1926, December 21.

INSOLVENCY.

Before Mr. Justice Beasley.

IN THE MATTER OF R. K. ABDUL RAHIMAN SAHIB AND CO. (INSOLVENTS).

MATHURASA HASANATHA ZARIA GIRLS' SCHOOL AT AMBUR BY ITS SECRETARY K. HAJEE ABDUL LATHIEF SAHIB (APPLICANT),

v.

THE OFFICIAL ASSIGNEE OF MADRAS (RESPONDENT).*

Indian Contract Act, (IX of 1872), sec. 204—Labbai firm—Muthalali—Deposits money—Receives share of profits—Ordinary incidents of partnership absent—If partner.

A muthalali in a Labbai firm, who merely deposits money in the firm and receives from the firm a certain share of the net profits, and as between whom and the firm there do not exist the ordinary incidents of partnership, such as, the right to participate in the management of the partnership business or the dissolution of the partnership on his death or retirement, is not a partner of the firm.

Cox v. *Hickman,* (1860) 8 H.L., 288, *Mollwo March Co.* v. *The Court of Wards,* (1872) L.R., 4 P.C., 419, *Ex parte Tennant, In re Howard,* (1877) L.R., 6 Ch. D., 303, followed. *Ramachandra Naidu* v. *Batcha Sahib,* (1917) 22 M.L.T., 225, referred to.

MOTION to set aside the order of the Official Assignee refusing to admit the applicant as a creditor in the insolvency of R. K. Abdul Rahiman and Co.

The facts necessary for this report appear in the judgment.

K. S. Krishnaswami Ayyangar for the applicant.

S. Duraiswami Ayyar for the respondent.

* Insolvency Petition No. 182 of 1922.

JUDGMENT.

This motion raises a question of great importance and interest because I have to consider the status of the classes of persons who are connected with the firms such as the insolvent firm here, a Labbai firm or what is sometimes known as an "Ejman partnership". My task has not been rendered any the easier by reason of the fact that though these Labbai firms are numerous in the Presidency and have been carried on for many years there has been no reported case in this Court which even considers the status of those persons who are connected with those firms merely by a deposit of money in the firm's business. That is the position of the petitioner here. He is a trustee of the Madrassa Girls' School at Ambur. The school was started in 1913 and K. Abdul Rahiman took a leading part in its foundation. Sums of money were set apart in the firm's books which became the school funds and an account was opened headed "account of the Madrassa at Ambur". Into these accounts there were brought sums of money by the insolvent firm and the firm as it was then known and at every settling day sums of money were set apart for that school. In addition to the insolvent's firm setting apart sums of money for the school other sums were collected from outside people and credited to the account of the "Madrassa" in the firm's books.

There were three classes of persons connected with the firm, the ejmans, the kutalis and the muthalalis. It is in the latter class that the Madrassa School is. At each settlement the net profits of the business were divided up amongst these three classes of persons. To the muthalalis was apportioned one-third share and to the kutalis and ejmans two-thirds share. Ejmans are clearly partners. Kutalis are persons who, while contributing labour do not contribute any money to the

In re ABDUL RAHIMAN SAHIB AND CO.

business. The muthalalis are persons who do not contribute labour to the business but contribute money. It is common ground that some of those persons who are ejmans are also muthalalis; that is to say, they contribute not only labour but money to the business and they not only receive money out of the one-third share but also out of the two-thirds share. With regard to the kutalis and ejmans definite proportions of the two-thirds shares are given to them. It is contended by the petitioners that this, though a fixed share, was liable to alteration at the times when the different settlements were arrived at and I think that that is so subject to this limitation that, if one of those kutalis or ejmans retired or died, the share of that person in the two-thirds share might be added to those who remained thereby increasing their share or a fresh ejman or kutali could be brought in to take over the share of the deceased or retiring kutali or ejman as the case might be. But whatever alteration there might be in the fixed share of these persons it was all within the limits of the two-thirds share of the net profits set apart for the kutalis and ejmans. There is this further observation to make with regard to the muthalalis. They have no voice in the management of the business whatsoever and are not present at the settlements. They seem to be persons who have merely deposited money in the business receiving their share of the net profits within the limits of the one-third share of those.

This motion comes before me under the following circumstances. The Madrassa claimed as a creditor of the insolvent's firm, which was adjudicated insolvent on the 5th December 1922. By his order in July 1924 the Official Assignee postponed this creditor for the reason that he thought that the trade creditors were to be preferred to all other unsecured creditors. In

making that order the Official Assignee was clearly in error because although under the English Bankruptcy law trade creditors are preferred to other unsecured creditors there is no provision for such preference under the Indian law. When this mistake was brought to his notice he made a further report and disputed the claim of this creditor on the ground that this creditor was not a creditor but was a partner in the insolvent firm, and he has treated the money standing in the name of the Madrassa School as capital contributed to the business. Mr. K. S. Krishnaswami Ayyangar argues that this deposit was nothing more than an investment or a loan to the business and argues that because, according to Muhammadan law and custom, Muhammadans are not allowed to pay or receive interest on loans the fiction has been resorted to by these Muhammadan firms of apportioning a share of the net profits to those who have deposited money in the business instead of paying interest to them in the ordinary way on their loans. No doubt there is a great deal to be said for that contention; but that Muhammadan law or custom is not so rigid as is contended for, is within the experience of most of the judges who have sat on the Original Side of this High Court; because it is within our experience that Muhammadans do in certain cases both pay and receive interest. I do not propose to examine in detail the various settlements arrived at by this firm. The first settlement was on the 10th February 1914, the second on the 29th October 1917, the 3rd on the 21st May 1918, the 4th on the 31st March 1919 and the 5th on the 31st March 1920. A statement was put in with regard to the 1914 settlement which I think gives a very fair indication of the practice of this firm. That as I say I do not propose to examine in detail. It shows the shares of the ejmans

In re ABDUL RAHIMAN SAHIB AND CO.

and kutalis and it also shows the amounts standing to the credit of the muthalalis and what the latter are entitled to as their one-third share of the net profits. What would have guided me very much in this case would have been evidence as to custom. This is an unusual kind of business, though there are many such, and I should have thought that some evidence as to the status of the three classes connected with the business would have been obtainable and that I should have had the evidence before me showing what would happen or has happened where at a settlement instead of there being any net profits the business has resulted in a loss. I should then have had before me evidence as to whether the muthalalis were liable for any of the losses of the firm. Neither side has chosen to adduce any such evidence, and since at none of the settlements of this firm was there anything else but profit the practice of this firm with regard to that has not helped me. It is true that K. Abdul Rahim who is one of the insolvents was called by the petitioner and he has stated that the ejmans are partners, the kutalis are working partners and that the muthalalis are not partners. I have had to consider whether this witness has come forward in the interest of justice to assist the Court or whether he has not some interested motive in coming here and giving the evidence which he has done. I prefer to adopt the latter alternative, and I do not think that it would be right for me to accept the evidence of this witness on the question as to whether or not muthalalis are partners in this business. Much reliance is placed by the petitioner upon the fact that the muthalalis have no voice in the management of the business and that they are not present at any of the settlements and that they can when they chose withdraw the money they have deposited in the firm. That is quite true, but I

think upon the evidence that the ejmans and the kutalis can also withdraw from the firm as and when they desire. So that that point is not one which helps the petitioners. The difficulty in this case is that there was no agreement at all when the Muthalalis deposited their money in the business except that they were to receive a portion of the one-third share assigned to the Muthalalis. Thus the individual share of each Muthalali would of course vary not only with the amount of the net profits but also because other Muthalalis could and might have deposited more money in the business thereby diminishing the share of the other Muthalalis in the one-third share of the net profits. The individual share therefore of each Muthalali would not only be fluctuating with the net profits but also by reason of the number and amount of the contribution of the other Muthalalis. There is very little in this case to gather what the intention was when the money was so deposited in the business by the Muthalalis and that after all seems to me to be the whole question in this case. The fact that a depositor of money in a business is to receive a share in the net profits of the business has since the decision of *Cox* v. *Hickman*(1) not been a conclusive test. That case decided that persons who share the profits of a business do not incur the liabilities of partners unless that business is carried on by themselves personally or by others as their real or ostensible agents. This decision brought about a substantial modification of the law as it stood prior to this decision. In the old case of *Grace* v. *Smith*(2), DE GREY, Chief Justice, laid down the proposition that "every man who has the share of the profits of a trade ought also to bear his share of the loss" and in *Waugh* v. *Carver*(3)

(1) (1860) 8 H.L., 268. (2) (1775) 2 Wm. Bl, 998.
(3) (1793) 2 Hy. Bl., 235.

In re ABDUL RAHIMAN SAHIB AND CO.

this doctrine was discussed and approved and from that time until the decision in *Cox* v. *Hickman*(1) it was considered as clearly established that by the law of England all persons who share the profits of a business incurred the liabilities of partners therein although no partnership between themselves might have been contemplated. In *Mollwo March & Co.* v. *The Court of Wards*(2), *Cox* v. *Hickman*(1) was acted upon and it was held in that case that "although a right to participate in profits of a trade is a strong test of partnership and there may be cases where from such a participation alone it may as a presumption, not of law but of fact, be inferred, yet, whether that relation does or does not exist must depend on the real intention and contract of the parties." In *Walker* v. *Hirsch*(3) it was held that "although an agreement for participation in profit and loss is *prima facie* evidence of partnership between the contracting parties as between themselves, yet the question of partnership must in all cases depend upon the evidence of the parties as it appears on the contract," and it appears to me that it is the intention of the parties that is to be looked to in all such cases. It really narrows itself down to that question. The same view was expressed in *Ex parte Tennant, In re Howard*(4) where it was held that participation in profits is not conclusive evidence as to the existence of a partnership. It is very cogent evidence and if it stands alone may be conclusive evidence of a partnership, but the fact of the participation in profits must be considered in the light of other circumstances. In *Badeley* v. *Consolidated Bank*(5) the decision is to the same effect. I therefore cannot take the fact of participation by the

(1) (1860) 8 H.L., 268.
(2) (1872) L.R., 4 P. C., 419.
(3) (1884) L.R., 27 Ch. D., 460.
(4) (1877) L.R., 6 Ch. D., 303.
(5) (1888) L.R., 38 Ch. D., 238.

Muthalalis—and it is admitted by Mr. Duraiswami Ayyar on behalf of the Official Assignee—in the net profits of the business as conclusive on the question of partnership. I have therefore to consider the other circumstances of the case and I am bound to say that they are not very helpful. Neither does the examination of the Contract Act give me any assistance because section 240 of that Act says that the mere sharing of the profits does not create a partnership. Then, can the ejman and the kutalis be said to be carrying on this business as agents for the Muthalalis for the benefit of all of them? To the extent that the ejmans and the kutalis work the business and that the profits in which the Muthalalis have a share depend upon their endeavour it can be said that they are carrying on the business for the benefit of all of them; but I do not think that they can really be described as the agents of the Muthalalis. Then it must be remembered that the Muthalalis have no voice whatever in the management of the business. They cannot object to additional Muthalalis coming into the business which may have the effect of decreasing their share in the net profits and the number of Muthalalis, it seems to me, can be unlimited. Muthalalis cannot object to other Muthalalis withdrawing their deposit. All that they do is to deposit money and receive a share of the net profits if any. It is difficult to conceive a partnership with so many partners. Ordinarily, in a partnership, if the capital of the partnership is increased, it can only be done in consultation with the partners and the same observation applies to the taking in of another partner or other partners. Another feature of this business is that the death of a partner does not apparently put an end to the partnership nor does a retirement. It is obvious that, if the amounts deposited by the muthalalis are to be called capital, then the capital is a

In re ABDUL RAHIMAN SAHIB AND CO.

fluctuating amount depending upon fresh Muthalalis coming in and others retiring. In this case there is no question of one Muthalali retiring and another Muthalali taking his place and taking over the amount deposited by the retiring Muthalali. All these before-mentioned matters seem to me to be things which are not to be found in any ordinary partnership. As I have said, there is no evidence as to the intention of the Muthalalis when they deposit their money. The only solid fact is that they receive a share in the net profits of the business. It does not seem to me to be sufficient to make the Muthalalis partners in this business. There is this further question to be considered and it is this. Ordinarily, partners are entitled to a share in the good-will of the partnership business. There is nothing in evidence to show me whether Muthalalis would be entitled to a share in the good-will of this business, but there is a decision of this Court to the effect that kutalis are not entitled to a share of the good-will of a business. That is a decision of KUMARASWAMI SASTRI, J., in *Ramachandra Naidu* v. *Batcha Saib* (1). The head-note is as follows: "But in the peculiar kind of partnership, well known in this Presidency where the ejman or proprietor of the firm takes in what are called 'working partners' who ordinarily begin by putting in no capital, but who, as the business goes on, put in the profits earned in the business itself as part of the capital, the presumption to be made is that the working partner has no interest in the 'good will' until the contrary is shown." On page 229, after some very valuable observations with regard to this type of partnership, KUMARASWAMI SASTRI, J., says, "I have not come across a single case either in my practice at the Bar or as a Judge where a

(1) (1917) 22 M.L.T., 225.

working partner in a firm in which there are ejmans has ever got any share in the goodwill. I do not think they ever claimed any share in the goodwill till quite recently." And earlier on page 229 he says, "These partnerships consist of three classes of persons, the first ejmans or proprietors, the second Muthalalis or persons who put in moneys to be used as capital and who get a share of the profits instead of interest in return and the third the working partners." I do not think that the Muthalalis can be put upon any higher place than the kutalis, and it seems quite clear that the kutalis cannot be regarded really as partners in the firm. As I have said before, I have had very little to guide me in this case but, in my view, for the reasons I have already stated, the Muthalalis cannot be held to be partners in this type of business; and I must therefore hold that the Official Assignee is wrong in having rejected the claim of the applicant and I declare that the applicant is a creditor of the insolvency and is entitled to rank for dividend out of the assets with the other creditors. The Official Assignee will pay the taxed costs on the Original Side scale of this application. The Official Assignee will take his own taxed costs on the Original Side scale as between attorney and client out of the estate.

V. Varadaraja Mudaliyar, attorney for applicant.

N. T. Shamanna, attorney for respondent.

B.C.S.