

PETITIONER:
STATE OF RAJASTHAN

Vs.

RESPONDENT:
SHYAM LAL

DATE OF JUDGMENT:
12/03/1964

BENCH:
WANCHOO, K.N.
BENCH:
WANCHOO, K.N.
GAJENDRAGADKAR, P.B. (CJ)
SHAH, J.C.
AYYANGAR, N. RAJAGOPALA
SIKRI, S.M.

CITATION:
1964 AIR 1495 1964 SCR (7) 174
CITATOR INFO :
R 1964 SC1903 (24)
R 1966 SC 442 (1,4,6,7)
R 1971 SC 530 (44)

ACT:
State-Liability of-Merger of one State into another
Liability incurred before merger-Merger agreement providing
for taking over liability of the merging State- Whether suit
against new State maintainable-Constitution of India, Art.
295(2).

HEADNOTE:
In 1947, the Dholpur State acceded to the Dominion of India.
Later on, it was merged with other States and as a result of
that merger, the Matsya Union was formed on March 18, 1948.
One of the provisions of the merger agreement was that the
existing laws in the Covenantee States were to be continued
till such time as they were modified or repealed by the new
State and that all the assets and liabilities of the
Covenantee States were taken over by the new State. Later
on, the Matsya Union was merged with the United State of
Rajasthan which had come into existence from April 7, 1949.
A similar provision with regard to the recognition of the
liabilities of the Covenantee States by the new State was
also provided. On January 26, 1950, Part B State of
Rajasthan came into existence.

In the four appeals the respondents secured permits from the
Dholpur State for the export of certain commodities and they
had to pay export duties in advance. As the respondents
could not export the full quantity for which they had
secured permits they asked the appellant to refund the
excess export duty and when the latter refused to do so,
filed suits for refund of the same with interest. The
defence taken up by the appellant was that it was not bound
by any liability which might have arisen against the former
State of Dholpur. It was a new Sovereign and was not bound
by any liability of the former State of Dholpur unless it
chose to recognise the obligation but no such obligation was
recognised in the present case. One suit was dismissed by

the trial court and other three were decreed. The appeals of the State to the District Judge were substantially dismissed while the appeal in the first suit by the plaintiff was substantially allowed. The State filed appeals to the High Court. After referring the matter to the Full Bench, a Division Bench of the High Court dismissed the appeals filed by the State. The Appellant came to this Court after obtaining certificate of fitness from the High Court. The only question raised before this Court was about the liability of the State of Rajasthan under Art. 295(2) of the Constitution in respect of the obligations of the former State of Dholpur which came to be included in the State of Rajasthan. Dismissing the appeals, Held, that the new State by continuing the old laws without change till they were repealed or altered, recognised that it was liable in the same way as the merging State would have been in any case. Throughout the process of integration from 1948 to 1950, the new Sovereign must be taken to have recognised the rights of the subjects and undertaken the liabilities

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of the old State. So under Art. 295(2) of the Constitution, the State of Rajasthan was liable to meet the liabilities of all old States which eventually were merged into it. Moreover, there was nothing to show that the right to claim the refund was taken away by any law competently passed. M/s Dalmia Dadri Cement Co. Limited v. The Commissioner of Income-tax [1959], S.C.R. 729 and Maharaja Shree Umaid Mill Limited v. Union of India, A.I.R. 1953, S.C. 953 referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 884-887 of 1962.

Appeals from the judgment and decree dated May 2, 1960, of the Rajasthan High Court in Civil Second Appeal Nos. 268 of 1954, 203 of 1955, 4 of 1954 and 27 of 1954.

S. K. Kapur and B. R. G. K. Achar, for the appellant
(in all the appeals).

R. P. Modi and R. K. Garg, for the respondents (in C.A. No. 887/1962).

March 12, 1964. The Judgment of the Court was delivered by WANCHOO, J.-These four appeals arise out of four certificates granted by the High Court of Rajasthan and raise a common question. We therefore, propose to set out facts in one of the present appeals (No. 887), as the facts in other appeals are similar, except that the commodity involved was different and so was the amount in dispute. The suit out of which appeal No. 887 has arisen was filed by the respondent against the State of Rajasthan. The respondent was a resident of the former Dholpur State and the dispute which led to the suit related to a time before the merger of former Dholpur State into the Matsya Union. The case of the respondent was that in 1947 certain commodities including chuni with which appeal No. 887 is concerned could only be exported from the former Dholpur State on export permits issued by the customs department of the said State. It was also the practice in that State that when permits for export were issued, export duties had to be paid in advance, though the actual export was made later. Consequently, in June 1947 the respondent applied for and was granted a permit for export of 15,000 maunds of chuni, and in connection therewith he deposited Rs. 30,000/as export duty in advance.

This permit had been granted on June 28, 1947 and remained in force upto December 2, 1947. The respondent however was not able to export the entire quantity of 15,000 maunds for which the permit was granted; he could only export 4,572 maunds and 20 seers of chuni before December 2, 1947. Thereafter he could not export further as his permit was not extended. It was alleged on behalf of the respondent that the reason why he failed to export the entire

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quantity of the commodity before December 2, 1947 was due to market conditions and inability to get allotment of railway wagons. The respondent's case further was that as he could not export the entire quantity of 15,000 maunds for which he had paid export duty in advance at the rate of Rs. 2/- per maund, he was entitled to refund of the proportionate export duty for the quantity of 10,427 maunds and 20 seers, which he could not export. His case further was that though he asked the State for refund of this advance duty, the State did not pay back the same to him. In the meantime, rapid constitutional changes took place after August 15, 1947. By May 15, 1949, the United State of Rajasthan was formed including the Matsya Union into which the former State of Dholpur had merged on March 17, 1948. The United State of Rajasthan eventually became the Part B State of Rajasthan on January 26, 1950 when the Constitution came into force. Eventually when the State refused to refund the amount, the suit was filed, out of which appeal No. 887 has arisen, in January 1952. The respondent claimed refund of Rs. 20,855/- along with interest and costs.

The suits were resisted by the State of Rajasthan on various grounds; but we are concerned now only with one ground which alone has been urged before us, namely, that the State of Rajasthan was not bound by any liability which might have arisen against the former State of Dholpur. It was a new sovereign and was not bound by any obligation against the old sovereign of the former State of Dholpur unless it chose to recognise the obligation. As the United State of Rajasthan into which the former State of Dholpur came to be merged in 1949 never recognised the obligations of the former State of Dholpur it was not bound to refund the amount due to the respondents.

In reply to this contention of the State, the respondent relied on Art. 295(2) of the Constitution and other provisions made during the period when mergers were taking place after August 15, 1947 and contended that in view of Art. 295(2) of the Constitution the State of Rajasthan was bound by the obligation of the former State of Dholpur.

Before we refer to the decisions of the courts below with regard to this controversy it would be convenient to clear the ground by indicating the admitted position, which resulted in the inclusion of the former Dholpur State into the Part B State of Rajasthan, which came into existence on January 26, 1950 and which would be bound by Art. 295(2) of the Constitution. The former Dholpur State remained a separate entity till March 17, 1948, though it had acceded to the Dominion of India after August 15, 1947 with respect to three subjects, namely, communications, defence and external affairs. In 1948, however, the process of merger in Rajasthan began and the

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first merger that took place was of the former States of Alwar, Bharatpur, Dholpur and Karauli, which formed the Matsya Union as from March 18, 1948 by a Covenant entered on February 28, 1948. It is not in dispute that on this merger, provision was made for the continuance of the laws

in the covenanting State till such time as they were modified by the new State. Provision was also made in the Covenant that all the assets and liabilities of the covenanting States shall be the assets and liabilities of the new State of Matsya. Then came another union of certain other Rulers in Rajasthan in March 1948 by which these Rulers united under the Ruler of Udaipur to form what later came to be known as the Former State of Rajasthan. In March 1949, the United State of Rajasthan was formed by Covenant entered into by fourteen Rulers of Rajasthan, including these who had formed the Former State of Rajasthan. and this State came into existence from April 7, 1949. It may be mentioned here that when this State came into existence on April 7, 1949, it provided for the continuance of all laws till they were repealed or amended by the new State. There was also a provision in the Covenant by which the assets and liabilities of the covenanting States became the assets and liabilities of the new State. In this State of United State of Rajasthan, the State of Matsya, merged in May 1949, and thus the former State of Dholpur came to be included in the United State of Rajasthan through the Matsya Union. When this merger took place it is not in dispute that the existing laws were to continue till they were repealed or altered by the new State. It is also not in dispute that the assets and liabilities of the Matsya Union were taken over as the assets and liabilities of the United State of Rajasthan in which the Matsya Union merged. Finally the United State of Rajasthan in which the State of Sirohi was also merged became the Part B State of Rajasthan on January 26, 1950. At this time also Art. 372 of the Constitution continued the existing laws subject to their being altered or repealed by the new State. Further Art. 295(2) provided that the Government of each State specified in Part B of the First Schedule shall, as from the commencement of the Constitution, be the successor of the Government of the corresponding Indian State as regards all property and assets and all rights, liabilities and obligations. whether arising out of any contract or otherwise, other than those referred to in cl. (1). This was subject to any agreement entered into in that behalf by the Government of India with the Government of the State concerned. This completes the narration of the political changes that took place till the Constitution came into force on January 26, 1950.

We have already indicated that a number of defences were raised on behalf of the State of Rajasthan and these defences were negatived by the trial court in three suits.

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of the suits, out of which appeal No. 886 has arisen, was ismised by the trial Court. The State went in appeal in two of the suits to the District Judge and in one (out of which appeal No. 887 has arisen) to the High Court direct in view of the valuation. In the fourth suit, the plaintiff went in appeal to the District Judge. The appeals of the State to the District Judge were substantially dismissed while the appeal in the fourth suit by the plaintiff was substantially allowed. Then followed three second appeals to the High Court by the State.

These second appeals were heard along with the first appeal in the High Court. It seems that in the High Court for the first time a point was raised that the liability of the former Dholpur State did not fasten on the State of Rajasthan as it emerged on January 26, 1950. The High Court permitted the point to be raised as it was a pure question of law. AU the appeals came before a Division Bench of the

High Court. The two learned Judges composing the Division Bench disagreed on this question of the liability of the State of Rajasthan under Art. 295(2) in respect of the liability of the former State of Dholpur. Thereupon there was a reference to a Full Bench on the question of liability which was formulated by the learned Judges thus: -

"Whether the expression 'Government of the corresponding State' used in Art. 295(2) of the Constitution with reference to Rajasthan properly means the Government of the United State of Rajasthan which was the only Indian State in existence at the time of the commencement of the Constitution or it also includes the Government of any of the Covenanted States which had integrated with the United State before the Constitution came into operation."

The three learned Judges who heard the reference were unanimously of the opinion that the expression "Government of the corresponding State" used in Art. 295(2) of the Constitution with reference to Rajasthan meant not only the Government of the United State of Rajasthan, but also the United State of Rajasthan including its component units. The matter then went back to the Division Bench. The three second appeals were dismissed by the High Court. The first appeal out of which appeal No. 887 had arisen was also dismissed except that no interest was allowed upto the date of decree and the amount was reduced to the actual excess export duty, which had been deposited in advance and it was ordered to be refunded.

The only question that has been raised before us on behalf of the appellant is about the liability of the State of Rajasthan under Art. 295(2) of the Constitution in respect of the obligations of the former State of Dholpur, which came to be

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included in the State of Rajasthan on account of political changes to which we have already referred. In this connection, the appellant relies on the decision of this Court in *M/s. Dalmia Dadri Cement Co. Ltd. v. The Commissioner of Incometax*. (1) That case dealt with the Covenant creating the State of Pepsu and particularly Art. VI thereof. The covenant in the State of Pepsu was more or less similar in terms to the Covenant in the United State of Rajasthan. This Court reviewed certain cases relating to the acquisition of territory by cession or by conquest, and held that it made no difference whether acquisition of new territory was by an existing State by conquest or by cession or a new State came into existence by agreement out of territories belonging to some former States. In either case, it was held that there was establishment of new sovereignty over the territory in question and that was an act of State. In consequence this Court further held that the Covenant by which the new State of Pepsu came into existence was in its entirety an act of State and that Art. VI therein could not operate to confer any right on the company as against the new State, for the principle was well settled that clauses in treaties entered into by sovereigns of independent States whereunder sovereignty in territories passed from one to the other providing for the recognition by the new sovereign of the existing rights of the residents of those territories must be regarded as invested with the character of an act of State and no claim based thereon could be enforced in a court of law. This Court also negatived the argument which was urged in that case that

part of the Covenant was an interim Constitution and head that the Covenant was in whole or in part an act of State and could not be treated as an interim Constitution. Strong reliance is placed on behalf of the appellant on that decision in support of the contention that even if there was any liability of the former State of Dholpur to; refund the amount of tax collected in advance for no export was made, that liability did not devolve on the Part B State of Rajasthan under Art. 295(2) of the Constitution, as there was no recognition of this liability by the new State at any time and in that respect the present case was on all fours with that decision.

After laying down the above principles, this Court proceeded to consider in that decision the particular point raised before it. That point was with respect to a clause in an agreement between the Ruler of the former Jind State and the Dalmia Dadri Cement Company with respect to income-tax and certain concessions given to the company in that behalf. The question that arose in that connection was whether there had been any recognition of the concessions by the new sovereign; and this Court held that there was no recognition of the concessions. In that connection reference was made to Pepsu Ordinance No. 1 of 2005, dated August 20, 1948 by s. 3 of which

(1) [1959] S. C. R. 729.

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all laws in all Covenanted States were repealed and the laws in force in the State of Patiala were to apply mutatis mutandis to the entire territories of the new State. This Ordinance was repealed and replaced by Ordinance XVI of Samvat 2006 which came into force on February 5, 1949 and which contained an exactly similar provision. This Court therefore held that if the agreement was treated as a special law, it must be deemed to have been repealed by s. 3 of Ordinance No. 1. It further held that the repeal of all laws in the covenanted States other than Patiala and their replacement by the Patiala laws showed that the new sovereign did not recognise the rights of the subjects of the covenanted States arising from any law in force thereafter the State of Pepsu came into existence. Therefore it was held in that case that the concessions in the agreement came to an end when Ordinance No. 1 was passed as they were never recognised by the new sovereign and could not be availed of by the company.

It would be noticed that the decision that the new sovereign had not recognised the rights in States other than Patiala was based on the fact that Ordinance No. 1 repealed all laws in all States other than Patiala and applied the Patiala laws to the entire territory. This was the basis of the particular decision arrived at in that case (apart from the general principles laid down in connection with the cession of territory to which we have already referred), and we shall refer to it when dealing with the facts in the present case. Further though in that case it was held that Art. VI could not be enforced by citizens against the new sovereign as it was part of the Covenant, which was an act of State, this Court went on to point out that Art. VI of the Covenant would be valuable evidence from which affirmance of the rights mentioned therein could be inferred and added that such inference must relate to act or conduct of the new State after it came into existence. If there were any acts of the new State which were equivocal in character, it would have been possible to hold in the light of Art. VI of the Covenant that its intention was to assume the liabilities. In that case, however, this Court refused to treat Art. VI

even as evidence because it pointed out that the first act of the new sovereign was the application of the Patiala State laws, including the Patiala Income-tax Act, to the territories of Jind involving negation of the rights claimed in that case. But apart from the particular decision in that case, we have to proceed on the basis of the general proposition enunciated in that case as to the effect of the coming into existence of a new State even in the manner in which the State of Pepsu or the United State of Rajasthan came into existence after their respective Covenants, and it is to this aspect of the matter we shall now turn.

We have already indicated when dealing with the history of the political changes which eventually culminated in the 181

Part B State of Rajasthan after the coming into force of the Constitution that two matters were always provided for there during all this process of merger. The first was that each time a merger took place the new State by a provision in the Covenant took over the assets and liabilities of the merging States. This provision in the Covenant could not be availed of by the subjects of the new State as, in view of the decisions in Dalmia Dadri Cement Co.'s case(1) the Covenant in whole or in part was an act of State. But according to the same decision the presence of such a clause in the Covenant throughout would be valuable evidence which would show that the new State assumed the liabilities of the merging State, if there are any acts of the new State which are equivocal in character. Now we find from the history we have already narrated above that every time there was a merger and formation of a new State, the old laws were always to continue till they were repealed, amended or altered by the new State. We are of opinion that when the new State continued all the old laws till they were altered or repealed, and there was specific provision in each Covenant that the assets and liabilities of the Covenanting States were to be the assets and liabilities of the Union the new State must have intended to respect all the rights flowing from laws so continued and assume all liabilities arising from the existence of those laws. Otherwise we see no sense or purpose in continuing the old laws till they are altered or repealed if the intention was that the obligations and liabilities flowing from the continuance of the old laws would notwithstanding the Covenant not be assumed by the new State. If the intention was otherwise, we should have found a provision similar to that in the Pepsu case by which all the old laws were repealed in the merging States except Patiala and the Patiala laws were to continue in the entire territory giving rise to such rights only as the Patiala Laws recognised or conferred. But whereas in the present case the old laws were to continue till they were repealed or altered it follows in our opinion that the rights arising under the old laws in the subjects of the merging States would continue and these subjects would have the same rights against the new State as they would have under the old laws against the merging State. Thus by continuing the old laws, till they are repealed, altered or modified, the new State in effect undertook the liability which might arise against it by virtue of the continuance of the old laws, Even if there was some doubt about the new State undertaking the liabilities of the old State in view of the continuance of the old laws, we can in accordance with the decision in the Daltia Dadri Cement Co.'s case(1) look to Art. VI of the Covenant to come to the conclusion that on continuing the old laws, until they were altered, repealed or modified, the

(1) [1959] S.C.R. 729.

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new State intended to affirm the rights of the subjects which they had against the merging State and to assume itself the liability if any arising against the merging State. This is the basic difference between the Dalmia Dadri Cement Company case(1) and the present case, for in that case the old laws were repealed and thus repudiated in areas other than Patiala State while in the present case the old laws were continued till they were repealed or altered; and in view of that basic difference between that case and the present case we can legitimately call in aid Art. VI of the Covenant and similar provisions which were always made throughout this process of merger in Rajasthan and treat them as evidence from which to come to the conclusion that the new State, by continuing the old laws, without change till they were repealed or altered, recognised that it was liable in the same way as would have been the merging State if there was any liability on the merging State. But this was of course subject to any law made by the new State repealing the old laws and the liabilities arising thereunder or even otherwise, provided the law so made was within the competence of the new State and after the Constitution came into force it did not transgress the constitutional limitations. The result would be that the new State would be bound by the liabilities of the merging States and as similar provisions were there always throughout till we reach the Part B State of Rajasthan, it follows that there was always recognition of the rights of the subjects and that the new State assumed liabilities of the old State, throughout this process. This was of course subject to any law passed by the New State provided that law was within its competence and after the Constitution came into force did not transgress the limitations contained therein. In these circumstances we are of opinion that the new sovereign throughout this process of integration from 1948 to 1950 must be taken to have recognised the rights of the subjects and undertaken the liability, if any, of the old States. It follows therefore that the State of Rajasthan will be liable under Art. 295(2) of the Constitution to meet the liabilities of all old States which eventually were included in it subject always to this that if the new State passed any law repealing the old law which would affect the liability or even otherwise that law would prevail and the liability may disappear provided the new law is within the competence of the State legislature and does not transgress the constitutional limitations after the Constitution came into force. We are therefore of opinion that there was recognition of liability by the new State throughout this process and under the circumstances the suit was maintainable against the Part B State of Rajasthan in view of Art. 295(2) of the Constitution. In this view of the matter we consider that it is unnecessary to decide whether the particular words used in Art. 295(2) include not only the United State of Rajasthan as it was just before January 26, 1950 but also the

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old States which came to be merged into it through the process to which we have already referred. Whether that is so or not, it follows in view of the history to which we have referred that there was always recognition by the new State of its liability in the manner already referred to with respect to the liabilities of the merging States, and if there is any doubt about it that doubt in our opinion is resolved by the existence of Art. VI or similar provision

throughout the process of these political changes. In this connection we may also refer to s. 3 of the Rajasthan Administration Ordinance No. 1 of 1949, which continued existing laws of the old States till they were altered by the competent legislature or other competent authority in the new State. Section 3 further said that the old laws will continue in force in the State concerned subject to the modification that reference therein to the Ruler or Government of that State shall be construed as a reference to the Rajpramukh or, as the case may be, to the Government of Rajasthan. These words also indicate that whatever could be enforced under the laws in force in a State against the Ruler or the Government of the merging State could be enforced against the Rajpramukh or the Government of the new State. This further bears out the conclusion that the new State recognised the rights of the subjects of the old States flowing from the old laws and was prepared to undertake the liability that may lie on it in consequence thereof. We therefore agree with the Full Bench that the liability lay upon the State of Rajasthan because there was recognition of the liability even on the principles enunciate in the Dalmia Dadri Cement Company's case(1). In this view of the matter we need not express any view on the question whether the expression "Government of the corresponding Indian State" used in Art 295(2) would mean only the United State of Rajasthan as it was on January 26, 1950 or would also include all the former States which came to be merged in the United State of Rajasthan as it was on January 26, 1950.

It only remains now to, refer to another decision of this Court in Maharaja Shree Umaid Mill Limited v. Union of India (2). In that case there was an agreement between the Ruler of the former State of Jodhpur and the Maharaja Shree Umaid Mills Limited by which certain exemptions from income-tax and excise duty were granted to the Mills. Two questions arose for decision there. The first was whether excise could be levied on the cloth manufactured and the second was whether income-tax could be levied on the income of the Mills, in view of the agreement between the Mills and the former Ruler of Jodhpur. The first question that was raised in that case was whether the agreement was a law; and this Court held that

(1) [1959] S.C.R. 729.

(2) A.I.R. 1963 S.C. 953.

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the agreement was not a law. With that aspect of the matter we are not concerned in the present appeals. The next question that arose was whether the agreement had been recognized by the new sovereign and reliance was placed on the continuance of laws and Art. VI of the Covenant in that connection, and it was urged that in view of Art. 295 of the Constitution the exemption as provided in the agreement continued. In that case, however, there was one vital difference; even though the old laws were continued for the time being by Rajasthan Ordinance No. 1 of 1949 the new State passed the Rajasthan Excise Duties Ordinance 1949 some time after. That Ordinance clearly applied to the Mills and there was no doubt as to the State's competence to enact it. In view of that law, the exemption in the agreement was held not to have been affirmed by the new State of Rajasthan. The facts of that case are thus different from the facts in the present case, for there was a competent law which clearly negatived the recognition of such an agreement and which clearly provided for excise duties. So far as income-tax was concerned it was imposed as from April 1, 1950 after

the Constitution had come into force. Here again we find a law which was competently passed by Parliament and which did not transgress any of the constitutional limitations. Such a law therefore must prevail and in the presence of such a law there can be no question of recognition by the Union of the right to exemption, if any, under the agreement with the Ruler of the former Jodhpur State. Therefore, with respect to both the claims raised in that case there was a law which clearly applied to the Mills and it was held that there was no recognition by the new sovereign. In the present case we have only the continuance of the old laws and the valuable evidence afforded by Art. VI of the Covenant and there is nothing to show that the right to claim refund was taken away by any law competently passed. In this view of the matter we are of opinion that the appellant can derive no assistance from the case of Maharaja Shree Umaid Mills(1). The appeals therefore fail and are hereby dismissed. Respondent in Appeal No. 887 will get his costs from the appellant.

Appeals dismissed.

(1)A.I.R. 1963 S.C. 953.