegal u/s 4, Companies Act and the plaintiff had no

cause of action against defendant 4 company. The District Munsif

further held that the claim against defendants 2 and 3 and 6 to 8 was barred by limitation. The plaintiffs are the appellants.

3. It was conceded by Mr. K. Bhashyam Aiyangar who appeared for the appellants that the two partnerships started in 1923 fell within the

mischief of Section 4, Sub-section (2), Companies Act, which runs thus:

No company, association or partnership consisting of more than 20 persons shall be formed for the purpose of carrying on any other business that

has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof unless it is registered as a

company under this Act, or is formed in pursuance of an Act of Parliament or some other Indian law or of Royal Charter or Letters Patent.

Sub-section (5) of the same section provides that any person who is a member of such a partnership formed in contravention of this section shall

be punishable with fine not exceeding as. 1000. It must, therefore, follow that the two partnerships were illegal. It was also conceded by the

learned counsel that a member of an illegal partnership cannot sue for its dissolution or for the taking of its accounts. As the partnership is illegal ab

initio, there could be strictly speaking no question of its dissolution or taking of accounts. The Court will not assist a person who claims to be a

partner of an illegal association to obtain a direction to have the accounts of the business taken so that he may have his share of its profits. One of

the consequences of the illegality of a partnership is that its members cannot maintain an action in respect of any contract made by it e.g., a

partnership for selling smuggled goods cannot recover the price of such goods which it may have sold. An illegal loan society could not recover

money which it had lent.

4. It is well established that the consequence of the illegality of a partnership is that its members have no remedy against each other for contribution

or apportionment in respect of partnership dealings and transactions. Lindley explains the reason of the rule thus (vide page 137 of Edn. 10):

However ungracious and morally reprehensible it may be for a person who has been engaged with another in various dealings and transactions to

set up their illegality as a defence to a claim by that other, for an account and payment of his share of the profits made thereby, such a defence must

be allowed to prevail in a Court of justice, were it not so, those who ex hypothesi have been guilty of a breach of the law, would obtain the aid of the law in enforcing demands arising out of that very breach; and not only would all laws be infringed with impunity, but what is worse, their very infringement would become a ground for obtaining relief from those whose business it is to enforce them. For these reasons, therefore, and not from any greater favour to one party to an illegal transaction than to his companions, if proceedings are instituted by one member of an illegal partnership against another in respect of the partnership transactions, it is competent to the defendant to resist the proceedings on the ground of illegality.

5. It was, however, contended by Mr. Bhashyam Aiyangar, that in spite of this well established rule, one of the partners can ask for a partition or similar relief in respect of the assets of such an illegal partnership. Of course, in obtaining that relief obviously there should be an account of the assets and liabilities of the partnership and it is only the net assets left after discharging all liabilities which could be partitioned. We see no real difference between the relief of dissolution and an account taking on such dissolution of a partnership and partition of the properties of a partnership left after discharging all its liabilities. It is a salutary legal principle that the Court will not permit what cannot be lawfully done directly to be done indirectly.

6. This argument of Mr. Bhashyam Aiyangar rests on the theory that though the partnership as such may be illegal and cannot be recognised by a Court, the property acquired by such a partnership belongs to the partners according to their shares and they have a beneficial co-ownership in such property. He relied on the decision in the Queen v. Tankard, (1894) 1 Q. B. 648 : 63 L. J. M. O. 61, in support of his argument. In that case, a member of an association called the Bowling Feast Club was charged under 31 and 32 vict., Ch. 116, Section 1, with having embezzled certain money belonging to the club. The club was an illegal association within Section 4, Companies Act, 1862 corresponding to Section 4, Indian Companies Act. The plea in defence was that as the club was an unregistered association of more than 20 persons, and therefore illegal, there could not be a conviction. The section enacted that;

If any person, being a member of any co-partnership, or being one of two or more beneficial owners of any money shall steal or embezzle

such money every such person shall be liable to be tried, convicted, and punished for the same.

This plea was overruled and the accused was convicted. Lord Coleridge C. J., observed :

It would almost seem as if the enactment was for the very purpose of sweeping away such an objection as has been taken here. There are a

number of persons who join themselves together, not for any criminal purpose, but their joining together is not legalized. It is true that they have no

legal existence as a company, association or co-partnership ; but they are none the less beneficial owners of property. It does not follow that,

because the club had no legal existence as a company, association, or co-partnership, the members had no legal existence as beneficial owners of

property. It is untrue to say that they are not beneficial owners in fact. It would be a very strong thing to hold that an association not expressly

sanctioned by law, yet not criminal is incapable of holding any property at all.

Hathew J., was also of the same opinion that the members of the club were clearly beneficial owners within the meaning of the section.

7. There is another case which belongs to the same category as the Queen v. Tankard, (1894) 1 Q B. 548 : 63 L. J. M. C. 61, though this case

was not cited to us by Mr. Bhaehyam Aiyangar, viz., Beg v. Stainer, (1870) 39 L. J. (M. o.) 64 : 21 L. T. 758, in which it was held that a person

could be convicted of stealing property belonging to an association in the nature of a trade union which was not legalised. These cases can take

Mr. Bhashyam Aiyangar very little distance. It may be in this case if any one had committed a theft of the machinery or furniture belonging to the

partnerships, he could have been convicted of theft. The question, however, remains whether the beneficial owner-ship which the partners of an

illegal partnership may have in the properties of the partnership is such that it can form the basis of an action for partition or other similar relief. No

case was cited to us in which such relief was granted on that basis. Prosecutions for offences stand on an entirely different footing.

8. Mr. Bhashyam Aiyangar also relied upon certain decisions of English Courts which deal altogether with a different aspect of the matter. It is well

established that a person who pays money to another to be used for an illegal purpose can recover the money before it has been actually used for

such illegal purpose. This principle may be extended to a case where a person subscribes for a share in an illegal partnership and sues to recover it

before the illegal objects are carried out. In *Greenlberg v. Cooperstein*, (1926) 1 Ch. 657 : 95 L. J Ch. 466, the plaintiffs were three members of a

club called the Pelham Club which was rendered illegal as being an unregistered association of more than 20 persons. They sued for an

administration of the assets of the Club and an account of the moneys received by the defendants (who were the Treasurer and Secretary of the

Club) from members of the Club, an enquiry as to any property of the Club in the defendants' custody available for the benefit of the members of

the Club and payment of the amount so ascertained. After coming to the conclusion that the Club was an illegal association, Tomlin J., considered

what relief could be given in a case of that sort. He said :

I do not myself believe that the law is so powerless that when money is in the hands of persons who have received it for application for an illegal

purpose it cannot protect the contributors or enable them to recover it before it has been applied for this illegal purpose.

Distinguishing cases where it was held that an illegal association could not recover money lent by it, he observed :

It is a different case where those who have subscribed money for an illegal purpose come requiring the agents in whose hands it is and who were

to apply it for that purpose and have not done so, to return it to them. I am happy to think that the law is not so feeble and that it cannot protect the

subscribers by ordering an account.

The learned Judge was, however, not certain what relief could be actually given to the plaintiffs after the account had been taken. He guarded

himself by saying that he expressed no opinion as to what will take place thereafter and by what means, if any, the defendants might discharge

themselves of the money they had received.

9. The following remarks of Vice-Chancellor Wood in *Butt v. Monteaux*, (1854) 69 E. K. 385 : (1 K. & J, 97) carry us no further:

. . . . it would be very difficult to persuade me that the members of such an association (unregistered), although they could not do more, or stir a

step further without registration, were not sufficiently qualified to be called a company, to have back their money . . . and the land and other things

acquired with that money, and to have an account from the promoters, whose duty it was to register, on the footing as between them and the

promoters of its being in truth a company, and upon the principle that a man could not aver any wrong or omission of his own as an answer to a bill

seeking such a relief.

Actually in the case before him the shareholders only prayed for a direction to have the partnership property properly secured. The law on this

point is summed up thus in Halabury's Laws of England, Edn. 2, vol. 5, at p. 813:

Parsons subscribing to the formation of a company, the agreement to form which is illegal, may, however, recover the money before it is actually

applied to the illegal purpose, and the Court will order any persons who have received the money subscribed to render an account but the

question, even now, seems open whether the Courts will assist members of illegal companies to recover their subscriptions from the persons who

have been the recipients of the money, and, if so, by what means.

10. In *U Sein Po v. U Phyu*, 7 Rang. 510 : A. I. R. 1930 Rang. 21, such a right was recognised. In that case an association consisting of more

than 20 members was formed for the purpose of carrying on a rice business, but it was not registered. The partnership bought land, built and

equipped a rice mill and was carrying on business. In 1926 three of the partners filed a suit to recover from the defendant whom they described as

the promoter"" of the partnership and its manager the shares which they contributed to the partnership or so much as they might be entitled to

recover in respect of those shares after converting the assets of the partnership into money and paying the debts incurred by the partnership. The

learned Judges held that though the partners could not sue for an account of the dealings and transactions of the partnership and of its profits, they

had a right to sue for the return of their subscriptions and if these had been converted into land or other things for the purpose of the company they

can be re-converted into money for payment of the debts and liabilities of the concern and then for repayment of the subscribers. The learned

Judges reviewed the English authorities and found that there was no decided case exactly on all fours, but they thought that the observation in *Butt*

v. Mon-teaux, (1854-69 B. R. 385 : 1 K. & J. 97) was sufficient authority for their decision. They also relied on the following passage from

Lindley on Partnership, Edn. 10, page 141:

Although, therefore the subscribers to an illegal company have not a right to an account of the dealings and transactions of the company and of the

profits made thereby, they have a right to have their subscriptions returned and the necessary account taken; and even though the moneys

subscribed have been laid out in the purchase of land and other things for the purpose of the company the subscribers are entitled to have that land

and these things reconverted into money, and to have it applied as far as it will go in payment of the debts and liabilities of the concern, and then in

repayment of the subscriptions. In such cases no illegal contract is sought to be enforced; on the contrary the continuance of what is illegal is sought

to be prevented.

11. In Mewa Ram Vs. Ram Gopal and Others , the suit was in respect of a partnership concerned with the ginning factories. There were more than

20 partners and therefore the partnership was illegal. The plaintiff claiming an eighth share in the partnership brought a suit for a declaration that the

partnership was invalid and prayed for a refund of the plaintiff's subscription out of the proceeds realised by an auction sale of the factories or in

some other proper way or in the alternative for a division of the properties of the factories and, if proper, for an auction sale of the property and an

award to the plaintiff of a one-eighth share in their sale proceeds. The case came up first before a Division Bench consisting of Sulaiman J. (as he

then was) and Mukherji J. The learned Judges differed. Sulaiman J. held that the prayer for a refund of the original subscription could not be

granted because the plaintiff had been participating in the profits of the partnership for several years and it was no longer open to him to claim a

refund of his original subscription after having received considerable sums of money from the partnership. But he held that the plaintiff was entitled

to a partition of the properties of the factories and if a division of the property was not feasible he directed a sale of the properties and distribution

of the proceeds. Mukherji J. on the other hand held that the plaintiff was not, entitled to any relief, because the partition would involve realisation of

the assets of the company, payment of its just debts, sale of property and

distribution among the members, the very things which would be done in a suit for dissolution of partnership or winding up a company. The case was thereupon referred to Walah J. who agreed with Mukherji J, that a decree for partition would be in substance a direction for winding up or a decree for dissolution and account. He added that when such a precedent was once established, there was nothing to prevent the formation of an unlimited number of such associations consisting of more than 20 persons carrying on trade for the purpose of gain, any one of the members of which could come to the Court and ask for relief in a suit in the nature of a winding up of the assets of the association. The result would be to give such associations under another guise the cloak of legality although the statute has forbidden it. In accordance with the opinion of the majority, the suit was dismissed as being barred by Section 4, Companies Act.

12. In the case before us, there is firstly no prayer for a refund of the subscriptions, if any, paid by the plaintiffs or their predecessor. Secondly, even if there had been such an averment and proof of it, there would still be the circumstance that the partnerships had carried on the business for several years with the help of that money and the plaintiffs and their predecessors had had the benefit of the profits from the business. This is not a case of an illegal purpose not having been carried out. Finally, the claim would be hopelessly barred by limitation. In *U Sem Ro v. U Phyu*, 7 Bang.

540 : AIR 1930 Rang. 21 the claim was well within the time though that began to run from the inception of the partnership. We agree with the decision in *Lala Ram Kumar Vs. Nem Chand and Others*, that the starting point for computing limitation in a suit for the return of the share money contributed by a person to an unregistered association of more than 20 members would be the date on which the money was paid and there would be no recurring cause of action. As already mentioned, both the businesses, were started in 1923 and the suit was brought in 1942. Treated as a suit for refund of share money, the suit was hopelessly barred.

13. There is no basis on which the claim of the plaintiffs to any of the reliefs which they prayed for can be sustained. Defendants 2, 3 and 5 to 8 are sought to be made liable as the persons in management of the two businesses. But it is not alleged that they are in possession of any of the assets of

the partnership. From the evidence it is clear that there had been a transfer of all the machinery and superstructure belonging to the partnerships to

defendant 4. The sum realised was Rs. 6000 and the District Munsif held that the valuation of the assets was not sham or nominal; nor was it low

or inadequate. If at all, the plaintiffs could only have asked for their proportionate share of this amount from the persons in whose hands it could be traced. The suit is not framed as one for recovery of the plaintiffs' share in the proceeds. A decree for account the plaintiffs undoubtedly cannot be entitled to.

14. We agree with the Courts below that the plaintiffs have no cause of action against defendant 4. It was an entirely different entity and the

learned Subordinate Judge was not quite accurate in stating the first point for decision thus;

Whether the partnership evidenced by defendant 4 company is simply a continuation of the prior partnership businesses which were admittedly an

unlawful association, or whether it was an independent concern.

It is not correct to say that a private limited company is a partnership. There could, therefore, be no legal foundation for any claim against

defendant 4 between whom and the plaintiffs there is no privity whatever. The plaintiffs cannot say that the assets belonging to the old partnerships

are in the possession of defendant 4, unless they affirm the validity of the sale by and on behalf of the old concerns, If the plaintiffs do affirm that

transaction, then their only remedy can be in respect of the sale proceeds, namely, Rs. 5000. But if the plaintiffs say that the assets have not been

properly conveyed to defendant 4, then, it inevitably follows that the plaintiffs can have no cause of action against defendant 4.

15. The Courts below were right in dismissing the suit. The second appeal is dismissed with costs, 2 sets, one set to respondents 1 and 2, another

to respondent 3.