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Partnership Continuity Upheld: Supreme Court Rejects IOCL’s Arbitrary Interpretation of Dealership Terms

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PUBLISHED 18 July 2025

Introduction

The recent Supreme Court judgment in Indian Oil Corporation Limited & Ors. v. M/s Shree Niwas Ramgopal & Ors[1]. is a landmark ruling that clarifies the interplay between statutory corporations' guidelines, the Indian Partnership Act, 1932 and the principles of natural justice. The case highlights the Supreme Court's strong stance against arbitrary and high-handed actions by state instrumentalities, particularly when they interfere with the legitimate continuation of established commercial enterprises. This judgment, upholding the mandamus issued by the Calcutta High Court, reinforces the supremacy of a well-drafted partnership deed and the need for public sector undertakings to act with fairness and commercial pragmatism.

Factual Background

The dispute originated from M/s Shree Niwas Ramgopal, initially a proprietorship firm, which was reconstituted as a partnership on November 24, 1989. This firm began with three partners: Kanhaiyalal Sonthalia (55% share), Ramesh Sonthalia (35% share), and Gobinda Sonthalia (10% share). The partnership acted as a kerosene oil distributor for Indian Oil Corporation Limited (IOCL) under a dealership agreement from May 11, 1990.

A crucial clause in this dealership agreement stipulated that in the event of a partner's death, the dealer (the firm) must immediately inform IOCL and provide details of the heirs. IOCL then had three options: (i) to continue the dealership with the existing firm; (ii) to enter into a fresh agreement with the reconstituted firm; or (iii) to terminate the dealership agreement. The decision of IOCL in this regard was to be final and binding.

The critical turning point occurred on November 29, 2009, when Kanhaiyalal Sonthalia, the partner with a 55% share, passed away, leaving behind a number of heirs, including his two sons who were already partners. Following his death, internal disputes arose among his heirs regarding the deceased's share in the partnership. The surviving partners informed IOCL and sought time to formalize the reconstitution of the firm, emphasizing their intent to continue the business. They even furnished an indemnity bond to assure IOCL of their commitment.

Despite the firm's efforts to reconstitute and admit one of the deceased partner's heirs (Bijoy Sonthalia) in line with the partnership deed, IOCL took a rigid stance. Citing its 2008 Guidelines, particularly Clause 1.5, "provides that in case of death of a partner(s), the partnership shall be reconstituted with the legal heir(s) of the deceased partner(s) and the surviving partner(s)." Since all the heirs of deceased Kanhaiyalal Sonthalia have not applied or joined as partners to the reconstituted partnership firm, the IOCL is not bound to continue business with the existing partnership or to recognise the alleged reconstituted partnership, so as to continue the supply of kerosene or else it would stop kerosene supplies. This rigid interpretation led IOCL to interrupt the supplies of kerosene, despite the firm's long-standing, complaint-free business relationship and the existence of a partnership deed explicitly stating that the death of a partner would not dissolve the firm if there were more than two partners and the business could be continued by the survivors.

Aggrieved by IOCL's cessation of supplies, M/s Shree Niwas Ramgopal approached the Calcutta High Court, which issued a mandamus[2] directing IOCL to maintain kerosene supplies until the firm was reconstituted or the dealership agreement was properly terminated. Aggrieved by the decision of the High Court, IOCL appealed against it, no grievance was raised by any of the legal heirs. However, this decision was subsequently upheld by a Division Bench of the High Court. Dissatisfied, IOCL filed a Special Leave Petition before the Supreme Court.

Legal and Judicial Reasoning

The Supreme Court delivered a strong rebuke to IOCL's actions, finding them to be arbitrary, high-handed, and devoid of fairness. The Court's reasoning was primarily based on:

1. Interpretation of Section 42 of the Indian Partnership Act, 1932: The Court clarified the settled legal position under Section 42, which states that a partnership is dissolved on the death of a partner unless the partnership deed provides otherwise. The Court emphatically stated that this principle of automatic dissolution primarily applies when there are only two partners. In cases with more than two partners, and crucially, where the partnership deed contains a clear stipulation for the firm's continuation despite a partner's death, Section 42 does not lead to automatic dissolution. In this case, Clause 18 of the partnership deed unequivocally stated that the death of a partner would not cause discontinuance of the business and that the surviving partners

could continue.

2. Multi-Partner Distinction: The Court affirmed that the principle of automatic dissolution upon a partner's death under Section 42(c) applies predominantly to firms with only two partners. As the firm initially had three partners and continued to have surviving partners, this specific limitation did not apply.

3. Supremacy of the Partnership Deed: The Court held that the partnership deed, being a commercial contract between the partners, must be given due weight. When it clearly provides for the continuity of the firm, a third party like IOCL, even a state instrumentality, cannot override its terms based on a hyper-technical interpretation of its own internal guidelines, especially when those guidelines are ambiguous or can be interpreted harmoniously with the Partnership Act.

4. Arbitrary Action by a State Instrumentality (Article 14): The Supreme Court criticized IOCL for acting in a "high-handed manner while exercising arbitrary powers with no sense of fairness in a matter of commercial interest." As a statutory corporation and a state instrumentality, IOCL is bound by the principles of Article 14 of the Constitution of India, which mandates fairness, reasonableness, and non-arbitrariness in all its actions. The Court found IOCL's insistence on all heirs joining the firm, despite internal family disputes and the partnership deed's provisions for continuity, to be an arbitrary and unreasonable interference with a running business.

5. "Doctrine of Flexible Reconstitution": While not explicitly termed, the judgment essentially laid down what could be called the "Doctrine of Flexible Reconstitution." It acknowledged that disputes among heirs are common and that business continuity should not be jeopardized by such internal matters, especially when the existing partners are willing to maintain operations and formalize reconstitution. The Court emphasized that IOCL should have adopted a commercially pragmatic approach rather than an inflexible, bureaucratic one.

6. Duty to Avoid Unnecessary Litigation: The Court also made a noteworthy observation that IOCL ought to "avoid such litigations by interfering with the continuance of any running business by taking a narrow approach." This reflects a broader judicial concern about public sector undertakings engaging in protracted and often unjust litigation, thereby burdening the courts and causing hardship to private entities.

7. Consistency with Precedent: The Court referred to previous judgments (e.g., M/s Wazid Ali Abid Ali vs. Commissioner of Income Tax, Lucknow[3], Sandersons & Morgans vs. ITO[4], Noor Mohammad and Co. vs. Commissioner of Income-Tax[5]) that supported the idea of firm continuity despite a partner's death if the deed provided for it, leading to a change in constitution rather than dissolution.

8. IOCL's Dealership Agreement: The Court noted that the dealership agreement itself allowed IOCL the option to continue with the existing firm, an option it had not terminated. Therefore, IOCL could not unilaterally stop supplies.

Outcome:

The immediate outcome of the Supreme Court's judgment is that M/s Shree Niwas Ramgopal can continue to receive kerosene supplies from IOCL, ensuring the continuity of its business. The order provides much-needed relief to the partnership firm, allowing it to navigate its internal family disputes regarding the deceased partner's share without the added burden of an arbitrary cessation of its core business supplies by a state entity.

For IOCL, the outcome is a judicial directive to re-evaluate its guidelines and their application, adopting a more flexible, fair, and commercially realistic approach in similar situations. It is also a warning against acting arbitrarily and engaging in prolonged litigation to defend unreasonable stances.

Conclusion:

The Supreme Court's decision in Indian Oil Corporation Limited & Ors. v. M/s Shree Niwas Ramgopal & Ors. is a significant judicial pronouncement with far-reaching implications for state instrumentalities, partnership firms, and commercial contracts.

Firstly, it solidifies the principle that statutory corporations, while acting under their guidelines, must do so justly, fairly, and reasonably, adhering to the constitutional mandate of Article 14. Their guidelines cannot be interpreted in a hyper-technical manner that overrides the clear provisions of a valid partnership deed or disrupts established business operations without cogent reason.

Secondly, the judgment reinforces the autonomy and validity of partnership deeds, particularly concerning clauses on continuity after a partner's demise. It clarifies that Section 42 of the Partnership Act, 1932, does not automatically dissolve a multi-partner

firm if the deed explicitly provides for its continuation. This offers crucial stability and predictability for partnership businesses, assuring them that well-defined internal agreements will be respected.

Finally, the ruling is a vital lesson in commercial pragmatism. It encourages state entities to adopt a more facilitative and less obstructive role, especially when faced with genuine internal challenges within their business partners. By dismissing IOCL's appeal and upholding the High Court's mandamus, the Supreme Court has unequivocally championed business continuity over bureaucratic rigidity, setting a strong precedent for future interactions between large corporations and their smaller commercial partners. This judgment ensures that the "ruthlessness of a party to a contract in the private law domain" is tempered by the expected fairness of a public body.

For more details, write to us at: contact@indialaw.in

1. SLP (Civil) No. 1381 of 2025 ??
2. W.P. No. 758 of 2010 ??
3. 1988 (Supp) SCC 193 ??
4. (1973) 87 ITR 270 ??
5. (1991) 191 ITR 550 ??

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