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August 22.

V. NARASIMHA RAJU

v.

V. GURUMURTHY RAJU AND OTHERS

(P. B. GAJENDRAGADKAR, K. C. DAS GUPTA and RAGHUBAR DAYAL, JJ.)

Arbitration—Agreement of reference—Consideration found unlawful—Legality af the award—Agreement for arbitration on withdrawal of criminal case—Public policy—Indian Contract Act, 1872 (9 of 1872), s.23.

In respect of a business which the appellant and the first respondent were carrying on in partnership along with others till September 15,1942, the first respondent demanded that the account should be made and the profits divided between the partners. Disputes arose when dividing the profits that whereas the first respondent claimed for himself alone the amount due to him and the fourth respondent, the latter demanded that the said amount should be divided half and half between them. The first respondent then proceeded to file a criminal complaint in the Magistrate's court against the partners including the appellant in which he alleged that the accused persons had committed offences under ss. 420, 465, 468 and 477 read with ss. 107 and 120-B of The Indin Penal Code. The charge levelled by the first respondent was that the accounts of the partnership had been fraudulently altered with a view to show that the fourth respondent was entitled to share equally the profits with the first respondent. Process was issued on the complaint and the matter stood adjourned for hearing to December 30,1943. On that date the first respondent and the accused persons entered into an agreement under which the dispute between the appellant and others and the first respondent was to be referred to a named arbitrator on the first respondent agreeing to withdraw his criminal complaint. Accordingly after the complaint was dismissed on the first respondent intimating to the Court that he had no evidence to support his case, the agreement signed by the parties was handed over to the arbitrator. In due course, the arbitrator pronounced his award and the first respondent took steps to have a decree passed in terms of the award. Thereupon the appellant filed an application under the provisions of the Arbitration Act, 1940, for setting aside the award on the ground that the consideration for the arbitration agreement was unlawful as it was

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the promise by the first respondent not to prosecute his complaint which involved a non-compoundable offence and, therefore, the agreement was invalid under s.23 of the Indian Contract Act, 1872.

Held, that the arbitration agreement executed by the parties on December 30, 1943, was invalid under s. 23 of the Indian Contract Act, 1872, because its consideration was opposed to public policy. Consequently the award could not be enforced.

Bhowanipur Banking Corporation Ltd. v. *Sreemati Durgesh Nandini Dassi*, A.I.R. 1941 P. C. 95, *Kamini Kumar Basu & Ors.* v. *Birendra Nath Basu & Anr.*, L. R. 57 I. A. 117 and *Sudhindra Kumar* v. *Ganesh Chandra* (1939)1 Cal. 241, relied on.

CIVIL APPELATE JURISDICTION : Civil Appeals Nos. 494 and 495 of 1957.

Appeals from the Judgment and decree dated March 5, 1954, of the Orissa High Court in Mics. Appeals Nos. 25 and 26 of 1949.

A. V. Viswanatha Sastri and *T. V. R. Tatachari*, for the appellant.

M. S. K. Sastri for respondent No. 1.

1962 August 22. The Judgment of the Court was delivered by

Gajendragadkar J.

GAJENDRAGADKAR, J.— The short question which arises in these two appeals is whether the Muchalika (Agreement of Reference) which was executed by the appellant and the four respondents in favour of Tanguda Narasimhamurty on the 30th of December, 1943, is invalid because its consideration was opposed to public policy under s. 23 of the Indian Contract Act. Both the trial Court and the High Court of Orrisa have answered this question in the negative, and the appellant, who has come to this Court with a certificate granted

by the High Court under Art. 133 of the Constitution, contends that the said conclusion is contrary to law.

It appears that the appellant took a lease of the Parlakimedi Samasthanam Rice and Oil Mill for three years from 1941 to 1944 under a registered lease-deed on the 9th December, 1940. The rent agreed to be paid was Rs. 7,000 per annum. For the working of the Mill, the appellant took six partners with him and their shares in the partnership were duly determined. The partnership carried on the work of milling rice and extracting oil from ground-nuts.

The appellant also carried on another business in paddy and ground-nuts and in this business too he took as his partners four out of his six partners in the business of milling rice and extracting oil from ground-nuts. Amongst these partners was respondent No. IV. Gurumurty Raju. This latter bussiness was carried on for about 14 months until the end of March, 1942. Two of the partners then retired from the said business and took away their shares in the Capital and the profits. The remaining three partners continued the business of the firm; the appellant had As.0.7.3 share, respondent No. 2 had 0.6.9 share and respondent No. 1 along with respondent No. 4. had 0.2.0 share. Thus, the partnership, in fact, consisted of five partners respondents 1 and 4 being together entitled to a share of As. 0.2.0. The business of the partnership thus carried on by these partners went on till the 15th September, 1942. Respondent No. 1 then demanded that the accounts should be made and the profits divided between the partners. As a result of this demand, the partnership was stopped, accounts were made and profits divided. The appellant and respondent

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No. 2 took away their respective amounts, but respondent No. 1 claimed for himself alone the amount due to him and respondent No. 4, whereas respondent No. 4 demanded that the said amount should be divided half and half between him and respondent No. 1. That is how a dispute arose about the share of respondent No. 1.

Respondent No. 1 then proceeded to file a criminal complaint in the Court of the Joint Magistrate at Berhampur against six persons, including the appellant. In this complaint he alleged that the six accused persons had committed offenecs under ss. 420, 465, 468 and 477 read with ss. 107 and 120-B of the Indian Penal Code. The substance of the charge thus levelled by respondent No. 1 was that the accounts of the partnership had been fraudulently altered with a view to show that respondent No. 4 was entitled to share equally the profits with respondent No. 1. In these proceedings, respondent No. 1 obtained an attachment of the account-books of the two businesses carried on by the appellant with his partners. This criminal complaint was numbered as Criminal Case No. 139 of 1943, and after process was issued on it and some preliminary steps had been taken, it stood adjourned for hearing to December 30, 1943.

On December 30, 1943, respondent No. 1 and the accused persons entered into an agreement (Exbt. 1) as a result of which the dispute between the appellant and others and respondent No. 1 was agreed to be referred to the arbitration of Mr. Murty on the respondent No. 1 agreeing to withdraw his criminal complaint. Accordingly, when the criminal case was called out for hearing on that date, respondent No. 1 stated that he had no evidence to support his case and so, the complaint was dismissed; and the arbitration paper signed by

the parties was handed over to the arbitrator, Mr. Murty. That is how the impugned arbitration agreement came to be passed between the parties and Mr. Murty came to be appointed an arbitrator.

The arbitrator then began his proceedings and after recording evidence, he pronounced his award *ex-parte* on September 14, 1946. During the pendency of the said arbitration proceedings, the appellant had applied to the Subordinate Judge at Berhampur for removing the arbitrator on the ground of his misconduct under ss. 5 and 11 of the Arbitration Act (M.J.C. No. 34 of 1944). The said application was dismissed. The appellant then preferred a Revisional Application against the order of the trial Judge (Revision Petition No. C.R. 78 of 1946), but the said petition was also dismissed on March 26, 1949. Pending the disposal of the said Revision Petition, the award was pronounced on September 14, 1946.

After the award was thus pronounced, respondent No. 1 made an application to the Subordinate Judge at Berhampur on December 10, 1946, (M.J.C. No. 105 of 1946) under ss. 14 and 30 of the Arbitration Act for the filing of the award and for passing a decree in terms thereof. The appellant filed an application on January 14, 1947, in the same Court under s. 33 of the Arbitration Act for setting aside the award (M.J.C. No. 8 of 1947). To both these applications, all the parties to the Reference and the Arbitrator were impleaded. By his application, the appellant claimed the setting aside of the award on several grounds, one of which was that the arbitration agreement was invalid under s. 23 of the Indian Contract Act. Both the Courts have rejected this contention. In the result, the application for setting aside of the award made by the appellant has been dismissed and the application made by respondent No. 1 for passing a decree in terms

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of the award has been allowed. Both the Courts have also considered and rejected the other contentions raised by the appellant in support of his plea that the award was invalid; but for the purpose of these appeals, it is unnecessary to refer to the said findings, because we have come to the conclusion that the appellant is right in contending that the arbitration agreement is invalid under s. 23 of the Indian Contract Act.

Section 23 provides that every agreement of which the object or consideration is unlawful is void, and it lays down that the consideration of an agreement is lawful unless, inter alia, it is opposed to public policy. Agreement made by parties for stifling prosecution are not enforced by courts on the ground that the consideration for such agreements is opposed to public policy. If a person sets the machinery of the Criminal Law into action on the allegation that the opponent has committed a non-compoundable offence and by the use of this coercive criminal process he compels the opponent to enter into an agreement, that agreement would be treated as invalid for the reason that its consideration is opposed to public policy. Under the Indian Law, offences are divided into three categories, some are compoundable between the parties, some are compoundable with the leave of the Court and some are non-compoundable. In the present case, it is common ground that amongst the offences charged by respondent No. 1 against the appellant and others were included non-compoundable offences, and so, we are dealing with a case where, according to the appellant, a criminal process was issued in respect of non-compoundable offences and the withdrawal of the criminal proceedings was a consideration for the agreement of reference to which the appellant has put his signature. Whether or not the appellant

proves his case, we will consider later; but the true legal position on this point is not in doubt. If it is shown that the consideratian for the arbitration agreement was the withdrawal and the non-prosecution of the criminal complaint, then the provisions of s. 23 of the Indian Contract Act would be attracted. The principle underlying this provision is obvious. Once the machinery of the Criminal Law is set into motion on the allegation that a non-compoundable offence has been committed, it is for the criminal courts and criminal courts alone to deal with that allegation and to decide whether the offence alleged has in fact been committed or not. The decision of this question cannot either directly or indirectly be taken out of the hands of criminal courts and dealt with by private individuals. When as a consideration for not proceeding with a criminal complaint, an agreement is made, in substance it really means that the complainant has taken upon himself to deal with his complaint and on the bargaining counter he has used his non-prosecution of the complaint as a consideration for the agreement which his opponent has been induced or coerced to enter into. As Mukherjea, J., has observed in *Sudhindra Kumar* v. *Ganesh Chandra*(1), "no Court of law can countenance or give effect to an agreement which attempts to take the administration of law out of the hands of the judges and put in the hands of private individuals." Therefore, it is clear that if the appellant proves that the consideration for the arbitration agreement was the promise by respondent No. 1 not to prosecute his complaint, then the said consideration would he opposed to public policy and the agreement based on it would be invalid in law.

In this connection. it would be relevant to refer to two decisions of the Privy Council. In *Bhowanipur Banking Corporation Ltd.* v. *Sreemati Durgesh Nandini Dassi*(2) Lord Atkin has observed

(1) [1939] I Cal. 241, 250. (2) A.I.R. 1941 P.C. 95.

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that "to insist on reparation as a consideration for promise to abandon criminal proceedings is a serious abuse of the right of private prosecution. The citizen who proposes to vindicate the criminal law must do so whole--heartedly in the interests of justice, and must not seek his own advantage." In dealing with the question as to whether the consideration for the agreement is opposed to public policy or not, it is immaterial that the debt in respect of which an agreement is made for the illegal consideration was real, nor is it necessary to prove that a crime in fact had been committed. All that is necessary to prove in such a case is "that each party should understand that the one is making his promise in exchange or part exchange for the promise of the other not to prosecute or continue prosecuting". In that case, a mortgage bond was executed by the respondent as a part of the consideration for a promise by the bank to withdraw criminal proceedings instituted by it against the mortgagor's husband, and it was held by the Privy Council that the mortagage bond was invalid. In dealing with the question that the debt which was a consideration for the mortgage bond was real, their Lordships observed that the existence of the debt made no difference at all because whether or not the debt was real, the mortgage had been executed for a consideration which was opposed to public policy and so, it became illegal and void.

In *Kamini Kumar Basu* v. *Virendra Nath Basu*,(1), their Lordships held that "if it is an implied term of a reference to arbitration, and of an 'ekrarnama' pursuant to an award, that a complaint that a non-compoundable offence under the Indian Penal Code has been committed shall not be proceeded with, the consideration is unlawful on the ground of public policy, and the award and ekrarnama are,

(1) [1930] L.R. 57 I.A. 117.

therefore, unenforceable, and this would be so irrespective of whether in law a prosecution has been commenced or not". In that case, the criminal case was withdrawn the day after the execution of the inpugned agreement, but it appeared that prior to the execution of the agreement, there had been an understanding between the parties that they would withdraw from their respective criminal cases. Sir Binod Mitter who delivered the judgment of the Board observed that in such cases, it is unlikely that it would be expressly stated in the ekrarnama that a part of its consideration was an agreement to settle the criminal proceedings. It would, however, be enough for the parties which impeached the validity of the agreement to give evidence from which the inference necessarily arises that part of the consideration was unlawful. It is in the light of these decisions that we will have to consider the question as to whether the appellant has succeeded in showing that the consideration for the agreement of reference in the present case was the withdrawal and non-prosecution of the criminal complaint filed by respondent No. 1.

We will first refer to the complaint filed by respondent No. 1 against the appellant and others. In this complaint it was alleged that all the accused persons conspired with each other with intent to defraud respondent No. 1 of a half of his 2 annas share in the partnership assets and altered the account books of both the Rice and Oil Mills, and the joint business in material parts by inserting the name of the 4th respondent by the side of respondent No. 1's name in order to make it appear that the 4th respondent also owned the two annas share along with or jointly with respondent No. 1. It is on the basis of this allegation that respondent No. 1 complained that the accused persons including the appellant had committed offences under ss. 420, 465, 468 and 477

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read with sections 107 and 120-B. I. P. C. It is common ground that process was issued on this complaint and it stood adjourned for hearing to December 30, 1943.

On December 30, 1943, the arbitration agreement was entered into by the parties. This document consists of eight clauses. It purported to authorise Mr. Murty to determine whether 2 annas share belonged exclusively to respondent No. 1 or jointly to respondents 1 and 4; and it also authorised him to determine incidental and subsidiary issues in respect of respondent No. 1's claim for his share in the profits of the partnership. Clause 5 of the agreement provided that the arbitrator was to determine who and in what manner are to bear the costs incurred by both the parties in Criminal Case No. 139 of 1943 on the file of Berhampur 2nd Officer's Court, according to justice and injustice. In other words, the arbitrator had to decide not only the civil dispute between the parties resulting from the claim made by respondent No. 1 to two annas share in the profits of the partnership, but also to determine the dispute about the expenses in the criminal proceedings.

Let us now examine the evidence which shows the circumstances under which the arbitration agreement came to be executed. Mr. Murty who has been examined for respondent No. 1 stated that he did not suggest any term to be embodied in the fair draft and he could not say at whose instructions the draft was written because it was written in his absence. Then he added that the parties gave the Muchalika to him first and as he was returning with it, they told him that they would intimate about the Muchalika to the Criminal Court and let him know court's orders thereon. He also pleaded that he could not say if the 1st respondent had any idea that after the Muchalika was given to him, he would

withdraw the case. The Muchalika has been attested by two witnesses both of whom have given evidence in this case. Sitharamaswamy is one of the two attesting witnesses. He has stated that the parties had gathered at about 1 or 2 p. m. in the Court hall of the Sub-Collector's Court where the criminal case was going to be heard. The document was executed to bring the crimial case between the parties then pending to a close. After the document was executed, the criminal case was got cancelled. The 1st respondent definitely stated that he would withdraw the case and accordingly, he went to the criminal court and got the case dismissed. Thereafter, the original of the document was handed over to the arbitrator. It is significant that this witness who has attested the document was one of the witnesses called by respondent No. 1 in the criminal case filed by him against the appellant and others and in fact he had come to the criminal court to give evidence on that day. To the same effect is the evidence of the other attesting witness Jayachandra Padhi. After the agreement was scribed and duly executed, respondent No. 1 told the criminal court about his inability to prove his case and accordingly the case was dismissed. Then all the parties gathered on the court verandah and the appellant handed over the fair copy of the agreement to the arbitrator. According to this witness, the reference was executed in order that respondent No. 1 should withdraw the criminal case and the arbitration should settle their dispute. This witness expressly stated that the condition was that after the criminal case was withdrawn, the reference was to be handed over to the arbitrator.

The other witness examined by the appellant is Appa Rao. He refers to the circumstances under which the arbitration agreement was executed and adds that the appellant kept the final draft with

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him and handed it over to the arbitrator after the criminal complaint was dismissed. It appears that Appa Rao was confronted with his prior statement made in the proceedings started by the appellant to remove the arbitrator for misconduct. We will have occasion to refer to this statement later on.

The appellant has stated on oath in support of his case that respondent No. 1 agreed to withdraw the criminal case and not to prosecute it and it was in consideration of that promise that he entered into the arbitration agreement. In his evidence he has added that after the criminal complaint was filed, the partnership books were seized and the joint business did not continue. According to him, Mr. Murty offered to effect a compramise if a reference was made to him and get the case withdrawn. It was at that stage that pleaders of both the sides prepared the draft of the agreement. Then the witness has narrated how respondent No. 1 went to the court and stated that he was unable to prove his case whereupon the complaint was dismissed. Then the parties came out and the agreement was delivered over to Mr. Murty. The evidence of this witness clearly shows that the agreement was executed by him because he was promised that the criminal case would be taken out if he executed the agreement. That is the evidence adduced by the appellant in support of his case that the consideration of the agreement was the promise of respondent No. 1 not to prosecute his case and that in fact the document was given over to the arbitrator after the promise was carried out by respondent No. 1 and the criminal case was dismissed.

Respondent No. 1 in his evidence has not made any categorical statement to the contrary. He has admitted the circumstances disclosed by the appellant and his witnesses as to the place

where, the time when and the manner in which the agreement came to be executed. He only stated that he could not say whether the talk of reference to the arbitrator in question cropped up before or after the dismissal of the case. He admits that he pleaded his inability to prove his case in the criminal court and that the arbitrator then entered upon arbitration.

It would thus be seen that the evidence adduced by the appellant is cogent, statisfactory and categorical, whereas the evidence of respondent No. 1 and of the arbitrator examined by him is not categorical to the contary and at best is ambiguous. Eeven according to respondent No. 1 and the arbitrator, the agreement was drafted within the premises of the criminal court just before the criminal case was taken out. In other words, the place where the agreement was drafted and the time at which it was drafted, are significant. It was known that the criminal case would be heard in the afternoon of December 30, 1943, and so, the sequence of events clearly indicates that the parties entered into an understanding, the essence of which was that respondent No. 1 was to get the criminal case dismissed and as a consideration for that, the appellant and the other accused persons had to agree to refer their dispute to the arbitration of Mr. Murty. In this connection, it is very significant that the final draft which was executed and attested was handed over to the arbitrator after the criminal case was withdrawn. Therefore, the circumstances attending the execution of the document and the sequence of events disclosed in the evidence clearly show that the Promise of respondent No. 1 to withdraw and not to prosecute the criminal case was a considertion for which the applelant and his friends entered into the arbitration agreement. This is not a case where it can be reasonably said that the withdrawal of the criminal case may have

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been a motive and not the consideration for the impugned transaction.

Then again cl.5 of the agreement corroborates the appllant's case that the withdrawal and non-prosecution of the criminal complaint was a consideration for the arbitration agreement. That is why the arbitrator was authorised to decide as to who and in what manner are to bear the expenes incurred in criminal proceedings. The intimate connection of the criminal proceedings and their withdrawal with the arbitration agreement is thus clearly established. That is another factor which supports the appellant's case.

It has, however, been urged by Mr. M. S. K. Sastri for respondent No. 1 that the agreement was entered into because Mr. Murty offered to settle the disputes between the parties and the parties accepted his advice. It does appear that Mr. Murty had stood surety for the appellant in the criminal case for his due appearance in the criminal court whenever the case would be fixed for hearing and Mr. Sastri relies on the statement made by the appellant that Mr. Murty offered to effect a compromise if a reference was made to him and get the case withdrawn. The argument is that it was at the suggestion of Mr. Murty that the whole incident took place and so, there can be no scope for arguing that respondent No. 1 promised to withdraw the criminal case as a consideration for the execution of the arbitration agreement. This argument cannot be accepted because Mr. Murty himself does not admit that he offered to mediate and parties thereupon accepted his advice. According to Mr. Murty he was not present when the agreement was written and he in fact does not know who dictated the contents of the agreement. But apart from this consideration, even the statement made by the appellant on which the argument is founded shows that the proposal

was clear—criminal case had to be withdrawn a not to be prosecuted and the agreement of reference had to be made. These two steps were related to each other as cause and effect, or one step was or consideration and the other was the acceptance of the proposal to enter into the arbitration agreement. Therefore, we do not see how it would be possible to repel the appellant's argument that the consideration for the arbitration agreement was the promise of respondest No. 1 not to prosecute his criminal complaint.

It is true that both the trial Court and the High Court have rejected the appellant's contention and normally this Court is reluctant to interfere with a concurrent finding made on an issue like this by both the courts below. But in this case, the judgment of the High Court shows that unfortunately the High Court has not considered the relevant evidence bearing on the point. Its conclusion rests mainly on two considerations. It has criticised the appellant for not having taken this point when the appellant applied for the removal of the arbirator by his petition M. J. C. 34 of 1944, and so, the High Court took the view that the present plea had been taken at a very belated stage. In our opinion, this criticism is not well-founded. Whether or not the appellant could have taken this plea by another proceeding under some provision of the Arbitration Act is a different matter. But it would be erroneous to find fault with the appellant for not taking this point in an application made by him for removing the arbitrator on the ground of his misconduct. If the appellant sought the removal of the arbitrator on the ground of his misconduct, it would not have been relevant or material in that context to allege that the arbitration agreement itself was invalid. In any case, the failure of the appellant to take this point otherwise in an earlier proceeding would

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not justify the rejection of the point without considering the merits of the evidence led by the appellant in support of it. and that substantially is what the High Court has purported to do in this case.

The other consideration which seems to have influenced the High Court proceeded from the fact that Appa Rao who has been examined by the appellant in the present proceedings had stated in the proceedings which were taken by the appellant by his application to remove the arbitrator that after respondent No. 1 had deposed in the criminal case, the reference to the arbitration was made, and the High Court apparently thought that this prior statement of Appa Rao is so completely inconsistent with the present version set up by the appellant and his witnesses that it should for that reason alone be rejected. This view is obviously erroneous. What Appa Rao stated in the earlier proceedings is wholly consistent with his evidence in the present proceedings as well as the evidence given by the appellant and his other witnesses. The reference in law and in fact was made only when the arbitration agreement duly executed was handed over to the arbitrator and this happened after the criminal case was dismissed. That is the appellant's version even now. This is not inconsistent with the other part of the appellant's version which deals with the negotiations between the parties which preceded the drafting of the arbitration agreement, the preparation of the draft and its final engrossment all of which took place before the criminal case was called out. All the witnesses of the appellant have said that the draft was shown to the arbitrator, but the final agreement was given to his after the criminal case was dismissed. Thus, what the High Court thought to be a serious inconsisteney between the present story deposed to by Appa Rao and his

past statement does not amount to any inconsistency at all. It is to be regretted that the High Court did not examine the rest of the evidence carefully before it came to the couclusion that the appellant's challenge to the validity of the arbitration agreement under s. 23 could not be sustained. It is because of this infirmity in the judgment of the High Court that we thought it necessary to examine the evidence ourselves. The said evidence, in our opinion, clearly supports the appellant's case and so, it must be held that the arbitration agreement executed by the parties on December 30, 1943, is invalid under s. 23 of the Indian Contract Act, because its considretion was opposed to public policy.

The result is, the two appeals are allowed, the application made by respondent No. 1 (M. J. C. 105 of 1946) for passing a decree in terms of the award is dismissed and the application made by the appellant (M. J. C. No. 8 of 1947) for setting aside the award is allowed. The appellant would be entitled to his costs from respondent No. 1 throughout. One set of hearing fees.

Appeals allowed.