

SEMINAR ON

The Banning of unregulated Deposit Scheme Ordinance 2019

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At

**6 Lyons Range, 3rd Floor, Unit-2
Kolkata-700 001**

**Organized by
ACAE Chartered Accountants' Study Circle- EIRC**

The BANNING OF UNREGULATED DEPOSIT SCHEME ORDINANCE 2019- A SNAPSHOT

1. Ever since the said ordinance was promulgated on 13th February 2019, the social media in the form of WhatsApp and twitter was flooded with the messages about the difficulties which will be faced by the Businessman in complying with the ordinance. Even the newspaper came out with its own explanation. However, a fine print of the reading of the Ordinance will reveal the truth as to how this ordinance came to be notified.
2. The preamble of the ordinance reads as follows:--

an ordinance to provide for a comprehensive mechanism to ban the unregulated deposit schemes and to protect the interest of depositors and for matters connected therewith or incidental thereto.

3. In this regard, it is important to note that the Ordinance deals with two important terminology i.e.,
 - I) Regulated deposit schemes
 - II) Unregulated deposit schemes

At the outset, it may be noted that it is only the unregulated deposit scheme(UDS) that is covered within the ambit and scope of this ordinance and those deposits which are already regulated are not covered.

4. Also it is important to note that prior to notifying this ordinance , a standing committee of the Parliament under the chairmanship of Dr Veerappa Moily with members from Lok Sabha and Rajya Sabha submitted a report in the month of January 2019. The committee noted in its report in Para 1.2 that there have been violations by the companies as well as unincorporated bodies of the regulations already in place in the Reserve Bank of India Act, 1934. The committee recommended this Bill to deal with the menace of unregulated deposit which will enable a central legislation with a central Data Bank and central agency to deal with the defaults.
5. In this regard , the following three judgements are important:-
 - a) State of West Bengal & Ors Vs Swapan Kumar Guha & Ors (1982) 1 SCC 561(SC)
 - b) T Velayudhan Achari & another Vs Union of India and others (1993) 2 SCC 582(SC)
 - c) Bhavesh D Parish & Ors Vs Union of India and another (2000) 5 SCC 471(SC)

The case of Swapan Kumar Guha also known as Sanchita case which laid the roadmap for the enactment of Section 45-S by the Banking Laws(Amendment) Act, 1983 in the RBI Act 1934, dealt with the meaning of the term “scheme” as follows:-

A scheme according to the dictionary meaning of that word, is a carefully arranged and systematic programme of action, a systematic plan for attaining some object , a project , a system of corelated things. The systematic programme has to be a consensual arrangement between two or more persons under which , the subscriber

agrees to advance or lend money on promise of being paid more money on the happening of any event or contingency relative or applicable to the enrolment of members into the programme. Reciprocally the person who promotes or conducts the programme promises , on receipt of an advance or loan, to pay more money on the happening of such event or contingency.

6. A glance at the definition of Unregulated deposit scheme (UDS) is defined in Section 2(17) as follows:-

Unregulated deposit scheme(UDS) means a scheme or an arrangement under which deposits are accepted or solicited by any deposit taker by way of business and which is not a regulated deposit scheme, as specified under Column (3) of the First Schedule.

Also Section 3 of the ordinance says that on and from the date of commencement of this ordinance, the unregulated deposit scheme shall be banned and no deposit taker shall directly or indirectly promote, operate, issue any advertisement soliciting participating or enrolment in or accept deposits in pursuance of an unregulated deposit scheme.

7. This what is banned as per the Ordinance is only UDS and nothing else. It is also to be noted that even before this Ordinance came into being, there were regulated deposit scheme as specified in the First Schedule of this ordinance and they are not covered by this ordinance. Also there are regulations in place in the Reserve Bank of India Act, 1934 in this regard.
8. In a nutshell , unless the deposit which is accepted is in pursuance to a scheme or arrangement by way of business, the same is not banned. There are several specific cases which have been given or specified as being not covered within the definition of deposit but they are not limited.

THANK YOU

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(1982) 1 Supreme Court Cases 561 : 1982 Supreme Court Cases (Cri) 283

(BEFORE Y.V. CHANDRACHUD, C.J. AND A. VARADARAJAN AND AMARENDRA NATH SEN, JJ.)

Civil Appeal No. 1129 of 1981[±]

STATE OF WEST BENGAL AND OTHERS . . Appellants;

Versus

SWAPAN KUMAR GUHA AND OTHERS . . Respondents.

And

Civil Appeal No. 1130 of 1981[±]

STATE OF WEST BENGAL AND OTHERS . . Appellants;

Versus

SANCHAITA INVESTMENTS AND OTHERS . . Respondents.

Civil Appeals Nos. 1129 and 1130 of 1981, decided on February 2, 1982

Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (43 of 1978) — Section 2(c) — Ingredients of — Transaction of accepting money deposits from public, investing them in high-risk investments earning huge unaccounted profits and paying to the depositors interest at a rate much higher than the agreed rate in a clandestine manner, held, does not fall within the definition of “money circulation scheme” and hence does not constitute an offence under Section 3 read with Section 4 — But on facts and in the circumstances of the case, the cash, documents and other materials seized as a result of searches and seizures made under Section 7 ordered to be retained by police for two months to enable the concerned authorities to institute an enquiry into the affairs of the firm

Criminal Procedure Code, 1973 — Section 157 — Police investigation under, can be commenced only if FIR prima facie discloses commission of a cognizable offence — Where such offence is not disclosed, held, court is justified in interfering with the investigation and quashing the same — Constitution of India, Articles 226 and 136

Words and Phrases — “Scheme” — Meaning of

Sanchaita Investments is a registered partnership firm consisting of three partners and a share capital of Rs 7000. The firm started its business in 1975 as financiers and investors and in its business it had been accepting loans or deposits from the general public, for different periods repayable with interest at the rate of 12 per cent per annum. The Commercial Tax Officer filed an FIR against the firm and its partners alleging that the firm had been offering 48 per cent and later 36 per cent interest which showed that “money circulation scheme” was being promoted and conducted for the making of quick and easy money, that prizes or gifts in cash were also being awarded to agents, promoters and members of the firm, and that the partners



of the firm thus had been carrying on business in violation of Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. It was alleged that the excess amount of interest was being paid in cash in a clandestine manner to the depositors, was not being accounted for and resulted in accumulation of black money, the firm used to invest the monies received from the depositors in high-risk investments earning huge amount of unaccounted profits, the investments made by the firm and the earnings from the investments also resulted in generation of black money, and because of the allurements of high rate of interest offered to the depositors, a major part of which was given in unaccounted black money, the firm with a meagre share capital received deposits over crores of rupees within a very short span of time.

Consequently, the office of the firm and also the houses of the partners were searched and

various documents and papers as also a large amount of cash were seized. The firm and its two partners then filed a writ petition in the High Court challenging the validity of the FIR and the proceedings arising out of the same including the validity of the searches and seizures. The Single Judge of the High Court held in the circumstances of the case that the Act did not apply to the firm and that the searches and seizures were also illegal and hence quashed the proceedings and directed return of all documents and refund of cash monies seized, to the petitioners. Dismissing the appeals by the State the Supreme Court

Held :

Per Chandrachud, C.J. (Varadarajan, J. concurring)

(1) The definition of the expression "money circulation scheme" contained in Section 2(c) of the Act does not comprehend within its scope any and every activity "for the making of quick or easy money". Two conditions must be satisfied before a person can be held guilty of an offence under Section 4 read with Sections 3 and 2(c) of the Act. In the first place, it must be proved that he is promoting or conducting a scheme for the making of quick or easy money and secondly, the chance or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrolment of members into that scheme. In other words, there has to be a community of interest in the happening of such event or contingency.

(Paras 6 to 8)

A "scheme" is a carefully arranged and systematic programme of action. The systematic programme has to be a consensual arrangement between two or more persons under which, the subscriber agrees to advance or lend money on promise of being paid more money on the happening of any event or contingency relative or applicable to the enrolment of members into the programme. Reciprocally, the person who promotes or conducts the programme promises, on receipt of an advance or loan, to pay more money on the happening of such event or contingency. Therefore, a transaction under which one party deposits with the other or lends to that other a sum of money on promise of being paid interest at a rate higher than the agreed rate of interest cannot, without more, be a "money circulation scheme" within the meaning of Section 2(c) of the Act, howsoever high the promised rate of interest may be in comparison with the agreed rate. He who conducts or promotes a money-spinning project may have manifold resources from which to pay fanciful interest by luring the unwary customer. But, unless the project envisages a mutual arrangement under which, the happening or



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non-happening of an event or contingency relative or applicable to the enrolment of members into that arrangement is of the essence, there can be no "money circulation scheme" within the meaning of Section 2(c) of the Act.

(Para 8)

(2) The police do not have an unfettered discretion to commence investigation under Section 157 of the Code. Their right of enquiry is conditioned by the existence of reason to suspect the commission of a cognizable offence and they cannot, reasonably, have reason so to suspect unless the FIR, prima facie, discloses the commission of such offence. If that condition is satisfied, the investigation must go on and the rule in Khwaja Nazir Ahmad case will apply. The court has then no power to stop the investigation. On the other hand, if the FIR does not disclose the commission of a cognizable offence, the court would be justified in quashing the investigation on the basis of the information as laid or received.

(Para 21)

King-Emperor v. Khwaja Nazir Ahmad, (1944) 71 IA 203 : AIR 1945 PC 18 : 217 IC 1, explained

R.P.Kapur v. State of Punjab, (1960) 3 SCR 388 : AIR 1960 SC 866 : 1960 Cri LJ 1239;

S.N. Sharma v. Bipen Kumar Tiwari, (1970) 1 SCC 653 : 1970 SCC (Cri) 258 : (1970) 3 SCR 946 : AIR 1970 SC 786 and *Prabhu Dayal Deorah v. D.M. Kamrup*, (1974) 1 SCC 103 : 1974 SCC (Cri) 18, relied on

State of W.B. v. S.N. Basak, (1963) 2 SCR 52 : AIR 1963 SC 447 : (1963) 1 Cri LJ 341 and *Jehan Singh v. Delhi Admn.*, (1974) 4 SCC 522 : 1974 SCC (Cri) 558 : (1974) 3 SCR 794 : 1974 Cri LJ

802, distinguished

In the present case the FIR does not allege, directly or indirectly, that the firm was promoting or conducting a scheme for the making of quick or easy money, dependent on any event or contingency relative or applicable to the enrolment of members into the scheme; nor does it contain any allegation whatsoever that persons who advanced or deposited their monies with the firm were participants of a scheme for the making of quick or easy money, dependent upon any such event or contingency. Since the FIR did not allege or disclose that the essential requirements of Section 2(c) read with Sections 4 and 3 of the Act are prima facie satisfied, it cannot be said in the absence of any allegation whatsoever in that behalf, that there is "reason to suspect" the commission of that offence within the meaning of Section 157 of the Code of Criminal Procedure, so as to justify the investigation undertaken by the State authorities.

(Paras 10 and 13)

Therefore, the investigation which has been commenced upon the FIR is without jurisdiction and must, therefore, be quashed. However, in the circumstances of the case the documents, books, papers and cash seized so far during the investigation shall be retained by the police in their custody for a period of two months so as to give an opportunity to the State Government and the RBI to see if it is possible, under the law, to institute an enquiry into the affairs of the firm and in the meanwhile, to regulate its affairs. The seized materials will be returned, on the expiry of that period, to persons from whom they were seized, subject to any lawful directions which may be given or obtained in the meanwhile regarding their custody and return.

(Paras 23 and 38)

Per A.N. Sen, J. (concurring)

(1) To be a money circulation scheme, a scheme must be for the making of quick or easy money on any event or contingency relative or applicable to the enrolment of the members into the scheme. The scheme has necessarily to be judged as a whole, both from the viewpoint of the promoters and also of the members.

(Para 78)



Various individuals may invest their monies in their business which may yield very high profits or may indulge in speculative business in expectation of high return of their money. If such transactions are made openly and not in violation of any law, then the investments cannot be said to have been made for making quick or easy money and such transactions can never come within the scheme for making easy or quick money, as enumerated in the Act. The position will not be any different, judged from the point of view of the depositors, even if a part of the transaction is not above-board and is secretive or clandestine in nature. Such transaction cannot be considered to be a scheme for making of quick or easy money, though it may offend revenue laws or any other law. Transactions in black money do not come within the mischief of the Act. Further, this return on investment by way of interest is not dependent on any event or contingency whatsoever and has nothing to do with any event or contingency relative or applicable to the enrolment of any new members, even if the depositors be assumed to be members.

(Para 78)

Judged from the point of view of the firm, there is nothing to indicate that the firm makes any investment in consultation with its depositors. The materials only indicate that the firm indulges in high-risk investments and also advances monies to political parties. Neither of these acts appears to be illegal and they do not go to show that the firm makes easy or quick money. The clandestine manner of payment of interest in excess of the stipulated rate does not, in any way, indicate the existence of any scheme for making quick or easy money. In any event the materials do not indicate that the payment of interest by the firm in excess of the stipulated rate is in any way dependent on any event or contingency. There is nothing to indicate any scheme for the receipt of the money by the firm from its depositors as a consideration for promise to pay the interest in excess of the stipulated rate and also to pay back principal amount on the expiry of the term dependent in any way on any event or contingency relative or applicable to the enrolment of new depositors, considering

the depositors to be members. Therefore, none of the requirements of a money circulation scheme is satisfied in the instant case.

(Para 79)

Srinivasa Enterprises v. Union of India, (1980) 4 SCC 507 : (1981) 51 Com Cas 464, referred to

(2) Whether an offence into which an investigation is made or to be made is disclosed or not must necessarily depend on the facts and circumstances of each particular case and in considering that question the court has mainly to take into consideration the complaint or FIR. On a consideration of all the relevant materials, the court has to come to the conclusion whether an offence is disclosed or not. If on such consideration, the court is satisfied that an offence is disclosed, the court will normally not interfere with the investigation into the offence and will generally allow the investigation into the offence to be completed for collecting materials for proving the offence. If, on the other hand, the court is satisfied that no offence is disclosed, it will be the duty of the court to interfere with any investigation and to stop the same to prevent any kind of uncalled for and unnecessary harassment to an individual.

(Para 66)

As on facts and in the circumstances of the present case no offence under the Act is at all disclosed, it will be manifestly unjust to allow the process of Criminal Code to be issued or continued against the firm and to allow any investigation which will be clearly without any authority.

(Para 82)



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The proceedings against the firm and its partners arising out of the FIR must be quashed as the FIR and the other materials do not disclose any offence under the Act and as such no investigation into the affairs of the firm under the Act can be permitted or allowed to be continued.

(Para 84)

State of W.B. v. S.N. Basak, (1963) 2 SCR 52 : AIR 1963 SC 447 : (1963) 1 Cri LJ 341 and *State of Bihar v. J.A.C. Saldanha*, (1980) 1 SCC 554 : 1980 SCC (Cri) 272 : (1980) 2 SCR 16 : 1980 Cri LJ 98, distinguished

S.N. Sharma v. Bipen Kumar Tiwari, (1970) 1 SCC 653 : 1970 SCC (Cri) 258 : (1970) 3 SCR 946; *King-Emperor v. Kwaja Nazir Ahmad*, (1944) 71 IA 203 : AIR 1945 PC 18 : 217 IC 1; *R.P. Kapur v. State of Punjab*, (1960) 3 SCR 388 : AIR 1960 SC 866 : 1960 Cri LJ 1239; *Jehan Singh v. Delhi Admn.*, (1974) 4 SCC 522 : 1974 SCC (Cri) 558 : (1974) 3 SCR 794 : 1974 Cri LJ 802 and *Re Wier, Ex parte Wier*, (1871) 6 Ch App 875 : 25 LT 369 : 19 WR 1042, referred to

Interpretation of Statutes — Internal aids — Commas — Use of — Construction solely with the aid of commas not always safe — Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (43 of 1978), Section 2(c)

Held :

Per Chandrachud, C.J.

How far a clause which follows upon a comma governs every clause that precedes the comma is a matter not free from doubt. Though in the statutory clause under interpretation here, commas have been placed both as a matter of convenience and of meaningfulness, yet, a more thoughtful use of commas and other gadgets of punctuation would have helped make the meaning of the clause clear beyond controversy. Grammar and punctuation are hapless victims of the pace of life and in this case it would not be proper to go merely by the commas used in the clause in question. It would instead be more safe and satisfactory to discover the true meaning of the clause by having regard to the substance of the matter as it emerges from the object and purpose of the Act, the context in which the expression is used and the consequences necessarily following upon the acceptance of any particular interpretation of the provision, the contravention of which is visited by penal consequences.

(Para 5)

Interpretation of Statutes — Penal statutes — Rule of strict construction in favour of the

subject restated — Rule subject to the primary rule of literal interpretation

Held :

Per Chandrachud, C.J.

Where a statute creates an offence and imposes a penalty of fine and imprisonment, the language of a statute should be so construed that no case shall be held to fall within it which does not come within the reasonable interpretation of the statute and in case of doubt, the construction favourable to the subject should be preferred. The court must see that the thing charged is an offence within the plain meaning of the words used and it must not strain the words. But this rule of strict interpretation of penal statutes in no way affects the fundamental principle of interpretation, that the primary test which can safely be applied is the language used in the Act and, therefore, when the words are clear and plain, the court must accept the expressed intention of the legislature.

(Para 15)

W.H. King v. Republic of India, 1952 SCR 418 : AIR 1952 SC 156 : 1952 Cri LJ 836 and



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M.V. Joshi v. M.U. Shimpi, (1961) 3 SCR 986 : AIR 1961 SC 1494 : (1961) 2 Cri LJ 696, *relied on*

R-M/5760/CR

Advocates who appeared in this case :

Somnath Chatterjee (CA No. 1129 of 1981) and M.K. Ramamurthi (CA No. 1130 of 1981), Senior Advocates (S.C. Birla, Advocate, with them), for the Appellants;

A.K. Sen (for Respondent 1 in CA No. 1130 of 1981) and S.S. Ray (for Respondent 2 in CA No. 1130 of 1981), Senior Advocates [Kapil Sibal (for Respondent 1 in CA No. 1129 of 1981), B. Gupta & T.K. Bose (for Respondent 1 in CA No. 1130 of 1981) and Rathin Das, Advocates, with them];

S.S. Ray, Senior Advocate (for Respondent 6) and (Tarun Kumar Bose, D. Mandal, Ms Bina Gupta and O.P. Khaitan, Advocates, with him, for Respondents 5 and 6) in both the appeals;

K.L. Hathi and Mrs H. Wahi, Advocates, for the Intervener — Mrs Sarla Sahedad Puri.

The Judgments* of the Court were delivered by

CHANDRACHUD, C.J. (*concurring*)— My learned Brother A.N. Sen has dealt fully with the various points argued before us. I agree respectfully with his judgment, but desire to add a few words in view of the importance which this matter has acquired by reason of the immense circulation of “black money” clearly and almost concededly involved in the affairs of the firm which is facing a prosecution.

2. These appeals by special leave arise out of the judgment dated March 5, 1981 of a learned Single Judge of the Calcutta High Court in Matters Nos. 2829 of 1980 and 37 of 1981. The appeals are, in substance, by the State of West Bengal while the contesting respondents are a firm called “Sanchaita Investments” and its three partners, Swapan Kumar Guha, Shambhu Prasad Mukherjee and Bihari Lal Murarka. The two matters in the Calcutta High Court were in the nature of writ petitions under Article 226 of the Constitution which were filed by the firm and its partners for quashing an investigation commenced against the firm. Allowing the writ petitions, the High Court issued a writ of mandamus directing the State Government and its concerned officers to “forthwith recall, cancel and withdraw the first information report . . . and all proceedings taken on the basis thereof”, since the searches, seizures and arrests made in pursuance of the said FIR are, according to the High Court, illegal and without jurisdiction. It has directed that the books, documents and moneys seized during the search be returned to the firm and its partners, including a sum of Rs

52,11,930.

3. The short question for consideration in these appeals by special leave is whether the FIR lodged by the Commercial Tax Officer, Bureau of Investigation, against the firm and its partners discloses an offence under Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act 43 of 1978. The Act, which was passed by the Parliament, came into force on December 13, 1978 and the two years' period allowed by Section 12 for winding up every kind of business relating to Prize Chits and Money



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Circulation Schemes expired on December 12, 1980. The FIR, which was lodged the next day on December 13, reads thus:

"To December 13, 1980
The Deputy Superintendent of Police
Bureau of Investigation
10, Madan Street
Calcutta-72
Sir,

On a secret information that 'Sanchaita Investments' of 5-6, Fancy Lane, Calcutta, is carrying on business of promoting and/or conducting prize chit and/or money circulation scheme enrolling members of such chit and/ or scheme, participating in those, and/or receiving and remitting monies in pursuance of such chits and/or scheme in violation of the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. Enquiry was held secretly to verify correctness or otherwise of the aforesaid secret information. Enquiry reveals that the said 'Sanchaita Investments' is a partnership firm, partners being Shri Bihari Lal Murarka, Shri Shambhu Prasad Mukherjee and Shri Swapan Kumar Guha and that it was floated in or around 1975. Enquiry further reveals that the said firm had been offering fabulous interest at the rate of 48 per cent per annum to its members until very recently. The rate of interest has of late been reduced to 36 per cent per annum. Such high rates of interest were and are being paid even though the loan certificate receipts show the rate of interest to be 12 per cent only. Thus, the amount in excess of 12 per cent so said clearly shows that the 'money circulation scheme' is being promoted and conducted for the making of quick and/or easy money. Prizes and/or gifts in cash were and are also awarded to agents, promoters and members too.

In view of the above, Sarvashri Bihari Lal Murarka, Shambhu Prasad Mukherjee and Swapan Kumar Guha appear to have been carrying on business in the trade name of 'Sanchaita Investments' in prize chits and money circulation scheme in violation of Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and are therefore, punishable under Section 4 of the said Act. Necessary action may, therefore, be kindly taken against the aforesaid offenders along with other accomplices as provided in the law.

Yours faithfully,

sd/-

Commercial Tax Officer,
Bureau of Investigation"

4. Section 4 of the Act provides that whoever contravenes the provisions of Section 3 shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to five thousand rupees, or with both, provided that in the absence of special and adequate reasons to the contrary to be mentioned in the judgment of the court, the imprisonment shall not be less than one year and the fine shall not be less than one thousand rupees. Though the FIR is riddled with the "and/or" clauses more



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appropriate in deeds of conveyancing, it is clear from its tenor and is common ground that the gravamen of the accusation against the accused is that they are conducting a "money circulation scheme". The reference in the FIR to "prize chits" reflects but a common human failing to err on the safe side and the notorious effort of draftsmen to embrace as much as possible so that no argument may be shut out for want of pleading.

5. Since the sole question for consideration arising out of the FIR, as laid, is whether the accused are conducting a money circulation scheme, it is necessary to understand what is comprehended within the statutory meaning of that expression. Section 2(c) of the Act provides:

" 2. (c) 'money circulation scheme' means any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions;"

Grammar and punctuation are hapless victims of the pace of life and I prefer in this case not to go merely by the commas used in clause (c) because, though they seem to me to have been placed both as a matter of convenience and of meaningfulness, yet, a more thoughtful use of commas and other gadgets of punctuation would have helped make the meaning of the clause clear beyond controversy. Besides, how far a clause which follows upon a comma governs every clause that precedes the comma is a matter not free from doubt. I therefore consider it more safe and satisfactory to discover the true meaning of clause (c) by having regard to the substance of the matter as it emerges from the object and purpose of the Act, the context in which the expression is used and the consequences necessarily following upon the acceptance of any particular interpretation of the provision, the contravention of which is visited by penal consequences.

6. Commas or no commas, and howsoever thoughtfully one may place them if they are to be there, I find it impossible to take clause (c) to mean that any and every activity "for the making of quick or easy money" is comprehended within its scope. For the matter of that, I cannot believe any law to ban every kind of activity for making quick or easy money, without more, on pain of penal consequences. It is far too vague and arbitrary to prescribe that "whosoever makes quick or easy money shall be liable to be punished with fine or imprisonment". For then, in the absence of any demarcation of legitimate money-making activities from those which fall within the ban, the question whether the penal provision is attracted in a given case will depend upon the will and temper, sweet or sour, of the magistracy. Besides, speaking of law and morals, it does not seem morally just or proper to say that no person shall make quick or easy money, especially quick. A person who makes quick money may do so

legitimately by the use of his wits and wisdom and no moral turpitude may attach to it. One need



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not travel afar to find speaking examples of this. Indeed, there are honourable men (and now women) in all professions recognised traditionally as noble, who make quite quick money by the use of their talents, acumen and experience acquired over the years by dint of hard work and industry. A lawyer who charges a thousand rupees for a special leave petition lasting five minutes (that is as far as a Judge's imagination can go), a doctor who charges a couple of thousands for an operation of tonsillitis lasting ten minutes, an engineer, an architect, a chartered accountant and other professionals who charge likewise, cannot by any stretch of imagination be brought into the dragnet of clause (c). Similarly, there are many other vocations and business activities in which, of late, people have been notoriously making quick money as, for example, the builders and real estate brokers. I cannot accept that the provisions of clause (c) are directed against any of these categories of persons. I do not suggest that law is powerless to reach easy or quick money and if it wills to reach it, it can find a way to do it. But the point of the matter is that it will verge upon the ludicrous to say that the weapon devised by law to ban the making of quick or easy money is the provision contained in Section 2(c) of the Prize Chits and Money Circulation Schemes (Banning) Act.

7. In order to give meaning and content to the definition of the expression "money circulation scheme" which is contained in Section 2(c) of the Act, one has, therefore, to look perforce to the adjectival clause which qualifies the words "for the making of quick or easy money". What is within the mischief of the Act is not "any scheme, by whatever name called, for the making of quick or easy money" simpliciter, but a scheme for the making of quick or easy money, "on any event or contingency relative or applicable to the enrolment of members into the scheme", (whether or not such money or thing is derived from the entrance money of the members of such scheme or their periodical subscriptions). Two conditions must, therefore, be satisfied before a person can be held guilty of an offence under Section 4 read with Sections 3 and 2(c) of the Act. In the first place, it must be proved that he is promoting or conducting a scheme for the making of quick or easy money *and* secondly, the chance or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrolment of members into that scheme. The legislative draftsman could have thoughtfully foreseen and avoided all reasonable controversy over the meaning of the expression "money circulation scheme" by shaping its definition in this form:

- " 'money circulation scheme' means any scheme, by whatever name called,
- (i) for the making of quick or easy money, or
 - (ii) for the receipt of any money or valuable thing as the consideration for a promise to pay money,
- on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions;"



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I have reshaped the definition, in order to bring out its meaning clearly, without adding or deleting a single word or comma from the original text of Section 2(c). The substance of the matter is really not in doubt: only the form of the definition is likely to create some doubt as to the meaning of the expression which is defined and, therefore, I have made a formal modification in the definition without doing violence to its language and indeed, without even so much as altering a comma.

8. There is another aspect of the matter which needs to be underscored, with a view to avoiding fruitless litigation in future. Besides the prize chits, what the Act aims at banning is money circulation *schemes*. It is manifestly necessary and indeed, to say so is to state the obvious, that the activity charged as falling within the mischief of the Act must be shown to be a part of a *scheme* for making quick or easy money, dependent upon the happening or non-happening of any event or contingency relative or applicable to the enrolment of members into that scheme. A "scheme", according to the dictionary meaning of that word, is "a carefully arranged and systematic program of action", a "systematic plan for attaining some object", "a project", "a system of correlated things" (see *Webster's New World Dictionary*, and *Shorter Oxford English Dictionary*, Vol. II). The systematic programme of action has to be a consensual arrangement between two or more persons under which, the subscriber agrees to advance or lend money on promise of being paid more money on the happening of any event or contingency relative or applicable to the enrolment of members into the programme. Reciprocally, the person who promotes or conducts the programme promises, on receipt of an advance or loan, to pay more money on the happening of such event or contingency. Therefore, a transaction under which, one party deposits with the other or lends to that other a sum of money on promise of being paid interest at a rate higher than the agreed rate of interest cannot, without more, be a "money circulation scheme" within the meaning of Section 2(c) of the Act, howsoever high the promised rate of interest may be in comparison with the agreed rate. What that section requires is that such reciprocal promises, express or implied, must depend for their performance on the happening of an event or contingency relative or applicable to the enrolment of members into the scheme. In other words, there has to be a community of interest in the happening of such event or contingency. That explains why Section 3 makes it an offence to "participate" in the scheme or to remit any money "in pursuance of such scheme". He who conducts or promotes a money-spinning project may have manifold resources from which to pay fanciful interest by luring the unwary customer. But, unless the project envisages a mutual arrangement under which, the happening or non-happening of an event or contingency relative or applicable to the enrolment of members into that arrangement is of the essence, there can be no "money circulation scheme" within the meaning of Section 2(c) of the Act.

9. Numerous persons lend their hard-earned monies in the hope of



earning high returns. It is notorious that, eventually, quite a few of them lose both the principal and the interest, for no project can succeed against the basic laws of economics. Sharp and wily promoters pay A's money to B and B's to C in order to finance interest at incredible rates; and eventually, when a high-risk investment made by them at the cost of the credulous lenders fails, the entire arrangement founders on the rock of foolish optimism. The promoters, of course, have easy recourse to gadgets of the law of insolvency. It is difficult to hold that the lender, himself a victim of the machinations of the crafty promoter, is intended by the Act to be arraigned as an

accused. I do not think that any civilised law can intend to add insult to injury.

10. The question as to whether the first information report prima facie discloses an offence under Section 4 read with Section 3 of the Act has to be decided in the light of these requirements of Section 2(c) of the Act. I have already reproduced in extenso the FIR lodged by the Commercial Tax Officer, Bureau of Investigation. Analysing it carefully, and even liberally, it makes the following allegations against the firm "Sanchaita Investments" and its three partners:

(1) The firm had been offering fabulous interest at the rate of 48 per cent per annum to its members, which rate of interest was later reduced to 36 per cent per annum;

(2) Such high rate of interest was being paid even though the loan certificate receipts show that interest was liable to be paid at the rate of 12 per cent per annum only; and

(3) The fact that interest was paid in excess of 12 per cent shows clearly that a "money circulation scheme" was being promoted and conducted for the making of quick or easy money.

It seems to me impossible to hold on the basis of these allegations that any offence can be said to be made out prima facie under Section 3 of the Act. In the first place, the FIR does not allege, directly or indirectly, that the firm was promoting or conducting a scheme for the making of quick or easy money, *dependent on any event or contingency relative or applicable to the enrolment of members into the scheme*. Secondly, the FIR does not contain any allegation whatsoever that persons who advanced or deposited their monies with the firm were participants of a scheme for the making of quick or easy money, *dependent upon any such event or contingency*. The FIR bears on its face the stamp of hurry and want of care. It seems to assume, what was argued before us by Shri Somnath Chatterjee on behalf of the prosecution, that it is enough for the purposes of Section 2(c) to show that the accused is promoting or conducting a scheme for the making of quick or easy money, an assumption which I have shown to be fallacious. An essential ingredient of Section 2(c) is that the scheme for making quick or easy money must be dependent on any event or contingency relative or applicable to the enrolment of members into the scheme. A first information report which does not allege or disclose that the essential requirements of the penal provision are prima facie satisfied,



cannot form the foundation or constitute the starting point of a lawful investigation.

11. In answer to the writ petitions filed by the accused in the Calcutta High Court, affidavits were filed on behalf of the prosecuting agency, which do not improve matters in any way. The affidavit filed by Arun Kanti Roy, Deputy Secretary, Finance Department, Government of West Bengal, alleges that:

(i) The actual payment of a very high rate of interest against the professed rate of 12 per cent attracted huge amounts of idle money into circulation;

(ii) The investment of money as collected is not under the regulatory control of the Reserve Bank of India or any other agency of the State dealing with credit control in relation to the country's economy;

(iii) The pooling of the purchasing power and the financial resources and the unfettered deployment thereof have resulted in the concentration of tremendous economic power in the hands of a few, posing a potential threat to the equilibrium

of the country's economy;

(iv) The entire process is speculative in nature and directed towards luring away the investing public to the speculative market for making quick and easy money;

(v) The very basis of the so-called contractual arrangement between the firm and its depositors is founded on the fraudulent device to assure to the people a high rate of interest, the major portion of which is paid through unaccounted for money, thereby encouraging the growth of such unaccounted money in the hands of the investing public;

(vi) The professed rate of interest is a mere subterfuge to provide a cloak of bona fides and legality to the underhand transactions, through which unaccounted for money comes into play in the market, generating further unaccounted for money, a part whereof goes back to the depositors in the form of the balance of interest over 12 per cent paid in cash, month by month;

(vii) The firm did not have enough income or resources so as to be able to pay interest at such high rates;

(viii) The irresistible conclusion, therefore, is that interest was being paid out of the capital itself;

(ix) "The depositor becomes a member of the investment scheme of the firm by subscribing to it and the payment of the quick and easy money by way of high rate of interest is dependent upon the period of investment and/or efflux of time which are very much relative and/or applicable to the membership of the



depositors of the scheme to which the depositor agrees to subscribe"; and

(x) In the process of its working, the scheme of the firm generates quick and easy money so as to render such scheme or arrangement a "money circulation scheme" within the meaning of the Act.

12. The Assistant Commissioner of Police Shri Sunil Kumar Chakravorty has adopted these pleas and statements in his own affidavit.

13. It is clear from these averments that even at the stage when the State of West Bengal and its concerned officers submitted detailed affidavits to the High Court, there was no clear basis for alleging and no material was disclosed to show that, prima facie, the firm was promoting or conducting a scheme for making quick or easy money which was dependent upon an event or contingency relative or applicable to the enrolment of members into that scheme. The burden of the State's song is that the scheme conducted by the accused generates black money and will paralyse the economy of the country. These are serious matters indeed and it is unquestionable that a private party cannot be permitted to issue bearer bonds by the back door. The fact that the accused are indulging in an economic activity which is highly detrimental to national interests is a matter which must engage the prompt and serious attention of the State and Central Governments. But the narrow question for our consideration is whether on the basis of the allegations made against the accused, there is reason to suspect that they are guilty of an offence under Section 4 read with Sections 3 and 2(c) of the Act. The allegation which we have reproduced in clause (ix) above from the affidavit of Arun Kanti Roy is the nearest that can be considered relevant for the purposes of Section 2 (c) of the Act. But even that allegation does not meet the requirement of that section since, what it says is that "the payment of quick and easy money by way of high rate of interest is dependent upon the period of investment and/or efflux of time which are very much relative and/or applicable to the membership of the depositors of the

scheme to which the depositor agrees to subscribe". This is too tenuous to show that the scheme is dependent upon an event or contingency of the description mentioned in Section 2(c), apart from the fact that the only participation which is alleged as against the depositors is that they become members of the "investment scheme" by subscribing to it. There is no allegation even in any of the affidavits filed on behalf of the State of West Bengal and its concerned officers that the depositors and the promoters are animated by a community of interest in the matter of the scheme being dependent upon any event or contingency relative or applicable to the enrolment of members into it. That being an essential ingredient of the offence charged, it cannot be said in the absence of any allegation whatsoever in that behalf, that there is "reason to suspect" the commission of that offence within the meaning of Section 157 of the Code of Criminal Procedure, so as to justify the investigation undertaken by the State authorities.



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14. My learned Brother, A.N. Sen, J., has considered exhaustively the various authorities cited at the Bar by both the sides on the question as to the power of the courts to quash an investigation. I fully concur with his careful analysis of those authorities and would content myself with a broad indication of the trend of law bearing on the subject.

15. Shri Ashok Sen and Shri Siddhartha Shankar Ray pressed upon us with considerable insistence the principle reiterated in *W.H. King v. Republic of India*¹ that a statute which creates an offence and imposes a penalty of fine and imprisonment must be construed strictly in favour of the subject. The principle that no person can be put in peril of his life and liberty on an ambiguity is well established. But, as observed in *M.V. Joshi v. M.U. Shimpi*² when it is said that penal statutes must be construed strictly, what is meant is that the court must see that the thing charged is an offence within the plain meaning of the words used and it must not strain the words: "To put it in other words, the rule of strict construction requires that the language of a statute should be so construed that no case shall be held to fall within it which does not come within the reasonable interpretation of the statute", and that in case of doubt, the construction favourable to the subject should be preferred. But I do not think that this rule of strict interpretation of penal statutes in any way affects the fundamental principle of interpretation, that the primary test which can safely be applied is the language used in the Act and, therefore, when the words are clear and plain, the court must accept the expressed intention of the legislature. It is unnecessary to pursue this matter any further in view of the fact that the language of Section 2(c) is, in my opinion, clear and admits of no doubt or difficulty.

16. In *R.P. Kapur v. State of Punjab*³ the question which arose for consideration was whether a first information report can be quashed under Section 561-A of the Code of Criminal Procedure, 1898. The Court held on the facts before it that no case for quashing the proceedings was made out but Gajendragadkar, J., speaking for the Court observed that though ordinarily, criminal proceedings instituted against an accused must be tried under the provisions of the Code, there are some categories of cases where the inherent jurisdiction of the Court can and should be exercised for quashing the proceedings. One such category, according to the Court, consists of cases where the allegations in the FIR or the complaint, even if they are taken at their face value and accepted in their entirety, do not constitute the offence alleged; in such

cases, no question of appreciating evidence arises and it is a matter merely of looking at the FIR or the complaint in order to decide whether the offence alleged is disclosed or not. In such cases, said the Court, it would be legitimate for the High Court to hold that it would be manifestly unjust to allow the process of the criminal court to be issued against the accused.



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17. In *S.N. Sharma v. Bipen Kumar Tiwari*⁴ a first information report was lodged naming an Additional District Magistrate (Judicial) as the principal accused. His application under Section 159 of the Criminal Procedure Code asking that the Judicial Magistrate should himself conduct a preliminary enquiry was dismissed, but the Court observed that though the Code of Criminal Procedure gives to the police unfettered power to investigate all cases where they suspect that a cognizable offence has been committed, in appropriate cases, an aggrieved person can always seek a remedy by invoking the power of the High Court under Article 226 of the Constitution and that the High Court could issue a writ of mandamus restraining the police from misusing their legal powers.

18. Shri Somnath Chatterjee has placed great reliance on the decision of this Court in *State of W.B. v. S.N. Basak*⁵ in which it was held that the statutory powers given to the police under Sections 154 and 156 of the Code of Criminal Procedure to investigate into the circumstances of an alleged cognizable offence without authority from a Magistrate cannot be interfered with by the exercise of powers under Section 439 or under the inherent powers conferred by Section 561-A of the old Code. It must be remembered that no question arose in that case as to whether, the allegations contained in the FIR disclosed any offence at all. The contention of the accused in that case was that the statutory power of investigation given to the police under Chapter XIV of the Code is not available in respect of an offence triable under the West Bengal Criminal Law Amendment (Special Courts) Act, 1949 and that being so, the investigation undertaken by the police was without jurisdiction. That contention was negated and, therefore, the application filed by the accused under Sections 439 and 561-A of the old Code was dismissed.

19. In *Jehan Singh v. Delhi Administration*⁶ the application filed by the accused under Section 561-A of the Code for quashing the investigation was dismissed as being premature and incompetent, but that was because the Court found (per Sarkaria, J., SCR p. 797 : SCC p. 526) that prima facie, the allegation in the FIR, if taken as correct, disclosed the commission of a cognizable offence by the accused.

20. The only other decision to which I need refer is that of the Privy Council in *King -Emperor v. Khwaja Nazir Ahmad*⁷ which constitutes, as it were, the charter of the prosecution all over, for saying that no investigation can ever be quashed. In a passage oft-quoted but much misunderstood. Lord Porter, delivering the opinion of the Judicial Committee, observed: (IA pp. 212-13)

"In Their Lordships' opinion, however, the more serious aspect of the



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case is to be found in the resultant interference by the court with the duties of the

police. Just as it is essential that every one accused of a crime should have free access to a court of justice so that he may be duly acquitted if found not guilty of the offence with which he is charged, so it is of the utmost importance that the judiciary should not interfere with the police in matters which are within their province and into which the law imposes on them the duty of inquiry. In India, as has been shown, there is a statutory right on the part of the police to investigate the circumstances of an alleged cognizable crime without requiring any authority from the judicial authorities, and it would, as Their Lordships think, be an unfortunate result if it should be held possible to interfere with those statutory rights by an exercise of the inherent jurisdiction of the court. The functions of the judiciary and the police are complementary, not overlapping, and the combination of individual liberty with a due observance of law and order is only to be obtained by leaving each to exercise its own function, always, of course, subject to the right of the court to intervene in an appropriate case when moved under Section 491 of the Criminal Procedure Code to give directions in the nature of habeas corpus. In such a case as the present, however, the court's functions begin when a charge is preferred before it, and not until then."

I do not think that this decision supports the wide proposition canvassed before us by Shri Somnath Chatterjee. In the case before the Privy Council, similar charges which were levelled against the accused in an earlier prosecution were dismissed. The High Court quashed the investigation into fresh charges after examining the previous record, on the basis of which it came to the conclusion that the evidence against the accused was unacceptable. The question before the Privy Council was not whether the fresh FIR disclosed any offence at all. In fact, immediately after the passage which I have extracted above, the Privy Council qualified its statement by saying:

"No doubt, if no cognizable offence is disclosed, and still more, if no offence of any kind is disclosed, the police would have no authority to undertake an investigation."

If anything, therefore, the judgment shows that an investigation can be quashed if no cognizable offence is disclosed by the FIR. It shall also have been noticed, which is sometimes overlooked, that the Privy Council took care to qualify its statement of the law by saying that the judiciary should not interfere with the police *in matters which are within their province*. It is surely not within the province of the police to investigate into a report which does not disclose the commission of a cognizable offence and the Code does not impose upon them the duty of enquiry in such cases.

21. The position which emerges from these decisions and the other decisions which are discussed by brother A.N. Sen is that the condition precedent to the commencement of investigation under Section 157 of the Code is that the FIR must disclose, *prima facie*, that a cognizable offence has been committed. It is wrong to suppose that the police have an unfettered discretion to commence investigation under Section 157 of the Code. Their right of enquiry is conditioned by the existence of reason to suspect the commission of a cognizable offence and they cannot, reasonably, have reason so to suspect



unless the FIR, *prima facie*, discloses the commission of such offence. If that condition is satisfied, the investigation must go on and the rule in *Khwaja Nazir Ahmad*² will apply. The court has then no power to stop the investigation, for to do so would be to trench upon the lawful power of the police to investigate into cognizable offences. On the other hand, if the FIR does not disclose the commission of a cognizable offence,

the court would be justified in quashing the investigation on the basis of the information as laid or received.

22. There is no such thing like unfettered discretion in the realm of powers defined by statutes and indeed, unlimited discretion in that sphere can become a ruthless destroyer of personal freedom. The power to investigate into cognizable offences must, therefore, be exercised strictly on the condition on which it is granted by the Code. I may, in this behalf, usefully draw attention to the warning uttered by Mathew, J. in his majority judgment in *Prabhu Dayal Deorah v. D.M., Kamrup*⁸ to the following effect: (SCC p. 114, para 21)

"We say, and we think it is necessary to repeat, that the gravity of the evil to the community resulting from anti-social activities can never furnish an adequate reason for invading the personal liberty of a citizen, except in accordance with the procedure established by the Constitution and the laws. The history of personal liberty is largely the history of insistence on observance of procedure. And observance of procedure has been the bastion against wanton assaults on personal liberty over the years. Under our Constitution, the only guarantee of personal liberty for a person is that he shall not be deprived of it except in accordance with the procedure established by law."

23. For these reasons, which, frankly, are no different from those given by my learned Brother A.N. Sen, I am of the opinion that the investigation which has been commenced upon the First Information Report is without jurisdiction and must, therefore, be quashed. I do accordingly and direct that no further investigation shall take place in pursuance or on the basis of the FIR dated December 13, 1980 lodged by the Commercial Tax Officer, Bureau of Investigation, with the Deputy Superintendent of Police, Bureau of Investigation, Madan Street, Calcutta.

24. I am free to confess that it is with considerable regret that I have come to the conclusion that the investigation must be quashed. If the State authorities had applied their mind carefully to the requirements of Section 2(c) of the Act, this appeal might have had a different story to tell, the bare outlines of which I must now proceed to narrate.

25. The firm "Sanchaita Investments" commenced its business on July 1, 1975, its three partners contributing a total capital of Rs 7000 (Rupees seven thousand). On December 25, 1978 an advertisement appeared in the *Hindu* in the name of the firm, claiming falsely that its business was



"approved by the Reserve Bank of India". Since the representation was likely to mislead the public, the Reserve Bank advised the firm in May 1979 to issue a suitable corrigendum, which the firm did.

26. On July 6, 1979, Shri Rudolph L. Rodrigues, a Member of the Lok Sabha, wrote a confidential letter to Shri Charan Singh, the then Deputy Prime Minister, complaining that the business of the firm was "a cover-up for a parallel banking system for black money". A copy of Shri Rodrigues' letter was forwarded by the Director, Department of Economic Affairs, Ministry of Finance, to the Chief Officer, Department of Non-Banking Companies, Reserve Bank of India, Calcutta, for enquiry. By his letter dated August 7, 1979 the Chief Officer pointed out the difficulty in directing investigation into the affairs of the firm since, its capital being less than Rs 1 lakh, it did not come within the definition of a Non-Banking institution as provided in Section 54(c) of the Reserve

Bank of India Act, 1934. On September 13, 1980 the Deputy Secretary, Finance Department, Government of West Bengal, wrote a letter to the Chief Officer requesting him to examine the question whether the business of the firm came within the purview of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and if not, under which Act the affairs of the firm could be regulated. On October 1, 1980, Shri Ashok Mitra, Finance Minister for the State of West Bengal, wrote a letter to Shri Venkataraman, Finance Minister to the Government of India, complaining that the firm was involved in high-risk investments and that large amounts of public moneys were kept in deposit with the firm, which were not subjected to any regulatory control. The letter of Shri Ashok Mitra appears to have been handed over informally to Dr K.S. Krishnaswamy, Deputy Governor of the Reserve Bank, who, by his reply dated October 22, 1980, informed Shri Mitra that the Legal Department of the Reserve Bank was of the opinion that the mere acceptance of loans by the firm would not ordinarily be covered by the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. There was further correspondence on the subject between the authorities of the Government of India and the State Government, but nothing came out of it.

27. The Act came into force on December 13, 1978 and immediately on the expiry of the two years' period of grace allowed by it, the FIR was lodged against the firm on December 13, 1980. On that day, the office of the firm at 5-6, Fancy Lane, Calcutta, was searched by the police, during the course of which a sum of Rs 42,16,530 (Rupees forty-two lakhs sixteen thousand five hundred and thirty) was recovered. The amount was tied in separate bundles of notes of different denominations. Several books of accounts were also seized during the search.

28. On the same date, a search was carried out at the residence of Shambhu Prasad Mukherjee, a partner of the firm, when the following articles were seized:

(1) One passbook of Syndicate Bank, Gariahat Branch, Calcutta, in



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the name of "Apcar Ave Toon", 9, Royd Street, Calcutta-17. (The account was in a fictitious name and the passbook shows that a sum of Rs 28 crores was lying in credit in that account.)

(2) A sum of Rs 9,95,000 (Rupees nine lakhs and ninety-five thousand) tied in separate bundles of notes of the denomination of Rs 100 and 50.

(3) A country-made six-chamber revolver, with one bullet inside.

29. From the house of another partner, Bihari Lal Murarka, certain account books were seized.

30. During the course of investigation until January 8, 1981 when it was stopped by an order of this Court, as many as 80 places were searched by the police and a large number of documents were seized. It is apparent from these documents that the firm was paying to its depositors interest at the rate of 48 per cent up to September 1979 and 36 per cent thereafter for a short period. The interest was paid to each depositor every month by the agents who called on each depositor personally for that purpose. The interest in excess of 12 per cent was invariably paid in cash. The oncoming elections to legislative bodies in 1980 appear to have led to reduction in the rate of interest, since the firm's circulating capital was needed by "political parties". Which parties, I do not know, but this much is fairly certain from the facts which have emerged before us that the funds available to the firm were diverted frequently for the use of political parties.

31. Certain lists of agents were seized during the investigation which show that

code numbers were assigned to at least 84 of them. The agents have acquired large properties at various places, consisting of lands, apartments, cars etc. Some of the agents have started new business activities.

32. A staggering revelation which came to light as a result of the searches at the office of the firm is that, as of September 1, 1980, the firm was holding deposits to the tune of Rs 73,51,23,500 (Rupees seventy-three crores fifty-one lakhs twenty-three thousand and five hundred). These deposits were received by the firm from persons drawn from all parts of the country, the pride of place belonging to Calcutta, Bombay, Delhi, Madras and Hyderabad. Remittances also appear to have been received by the firm from overseas clients. A compilation prepared by the State authorities in pursuance of an interim order passed by this Court shows that the total amount of deposits made by persons who had deposited a sum of Rs 10,000 or less each comes to Rs 11,49,40,950 (Rupees eleven crores forty-nine lakhs forty thousand nine hundred and fifty).

33. The documents relating to the account in the fictitious name of "Apcar Ave Toon" show that a person alleged to bear that name was introduced to the Syndicate Bank, Gariahat Branch, Calcutta, by the firm's partner Shambhu Prasad Mukherjee. The passbook relating to the account



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(Current Account No. 210) shows that the account was opened with a cash deposit of Rs 28 lakhs. A total sum of rupees twenty-seven crores ninety-seven lakhs eighty-six thousand and odd was deposited in that account until December 6, 1980, all deposits being in cash. Such cash deposits varied often between 50 and 80 lakhs at a time. The amount of nearly Rs 28 crores was withdrawn from the account steadily from November 11, 1980. The account was closed on December 6, 1980, that is, a week before the FIR was lodged on December 13, 1980. Some of the entries in the passbook do not tally with the Bank's ledger.

34. A study of Current Account No. S-502 in the name of the firm with the United Bank of India, High Court Branch, Calcutta, shows that the firm had invested several lakhs of rupees in various concerns numbering about forty. Lakhs of rupees have been transferred by the firm to various concerns.

35. Documents seized from the office premises of the firm show that the partners and their family members are insured with the LIC in heavy amounts. They have acquired large properties, particularly in Bombay.

36. Several offices and concerns in Bombay were searched by the police and interesting discoveries were made. Their magnitude and variety are too large for the scope of this judgment. I will close this narrative by saying that the income tax returns of Shambhu Prasad Mukherjee reveal that he had shown a sum of Rs 8,00,000 as prizes received from Delhi Lotteries in 1979 and that the firm has not filed any income tax return after the financial year ending June 30, 1977. It had asked for an extension of time on the ground that its accounts were not finalised but the Department rejected that prayer on December 9, 1980. What further indulgence they have managed cleverly to secure is not yet known.

37. These facts disclose a bizarre state of affairs. A token capital of Rs 7000 has begotten a wealth of crores of rupees within a span of five years. A Bank account opened by the firm in a fictitious name had a sum of Rs 28 crores in it, which was withdrawn within a week before the lodging of the FIR Interest was being paid to depositors at the incredible rate of 48 per cent per annum. The firm had no ostensible

source of income from which such exorbitant amounts could be paid and its account books, such as were seized from its head office, give no clue to its income or its assets. The partners of the firm have become millionaires overnight. Clerks and Chemists that they and some of their agents were in 1975, today they own properties which will put a prince to shame. "Rags to riches" is how one may justly describe this story of quick and easy enrichment. There is no question that this vast wealth has been acquired by the firm by generating and circulating black money. Indeed, rightly did Shri Ashok Sen appearing for the firm, ask us to be free to proceed on the assumption that the exorbitant amount of interest was being paid from out of unaccounted money.



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38. In these circumstances, though I see no alternative save to stop all further investigation on the basis of the FIR as laid, no offence being disclosed by it under Section 4 of the Act, I am unable to accept the contention of Shri Ashok Sen that all documents, books, papers and cash seized so far during the investigation should be returned to the firm and its partners forthwith. The firm appears to be on the brink of an economic crisis, as any scheme of this nature is eventually bound to be. Considering the manner in which the firm has manipulated its accounts and its affairs, I have no doubt that it will secret the large funds and destroy the incriminating documents if they are returned to it. The State Government, the Central Government and the Reserve Bank of India must be given a reasonable opportunity to see if it is possible, under the law, to institute an enquiry into the affairs of the firm and, in the meanwhile, to regulate its affairs. I consider such a step essential in the interests of countless small depositors who, otherwise, will be ruined by being deprived of their life's savings. The big black money bosses will take any loss within their stride but the small man must receive the protection of the State, which must see to it that the small depositors are paid back their deposits with the agreed interest as quickly as possible. I therefore direct that the documents, books, papers, cash and other articles seized during the investigation shall be *retained* by the police in their custody for a period of two months from today and will be returned, on the expiry of that period, to persons from whom they were seized, subject to any lawful directions which may be given or obtained in the meanwhile regarding their custody and return.

39. With this modification, I agree respectfully with brother A.N. Sen that the appeals be dismissed.

VARADARAJAN, J. (*concurring*)— I agree with the judgment and the final order proposed by the learned Chief Justice.

A.N. SEN, J.— This appeal by special leave has been filed by the State of West Bengal and three officers of the State against an order passed by a learned Single Judge of the Calcutta High Court. The facts material for the purpose of this appeal have been fully set out in the judgment of the learned Single Judge of the Calcutta High Court. The facts material for the purpose of this appeal may, however, be briefly indicated:

42. Sanchaita Investments is a partnership firm duly registered under the Indian Partnership Act. Sanchaita Investments (hereinafter referred to as "the firm") has its principal place of business at 5-6, Fancy Lane, Calcutta. Shambhu Prasad Mukherjee, Bihari Lal Murarka and Swapan Kumar Guha are the three partners of the firm. The capital of the partnership firm is Rs 7000. The firm carries on the business as

financiers and investors and in its business the firm accepts loans or deposits from the general public, for different periods repayable with interest at the rate of



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12 per cent per annum. Under the terms of deposits, the depositors have a right to withdraw their deposits with the firm at any time before the expiry of the fixed period of the deposit. In case of premature withdrawal, the depositors however loses interest of one per cent and is paid interest at the rate of 11 per cent per annum. Under the terms and conditions of the deposits, the firm has also the liberty to repay the amount with interest to any depositor at any time before the expiry of the stipulated period of the deposit and in the event of such repayment by the firm, the firm is not required under the terms and conditions of the deposit or loan, to give any reason. It appears that the firm has been carrying on its business on a very extensive scale.

43. In the year 1978, Parliament passed an Act called the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (hereinafter referred to as "the Act").

44. On December 13, 1980, the Commercial Tax Officer, Bureau of Investigation, lodged a complaint of violation of the Act by the firm with the police. The FIR has been set out in full in the judgment of the learned trial Judge and the same reads as follows:

"To December 13, 1980

The Deputy Superintendent of Police

Bureau of Investigation

10, Madan Street

Calcutta-72

Sir,

On a secret information that 'Sanchaita Investments' of 5-6, Fancy Lane, Calcutta, is carrying on business of promoting and/or conducting prize chit and/or money circulation scheme enrolling members of such chit and/or scheme, participating in these, and/or receiving and remitting monies in pursuance of such chits and/or scheme in violation of the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. Enquiry was held secretly to verify correctness or otherwise of the aforesaid secret information. Enquiry reveals that the said 'Sanchaita Investments' is a partnership firm, partners being Shri Bihari Lal Murarka, Shri Shambhu Prasad Mukherjee and Shri Swapan Kumar Guha and that it was floated in or around 1975. Enquiry further reveals that the said firm had been offering fabulous interest at the rate of 48 per cent per annum to its members until very recently. The rate of interest has of late been reduced to 36 per cent per annum. Such high rates of interest were and are being paid even though the loan certificate receipts show the rate of interest to be 12 per cent only. Thus, the amount in excess of 12 per cent so paid clearly shows that the 'Money Circulation Scheme' is being promoted and conducted for the making of quick and/or easy money, prizes and/or gifts in cash were and are also awarded to agents, promoters and members too.

In view of the above, Sarvashri Bihari Lal Murarka, Shambhu Prasad Mukherjee and Swapan Kumar Guha appear to have been carrying



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on business in the trade name of 'Sanchaita Investments' in prize chits and money circulation scheme in violation of Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and are therefore, punishable under Section 4 of the said Act. Necessary action may, therefore, be kindly taken against the aforesaid offenders along with other accomplices as provided in the law.

Yours faithfully,

sd/- Illegible

13-12-1980

Commercial Tax Officer,

Bureau of Investigation"

45. On December 13, 1980 two of the partners of the firm were arrested. The office of the firm and also the houses of the partners were searched. Various documents and papers were seized and a large amount of cash was also seized from the office and also from the residence of one of the partners. Two partners who were arrested were, however, thereafter enlarged on bail.

46. The firm and its two partners, namely, Shambhu Prasad Mukherjee and Bihari Lal Murarka filed this writ petition in the High Court challenging the validity of the FIR and the proceedings arising out of the same including the validity of the searches and seizure of documents, papers and cash. The respondents in the writ petition were six. The 1st respondent was the State of West Bengal, Respondent 2 was the Officer who had lodged the FIR, Respondent 3 was the Assistant Commissioner of Police and Superintendent of Police, Bureau of Investigation, and Respondent 4 was the Investigating Officer in the cases pending before the Chief Metropolitan Magistrate, Calcutta. Respondent 5 was the Reserve Bank of India and Respondent 6 was the Union of India.

47. In brief the case made by the firm and its partners in the writ petition is that the firm is a non-banking financial institution which carries on business of accepting deposits or loans from the general public on terms and conditions mentioned in the agreement of loan or deposit, pays interest to persons who invest or advance money to the firm in terms of the agreement between the parties and repays all amounts received from the parties with interest in terms of the agreement between the parties. The further case made by the writ petitioners in the writ petition is that the amounts which they receive from parties are reinvested by them and out of the investments made by the firm, the firm pays the interest to the depositors and also the principal amount deposited by them in terms of the agreement between the parties. In the writ petition, there is a denial of the allegations made in the FIR and the case is further made that even if the allegations made in the FIR are assumed to be correct, there cannot be any question of any violation of the Act and no offence under the Act is disclosed. It



is the positive case of the writ petitioners in the writ petition that the Act has no application to the firm. In the writ petition, the validity of the FIR and the proceeding arising therefrom is challenged mainly on the ground that the FIR does not disclose any offence under the Act which does not apply to the firm and there can be no

question of any violation of any provisions of the Act which has no application to the firm at all.

48. In answer to the averments made in the writ petition, an affidavit affirmed by Shri Arun Kanti Roy, was filed on behalf of Respondents 1 and 2, an affidavit affirmed by Shri Sunil Kumar Chakravorty on behalf of Respondents 3 and 4 was filed and an affidavit affirmed by Shri Rani Annaji Rao on behalf of the Reserve Bank of India was also filed. In the affidavit affirmed by Arun Kanti Roy, Deputy Secretary, Finance Department and Ex-Officio Director of Small Savings, Government of West Bengal, on behalf of Respondents 1 and 2, that is, the State of West Bengal and Shri B.K. Kundu, there is an assertion that the respondents come within the mischief of the Act and they have violated Section 3 of the Act. The relevant averments are contained in paras 6, 7, 8, and 9 of the said affidavit and it is necessary to set out the same in their entirety:

"6. With reference to paras 3 and 4 of the petition, I say that the petitioner firm accepts loans and/or deposits from all and sundry for varying periods without any authority of law. Although the professed rate of interest of such deposit is at the rate of 12 per cent per annum, the petitioner firm was actually paying interest at the rate of 48 per cent per annum, which was recently reduced to 36 per cent per annum. The actual payment of such high rate of interest against the professed rate of 12 per cent attracts huge amount of idle money into circulation and the investment of money as collected is not under the regulatory control of the Reserve Bank of India or any other agency of the State dealing with credit control in relation to the country's economy. The receipt of such money from the members of public at such high rate of interest is without any fetters as against the case of the receipt of money by banking companies as also non-banking companies which are regulated under different provisions of law, to which I will crave reference at the time of hearing, if necessary. The pooling of the purchasing power and/or the financial resources and the deployment thereof being unfettered has resulted in the concentration of tremendous economic power in the hands of a few posing a potential threat to the equilibrium of the country's economy. The terms of the deposit are unilaterally determined without any scrutiny by the Reserve Bank of India or with reference to the norms as to the credit control which the said Bank lays down and follows from time to time. The acceptances of such deposits from the members of public with unrestricted use of the moneys so collected are completely repugnant to the accepted modes of public savings and investment thereof for generation of goods and services contributing to the economic growth of the country. The entire process is speculative in nature and directed towards luring away the investing public to the speculative market for making quick and easy money. These are some of the activities which are sought to be banned by the banning provisions of the said Act, which has replaced similar regulatory measures contained in the several directions issued



by the Reserve Bank of India under the Reserve Bank of India Act, 1934 to the various financial institutions and non-banking companies. The present Act is applicable not only to such companies but also to individuals and firms All allegations contrary to and save as aforesaid are denied.

7. With reference to para 5 of the petition I call upon the petitioner to disclose full particulars of their deposit scheme, which if disclosed will go to show that the

terms and conditions are wholly arbitrary and contrary to the economic norms. The very basis of the so-called contractual arrangement between the petitioner firm and its depositors is founded on the fraudulent device to assure the people with a high rate of interest, the major portion of which is paid through unaccounted for money, thereby encouraging growth of such unaccounted for money in the hands of the investing public. The professed rate of interest is a mere subterfuge to provide a cloak of bona fide and legality over the underhand transactions through which unaccounted for money comes into play in the market generating further unaccounted for money; a part thereof goes back to the depositors in the form of the balance of interest over 12 per cent paid in cash month by month. All allegations contrary to and save as aforesaid are denied.

8. With reference to para 8 of the petition I say that the petitioners have been very much working on the above scheme to which the depositors have subscribed. Whether such deposits are one-time deposits and whether such deposits actually earn income in excess of the interest actually paid to the depositors are a matter of detailed investigation, which were in progress until the same was stopped by the order of the learned court of appeal passed on January 8, 1981. From whatever particulars are so far available to the answering respondents it can be stated that the firm did not have so much income as the quantum of interest that was being paid by it and the irresistible conclusion from such state of affairs is that payment of interest was being made out of capital itself. All allegations contrary to and save as aforesaid are denied.

9. With reference to para 7 of the petition I reiterate the statements made hereinbefore and deny all allegations contrary thereto. I specifically deny that no quick or easy money is accepted or received by the depositors or lenders or that payment of any such money is not contemplated or made by the firm as purported to be alleged. The depositor becomes a member of the investment scheme of the company by subscribing to it and the payment of the quick and easy money by way of high rate of interest is dependent upon the period of investment and/or efflux of time which are very much relative and/or applicable to the membership of the depositors of the scheme, to which the depositor agrees to subscribe. In the process of its working the scheme of the firm generates quick and easy money so as to render such scheme or arrangement as a money circulation scheme within the meaning of the said Act. All allegations contrary to and save as aforesaid are denied.

49. The following further averments contained in para 22 and in para 30 of the said affidavit may also be noted:

"22. ... I further say that payment of interest at the clandestine rate of 36 per cent or 48 per cent as against the aforesaid rate of 12 per



cent is in the context of the scheme promoted and conducted by the petitioners tantamount to activity which is banned under the banking provisions of the said Act.

30. ... No question of the depositors being ruined should arise if the petitioners had been running their business on sound economic line and had invested the fund collected from the depositors in safe and sound investment. The very fact that the petitioners are apprehensive of innumerable depositors being ruined goes to show that they engaged themselves and also the depositors in the speculative market and have rendered the investment insecure by reasons of the very nature of the

business i.e. money circulation scheme, transacted by them.”

In the affidavit affirmed by Shri Sunil Kumar Chakravorty, Assistant Commissioner of Police and Deputy Superintendent of Police, Bureau of Investigation, Government of West Bengal, Finance, Taxation Department and filed on behalf of Respondents 3 and 4, the deponent adopts the statements made in the affidavit of Arun Kanti Roy and the deponent denies that the searches and seizures were unlawful and illegal. The deponent further stated that as a result of the searches effected a mass of documents and a large amount of cash had been seized and the documents were being scrutinised.

50. In the affidavit affirmed by Shri Rani Annaji Rao, filed on behalf of Reserve Bank of India, the deponent has stated that the Reserve Bank of India which has no regulatory control over the firm has been unnecessarily made a party to the proceeding. It has been further stated in the said affidavit that as desired by the parties and the court, Reserve Bank of India was placing the materials which had come to the knowledge of Reserve Bank. In this affidavit reference has been made to certain correspondence between the State Finance Minister, Union Finance Minister and the Deputy Governor of Reserve Bank of India and also to various queries made and the enquiries made by Reserve Bank of India. It has been further stated that the view of the Legal Department of Reserve Bank on the basis of the enquiries made had been indicated to the Finance Minister of the State of West Bengal. In this connection it will be relevant to set out two letters which have been annexed to the said affidavit filed on behalf of the Reserve Bank of India and are Annexures D and E thereto. Annexure D is the copy of a letter addressed by Shri Ashok Mitra, State Finance Minister to the Union Minister for Finance and the said letter reads as follows:

Informally handed over to
DG(K) at Calcutta.
Ashok Mitra
D.O. No. I.M. 28-2-80 Calcutta, October 1, 1980
Dear Shri Venkataraman,

In the context of the action being taken by the Government of West Bengal under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, a question has arisen whether an organisation called “Sanchaita Investments” with the address at 5-6, Fancy Lane, Calcutta-1, come



within the purview of the above Act. A reference in the matter has been made by our authorised officer under the above Act to the Chief Officer, Department of Non-Banking Companies, Reserve Bank of India, Calcutta today. I am enclosing a copy of an advertisement published by the above organisation in the local newspapers as also a copy of a loan certificate receipt issued by the said organisation. I may mention that the authorised officer has issued notice under the above Act to a “Sanchaita Savings Scheme (P) Ltd.” which is to be distinguished from “sanchaita Investments”. It appears that the organisation called “Sanchaita Investments” is receiving large amount of monies from the public ostensibly as loans, and in lieu they are issuing loan certificates receipts. While we have no documentary evidence, the news is strongly circulating in the market that the organisation is in fact offering rates of interest as high as 30 to 40 per cent even though the loan certificate receipts indicate a rate of interest of 12 per cent only. There seems reasonable grounds for suspicion that this organisation is involved in extremely high-risk investments which only can enable them to pay such rates of interest. Since the security of monies deposited by the

public is involved, we would suggest that a thorough enquiry be conducted by the Government of India into the activities of this organisation particularly for finding out whether they are infringing provisions of any relevant status. It is felt necessary to conduct such an investigation on an urgent basis since large amounts of public monies are reported to be kept with this organisation, which does not seem as yet to have subjected to any regulatory control. We are meanwhile awaiting a reply to our reference (copy enclosed) to the Reserve Bank of India regarding the applicability of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 to this organisation.

With regards,

Yours Sincerely,

sd/-

(Ashok Mitra)

Shri R.V. Venkataraman
Union Minister for Finance
North Block
New Delhi-110 001

Annexure E is a letter by Shri K.S. Krishnaswamy, Deputy Governor of Reserve Bank to Dr Ashok Mitra, State Finance Minister. The said letter is also hereunder set out:
D.O. DNBC No. 2020/102(Gen)LO-80/81 October 22, 1980

Sanchaita Investments

My dear Ashok,

You might recall that during my recent visit to Calcutta, you had sent me a copy of your D.O. letter dated October 1, 1980 to Shri Venkataraman, Union Minister for Finance as also of a letter dated September 30, 1980 addressed to our Chief Officer, DNBC, Calcutta, in connection with the above firm. I have had the position examined by our Legal Department. According to them (vide extract of the note dated



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October 17, 1980, enclosed for your confidential information) the acceptance of loans simpliciter by the firm by issue of receipts (as per the specimen received by us from our Calcutta Office) without floating any scheme or arrangement would not ordinarily be covered by the definition of "Prize Chit" and hit by the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. However, you may also like to consult your Legal Adviser on the subject.

As you may know, there are a few writ petitions pending in the Calcutta High Court where the interpretation of Section 2(e) of the Banning Act is involved. In that context I have thought it advisable to write to you on a confidential basis, rather than send a separate official reply. I shall therefore be grateful if you could leave instructions with your staff to keep this matter and the views of our Legal Department strictly confidential.

With warm regards,

sd/-

(K.S. Krishnaswamy)

Dr Ashok Mitra, Minister of Finance

51. Further supplementary affidavits had also been filed. On consideration of the facts and circumstances of this case and the materials which were placed before the learned Judge, the learned Judge came to the conclusion that the Act did not apply to the firm and the learned Judge further held that the searches and seizures were also wrongful, illegal and improper; and in view of his finding the learned Judge quashed the proceedings and directed the return of all documents and the refund of cash monies seized, to the writ petitioners. It appears from the judgment of the learned Judge that the matter had been very fully argued before him and the learned Judge in an elaborate judgment had considered the arguments advanced before him and thereupon recorded his findings and passed the order allowing the said writ petition.

52. Against the judgment and order passed by the learned Judge, the State of West Bengal and its three officers have preferred this appeal with special leave granted by this Court. The writ petitioners, Reserve Bank of India and the Union of India have been made respondents in this appeal. It does not appear that Union of India has participated in the proceedings before the learned Judge and no affidavit on behalf of the Union of India appears to have been filed before the learned Judge.

53. Mr Somnath Chatterjee, learned counsel appearing on behalf of the appellants has attacked the judgment under appeal on the main ground that the learned Judge in this extraordinary jurisdiction should not have held that the Act has no application to the respondent firm and should not have on the basis of the said finding interfered with the investigation into the affairs of the firm. Mr Chatterjee contends that the question of applicability of the Act will only come for consideration after the investigation has been completed and all relevant materials have been gathered on such investigation. It is the contention of Mr Chatterjee that at the investigation stage,



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the court does not interfere and does not quash any proceedings before the investigation has been completed. In support of this contention, Mr Chatterjee has referred to a number of decisions of this Court. I shall consider the relevant decisions referred to by Mr Chatterjee at the appropriate time. Mr Chatterjee has submitted that after the investigation has been completed and all relevant materials have been gathered a charge under the Act may or may not be framed against the appellant firm for violation of the provisions of the Act. It is his submission that if the materials collected do not indicate any infringement of the Act, no charge against the firm will be preferred, and all the accused persons will be discharged; if, on the other hand, materials gathered disclose an offence under the Act, proper charge against the accused persons will be framed and it will be open to the accused persons to raise the plea in the course of the prosecution that no offence under the Act has been committed by them and the Act has no application to the transactions of the firm and to the firm.

54. In the case of *State of W.B. v. S.N. Basak*⁹ this Court held at SCR pp. 55-56 as follows:

“... The powers of investigation into cognizable offences are contained in Chapter XIV of the Code of Criminal Procedure. Section 154 which is in that Chapter deals with information in cognizable offences and Section 156 with investigation into such offences and under these sections the police has the statutory right to investigate

into the circumstances of any alleged cognizable offence without authority from a Magistrate and this statutory power of the police to investigate cannot be interfered with by the exercise of power under Section 561-A of Criminal Procedure Code. As to the powers of the judiciary in regard to statutory right of the police to investigate, the Privy Council in *King-Emperor v. Khwaja Nazir Ahmad*¹⁰ observed as follows:

The functions of the judiciary and the police are complementary, not overlapping, and the combination of individual liberty with a due observance of law and order is only to be obtained by leaving each to exercise its own function, always, of course, subject to the right of the court to intervene in an appropriate case when moved under Section 491 of the Criminal Procedure Code to give directions in the nature of habeas corpus. In such a case as the present, however, the court's functions begin when a charge is preferred before it, and not until then. It has sometimes been thought that Section 561-A has given increased powers to the court which it did not possess before that section was enacted. But this is not so, the section gives no new powers, it only provides that those which the court already inherently possesses shall be preserved and is inserted as their Lordships think, lest it should be considered that the only powers possessed by the court are those expressly conferred by the Criminal Procedure Code and that no inherent powers had survived the passing of that Act.



With this interpretation, which has been put on the statutory duties and powers of the police and of the powers of the court, we are in accord. The High Court was in error therefore in interfering with the powers of the police in investigating into the offence which was alleged in the information sent to the Officer-in-Charge of the police station."

55. In the case of *State of Bihar v. J.A.C. Saldanha*¹¹ this Court at SCR pp. 39-40 observed: (SCC p. 572, paras 24 and 25)

"The next contention is that the High Court was in error in exercising jurisdiction under Article 226 at a stage when the Additional Chief Judicial Magistrate who has jurisdiction to entertain and try the case has not passed upon the issues before him, by taking upon itself the appreciation of evidence involving facts about which there is an acrimonious dispute between the parties and giving a clean bill to the suspects against whom the first information report was filed. By so directing the learned Additional Chief Judicial Magistrate the judgment of the High Court virtually disposed of the case finally. As we are setting aside the judgment of the High Court with the result that the case would go back to the learned Additional Chief Judicial Magistrate, it would be imprudent for us to make any observation on facts involved in the case.

There is a clear-cut and well demarcated sphere of activity in the field of crime detection and crime punishment. Investigation of an offence is the field exclusively reserved for the executive through the police department the superintendence over which vests in the State Government. The executive which is charged with a duty to keep vigilance over law and order situation is obliged to prevent crime and if an offence is alleged to have been committed it is its bounden duty to investigate into the offence and bring the offender to book. Once it investigates and finds an offence

having been committed it is its duty to collect evidence for the purpose of proving the offence. Once that is completed and the investigating officer submits report to the Court requesting the Court to take cognizance of the offence under Section 190 of the Code its duty comes to an end. On a cognizance of the offence being taken by the Court the police function of investigation comes to an end subject to the provision contained in Section 173(8), there commences the adjudicatory function of the judiciary to determine whether an offence has been committed and if so, whether by the person or persons charged with the crime by the police in its report to the Court, and to award adequate punishment according to law for the offence proved to the satisfaction of the Court. There is thus a well defined and well demarcated function in the field of crime detection and its subsequent adjudication between the police and the Magistrate."

Same views have been reiterated by this Court in the other decisions which were cited by Mr Chatterjee. In the case of *S.N. Sharma v. Bipen Kumar Tiwari*¹² this Court at SCR p. 951 referred to the observations of the Privy Council in the case of *King-Emperor v. Khwaja Nazir Ahmad*¹³ which have been quoted in the judgment of this Court in the earlier decision and then proceed



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to hold at SCR pp. 951-52: (SCC pp. 657-58, para 11)

"Counsel appearing on behalf of the appellant urged that such an interpretation is likely to be very prejudicial particularly to officers of the judiciary who have to deal with cases brought up by the police and frequently give decisions which the police dislike. In such cases, the police may engineer a false report of a cognizable offence against the judicial officer and may then harass him by carrying on a prolonged investigation of the offence made out by the report. It appears to us that, though the Code of Criminal Procedure gives to the police unfettered power to investigate all cases where they suspect that a cognizable offence has been committed, in appropriate cases an aggrieved person can always seek a remedy by invoking the power of the High Court under Article 226 of the Constitution under which, if the High Court could be convinced that the power of investigation has been exercised by a police officer mala fide, the High Court can always issue a writ of mandamus restraining the police officer from misusing his legal powers."

56. Relying on these decisions and the principles enunciated therein, Mr Chatterjee has argued that the learned Judge clearly erred in interfering with the investigation and quashing the proceedings at the stage of investigation before framing of charges against the accused persons. Mr Chatterjee argues that there is no allegation of mala fide in the instant case and the learned Judge has also come to a conclusion that there is no case of any mala fide on the part of the appellants. Mr Chatterjee has submitted that the materials which have been gathered as a result of the investigation which could be carried on only for a short while go to indicate that the transactions of the firm are not above-board and they are not what they pretend or purport to be. It is his submission that materials gathered clearly indicate that though the loan certificates stipulate interest to be paid at the rate of 12 per cent a much larger sum by way of interest ranging between 36 per cent to 48 per cent is actually paid to the depositors, and the amount which is paid in excess of the rate stipulated in the loan certificates is paid in cash in a clandestine manner, depriving and defrauding revenue of its legitimate dues. Mr Chatterjee comments that the payment of interest in this clandestine manner at a very high rate which is not shown or otherwise accounted for

results not only in generation of black money, but paralyses the economy of the State. Mr Chatterjee has further commented that in view of this allurements to the depositors of payment of large sums of money in a clandestine manner, the firm which has a share capital of only Rs 7000 has succeeded in alluring depositors and the deposits received by the firm with the capital of Rs 7000 now exceed crores of rupees. Mr Chatterjee submits that a firm which carries on clandestine business of this nature is not entitled to invoke the extraordinary jurisdiction conferred on the court under Article 226 of the Constitution.

57. Mr Chatterjee has contended that the violation of Section 3 of the Act has been alleged and it is his contention that the nature of business carried on by the firm indicates that the firm is conducting a "Money Circulation Scheme". According to Mr Chatterjee, "Money Circulation Scheme" by



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virtue of its definition in Section 2(c) of the Act means any scheme, by whatever name called, for the making of quick or easy money. It is his argument that the transactions disclose that the firm and the depositors are both trying to make quick or easy money, the scheme being that the depositors will deposit money against certificate stipulating interest to be paid at the rate of 12 per cent but they will in fact be paid interest at a much higher rate and thereby make quick or easy money and the firm invests the money received from the depositors in such transactions as to enable them to earn easy or quick money. Mr Chatterjee has further argued that money circulation scheme has to be interpreted to mean any scheme for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscription. Further investigation according to Mr Chatterjee, can only show whether the scheme of making quick or easy money depends on any contingency relative in the enrolment of members into the scheme. Mr Chatterjee submits that the question of proper interpretation of the provisions of the Act and also of what money circulation scheme means, should come up only after investigation has been completed and all relevant materials have been collected. It is Mr Chatterjee's submission that the interpretation of the provisions of the Act and particularly what "Money Circulation Scheme" means, is not to be made in a hypothetical way in the absence of relevant materials being gathered on completion of investigation. Mr Chatterjee has argued that after all the materials have been collected on completion of the investigation, it may be that materials may show that the firm is not conducting a money circulation scheme and no charge against the firm may at all be preferred; if, however, on the other hand, the materials indicate that the firm is conducting a money circulation scheme and a charge is preferred, it will be open to the accused persons to take the defence that the business conducted by them is not one which will be considered to be a money circulation scheme within the meaning of the Act. As I have earlier observed, the main grievance of Mr Chatterjee is that the court should (*sic* not) have interfered at the stage of investigation and quashed the proceedings.

58. Mr Chatterjee has next contended that Section 7 of the Act, clearly empowers a police officer not below the rank of an officer-in-charge of a police station to enter, search and seize in the manner provided in the said section. It is Mr Chatterjee's contention that the searches have been carried out duly in terms of the provisions contained in the said section and cash money and other books and documents have

been lawfully seized in terms of the provisions contained in the said section. Mr Chatterjee has further submitted that even if there had been any irregularity in the matter of searches and seizure, the searches and seizure are not rendered illegal and void as a result thereof. Various decisions were also referred to by Mr Chatterjee in support of his submissions.



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59. Mr A.K. Sen, learned counsel appearing on behalf of the firm has submitted that the learned Judge on a proper consideration of all the relevant materials and the provisions of the Act has correctly come to the conclusion that no offence under the Act is disclosed and the Act has no application to the firm and in that view of the matter the learned Judge was perfectly justified in quashing the proceedings against the firm, and in directing the return of the documents and cash money seized by the police to the firm. Mr Sen has argued that investigation has to be done when an offence is disclosed for collecting materials for establishing an offence. It is the argument of Mr Sen that if no offence is disclosed there cannot be any investigation and any investigation when no offence is disclosed by the FIR and the other materials, means unnecessary harassment for the firm and its partners and illegal and improper deprivation of their liberty and property. Mr Sen submits that it is no doubt true that when an offence is disclosed, the court normally does not interfere with the investigation into an offence. He, however, contends that when no offence is disclosed, it, indeed, becomes the duty of the court to interfere with any investigation which is improperly and illegally carried out to the serious prejudice of the persons. In support of this contention Mr Sen has referred to the decision of the Judicial Committee in the case of *King-Emperor v. Khwaja Nazir Ahmad*² and has relied on the following observations at IA p. 213:

"No doubt, if no cognizable offence is disclosed, and still more, if no offence of any kind is disclosed, the police would have no authority to undertake an investigation, ..."

In this connection, Mr Sen also referred to the decision of this Court in the case of *R.P. Kapur v. State of Punjab*¹⁴ and has placed very strong reliance on the following observations at SCR page 393:

"Cases may also arise where the allegations in the first information report or the complaint, even if they are taken at their face value and accepted in their entirety, do not constitute the offence alleged; in such cases no question of appreciating evidence arises; it is a matter merely of looking at the complaint or the first information report to decide whether the offence alleged is disclosed or not. In such cases it would be legitimate for the High Court to hold that it would be manifestly unjust to allow the process of the criminal court to be issued against the accused person."

Mr Sen has also referred to the decision of this Court in *Jehan Singh v. Delhi Administration*¹⁵; in which the aforesaid observations made by Gajendragadkar, J. in the case of *R.P. Kapur v. State of Punjab*³, have been reproduced and reiterated. Mr Sen further points out that in the case of *S.N. Sharma v. Bipen Kumar Tiwari*⁴ this Court at SCR p. 951 (SCC pp. 657-58, para 11) recognises that

"in appropriate cases an aggrieved person can always seek a remedy by invoking the power of the High Court under Article 226 of the



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Constitution under which, if the High Court could be convinced that the power of investigation has been exercised by a police officer mala fide, the High Court can always issue a writ of mandamus restraining the police officer from misusing his legal powers.”

60. Mr Sen has argued that the learned Judge having properly appreciated the legal position has made the correct approach to the consideration of the present case. It is his argument that the learned Judge has carefully considered the materials which have been placed before him including the FIR and he has properly analysed the provisions of the Act and on a proper interpretation of the Act and on a proper appreciation of the materials which were there before the learned Judge, the learned Judge has come to the conclusion that no offence under the Act is disclosed and the Act has no application to the firm. Mr Sen argues that for a proper appreciation of the question whether the materials disclose any offence under the Act, it is imperative to interpret the Act. He contends that it will not be a proper approach to leave the question of interpretation to the stage after the investigation is complete, as according to Mr Sen, there can be no investigation unless an offence has been disclosed. Mr Sen argues that if the materials do not disclose any offence, no investigation can be permitted to find out whether as a result of the investigation an offence may be disclosed or not. Mr Sen submits that investigation can legitimately go on, once an offence is disclosed for collecting materials for establishing and proving the offence. It is the contention of Mr Sen that the case of the appellants is that the firm is conducting money circulation scheme which is banned by the Act. Mr Sen argues that to find out whether the firm is conducting a money circulation scheme, it is necessary to consider what a money circulation scheme is within the meaning of the Act and to find out whether on the materials alleged in the FIR and also in the affidavits, it can be said that the business carried on by the firm is one in the nature of conducting a money circulation scheme. Mr Sen has argued that the learned Judge in his judgment has correctly interpreted what constitutes “money circulation scheme” within the meaning of the Act, and it is the argument of Mr Sen that such interpretation is absolutely essential to find out whether the allegations made in the FIR make out a case that the firm is conducting a money circulation scheme. Mr Sen submits that the materials on record including the allegations made in the FIR, even if they are all assumed to be correct, do not go to show that the firm is conducting a money circulation scheme; and, in that view of the matter there can be no investigation, if no offence under the Act is disclosed. Analysing the FIR and the other materials which have been placed before the Court, Mr Sen submits that the materials go to indicate— (1) that the firm is accepting deposits or loans from the public for a term against loan certificates which stipulate payment of interest at the rate of 12 per cent; (2) though interest is stipulated to be paid at the rate of 12 per cent, the firm, in fact, is paying interest at a much higher rate. It used to pay interest at the rate of 48 per cent previously



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and is now paying interest at the rate of 36 per cent. The amount of interest paid in excess of the stipulated rate of 12 per cent is paid in cash in a clandestine manner to the depositors. The excess amount of interest paid is not accounted for and results in accumulation of black money; (3) the firm invests the monies received from the

depositors in high-risk investments earning huge amount of unaccounted profits. The investments made by the firm and the earnings from the investments made, also result in generation of black money; (4) because of the allurements of high rate of interest offered to the depositors, a major part of which is given in unaccounted black money, the firm which has a share capital of about Rs 7000 only has received deposits over crores of rupees.

61. It is the contention of Mr Sen that even if all these allegations which are there in the FIR and also in the other materials which have been placed before the Court are accepted to be correct, the said allegations do not go to show that the firm is conducting a money circulation scheme and do not disclose any offence under the Act. Mr Sen in this connection has commented that though in the FIR it has been alleged that the firm is carrying on business of promoting prize chits, no such case was sought to be made out before the learned Judge or before this Court and there are no allegations or materials to show that the firm is carrying on business of promoting prize chits; and the only case that has been sought to be made before the trial court and also this Court is that the firm is carrying on business of conducting or promoting money circulation scheme. Mr Sen has argued that the money circulation scheme has been defined in Section 2(c) of the Act to mean "any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions". According to Mr Sen, the essential requirements of a money circulation scheme are — (1) there must be a scheme for the making of quick or easy money on any event or contingency relative or applicable to the enrolment of members into the scheme whether or not such money is derived from the entrance money of the members of such scheme or periodical subscription; or (2) there must be a scheme for the receipt of any money or valuable thing as the consideration for promise to pay money on any event or contingency relative or applicable to the enrolment of members into a scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or from periodical subscription. Mr Sen submits that neither FIR nor any of the other materials go to show that the business carried on by the firm is, in any way, in the nature of conducting or promoting a money circulation scheme. In this connection Mr Sen has drawn our attention to the Statement of Objects and Reasons for the passing of this



enactment. Mr Sen has further submitted that this enactment which is in the nature of penal one has to be construed in the event of doubt or ambiguity in a manner beneficial to the party against whom any accusation is made.

62. Mr Sen has further argued that the rules framed under the Act can also be taken into consideration for proper interpretation of the Act and the learned Judge in the instant case was justified in referring to the rules in construing the provisions of the Act. In this connection Mr Sen has referred to the decision in *Re Wier, Ex parte Wier*¹⁶ and has relied upon the following observations at p. 879:

"We do not think that any other section of the Act throws any material light upon the proper construction of this section, and if the question had depended upon the Act alone we should have had great doubt what the proper construction was; but

we are of opinion that, where the construction of the Act is ambiguous and doubtful on any point, recourse may be had to the rules which have been made by the Lord Chancellor under the authority of the Act, and if we find that in the rules any particular construction has been put on the Act, that it is our duty to adopt and follow that construction."

Mr Sen in this connection has drawn our attention to the relevant Rules and he has argued that the Rules leave no room for doubt that the Act has no application to the firm and no offence under the Act has been disclosed by the firm. Mr Sen has submitted that the construction of the Act by the learned Judge is correct and it is his submission that in view of the provisions of the Act properly interpreted, there cannot be any doubt that the Act has no application to the instant case and there can be no question of any violation of the said Act by the firm. It is the submission of Mr Sen that the approach and the reasoning of the learned Judge are both sound. Mr Sen has next contended that the search and seizure carried on in the instant case are also illegal and unjustified. It is the argument of Mr Sen that if no offence under the Act is disclosed and the Act has no application, there cannot be any question of any search or seizure under the Act. Mr Sen has argued that the search and seizure done in the instant case have also not been done in conformity with the provisions of law. Mr Sen has submitted that the learned Judge has correctly come to the conclusion that the search and seizure in the instant case were also illegal. In this connection Mr Sen referred to a number of decisions.

63. Mr Ray and Mr Sibal who followed Mr Sen mainly adopted the submissions made by Mr Sen. Mr Ray, further contended that to be a chit fund or to be a money circulation scheme, an element of uncertainty or luck is essential. It is the argument of Mr Ray that insofar as the transactions carried on by the firm in the instant case are concerned, the said element is nowhere there. Mr Ray, in this connection referred to the definition of conventional chit and has argued that the conventional chits



have not been brought within the purview of this Act. Mr Ray has drawn our attention to the decision of this Court in the case of *Srinivasa Enterprises v. Union of India*¹⁷ in which the validity of the Act came to be challenged in this Court and was upheld by this Court.

64. The appeal before us has been argued at great length. A number of decisions have also been cited from the Bar. I have already referred to some of the decisions which were cited before us. I do not propose to consider all the cases which were referred to in the course of argument by the learned counsel appearing on behalf of the parties as I do not consider the same to be necessary. I have already stated that the matter appears to have been elaborately argued before the learned trial Judge who in his judgment has fully set out the relevant facts and circumstances of the case has noted the arguments which were advanced before him and the learned Judge has also referred to a number of decisions. I may, however, note that Mr Chatterjee, appearing on behalf of the appellants, has made a grievance before us that some of the decisions cited by him have not been considered by the learned Judge. Though the matter has been argued at great length, yet, to my mind, the case appears to rest in a fairly short compass.

65. In my opinion, the legal position is well settled. The legal position appears to be that if an offence is disclosed, the court will not normally interfere with an investigation into the case and will permit investigation into the offence alleged to be

completed; if, however, the materials do not disclose an offence, no investigation should normally be permitted. The observations of the Judicial Committee and the observations of this Court in the various decisions which I have earlier quoted, make this position abundantly clear. The propositions enunciated by the Judicial Committee and this Court in the various decisions which I have earlier noted, are based on sound principles of justice. Once an offence is disclosed, an investigation into the offence must necessarily follow in the interests of justice. If, however, no offence is disclosed, an investigation cannot be permitted, as any investigation, in the absence of any offence being disclosed, will result in unnecessary harassment to a party, whose liberty and property may be put to jeopardy for nothing. The liberty and property of any individual are sacred and sacrosanct and the court zealously guards them and protects them. An investigation is carried on for the purpose of gathering necessary materials for establishing and proving an offence which is disclosed. When an offence is disclosed, a proper investigation in the interests of justice becomes necessary to collect materials for establishing the offence, and for bringing the offender to book. In the absence of a proper investigation in a case where an offence is disclosed, the offender may succeed in escaping from the consequences and the offender may go unpunished to the detriment of the cause of justice and the society at large. Justice requires that a person who commits an offence has to be brought to



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book and must be punished for the same. If the court interferes with the proper investigation in a case where an offence has been disclosed, the offence will go unpunished to the serious detriment of the welfare of the society and the cause of the justice suffers. It is on the basis of this principle that the court normally does not interfere with the investigation of a case where an offence has been disclosed. The decisions on which Mr Chatterjee has relied are based on this sound principle, and in all these cases, an offence had been disclosed. Relying on the well settled and sound principle that the court should not interfere with an investigation into an offence at the stage of investigation and should allow the investigation to be completed, this Court had made the observations in the said decisions which I have earlier quoted reiterating and reaffirming the sound principles of justice. The decisions relied on by Mr Chatterjee, do not lay down, as it cannot possibly be laid down as a broad proposition of law, that an investigation must necessarily be permitted to continue and will not be prevented by the court at the stage of investigation, even if no offence is disclosed. While adverting to this specific question as to whether an investigation can go on even if no offence is disclosed, the Judicial Committee in the case of *King-Emperor v. Khwaja Nazir Ahmad*² and this Court in *R.P. Kapur v. State of Punjab*³, *Jehan Singh v. Delhi Administration*⁶ and *S.N. Sharma v. Bipen Kumar Tiwari*⁴ have clearly laid down that no investigation can be permitted and have made the observations which I have earlier quoted and which were relied on by Mr Sen. As I have earlier observed this proposition is not only based on sound logic but is also based on fundamental principles of justice, as a person against whom no offence is disclosed, cannot be put to any harassment by the process of investigation which is likely to put his personal liberty and also property which are considered sacred and sacrosanct into peril and jeopardy.

66. Whether an offence has been disclosed or not must necessarily depend on the facts and circumstances of each particular case. In considering whether an offence into which an investigation is made or to be made, is disclosed or not, the court has mainly to take into consideration the complaint or the FIR and the court may in appropriate

cases take into consideration the relevant facts and circumstances of the case. On a consideration of all the relevant materials, the court has to come to the conclusion whether an offence is disclosed or not. If on a consideration of the relevant materials, the court is satisfied that an offence is disclosed, the court will normally not interfere with the investigation into the offence and will generally allow the investigation into the offence to be completed for collecting materials for proving the offence. If, on the other hand, the court on a consideration of the relevant materials is satisfied that no offence is disclosed, it will be the duty of the court to interfere with any investigation and to stop the same to prevent any kind of uncalled for and unnecessary harassment to an individual.

67. In the instant case, the offence complained of is violation of the



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Act. For a proper adjudication of the case and for a proper appreciation of the question, it, therefore, becomes necessary to consider the relevant materials and also the provisions of the Act for being satisfied as to whether the relevant materials go to indicate any violation of the Act and disclose any offence under the Act. The materials are mainly contained in the FIR which has been earlier set out in its entirety. An analysis of the FIR mentions the following allegations on the basis of which the said FIR has been lodged:

"1. Sanchaita Investments is a partnership firm. Its partners are Sri Bihari Lal Murarka, Sri Shambhu Prasad Mukherjee and Sri Swapan Kumar Guha. The firm was started in or around 1975.

2. The firm had been offering fabulous interest at the rate of 48 per cent to its members until very recently. The rate of interest has of late been reduced to 36 per cent per annum.

3. Such high rates of interest were and are being paid even though the loan certificate receipts show rate of interest to be 12 per cent only.

4. Thus, the amount in excess of 12 per cent so paid clearly shows that "money circulation scheme" is being promoted and conducted for the making of quick and/or easy money, prizes and/or gifts.

5. Prizes or gifts in cash are also being awarded to agents, promoters and members too.

6. In view of the above, Sarvashri Bihari Lal Murarka, Shambhu Prasad Mukherjee and Swapan Kumar Guha appear to have been carrying on the business in the trade name of "Sanchaita Investments" in prize chits and money circulation scheme in violation of Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978.

68. The other materials are contained in paras 6, 7, 8, 9, 22, 27 and 30 of the affidavit and the two documents, namely, the article published in the newspaper *Business Standard* dated November 16, 1980 and the documents seized in the course of searches. I have earlier set out in extenso the statement made in the said paras of the affidavit filed on behalf of the State. A copy of the article has been enclosed to the affidavit filed on behalf of the State. The document seized in the course of searches and handed over to the court in the course of the arguments was a letter addressed by an officer of the Air Force to the firm in which the officer makes a grievance that the firm which was paying interest at the rate of 48 per cent has now reduced the same to 36 per cent in view of advances made to political parties. The letter further records the fact that the firm hopes to pay the enhanced rate of interest of 48 per cent in the near

future. An analysis of these materials suggest that the firm is carrying on activities of accepting deposits from the members promising to pay them interest on such deposits at an agreed rate of 12 per cent as stipulated in the loan certificate; but, in fact,



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it has been paying interest to them at much higher rate of interest. The materials further indicate that the firm is making high-risk investments of the monies received from the depositors and has also been advancing monies to political parties.

69. The crux of question is whether these allegations disclose an offence under the Act namely, violation of Section 3 of the Act even if all these allegations are deemed to be correct.

70. The question whether these allegations disclose an offence under the Act and can be the basis for any suspicion that an offence under Section 3 of the Act has been committed or not, must necessarily depend on the provisions of the Act and its proper interpretation.

71. The Act has been enacted for implementing the recommendations of a Study Group of Reserve Bank of India under the chairmanship of Shri James S. Raj the then Chairman of the Unit Trust of India, constituted for examining in depth the provisions of Chapter III-B of Reserve Bank of India Act, 1934 and the directions issued thereunder to non-banking companies in order to assess their adequacy in the context of ensuring the efficacy of the monetary and credit policies of the country and affording a degree of protection to the interests of the depositors who place their savings with such companies. Para 2 of the Statement of Objects and Reasons of the Act states:

"Prize chits would cover any kind of arrangement under which moneys are collected by way of subscriptions, contributions, etc. and prizes, gifts, etc. are awarded. The prize chit is really a form of lottery. its basic feature is that the foreman or promoter who ostensibly charges no commission collects regular subscriptions from the members. Once a member gets the prize, he is very often not required to pay further instalments and his name is dropped from further lots. The institutions conducting prize chits are private limited companies with a very low capital base contributed by the promotorers, directors or their close relatives. Such schemes confer monetary benefit only on a few members and on the promoter companies. The Group had, therefore, recommended that prize chits or money circulation schemes, by whatever name called, should be totally banned in the larger interests of the public and suitable legislative measures should be undertaken for the purpose."

72. The relevant portion of para 3 of the Statement of Objects and Reasons reads as follows:

"The Bill proposes to implement the above recommendation of the Group by providing for the banning of the promotion or conduct of any prize chit or money circulation scheme, by whatever name called, and of the participation of any person in such chit or scheme. The Bill provides for a period of two years within which the existing units carrying on the business of prize chits or money circulation schemes may be wound up and provides for penalties and other incidental matters. . . ."

It is, therefore, clear that the main object of the Act is to ban promotion or conduct of any prize chit or money circulation scheme, by whatever name



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called, and of the participation of any person in such chit or scheme. Section 2 of the Act deals with definitions. "Money Circulation Scheme" is defined in Section 2(c) in the following words:

" 'money circulation scheme' means any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions;"

"Prize chit" is defined in Section 2(e) in the following terms:

"prize chit includes any transaction or arrangement by whatever name called under which a person collects whether as a promoter, foreman, agent or in any other capacity, monies in one lump sum or in instalments by way of contributions or subscriptions or by sale of units, certificates or other instruments or in any other manner or as membership fees or admission fees or service charges to or in respect of any savings, mutual benefit, thrift, or any other scheme or arrangement by whatever name called, and utilises the monies so collected or any part thereof or the income accruing from investment or other use of such monies for all or any of the following purposes, namely:

(i) giving or awarding periodically or otherwise to a specified number of subscribers as determined by lot, draw or in any other manner, prizes or gifts in cash or in kind, whether or not the recipient of the prize or gift is under a liability to make any further payment in respect of such scheme or arrangement;

(ii) refunding to the subscribers or such of them as have not won any prize or gift, the whole or part of the subscriptions, contributions or other monies collected, with or without any bonus, premium, interest or other advantage by whatever name called, on the termination of the scheme or arrangement, or on or after the expiry of the period stipulated therein,

but does not include a conventional chit;"

A "conventional chit" which is specifically excluded in the definition of prize chit in Section 2(e)(ii) is defined in Section 2(a) as follows:

" 'conventional chit' means a transaction whether called chit, chit fund, *kuri* or by any other name by or under which a person responsible for the conduct of the chit enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or certain quantity of grain instead) by way of periodical instalments for a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the chit agreement, be entitled to a prize amount".

Section 3 of the Act the violation of which alleged reads:

"No person shall promote or conduct any prize chit or money circulation scheme, or enrol as a member to any such chit or scheme, or



participate in it otherwise, or receive or remit any money in pursuance of such chit or scheme".

Section 7 of the Act provides:

"7. (1) It shall be lawful for any police officer not below the rank of an officer in charge of a police station,—

(a) to enter, if necessary by force, whether by day or night with such assistance as he considers necessary, any premises which he has reason to suspect, are being used for purposes connected with the promotion or conduct of any prize chit or money circulation scheme in contravention of the provisions of this Act;

(b) to search the said premises and the persons whom he may find therein;

(c) to take into custody and produce before any Judicial Magistrate all such persons as are concerned or against whom a complaint has been made or credible information has been received or a reasonable suspicion exists of their having been concerned with the use of the said premises for purposes connected with, or with the promotion or conduct of, any such prize chit or money circulation scheme as aforesaid;

(d) to seize all things found in the said premises which are intended to be used, or reasonably suspected to have been used, in connection with any such prize chit or money circulation scheme as aforesaid.

(2) Any officer authorised by the State Government in this behalf may—

(a) at all reasonable times, enter into and search any premises which he has reason to suspect, are being used for the purposes connected with, or conduct of, any prize chit or money circulation scheme in contravention of the provisions of this Act;

(b) examine any person having the control of, or employed in connection with, any such prize chit or money circulation scheme;

(c) order the production of any documents, books or records in the possession or power of any person having the control of, or employed in connection with, any such prize chit or money circulation scheme; and

* * *

(3) All searches under this section shall be made in accordance with the provisions of the Code of Criminal Procedure, 1973."

Section 13 confers necessary powers to make rules and reads as under:

"13. (1) The State Government may, by notification in the Official Gazette and in consultation with the Reserve Bank, make rules for the purpose of carrying out the provisions of this Act.

(2) In particular and without prejudice to the generality of the foregoing power, such rules may provide for—

(a) the office of the Reserve Bank to whom full information regarding any prize chit or money circulation scheme may be furnished under the first proviso to sub-section (1) of Section 12,



and the form in which and the period within which such information may be furnished;

(b) the particulars relating to the winding up plan of the business relating to prize chits or money circulation schemes.

73. The complaint alleges violation of Section 3 of the Act. In other words, the complaint is that the firm is promoting or conducting a prize chit or a money circulation scheme. The definition of prize chit has been earlier set out. I have also

earlier analysed the FIR and the other materials on the basis of which the complaint is made and the materials which have been placed before the court. The materials do not indicate anything to disclose that the firm is promoting or conducting any prize chit. I may also here note that no arguments have been advanced on behalf of the appellants that the firm is promoting or conducting any prize chit; and in my opinion, rightly, as the allegations do not give any indication whatsoever of any case of a prize chit being promoted or conducted by the firm. The argument on behalf of the appellants has been that the firm is promoting or conducting a money circulation scheme. Though the Statement of Objects and Reasons of the Act may suggest that the prize chit and a money circulation scheme are more or less of like nature, yet, in view of the separate definitions of these two being given in Section 2 of the Act and in view of the further fact that Section 3 speaks of prize chit or money circulation scheme, each of the aforesaid must be considered to be separate and distinct for the purposes of the Act; and promoting or conducting either prize chit or any money circulation scheme or both must be held to be an offence under the Act.

74. I shall now proceed to consider whether the materials disclose that the firm is promoting or conducting a money circulation scheme. I have already set out the definition of money circulation scheme as given in Section 2(c) of the Act. On a plain reading of the said definition, the requirements of a money circulation scheme are—

“(i) there must be a scheme;

(ii) there must be members of the scheme;

(iii) the scheme must be for the making of quick or easy money on any event or contingency relative or applicable to the enrolment of members into the scheme or there must be a scheme for the receipt of any money or valuable thing as the consideration for a promise to pay money on any event or contingency relative or applicable to the enrolment of members into the scheme;

(iv) the event of contingency relative or applicable to the enrolment of members into the scheme will however not be in any way affected by the fact whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscription.



75. On a proper interpretation of this definition, it clearly appears that the condition in the said definition —“on any event or contingency relative or applicable to the enrolment of members into the scheme whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions” qualifies both the provisions contained therein, namely, (i) “money circulation scheme” means any scheme, by whatever name called, for the making of quick or easy money, or (ii) “money circulation scheme” means any scheme, for the receipt of any money or valuable thing as the consideration for a promise to pay money. Taking into consideration the language used in the clause and particularly the two commas, one after the words “easy money” and the other after the words “pay money”; it becomes clear that this stipulation is intended to cover both; and the interpretation contended for by Mr Chatterjee that the further provision in the definition, namely, “on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions”, applies only to the second part, namely, “ ‘money circulation scheme” means any scheme, by whatever name called,

for the receipt of any money or valuable thing as the consideration for a promise to pay money", is not sound. On this interpretation of Mr Chatterjee, the provision in the definition, namely, "money circulation scheme" means any scheme, by whatever name called, for the making of quick or easy money" will indeed become vague and meaningless.

76. For properly appreciating whether the offence of promoting or conducting a money circulation scheme is disclosed or not, it becomes necessary to consider whether the materials, even if they are all accepted to be correct, indicate that the business carried on by the firm satisfies the requirements of money circulation scheme and disclose an offence under the Act.

77. The materials show that the firm accepts loans or deposits from general public for a term against loan certificates which stipulate payment of interest at the rate of 12 per cent. Materials also indicate that the firm pays stipulated amount of interest and further pays a much larger amount of interest in a clandestine manner to the persons who invest their monies in the firm against loan certificates. The materials further indicate that the persons who have invested their monies with the firm against loan certificates used to receive, in fact, the stipulated amount of interest at the rate of 12 per cent and also used to receive an additional sum as further interest at the rate of 36 per cent in a clandestine manner. The materials also indicate that this further rate of interest at the rate of 36 per cent paid clandestinely in addition to the stipulated rate of 12 per cent has been reduced now to 24 per cent, because of investments by the firm with political parties. In other words, the materials go to show that though the rate of interest stipulated in the loan certificate was 12 per cent, the firm used to pay



altogether interest at the rate of 48 per cent previously and is now paying interest at the rate of 36 per cent inclusive of payment of interest stipulated in the loan certificate. The materials also indicate that the firm invests the deposits or loans received from the general public in high-risk investments. The materials, however, do not show that the payment of interest at the stipulated rate of 12 per cent or at any enhanced rate in excess of the stipulated rate depends on any event or contingency relative or applicable to the enrolment of any new depositors. The materials also do not indicate that the firm makes any discrimination in the matter of payment of interest to its depositors. The materials also do not indicate that the payment of Interest to the depositors whether at the stipulated rate or at the enhanced rate is dependent on any element of chance and the materials do not indicate that any kind of gifts is made by the firm to the depositors in addition to the payment of interest.

78. The first question that requires to be considered is whether these materials go to indicate that there is any scheme. The word "scheme" has not been defined in the Act. The word "schemer" however, has been defined in the Rules, in Rule 2(g) thereof. Rule 2(g) of the Rules state that a "scheme means a money circulation scheme or as the case may be a prize chit as defined in clauses (c) and (e) respectively of Section 2". The word "scheme" as contemplated in Section 2(c) of the Act is therefore, to be money circulation scheme within the meaning of the Act. To be a money circulation scheme, a scheme must be for the making of quick or easy money on any event or contingency relative or applicable to the enrolment of the members into the scheme. The scheme has necessarily to be judged as a whole, both from the viewpoint of the promoters and also of the members. Even if it be assumed that the firm may be considered to be the promotor and the persons who invest their monies in the firm are

members, the question has still to be considered whether investments of the monies with the firm in expectation of getting interest at the rate of 48 per cent and a big part of it in black in a clandestine manner, can be said from the viewpoint of the depositors that the investment is for the making of quick or easy money. If any individual invests his money in expectation of getting a high return, say 50 per cent or more and there is nothing clandestine in the transaction which is above-board, can it be said that the investment is for making easy money or quick money? Various individuals may invest their monies in their business which may yield very high profits. Many individuals also may indulge in speculative business in expectation of high return of their money and may succeed or may not succeed in speculative transactions. If such transactions are made openly and not in violation of any law, I have no doubt in my mind that it can never be said that such investment has been made for making quick or easy money, and such transactions can never come within the scheme for making easy or quick money as enumerated in the Act. The further question that, however, arises for consideration is whether the position will be any different, if a part of the transaction is not above-



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board and is secretive in nature. To my mind, that will not make any difference and the transaction cannot be considered to be a scheme for the making of quick or easy money, though the transaction may offend against revenue laws or any other law. Transactions in black money do not come within the mischief of this Act. Judged from the point of view of the depositors, it cannot, therefore, be said that their investment in the firm for high return by way of interest, part of which is above-board and a part of which is clandestine, will form any part of a scheme for making easy or quick money. It is further to be noted that this return on investment by way of interest is not dependent on any event or contingency whatsoever and has nothing to do with any event or contingency relative or applicable to the enrolment of any new members, even if the depositors be assumed to be members.

79. Judged from the point of view of the firm, there is nothing to indicate that the firm makes any investment in consultation with its depositors. The materials only indicate that the firm indulges in high-risk investments and also advances monies to political parties. Neither of these acts appears to be illegal and they do not go to show that the firm makes easy or quick money. It is no doubt true that the materials go to show that the firm pays a larger amount by way of interest than payable on the basis of the rates stipulated in the loan certificate and the firm pays the excess amount of interest to the depositors in a clandestine manner. The clandestine manner of payment of interest in excess of the stipulated rate does not, in any way, indicate the existence of any scheme for making quick or easy money. It is again to be pointed out that in any event the materials do not indicate that the payment of interest by the firm in excess of the stipulated rate is in any way dependent on any event or contingency. There is nothing to indicate any scheme for the receipt of the money by the firm from its depositors as a consideration for promise to pay the interest in excess of the stipulated rate and also to pay back principal amount on the expiry of the term dependent in any way on any event or contingency relative or applicable to the enrolment of new depositors, considering the depositors to be members. I am, therefore, of the opinion, that not any of the requirements of a money circulation scheme is satisfied in the instant case. As there is no money circulation scheme, there can be no scheme as contemplated in the Act in view of the definition of "scheme" in the Rules. The materials, appear to disclose violation of revenue laws. They, however,

do not disclose any violation of the Act. The materials do not disclose that the firm is promoting or conducting money circulation scheme and the question, therefore, of any violation of Section 3 of the Act does not arise in the instant case. As the firm is not conducting or promoting a money circulation scheme, and as no case is made that the firm is conducting or promoting a chit fund, the Act cannot be said to be applicable to the firm. In my opinion, it does not become necessary to refer to the Rules for coming to the conclusion. I



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may, however, add that a consideration of the Rules also clearly lends support to the conclusion to which I have come. I find that the learned Judge has very carefully and elaborately considered all the aspects in his judgment and in the course of elaborate discussion, he has noted all the contentions raised by the parties and has carefully considered them. The learned Judge on a careful consideration of all aspects and on a proper interpretation of the Act, has expressed the view that no offence under the Act is disclosed against the firm which does not conduct or promote money circulation scheme or a chit fund and the Act has no application to the firm. It may also be noted that the learned Judge has also in his judgment referred to the report of the Reserve Bank and the opinion of the learned Advocate-General of the State which lent support to the view taken by the learned Judge. The view expressed by the learned Judge that the materials do not disclose that the firm is promoting or conducting a money circulation scheme and the Act has, therefore, no application to the firm meets with my approval and I agree with the same.

80. Before concluding it will be proper to refer to the decision of this Court in the case of *Srinivasa Enterprises v. Union of India*¹⁷ which was relied on before the learned Judge and has been considered by me. In this case, the validity of the Act was challenged before this Court while upholding the validity of the Act for reasons stated in the judgment. Krishna Iyer, J. who spoke for the Bench observed at SCC p. 514 as follows:

“In many situations, the poor and unwary have to be saved from the seducing processes resorted by unscrupulous racketeers who glamourize and prey upon the gambling instinct to get rich quick through prizes. So long as there is the resistless spell of a chance, though small, of securing a prize, though on paper, people chase the prospect by subscribing to the speculative scheme only to lose what they had. Can you save moths from the fire except by putting out the fatal glow? Once this prize facet of the chit scheme is given up, it becomes substantially a ‘conventional chit’ and the ban of the law ceases to operate. We are unable to persuade ourselves that the State is wrong in its assertion, based upon expert opinions that a complete ban of prize chits is an over-kill or excessive blow. Therefore, we decline to strike down the legislation on the score of Articles 19(1)(f) and (g) of the Constitution.”

81. As I have earlier noticed the materials in the instant case do not disclose any element of chance in the matter of business carried on by the firm. It may, however, be said that these observations which were made while dealing with a case of chit fund are not of very great assistance while considering what may be a money circulation scheme within the meaning of the Act.

82. As no offence under the Act is at all disclosed, it will be manifestly unjust to allow the process of criminal code to be issued or continued against the firm and to allow any investigation which will be clearly without any authority.



83. In the view that I have taken, I do not consider it necessary to deal with other aspects, namely, as to whether the searches and seizures were lawfully and properly done.

84. I, therefore, hold that the proceedings against the firm and its partners arising out of the FIR must be quashed as the FIR and the other materials do not disclose any offence under the Act and as such no investigation into the affairs of the firm under the Act can be permitted or allowed to be continued. I, accordingly, quash the proceedings against that firm and its partners and order that no investigation under the Act into the affairs of the firm is to be carried on or continued.

85. I agree with the final order proposed by the learned Chief Justice in regard to the return of the documents, books and cash.

86. The appeal, therefore, fails and is dismissed. I, however, make no order as to costs.

— — —

[†] Appeal by Special Leave from the Judgment and Order dated March 12, 1981 of the Calcutta High Court in Matter No. 37 of 1981

^{*} Appeal by Special Leave from the Judgment and Order dated March 5, 1981 of the Calcutta High Court in Matter No. 2829 of 1980

^{*} Judgments printed in the order as received from the Registry. The leading judgment is that of A.N. Sen, J.

¹ AIR 1952 SC 156 : 1952 SCR 418, 424 : 1952 Cri LJ 836

² AIR 1961 SC 1494 : (1961) 3 SCR 986, 993-94 : (1961) 2 Cri LJ 696

³ AIR 1960 SC 866 : (1960) 3 SCR 388, 392-93 : 1960 Cri LJ 1239

⁴ (1970) 1 SCC 653 : 1970 SCC (Cri) 258 : AIR 1970 SC 786 : (1970) 3 SCR 946

⁵ AIR 1963 SC 447 : (1963) 2 SCR 52 : (1963) 1 Cri LJ 341

⁶ (1974) 4 SCC 522 : 1974 SCC (Cri) 558 : AIR 1974 SC 1146 : (1974) 3 SCR 794 : 1974 Cri LJ 802

⁷ AIR 1945 PC 18 : (1944) 71 IA 203 : 217 IC 1

⁸ (1974) 1 SCC 103 : 1974 SCC (Cri) 18 : AIR 1974 SC 183 : (1974) 2 SCR 12, 22-23 : 1974 Cri LJ 286

⁹ AIR 1963 SC 447 : (1963) 2 SCR 52 : (1963) 1 Cri LJ 341

¹⁰ AIR 1945 PC 18 : (1944) 71 IA 203, 212 : 217 IC 1

¹¹ (1980) 1 SCC 554 : 1980 SCC (Cri) 272 : 1980 Cri LJ 98 : (1980) 2 SCR 16

¹² (1970) 1 SCC 653 : 1970 SCC (Cri) 258 : AIR 1970 SC 786 : (1970) 3 SCR 946

¹³ AIR 1945 PC 18 : (1944) 71 IA 203 : 217 IC 1

¹⁴ AIR 1960 SC 866 : (1960) 3 SCR 388 : 1960 Cri LJ 1239

¹⁵ (1974) 4 SCC 522 : 1974 SCC (Cri) 558 : AIR 1974 SC 1146 : (1974) 3 SCR 794 : 1974 Cri LJ 802

¹⁶ (1871) 6 Ch App 875 : 25 LT 369 : 19 WR 1042

¹⁷ (1980) 4 SCC 507 : (1981) 51 Com Cas 464

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(1993) 2 Supreme Court Cases 582

(BEFORE L.M. SHARMA, C.J. AND S. MOHAN AND N. VENKATACHALA, JJ.)

T. VELAYUDHAN ACHARI AND ANOTHER . . Petitioners;

Versus

UNION OF INDIA AND OTHERS . . Respondents.

Writ Petition (Civil) No. 508 of 1988⁺ with W.P. (C) Nos. 534 of 1988, 143, 269, 434 of 1986, C.A. Nos. 5513, 5679, 5686 of 1985, 183, 192, 235-36, 363, 447, 510-15, 529, 646, 647, 1199, 1200, 1250, 81-83 of 1986, T.P. (C) Nos. 76-79, 88, 139-49, 154, 155, 81 of 1986, I.A. Nos. 1 & 2 of 1992 in C.A. No. 5513 of 1985 with C.A. No. 174 of 1986 Manipal Finance Corpn. v. U.O.I. and Another with C.A. Nos. 193, 624, 509 of 1986, W.P. (C) Nos. 1506 of 1987, C.A. Nos. 696-99, 949-50, 541 of 1986, W.P. (C) No. 60 of 1989, decided on February 5, 1993

Reserve Bank of India Act, 1934 — S. 45-S(1) [as introduced by Banking Laws (Amendment) Act, 1983 (1 of 1984)] — Limiting number of depositors that can be accepted by individual, firm or unincorporated association — Held, not violative of Art. 19(1)(g) — It protects larger interest of depositors — Regulation of economic activities permissible —



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Constitution of India, Arts. 19(1)(g) & (6) & 14 — Kerala Money-lenders Act, 1958, S. 4(2)(iii)

Held :

Although the impugned legislation places restrictions on the right of the appellants to carry on business, yet what is essential is to safeguard the rights of various depositors and to see that they are not preyed upon. The Reserve Bank of India, right from 1966, has been monitoring and following the functioning of non-banking financial institutions which invite deposits and then utilise those deposits either for trade or for other various industries. A ceiling for acceptance of deposits and to require maintenance of certain liquidity of funds as well as not to exceed borrowings beyond a particular percentage of the net-owned funds have been provided in the corporate sector. But for these requirements, the depositors would be left high and dry without any remedy. May be the Kerala Money-lenders Act, 1958 restricts the rates of interest under Section 4(2)(iii) but that cannot enable the petitioners to disregard these provisions, being the non-banking financial institutions.

(Paras 30 and 33)

Kanta Mehta v. Union of India, (1987) 62 Comp Cas 769 (Del), approved

Morey v. Doud, 354 US 457 : 1 L Ed 2d 1485 (1957); *Munn v. Illinois*, 94 US 113 : 24 L Ed 77 (1875); *Metropolis Theater Co. v. City of Chicago*, 228 US 61 : 57 L Ed 730 (1912); *Prag Ice and Oil Mills v. Union of India*, (1978) 3 SCC 459 : AIR 1978 SC 1296; *B. Banerjee v. Anita Pan (Smt)*, (1975) 1 SCC 166 : AIR 1975 SC 1146, cited

R.K. Garg v. Union of India, (1981) 4 SCC 675 : (1982) 1 SCR 947 : 1982 SCC (Tax) 30, relied on

Mayavaram Financial Corporation Ltd. v. Reserve Bank of India, (1971) 41 Comp Cas 890 (Mad); *Srinivasa Enterprises v. Union of India*, (1980) 4 SCC 507 : (1981) 1 SCR 801; *A.S.P. Aiyar v. Reserve Bank of India*, AIR 1983 Mad 330; *State of W.B. v. Swapn Kumar Guha*, (1982) 1 SCC 561 : (1982) 3 SCR 121 : 1982 SCC (Cri) 283; *Fatehchand Himmatlal v. State of Maharashtra*, (1977) 2 SCC 670 : (1977) 2 SCR 828, referred to

Reserve Bank of India Act, 1934 — S. 45-S(2) [as introduced by Banking Laws (Amendment) Act, 1983 (1 of 1984)] — Requirement to repay within two years from the date of commencement of S. 10 of Act 1 of 1984 the deposits to bring the number of

depositors within the limits specified in sub-s. (1) — Held, reasonable — There being enough sources of deposit as per the definition of deposit under S. 45-I(bb), there is no reason why appellants/petitioners cannot reduce the deposits — In view of cl. 4(3) of Non-Banking Financial Companies (Reserve Bank) Directions, 1966 and cl. 5 of Miscellaneous Non-Banking Companies (Reserve Bank) Directions, it cannot be said that suddenly the appellant/petitioner companies were called upon to reduce deposit — Even otherwise, interests of the depositors is the prime concern — Constitution of India, Arts. 19(1)(g) & (6) and 14

(Paras 35 to 38)

Reserve Bank of India Act, 1934 — S. 58-B(5-A) [as introduced by Banking Laws (Amendment) Act, 1983 (1 of 1984)] — Contravention of S. 45-S regarding acceptance of depositors within the limit prescribed and repayment of the excess deposit within two years from date of commencement of S. 10 of Act 1 of 1984 made punishable under S. 25-B(5-A)



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— Penal provision challenged on ground that while receiving deposits was not an offence, making it a criminal liability and directing payment would amount to ex post facto law offending Art. 20(1) — Held, challenge not sustainable — Constitution of India, Art. 20(1)

Delhi Cloth and General Mills Ltd. v. Union of India, (1983) 4 SCC 166 : (1983) 3 SCR 438, *followed*
Chennai Bottling Co. Pvt. Ltd. v. Assistant Registrar of Companies, Madras, (1987) 61 Comp Cas 770 (Mad), *overruled*

Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd., (1987) 1 SCC 424;
Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India, (1992) 2 SCC 343, *relied on*

Oudh Sugar Mills Ltd. v. Union of India, AIR 1970 SC 1070, *referred to*

D.S. Nakara v. Union of India, (1983) 1 SCC 305 : 1983 SCC (L&S) 145, *cited*

Appeals and petitions dismissed

R-M/AT/11942/C

Advocates who appeared in this case:

D.N. Dwivedi, Additional Solicitor General G. Viswanatha Iyer, K.N. Bhat and Anil B. Divan, Senior Advocates (E.M.S. Anam, P.H. Parekh, C.N. Sree Kumar, R. Mohan, S. Balakrishnan, M.K.D. Namboodiri, M.S. Ganesh, S.S. Khanduja, Y.P. Dhingra, B.K. Satija, Kuldeep S. Parihar, H.S. Parihar, Ms A. Subhashini, C.V. Subba Rao, K.R. Nambiar, M.P. Shorawala, D.K. Garg, S.K. Nandy, Randhir Jain, Ms Malini Poduval, M.A. Krishnamoorthy, K.J. John, Ms S. Vaidyalingam, A.K. Sanghi, P.N. Puri, Ms Abha Jain, Ms Madhu Moolchandani and A.G. Ratnaparkhi, Advocates, with them) for the appearing parties.

The Judgment of the Court was delivered by

S. MOHAN, J.— All these civil appeals arise by certificate granted by the High Court of Delhi against the decision reported in *Kanta Mehta v. Union of India*¹.

2. All these civil appeals and writ petitions challenge the constitutional validity of Chapter III-C read with Section 58-B(5-A) of the Reserve Bank of India Act, 1934, introduced by the Banking Laws (Amendment) Act, 1983 (Act 1 of 1984). Hence, they are dealt with under a common judgment.

3. In order to appreciate the challenge the necessary legal background may be set out.

4. In the year 1949, the Banking Regulation Act of 1949 was enacted. That contained regulatory provisions in regard to banking under the surveillance of the Reserve Bank of India as to what would constitute “banking” as defined under Section 5(b) of the 1949 Act.

5. In the year 1959, the Banking Companies (Amendment) Act, 1959 was passed. Sections 17 and 18 were substituted which required banking companies to create reserve fund and maintain cash reserve. In the year 1963, Banking Laws (Miscellaneous Provisions) Act, 1963 inserted Chapter III-B in the Reserve Bank of India Act. This chapter conferred extensive powers on the Reserve Bank of India to issue suitable instructions, to regulate and monitor diverse activities of non-banking



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companies. The powers to control and regulate these non-banking institutions are set out in Sections 45-I to 45-L. While exercising these powers, the Reserve Bank of India was issuing various directions to these non-banking financial institutions. One such important direction was issued on January 1, 1967 to the effect that the non-banking financial companies were not to hold deposits in excess of 25 per cent of its paid-up capital and the reserves as also to non-banking, non-financial companies. They were also required to take steps to keep the deposits within the limits. This direction was challenged unsuccessfully before the Madras High Court as seen from the case of *Mayavaram Financial Corporation Ltd. v. Reserve Bank of India*².

6. In 1968, by Banking Laws (Amendment) Act, 1968, Sections 10-A to 10-D were introduced. Section 10-A provided that the Board of Directors shall include persons with professional or special knowledge. Section 10-A(5) empowered the Reserve Bank of India to vary the composition of the Board.

7. When a report of the Study Group of non-banking financial intermediaries was submitted in the year 1971 that was studied. Thereafter in 1973 the Reserve Bank of India issued Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973 placing certain restrictions on companies carrying on prize chit and chit business from receiving deposits from the public.

8. In 1974, Section 58-A of the Companies Act was inserted by the Companies (Amendment) Act of 1974, which came into force from February 1, 1975. The object was to regulate deposits received by non-banking non-financial companies. The financial companies were already covered by Reserve Bank of India directions under the Reserve Bank of India Act. Therefore, they were exempted under Section 58-A(7) from the purview of that section. Since the non-banking non-financial companies came within the purview of Section 58-A, the earlier directions issued by the Reserve Bank of India Act to non-banking non-financial companies in the year 1966 were withdrawn. By an amendment of 1977, Section 58-A was further enlarged and the Central Government was empowered to grant extensions.

9. In June 1974, another Study Group was constituted which is popularly known as James Raj Committee.

10. In July 1975, the above Study Group gave its report. In accordance with the recommendations of the Study Group elaborate rules were issued by the Central Government under Section 58-A, called Banking Companies (Acceptance of Deposits) Rules, 1975 with a view to regulate the various activities of the companies to accept deposits from public. The validity of the section and the deposit rules were questioned.



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This Court in *Delhi Cloth and General Mills Co. Ltd. v. Union of India*³ upheld the same.

11. In 1977, directions were issued by the Reserve Bank of India superseding earlier directions of 1966 and 1973.

12. In 1978, Bill 183 of 1978 called Banking Laws (Amendment) Bill, 1978 was introduced in the Parliament. The said Bill provided limits on depositors which were lower than the current provisions. However, the Bill lapsed on dissolution of Parliament. Thereafter Prize Chits and Money Circulation Schemes (Banning) Act, 1978 was enacted. This was also challenged. But that challenge was thrown out by this Court in *Srinivasa Enterprises v. Union of India*⁴.

13. In 1981, several new regulatory directions were given by the Reserve Bank of India. Inter alia they included restrictions on accepting or renewing deposits from shareholders, Directors etc. which exceeded 15 per cent of the net-owned funds of the companies as also restricted payment of interest on deposits at a rate of interest exceeding 15 per cent per annum. The validity of the amendments was upheld by the Madras High Court in the case reported in *A.S.P. Aiyar v. Reserve Bank of India*⁵.

14. In *State of W.B. v. Swapan Kumar Guha*⁶ known as *Sanchaita case* this Court while quashing the FIR launched against the firm, Sanchaita Investments, directed that the Government and Reserve Bank of India should look into the matter deeply. It is in this background the Banking Laws (Amendment) Act, 1983 came to be enacted. Section 45-S states thus:

"45-S. *Deposits not to be accepted in certain cases.*— (1) No person, being an individual or a firm or an unincorporated association of individuals shall, at any time, have deposits from more than the number of depositors specified against each, in the table below:

TABLE

(i)	Individual	Not more than twenty-five depositors excluding depositors who are relatives of the individual.
(ii)	Firm	Not more than twenty-five depositors per partner and not more than two hundred and fifty depositors in all, excluding, in either case, depositors who are relatives of any of the partners.
	Unincorporated association of individuals	Not more than twenty-five depositors per individual and not more than two hundred and fifty depositors in all, excluding, in either case, depositors who are relatives of any of the individuals constituting the association.
(iii)		

(2) Where at the commencement of Section 10 of the Banking Laws (Amendment) Act, 1983, the deposits held by any such person are not in accordance with sub-section (1), he shall, before the expiry of a period of two years from the date of such commencement, repay such of the deposits as are necessary for bringing the number of depositors within the relative limits specified in that sub-section.

Explanation.— For the purposes of this section—



- (a) a person shall be deemed to be a relative of another if, and only if,—
(i) they are members of a Hindu undivided family; or
(ii) they are husband and wife; or
(iii) the one is related to the other in the manner indicated in the list of relatives below:

List of Relatives

1. Father. 2. Mother (including step-mother). 3. Son (including step-son). 4. Son's wife. 5. Daughter (including step-daughter). 6. Father's father. 7. Father's mother. 8. Mother's mother. 9. Mother's father. 10. Son's son. 11. Son's son's wife. 12. Son's daughter. 13. Son's daughter's husband. 14. Daughter's husband. 15. Daughter's son. 16. Daughter's son's wife. 17. Daughter's daughter. 18. Daughter's daughter's husband. 19. Brother (including step-brother). 20. Brother's wife. 21. Sister (including step-sister). 22. Sister's husband;

(b) a person in whose favour a credit balance is outstanding for a period not exceeding six months in any account relating to mutual dealings in the ordinary course of trade or business shall not, on account of such balance alone, be deemed to be a depositor."

Thus, the number of depositors has come to be limited.

15. As to the penalty for contravention of Section 45-S it is provided for under Section 58-B(5-A). It runs thus:

"(5-A) If any person contravenes any provision of Section 45-S, he shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of deposit received by such person in contravention of that section or rupees two thousand, whichever is more, or with both."

16. These provisions were challenged by the appellants in the various civil appeals as violative of Articles 14 and 19 of the Constitution. A Division Bench of the High Court of Delhi in *Kanta Mehta case*¹ held:



"Section 45-S read with Section 58-B(5-A) of Chapter III-C of the Reserve Bank of India Act, 1934, as introduced by Section 10 of the Banking Laws (Amendment) Act, 1983, is not violative of Articles 14 and 19 of the Constitution. There is nothing demonstrably irrelevant or perverse in limiting in Section 45-S the number of depositors that an individual, firm or association could accept.

Nor is there any element of compulsion on individuals and firms or associations which are not incorporated to incorporate themselves as a company and Article 19 (1)(c) is not violated by the provisions of Section 45-S limiting the number of depositors whom individuals, firms and unincorporated associations could accept.

Chapter III-C of the Reserve Bank of India Act, 1934, imposes reasonable restrictions on the right of individuals, firms and unincorporated associations to carry on the business of acceptance of deposits and advancing or giving loans to the public. There is also a further safeguard that Chapter III-C is being operated under the supervision and control of the Reserve Bank of India.

The business of acceptance of deposits from the public does not fall within Entry 30 or Entry 32 of List II of Schedule VII of the Constitution. It falls within Entry 45 or in any case under Entry 97 of List I of Schedule VII under which only Parliament

has power to pass the impugned legislation. Parliament had full competence and power to pass Chapter III-C of the Reserve Bank of India Act, 1934."

17. Mr G. Viswanatha Iyer, learned counsel for the writ petitioners in W.P. Nos. 508 and 534 of 1988 submits that Section 45-B is violative of the fundamental right under Article 19(1)(g) of the Constitution as it restricts the number of depositors and the rate of interest under Section 4(2)(iii) of the Kerala Money-Lenders Act, 1958 (hereinafter referred to as the Kerala Act). The two years' period prescribed under Section 45-S(2) is unreasonable. Under Kerala Act, with effect from October 15, 1985 only 14 per cent interest alone could be charged. In any event, while receiving deposits was not an offence, making it a criminal liability and directing payment, would amount to ex post facto law, offending Article 20(1) of the Constitution. In support of this submission, reliance is placed on *Chennai Bottling Co. Pvt. Ltd. v. Assistant Registrar of Companies, Madras*⁷ and *Oudh Sugar Mills Ltd. v. Union of India*⁸.

18. The other learned counsel seriously pressed the point relating to criminal liability and prayed for time to comply with the provisions of Section 45-S.

19. Mr Anil B. Divan, learned counsel appearing for respondent 2 in C.A. No. 447 of 1986, after referring us to the development of law, would



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submit that it is open to the Government to regulate the economic activities. While examining the validity of such provisions the courts always have regard to the wisdom of the legislature because that alone has the necessary information and expertise pointing to the need of such a legislation.

20. In *R.K. Garg v. Union of India*⁹ this aspect of the matter was highlighted.

21. It was in this view, this Court upheld Maharashtra Debt Relief Act, 1976 in *Fatehchand Himmatlal v. State of Maharashtra*¹⁰. If properly analysed, it can be seen that these provisions constitute a regulatory scheme and not a penal liability.

22. Much is made of the penal provisions under Section 58-B(5-A). It is submitted that imprisonment of a recalcitrant debtor is permissible in law. If one goes by the facts of these cases even after 1986, they collect deposits when law required them not to do so.

23. Under Section 45-I(bb) deposit has been defined. If as per the definition there are enough sources of deposit there is no reason why the appellants cannot reduce the deposits. If, therefore, the package is reasonable there is no justification to dilute the effect of Section 58-B(5-A). While examining the scope of the section it might be contrasted with Section 125(3) of the Criminal Procedure Code wherein a sufficient cause is provided.

24. In *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.*¹¹ this Court had occasion to consider the adventures indulged by persons like the appellants. It criticised the fraud played by such financial vultures.

25. This approach was approved in *Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India*¹².

26. The learned counsel also draws our attention to the Non-banking Financial Companies (Reserve Bank) Directions of 1966. They came into force on January 1, 1967. Clause 4 sub-clause (3) specifically provides that the deposit shall be reduced to 25 per cent of the paid-up capital for which a two-year period was provided. Similar directions of 1977 known as Non-Banking Financial Companies (Reserve Bank)

Directions, 1977 came to be issued with effect from July 1, 1977.

27. There were complaints, even then, that the financial companies were not paying interest regularly and the Reserve Bank was requested to help the depositor. Therefore, in the teeth of this provision, to say that suddenly the appellants and the writ petitioners are called upon to reduce,



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would work hardship and they should not be penalised, is incorrect. They took a calculated risk and, therefore, they had to suffer for their own fault.

28. In examining the various submissions addressed on behalf of the appellants and the petitioners we propose to examine the same in the following background since it is a law relating to regulation of economic activities.

29. In *R.K. Garg case*⁹ it is held: (SCC pp. 690-91, para 8)

“Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J. that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey v. Doud*¹³ where Frankfurter, J. said in his inimitable style:

‘In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events — self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.’

The Court must always remember that ‘legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry’; ‘that exact wisdom and nice adaptation of remedy are not always possible’ and that ‘judgment is largely a prophecy based on meagre and uninterpreted experience’. Every legislation particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be



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crudities and inequities in complicated experimental economic legislation but on that

account alone it cannot be struck down as invalid.”

At page 706, para 19 it is held:

“... That would depend upon diverse fiscal and economic considerations based on practical necessity and administrative expediency and would also involve a certain amount of experimentation on which the Court would be least fitted to pronounce. The Court would not have the necessary competence and expertise to adjudicate upon such an economic issue. The Court cannot possibly assess or evaluate what would be the impact of a particular immunity or exemption and whether it would serve the purpose in view or not. There are so many imponderables that would enter into the determination that it would be wise for the Court not to hazard an opinion where even economists may differ. The Court must while examining the constitutional validity of a legislation of this kind, ‘be resilient, not rigid, forward looking, not static, liberal, not verbal’ and the Court must always bear in mind the constitutional proposition enunciated by the Supreme Court of the United States in *Munn v. Illinois*¹⁴ namely, ‘that courts do not substitute their social and economic beliefs for the judgment of legislative bodies’. The Court must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. The Court should constantly remind itself of what the Supreme Court of the United States said in *Metropolis Theater Co. v. City of Chicago*¹⁵:

‘The problems of government are practical ones and may justify, if they do not require, rough accommodations, illogical it may be, and unscientific. But even such criticism should not be hastily expressed. What is best is not always discernible, the wisdom of any choice may be disputed or condemned. Mere errors of government are not subject to our judicial review’.”

30. No doubt, the impugned legislation places restrictions on the right of the appellants to carry on business, but what is essential is to safeguard the rights of various depositors and to see that they are not preyed upon. From the earlier narration, it would be clear that the Reserve Bank of India, right from 1966, has been monitoring and following the functioning of non-banking financial institutions which invite deposits and then utilise those deposits either for trade or for other various industries. A ceiling for acceptance of deposits and to require maintenance of certain liquidity of funds as well as not to exceed borrowings beyond a particular percentage of the net-owned funds have been provided in the corporate sector. But



for these requirements, the depositors would be left high and dry without any remedy.

31. Even the corporate sector was not free from blame. It had done damage to the economy and brought ruination to small depositors. This was why Section 58-A in the Companies Act of 1956 came to be introduced. It is worthwhile to quote the notes on clauses concerning this provision:

“It has been the practice of the companies to take deposits from the public at high rates of interest. Experience had shown that in many cases deposits taken by the companies have not been refunded on the due dates, either the companies have gone in liquidation or funds are depleted to such an extent that the companies are not in a position to refund the deposits, it was accordingly considered necessary to control the activities of the companies when accepting deposits from the ‘the public’.”

32. We approve of the reasoning of the Delhi High Court in *Kanta Mehta case*¹. At pages 798-99 it runs as follows:

"The danger of allowing deposits to be accepted without regulation is so acute and urgent, that to bind the hands of the legislature that only one course alone is permissible and not to permit a play of joints would be to totally make it ineffective in meeting the challenge of the social evil. For, it must be remembered that 'In the ultimate analysis, the mechanics of any economic legislation has necessarily to be left to the judgment of the executive and unless it is patent that there is hostile discrimination against a class, the processual basis of price fixation has to be accepted in the generality of cases as valid'. (See *Prag Ice and Oil Mills v. Union of India*¹⁶.) Also such provisions meant to check such evil must be viewed, as Krishna Iyer, J. said, through a socially constructive, not legally captious, microscope to discover glaring unconstitutional infirmity, that when laws affecting large chunks of the community are enacted, stray misfortunes are inevitable and that social legislation without tears, affecting vested rights is virtually impossible. (See *B. Banerjee v. Smt Anita Pan*¹⁷.)

The stress by learned counsel for the petitioners on the private right of the petitioners to have unrestricted deposits and make advances in any manner they like must receive short shrift, for by now, it is too well settled to be doubted that private rights must yield to the public need and that any form of regulation is unconstitutional only if arbitrary, discriminatory or demonstrably irrelevant to the policy the legislature is free to adopt."



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33. Maybe, Kerala Act restricts the rates of interest under Section 4(2)(iii) but that cannot enable the writ petitioners in W.P. Nos. 508 and 534 of 1988 to disregard these provisions, being the non-banking financial institutions.

34. Hence, we reject the first of the arguments.

35. As regards the reasonableness of two-year period Section 45-I(bb) of the Reserve Bank Act defines "deposit" as follows:

"(bb) 'deposit' includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form, but does not include—

- (i) amounts raised by way of share capital;
- (ii) amounts contributed as capital by partners of a firm;
- (iii) amounts received from a scheduled bank or a cooperative bank or any other banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (iv) any amount received from,—
 - (a) the Development Bank,
 - (b) a State Financial Corporation established under the State Financial Corporations Act, 1951,
 - (c) any financial institution specified in or under Section 6-A of the Industrial Development Bank of India Act, 1964 (18 of 1964), or
 - (d) any other financial institution that may be specified by the Bank in this behalf;
- (v) amounts received, in the ordinary course of business, by way of—

- (a) security deposit,
- (b) dealership deposit,
- (c) earnest money, or
- (d) advance against orders for goods, properties or services;
- (vi) any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money-lending which is for the time being in force in any State; and
- (vii) any amount received by way of subscriptions in respect of a chit."

36. Therefore, as rightly argued by Mr Anil Divan as per this definition, if there are enough sources of deposit there is no reason why the appellants and the writ petitioners cannot reduce the deposits. Further,



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non-banking financial companies are required under clause 4 sub-clause (3) as follows:

"(3) Every non-banking financial company, not being a hire-purchase finance company, or a holding finance company, which on the date of commencement of these directions holds deposits in excess of twenty five per cent of its paid-up capital and free reserves shall secure before the expiry of a period of two years from the date of such commencement, by taking such steps as may be necessary for this purpose, that the deposits, received by the company and outstanding on its books are not in excess of the aforesaid limit."

37. These directions came into force from January 1, 1967. Similar directions came to be issued as Miscellaneous Non-Banking Companies (Reserve Bank) Directions. Clause 5 dealing with acceptance of deposits states as under:

"Acceptance of deposits by miscellaneous non-banking companies.— On and from 1st of July, 1977, no miscellaneous non-banking company shall—

- (a) receive any deposit repayable on demand or on notice, or repayable after a period of less than six months and more than thirty-six months from the date of receipt of such deposit or renew any deposit received by it, whether before or after the aforesaid date unless such deposit, on renewal, is repayable not earlier than six months and not later than thirty-six months from the date of such renewal;

Provided that where a miscellaneous non-banking company has before 1st July, 1977, accepted deposits repayable after a period of more than thirty-six months, such deposits shall, unless renewed in accordance with these directions, be repaid in accordance with the terms of such deposits:

Provided further that nothing contained in this clause shall apply to monies raised by the issue of debentures or bonds;

- (b) receive or renew—

- (i) any deposit against an unsecured debenture or any deposit from a shareholder (not being a deposit received by a private company from its shareholders as is referred to in clause (vi) or paragraph 4) or any deposit guaranteed by any person who, at the time of giving such guarantee, was or is a director to the company, if the amount of any such deposit together with the amount of such other deposits of all or any of the kinds referred to in this sub-clause and outstanding in the books of the company as on the

date of



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acceptance or renewal of such deposits, exceeds fifteen per cent of its net owned funds.

(ii) any other deposit, if the amount of such deposit, together with the amount of such other deposits, not being deposits of the kind referred to in sub-clause (i) of this clause already received and outstanding in the books of the company as on the date of acceptance of such deposits, exceeds twenty five per cent of its net owned funds.”

38. If, therefore, this was the position, it cannot be contended that suddenly the companies like the appellants and the petitioners are called upon to reduce deposits. Even otherwise, the interests of the depositors is the prime concern.

39. Coming to the last point, as to whether Section 58-B(5-A) is violative of Article 20(1) of the Constitution, we find, when a similar argument was raised against Section 58-A of the Companies Act, that was repelled by this Court in *Delhi Cloth and General Mills Co. Ltd. v. Union of India*³ (SCR p. 468) which runs thus: (SCC pp. 192-93, para 34)

“Mr G.A. Shah canvassed one more contention. After stating that Rule 3-A became operative from April 1, 1978, he specifically drew attention to the proviso to Rule 3-A(1) which required that with relation to the deposits maturing during the year ending on March 31, 1979, the sum required to be deposited or invested under sub-rule (1) of Rule 3-A shall be deposited or invested before September 30, 1978. It was then contended that this provision would necessitate depositing 10% of the deposits maturing during the year ending with March 31, 1979 which may have been accepted prior to the coming into force of Rule 3-A and to this extent the rule has been made retrospective and as there was no power conferred by Section 58-A to prescribe conditions subject to which deposits can be accepted retrospectively Rule 3-A is ultra vires Section 58-A. Unquestionably, Rule 3-A became operative from April 1, 1978. The obligation cast by Rule 3-A is to deposit 10% of the deposits maturing during the year in the manner prescribed in Rule 3. Some deposits would be maturing between April 1, 1978 and March 31, 1979. To provide for such marginal situation, a proviso is inserted. Does it make the rule retroactive? Of course, not. In *D.S. Nakara v. Union of India*¹⁸ a Constitution Bench of this Court has, in this context, observed as under:

‘A statute is not properly called a retroactive statute because a part of the requisites for its action is drawn from a time antecedent to its passing.’



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Viewed from this angle, the provision can be properly called prospective and not retroactive. Therefore, the contention does not commend to us.”

40. In the light of this, we should hold that the ruling of the Madras High Court in *Chennai Bottling Co. Pvt. Ltd.*² is incorrect.

41. As to the plight of these depositors we need only to quote the case in *Peerless*

*General Finance and Investment Co. Ltd.*¹¹ At paragraph 37 it is held: (SCC pp. 452-53)

"We would also like to query what action the Reserve Bank of India and the Union of India are taking or proposing to take against the mushroom growth of 'finance and investment companies' offering staggeringly high rates of interest to depositors leading us to suspect whether these companies are not speculative ventures floated to attract unwary and credulous investors and capture their savings. One has only to look at the morning's newspaper to be greeted by advertisements inviting deposits and offering interest at astronomic rates. On January 1, 1987 one of the national newspapers published from Hyderabad, where one of us happened to be spending the vacation, carried as many as ten advertisements with 'banner headlines', covering the whole of the last page, a quarter of the first page and conspicuous spaces in other pages offering fabulous rates of interest. At least two of the advertisers offered to double the deposit in 30 months, 2000 for 1000, 10,000 for 5000, they said. Another advertiser offered interest ranging between 30 per cent to 38 per cent for periods ranging between six months to five years. Almost all the advertisers offered extra interest ranging between 3 per cent to 6 per cent if deposits were made during the Christmas-Pongal season. Several of them offered gifts and prizes. If the Reserve Bank of India considers the Peerless Company with eight hundred crores invested in Government securities, fixed deposits with National Banks etc. unsafe for depositors, one wonders what they have to say about the mushroom non-banking companies which are accepting deposits, promising most unlikely returns and what action is proposed to be taken to protect the investors. It does not require much imagination to realise the adventurous and precarious character of these businesses. Urgent action appears to be called for to protect the public. While on the one hand these schemes encourage two vices affecting public economy, the desire to make quick and easy money and the habit of excessive and wasteful consumer spending, on the other hand the investors who generally belong to the gullible and less affluent classes have no security whatsoever. Action appears imperative."

And paragraph 42 also requires to be quoted: (SCC p. 454)

"I share my brother's concern about the mushroom growth of financial companies all over the country. Such companies have



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proliferated. The victims of the schemes, that are attractively put forward in public media, are mostly middle class and lower middle class people. Instances are legion where such needy people have been reduced penniless because of the fraud played by such financial vultures. It is necessary for the authorities to evolve fool-proof schemes to see that fraud is not allowed to be played upon persons who are not conversant with the practice of such financial enterprises who pose themselves as benefactors of people."

42. We may also add that this has been reaffirmed in *Peerless General Finance and Investment Co. Ltd. v. RBI*¹² (SCC at page 354).

43. Therefore, we are in entire agreement with the Delhi High Court.

44. Since, as we have stated above, all the appellants and writ petitioners were praying for time to comply with these provisions, the matter was adjourned from time to time. Though some of them have complied with the requirements of law yet a few

others have not done so. We make it clear that in spite of this indulgence, their failure to comply cannot be countenanced.

45. We dismiss the appeals and the petitions along with I.A. Nos. 1 and 2 in C.A. No. 5513 of 1985. However, there shall be no orders as to cost.

— — —

[†] Under Article 32 of the Constitution of India

¹ (1987) 62 Com Cas 769 (Del)

² (1971) 41 Com Cas 890 (Mad)

³ (1983) 4 SCC 166 : (1983) 3 SCR 438

⁴ (1980) 4 SCC 507 : (1981) 1 SCR 801

⁵ AIR 1983 Mad 330

⁶ (1982) 1 SCC 561 : 1982 SCC (Cri) 283 : (1982) 3 SCR 121

⁷ (1987) 61 Com Cas 770 (Mad)

⁸ AIR 1970 SC 1070

⁹ (1981) 4 SCC 675, 690-91 : 1982 SCC (Tax) 30 : (1982) 1 SCR 947, 969-70

¹⁰ (1977) 2 SCC 670 : (1977) 2 SCR 828

¹¹ (1987) 1 SCC 424

¹² (1992) 2 SCC 343, 354

¹³ 354 US 457 : 1 L Ed 2d 1485 (1957)

¹⁴ 94 US 113 : 24 L Ed 77 (1875)

¹⁵ 228 US 61 : 57 L Ed 730 (1912)

¹⁶ (1978) 3 SCC 459, 489, para 52 : AIR 1978 SC 1296, para 50

¹⁷ (1975) 1 SCC 166, 173-75 : AIR 1975 SC 1146, 1150-51

¹⁸ (1983) 1 SCC 305 : 1983 SCC (L&S) 145

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(2000) 5 Supreme Court Cases 471

(BEFORE B.N. KIRPAL AND M.B. SHAH, JJ.)

BHAVESH D. PARISH AND OTHERS . . Appellants;

Versus

UNION OF INDIA AND ANOTHER . . Respondents.

Writ Petition (C) No. 168 of 1997⁺, decided on May 12, 2000

A. Reserve Bank of India Act, 1934 — Ss. 45-S (as substituted by Act 23 of 1997), 58-B (5-A) and Ss. 45-H to 45-Q (Ch. III-B) — Constitutionality of S. 45-S — Restrictions placed on financial activities of unincorporated bodies and prohibition on accepting public deposits — There can be no unrestricted fundamental right to accept deposits from the public — Restriction can be placed on utilising deposits by the public — Unincorporated business firms/individuals can always incorporate to escape the ban — Constitution of India, Arts. 19 (1)(g) & (6) and 14 — Reserve Bank of India (Amendment) Act, 1997, S. 9

B. Constitution of India — Art. 32 — Judicial review — Policy matters — Economic policy of the State, held, should not be lightly interfered with — Policy decisions — Economic policy — Scope of judicial review of — Reserve Bank of India Act, 1934, S. 45-S (as ins. in 1997)

Section 9 of the Reserve Bank of India (Amendment) Act, 1997 substituted a new Section 45-S for the former one in the Reserve Bank of India Act, 1934. The writ petitioners herein were shroffs engaged in the business of providing credit to the members of the public. Their business generally involved the maintaining of a mutual current account where the customer might either place deposit on call or withdraw money on call, without security. The financing activity of the shroff firms was through capital contributions of the partners/proprietor and deposits made by members of the public. They challenged the constitutionality of the new Section 45-S on the ground that facility of deposit and withdrawal of the funds made available by the petitioners to customers like agriculturists, such as cotton farmers, tobacco farmers, vegetable producers etc. who had a seasonal need for finance and a periodic surplus of investible funds, would cease. That Section 45-S restrained the firms of or individual shroffs from accepting any deposit from the public for the



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purpose of their business activities and was therefore, violative of Article 19(1)(g). They added that the restrictions imposed by the impugned provision were neither reasonable nor in public interest and, therefore, did not meet the test of Article 19(6). They further added that the impugned provisions were violative of Article 14 of the Constitution being arbitrary, discriminatory and unreasonable. Dismissing the writ petition, the Supreme Court

Held :

After the introduction of old Section 45-S in 1984, several complaints were received by RBI from various parts of the country regarding rampant malpractices being adopted by several persons/firms especially in the State of Kerala. Whereas in 1987 the daily newspapers and periodicals were filled with flashy advertisements for attracting business subsequently most of the firms disappeared. Public confidence had been shattered beyond description and the fate of several depositors stood sealed. Similarly complaints were also received by RBI of individuals/firms and unincorporated bodies accepting deposits in Tamil Nadu.

(Para 16)

With the spread of formal financial agencies such as commercial banks, regional rural banks, cooperative banks, development financial institutions and non-banking financial companies etc., the institutional finance is available far more easily now than earlier. With these facilities now being available and in view of the inherent risks to the general public at the hands of the unincorporated bodies engaged in financial activities and accepting public deposits, it has to be held that the

restrictions now imposed by the amended Section 45-S are not unreasonable.

(Paras 17 and 18)

The impugned Section 45-S does not in any way prohibit or restrict any unincorporated body or individual from carrying on the business that it likes. It is open to unincorporated bodies to carry on their financial business either from their own funds or the funds borrowed from their relatives or from financial institutions. The restriction, which is placed by Section 45-S, is on the carrying on of such business by utilising public deposits. The petitioners cannot claim a fundamental right to carry on the business of financing with other people's money. In other words, there can be no unrestricted fundamental right to accept deposits from the public.

(Paras 10, 19 and 21)

Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India, (1992) 2 SCC 343, followed

The amended Section 45-S further expands the provisions of Ch. III-B relating to non-banking institutions receiving deposits by making it necessary for all those, who mobilise public funds for deployment in the financial sector, to follow the norms of prudential management which is the internationally accepted practice in relation to those handling public funds. In view of Chapter III-B, particularly in its revised form after the amendment, it would have been highly incongruous to permit people to sidestep the discipline of Chapter III-B by refusing to incorporate themselves. Nothing prevented the appellants who alleged to be the partners of different firms from incorporating themselves as a company. There is absolutely no restriction on any person to utilise his own funds (including the funds received from his relatives) for any purpose he likes including parabanking or financial activity.

(Para 20)

RBI has not acted hastily. Before amending Section 45-S of the Act in 1997, it had the benefit of having with it the reports of a number of committees, all of



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whom had recommended that the unincorporated business firms/individuals be brought under certain discipline and, if possible, non-banking financial business was not to be permitted to be carried on by the unincorporated bodies. The question of restricting such financial activity by unincorporated bodies, is a question of economic policy as it involves regulation of economic activities by different constituents. In such matters of economic policy, the Supreme Court does not interfere with the decision of the expert bodies which have examined the matter.

(Para 23)

R.K. Garg v. Union of India, (1981) 4 SCC 675 : 1982 SCC (Tax) 30 : (1982) 1 SCR 947, 969, relied on

Morey v. Doud, 354 US 457 : 1 L Ed 2d 1485, referred to

Even if these restrictions incorporated in the Act amount to a total prohibition, such action was necessary in the public interest as the mushroom growth of unincorporated bodies accepting deposits had gone beyond control calling for restriction of the nature imposed by the amended Section 45-S.

(Para 24)

Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd., (1987) 1 SCC 424 : (1987) 61 Comp Cas 663; *Srinivasa Enterprises v. Union of India*, (1980) 4 SCC 507, relied on

The inherent danger to the public in permitting such business to be carried on unchecked and unregulated was ample justification for the impugned legislation, keeping in mind the experience of the public which had been dealing with such unincorporated bodies in Kerala and Tamil Nadu. The prohibition on partnership firms to carry on their business like that of shroffs cannot be regarded as being an unreasonable restriction on the fundamental right of the appellants to carry on their trade. They can continue lending money as long as they do not borrow from the public.

(Para 25)

The services rendered by certain informal sectors of the Indian economy could not be belittled.

However, in the path of economic progress, if the informal system was sought to be replaced by a more organised system, capable of better regulation and discipline, then this was an economic philosophy reflected by the legislation in question. Such a philosophy might have its merits and demerits. But these were matters of economic policy. They are best left to the wisdom of the legislature and in policy matters the accepted principle is that the courts should not interfere. Moreover in the context of the changed economic scenario the expertise of people dealing with the subject should not be lightly interfered with. The consequences of such interdiction can have large-scale ramifications and can put the clock back for a number of years. The process of rationalisation of the infirmities in the economy can be put in serious jeopardy and, therefore, it is necessary that while dealing with economic legislations, the Supreme Court, while not jettisoning its jurisdiction to curb arbitrary action or unconstitutional legislation, should interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all.

(Para 26)

Section 45-S is in no way illegal or bad in law. Section 45-S no doubt prohibits the conduct of banking business by an unincorporated non-banking entity like a shroff, but this prohibition has come about, inter alia, in the interest of unwary depositors and borrowers (from shroffs) and with a view to prevent them from committing financial suicide.

(Paras 27 to 29)

Papnasam Labour Union v. Madura Coats Ltd., (1995) 1 SCC 501 : 1995 SCC (L&S) 339, followed



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Kanta Mehta v. Union of India, (1987) 62 Comp Cas 769 (Del); *T. Velayudhan Achari v. Union of India*, (1993) 2 SCC 582, referred to

C. Constitution of India — Art. 226 — Injunction/Stay — Staying the operation of a piece of legislation during pendency of challenge to its validity — Propriety — Unless the impugned provision is manifestly unjust or glaringly unconstitutional, High Court should show judicial restraint in staying the applicability thereof, particularly in case of legislation pertaining to economic reform or change

When considering an application for staying the operation of a piece of legislation, and that too pertaining to economic reform or change, the courts must bear in mind that unless the provision is manifestly unjust or glaringly unconstitutional, the courts must show judicial restraint in staying the applicability of the same. Merely because a statute comes up for examination and some arguable point is raised, which persuades the courts to consider the controversy, the legislative will should not normally be put under suspension pending such consideration. It is now well settled that there is always a presumption in favour of the constitutional validity of any legislation, unless the same is set aside after final hearing. The system of checks and balances has to be utilised in a balanced manner with the primary objective of accelerating economic growth rather than suspending its growth by doubting its constitutional efficacy at the threshold itself.

(Para 30)

While the courts should not abdicate their duty of granting interim injunctions where necessary, equally important is the need to ensure that the judicial discretion does not abdicate from the function of weighing the overwhelming public interest in favour of the continuing operation of a fiscal statute or a piece of economic reform legislation, till on a mature consideration at the final hearing, it is found to be unconstitutional.

(Para 31)

Suggested Case Finder Search Text (inter alia):

"judicial review" near policy

Writ petition dismissed

H-M/ACTZ/22597/C

Advocates who appeared in this case:

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S. Parihar, Ms Manisha, Ms Binu Tamta, S.K. Dwivedi, E.M.S. Anam, S.C. Birla, Ms Shanta Vasudevan, P.K. Manohar, K.V. Viswanathan, K.V. Venkataraman, Krishnamurthi Swami, T. Harish Kumar, V. Balachandran, A.T.M. Sampath, V. Balaji and Manish Singhvi, Advocates, with them) for appearing parties.

Chronological list of cases cited

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1. (1995) 1 SCC 501 : 1995 SCC (L&S) 339, *Papnasam Labour Union v. Madura Coats Ltd.* 479e-f, 486e
2. (1993) 2 SCC 582, *T. Velayudhan Achari v. Union of India* 476g-h
3. (1992) 2 SCC 343, *Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India* 482d-e
4. (1987) 62 Comp Cas 769 (Del), *Kanta Mehta v. Union of India* 476f
5. (1987) 1 SCC 424 : (1987) 61 Comp Cas 663, *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.* 485c
6. (1981) 4 SCC 675 : 1982 SCC (Tax) 30 : (1982) 1 SCR 947, 969, *R.K. Garg v. Union of India* 484b



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7. (1980) 4 SCC 507, *Srinivasa Enterprises v. Union of India* 485d, 485e-f
8. 354 US 457 : 1 L Ed 2d 1485, *Morey v. Doud* 484d-e

The Judgment of the Court was delivered by

B.N. KIRPAL, J.— The appellants who carry on the business of “shroffs” are impugning the validity of Section 9 of the Reserve Bank of India Act as amended by the Amendment Act, 1997 (hereinafter referred to as “the Act”) on the ground that the said provision is violative of Articles 14 and 19(1)(g) of the Constitution of India.

2. The trade of business of shroffs in India has been in existence for a long time. This trade is carried on not only in cities but also in small towns and villages in parts of India.

3. The appellants are shroffs engaged in the business of providing credit to the members of the public. The traditional mode of organising the business of shroffs over the past several decades had been by way of partnership firms. The nature of the services practised by the appellants generally involved maintaining a mutual current

account where the customer may either place deposit on call or withdraw money on call, without security. The financing activity of the shroff firms was through capital contributions of the partners/proprietor and deposits made by members of the public. Some of the other activities of the shroffs include cheque discounting, the issuance of hundis, the collection of cheques from different centres and providing other similar facilities to customers. The services extended by the appellants are availed of by small and medium-sized traders, professionals, salaried workers, agriculturists and individuals.

4. Reserve Bank of India (hereinafter referred to as "RBI") is a statutory corporation constituted as the central banking authority for the country by the Reserve Bank of India Act, 1934. RBI is constituted, inter alia, to regulate the issue of banknotes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage. RBI is also vested with various powers to regulate the currency and credit system of the country. The powers so vested in RBI include the power to issue directions to non-banking institutions receiving deposits and to financial institutions. By amendment in 1963 a new Chapter III-B was inserted in the said Act. This chapter inserted Sections 45-H to 45-Q which were provisions relating to non-banking institutions receiving deposits and financial institutions. In the Statement of Objects and Reasons it was provided that the existing enactments relating to banks did not provide for any control over companies or institutions, which, although were not treated as banks, accept deposits from the general public or carry on other business which was allied to banking. For ensuring more effective supervision and management of the monetary and credit system by RBI, it was observed that RBI should be enabled to regulate the conditions on which deposits may be accepted by these non-banking companies or institutions. The provisions of the said Chapter III-B did not apply to



individuals or firms like the appellants who are not incorporated but still do business which is akin to that of banking.

5. In order to place some restrictions on the acceptance of deposits by unincorporated bodies, by the Banking Laws (Amendment) Act, 1983 (Act 1 of 1984), Chapter III-C and Section 58-B(5-A) were inserted into the Act. The relevant portion of principal restrictions in Chapter III-C which were contained in Section 45-S, read as under:

"45-S. *Deposits not to be accepted in certain cases.*—(1) No person, being an individual or a firm or an unincorporated association of individuals shall, at any time, have deposits from more than the number of depositors specified against each, in the table below:

Table

(i)	Individual	Not more than twenty-five depositors excluding depositors who are relatives of the individual.
(ii)	Firm	Not more than twenty-five depositors per partner and not more than two hundred and fifty depositors in all, excluding, in either case, depositors who are relatives of any of the partners.
(iii)	Unincorporated association of individuals	Not more than twenty-five depositors per individual and not more than two hundred and fifty depositors in all, excluding, in either case,

depositors who are relatives of any of the individuals constituting the association.

(2) Where at the commencement of Section 10 of the Banking Laws (Amendment) Act, 1983, the deposits held by any such person are not in accordance with sub-section (1), he shall, before the expiry of a period of two years from the date of such commencement, repay such of the deposits as are necessary for bringing the number of depositors within the relative limits specified in that sub-section."

6. The constitutional validity of Section 45-S of the Act was upheld by the Delhi High Court in *Kanta Mehta v. Union of India*¹. The main challenge was on the ground that it infringed the appellants' right under Article 19(1)(g) of the Constitution of India and was violative of Articles 14 and 19 of the Constitution. While upholding the validity of Section 45-S, the High Court noted that expert reports by study groups had recommended that it would not be in the interest of all, especially the depositors, if unincorporated bodies such as partnerships were to work as companies without any control or supervision of RBI. This decision of the High Court was affirmed by this Court in *T. Velayudhan Achari v. Union of India*². While upholding the validity of Section 45-S, this Court at pp. 591-92 observed as follows: (SCC para 30)



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"30. No doubt, the impugned legislation places restrictions on the right of the appellants to carry on business, but what is essential is to safeguard the rights of various depositors and to see that they are not preyed upon. From the earlier narration, it would be clear that Reserve Bank of India, right from 1966, has been monitoring and following the functioning of non-banking financial institutions which invite deposits and then utilise those deposits either for trade or for other various industries. A ceiling for acceptance of deposits and to require maintenance of certain liquidity of funds as well as not to exceed borrowings beyond a particular percentage of the net-owned funds have been provided in the corporate sector. But for these requirements, the depositors would be left high and dry without any remedy."

7. It appears that Section 45-S of the Act, as originally incorporated, did not have the desired effect. The non-corporate sector was virtually free from all disciplines even though its activities were same or similar to the corporate sector, the difference only being in the magnitude and that too only in some cases. According to the respondents it was to rectify this imbalance that first an Ordinance was issued which sought to completely prohibit any receipt of deposits by unincorporated associations in the non-corporate sector. When certain hardships were pointed out by those who did not carry on the business comparable to the companies which were under Chapter III-B i.e. who did not borrow money or receive advances to carry on business in the financial sector but borrow money for their own trade or manufacture, the Act, which replaced the Ordinance, watered down the rigour to some extent.

8. The newly incorporated Section 45-S⁺⁺, which is impugned in this writ petition, is as follows:

"45-S. (1) No person, being an individual or a firm or an unincorporated association of individuals shall, accept any deposit—

(i) If his or its business wholly or partly includes any of the activities specified

in clause (c) of Section 45-I; or

(ii) If his or its principal business is that of receiving of deposits under any scheme or arrangement or in any other manner, or lending in any manner:

Provided that nothing contained in this sub-section shall apply to the receipt of money by an individual by way of loan from any of his relatives or to the receipt of money by a firm by way of loan from the relative or relatives of any of the partners.

(2) Where any person referred to in sub-section (1) holds any deposit on the 1st day of April, 1997 which is not in accordance with sub-section (1), such deposit shall be repaid by that person immediately after such deposit becomes due for repayment or within three years from the date of such commencement, whichever is earlier:

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(3) On and from the 1st day of April, 1997, no person referred to in sub-section (1) shall issue or cause to be issued any advertisement in any form for soliciting deposit.

Explanation.—For the purposes of this section, a person shall be deemed to be a relative of another if, any only if,—

(i) they are members of a Hindu undivided family; or

(ii) they are husband and wife; or

(iii) the one is related to the other in the manner indicated in the list of relatives below—

List of relatives

1. Father, 2. Mother (including stepmother), 3. Son (including stepson) 4. Son's wife, 5. Daughter (including stepdaughter), 6. Father's father, 7. Father's mother, 8. Mother's mother, 9. Mother's father, 10. Son's son, 11. Son's son's wife, 12. Son's daughter 13. Son's daughter's husband, 14. Daughter's husband, 15. Daughter's son, 16. Daughter's son's wife, 17. Daughter's daughter, 18. Daughter's daughter's husband, 19. Brother (including stepbrother), 20. Brother's wife, 21. Sister (including stepsister), 22. Sister's husband."

9. The principal features of the amended Section 45-S insofar as they relate to the appellants are:

(a) From 1-4-1997, no individual or firm may accept any deposit:

(i) if his or its business wholly or partly includes financing activities, whether by way of making loans or advances or otherwise; or

(ii) if his or its principal business is that of receiving deposits under any scheme or arrangement or lending in any manner.

(b) The prohibition on the acceptance of deposits does not apply to loans from relatives.

(c) A company may continue to accept deposits for financing activities or lending subject to the regulations in respect of non-banking financial companies.

(d) Individuals and firms holding deposits on 1-4-1997 must repay such deposits immediately after such deposits become due for repayment or within two years (before 31-3-1999), whichever is earlier.

(e) On and from 1-4-1997 no individual or firm may issue advertisement in any

form for soliciting deposits.

- (f) All non-banking financial companies must have a minimum of Rs 25,00,000 of net-owned funds (NOF) and withdraw the deposits and/or take loans before the agricultural operations commence. The agriculturists and small traders who earn valuable interest on net deposits will no longer be able to do so.

10. The impugned Section 45-S does not in any way prohibit or restrict any unincorporated body or individual from carrying on the business that it likes. It is open to unincorporated bodies to carry on their financial business



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either from their own funds or the funds borrowed from their relatives or from financial institutions. The restriction, which is placed by Section 45-S, is on the carrying on of such business by utilising public deposits.

11. The grievance of the appellants is that the firms of or individual shroffs, as a result of amendment to Section 45-S, will not be allowed to accept any deposit from the public for the purposes of their business activities. There is a complete prohibition on sharafi transactions (mutual current account transactions) which had formed the bedrock of the financing activities of the shroffs. This is because individuals and firms will no longer be entitled to accept deposits on current account and the minimum period for which a non-banking financial company may accept deposit is now one year. The shroffs will now be compelled to convert from partnership firms into limited companies.

12. Challenging the vires of Section 45-S, it was submitted by the learned counsel for the appellants that shroffs provided the facility of deposit and loan transactions 24 hours a day and this facility was traditionally extended to customers like agriculturists, such as cotton farmers, tobacco farmers, vegetable producers etc. who had a seasonal need for finance and a periodic surplus of investible funds. The flexibility of deposit and withdrawal of the funds available to this sector which was provided by the shroff community will now cease. It was submitted that the impugned provisions are violative of the appellants' right to carry on their trade and business guaranteed under Article 19(1)(g) of the Constitution. Elaborating this contention it was urged that though it is open to the Government to impose reasonable restriction in the public interest under Article 19(6) of the Constitution but the impugned provisions neither met the test of reasonableness nor public interest. It was also submitted that the impugned provisions were violative of Article 14 of the Constitution being arbitrary, discriminatory and unreasonable.

13. This Court in *Papnasam Labour Union v. Madura Coats Ltd.*³ while considering the challenge to Section 25-M of the Industrial Disputes Act, 1947 as being violative of Article 19 of the Constitution referred to earlier decisions of this Court and at p. 511 set out the following principles and guidelines which should be kept in mind for considering the constitutionality of statutory provision upon a challenge on the alleged vice of unreasonableness of the restriction imposed by it: (SCC pp. 512-13, para 15)

“(a) The restriction sought to be imposed on the Fundamental Rights guaranteed by Article 19 of the Constitution must not be arbitrary or of an excessive nature so as to go beyond the requirement of felt need of the society and object sought to be achieved.

(b) There must be a direct and proximate nexus or a reasonable connection between the restriction imposed and the object sought to be achieved.



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(c) No abstract or fixed principle can be laid down which may have universal application in all cases. Such consideration on the question of quality of reasonableness, therefore, is expected to vary from case to case.

(d) In interpreting constitutional provisions, courts should be alive to the felt need of the society and complex issues facing the people which the legislature intends to solve through effective legislation.

(e) In appreciating such problems and felt need of the society the judicial approach must necessarily be dynamic, pragmatic and elastic.

(f) It is imperative that for consideration of reasonableness of restriction imposed by a statute, the Court should examine whether the social control as envisaged in Article 19 is being effectuated by the restriction imposed on the Fundamental Rights.

(g) Although Article 19 guarantees all the seven freedoms to the citizen, such guarantee does not confer any absolute or unconditional right but is subject to reasonable restriction which the legislature may impose in public interest. It is therefore necessary to examine whether such restriction is meant to protect social welfare satisfying the need of prevailing social values.

(h) The reasonableness has got to be tested both from the procedural and substantive aspects. It should not be bound by processual perniciousness or jurisprudence of remedies.

(i) Restriction imposed on the Fundamental Rights guaranteed under Article 19 of the Constitution must not be arbitrary, unbridled, uncanalised and excessive and also not unreasonably discriminatory. Ex hypothesi, therefore, a restriction to be reasonable must also be consistent with Article 14 of the Constitution.

(j) In judging the reasonableness of the restriction imposed by clause (6) of Article 19, the Court has to bear in mind Directive Principles of State Policy.

(k) Ordinarily, any restriction so imposed which has the effect of promoting or effectuating a directive principle can be presumed to be a reasonable restriction in public interest."

14. Keeping the aforesaid principles in mind let us now examine the reasons for enacting Section 45-S.

15. In the affidavit filed by the respondent it has been, inter alia, stated that the growing volume of deposits with the unorganised financial sector affected the operation of monetary and credit policy to the extent that it involved a loss of control by the central monetary authority on the use of these funds. Further, the unincorporated bodies were susceptible to default as the costs of funds and returns could not be matched in a viable way leading to adverse selection i.e. the funds being directed to risky illiquid investments. Whereas incorporated bodies were subject to regulatory controls, it was impossible to regulate unincorporated bodies at all. It is also stated in the affidavit that over the years, the functioning of various unincorporated bodies was under observation and in 1984 when Chapter III-C was added to the Act,



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the prohibition to accept deposits was partial in the sense that unincorporated bodies

were allowed to accept deposits from a limited number of depositors with no ceiling on the amount of deposit. The working of the provisions of Chapter III-C did not result in healthy development but there was a proliferation of such unincorporated bodies engaged in financial intermediation. As pointed out in para 3 of the Statement of Objects and Reasons the existing provisions were flouted by unscrupulous entities by floating different partnership firms when a firm reached the level of 250 depositors. This multiplication of firms took place with a view to circumvent the rigour of the law.

16. It appears that after the introduction of Section 45-S in 1984, several complaints were received by RBI from various parts of the country regarding rampant malpractices being adopted by several persons/firms especially in the State of Kerala. Sample studies, which were conducted, revealed several astonishing features and the menace of such unincorporated associations accepting public deposits and the mushroom growth of such intermediaries. These business firms were commonly known in Kerala as "blade companies" so called because of their usurious lending rates. The study showed that these "blade companies" drew sustenance from human greed. These "blade companies" were offering interest of 36% and in turn were charging excessive interest from the borrowers. By the time the study was conducted, it showed that the private financing scenario in Kerala pointed out to near desolation. Whereas in 1987 the daily newspapers and periodicals were filled with flashy advertisements for attracting business subsequently most of the firms had disappeared. Public confidence had been shattered beyond description and the fate of several depositors stood sealed with the tragedy which had overtaken them having lost their hard-earned money. Similar complaints were also received by RBI of individuals/firms and unincorporated bodies accepting deposits in Tamil Nadu. The report received from that State recommended that RBI should oversee the functioning of such financial firms and it ought to consider banning the activities in public interest.

17. It is the case of RBI that the flexibility, convenience and facilities etc. provided by the appellants were turning out to be mirages for the gullible public who ultimately had to bear the brunt of the callous ways in which the unincorporated bodies extended credit under the guise of flexibility and convenience. Unquestionably high interest rates were charged by such firms from the borrowers, but when the time came for the return of money borrowed by such firms, a number of such firms had folded up resulting in great loss to the depositors. RBI, being a statutory expert body entrusted with monetary management, came to the conclusion that these unincorporated bodies which were functioning as financial intermediaries in an informal and unorganised manner be restrained from having access to deposits from the public. The spread of formal financial agencies such as commercial banks, regional rural banks, cooperative banks, development financial institutions and non-banking financial companies etc. had taken care of the need to



mobilise the domestic savings of the nation and to deploy the same in a proper manner.

18. As regards availability of banking facilities in small towns and villages, the number of rural branches of commercial banks, which were 1833 in June 1969, increased to 33,069 as on June 1996. The average population per branch has increased manifold. The regional rural banks had been established in 1975 with a view to serve the people. Several State Governments had promoted cooperative banking culture amongst the rural masses for effectively tapping the resources so as to meet

their credit requirements. It appears that institutional finance is available far more easily now than before. With these facilities now being available and in view of the inherent risks to the general public at the hands of the unincorporated bodies engaged in financial activities and accepting public deposits, we agree that the restrictions now imposed by the amended Section 45-S cannot be considered as being unreasonable.

19. As has already been observed, there is no total prohibition or ban on accepting deposits by incorporated bodies. It is only such incorporated bodies as are carrying on business referred to in clauses (i) and (ii) of sub-section (1) of Section 45-S of the Act which cannot accept deposits from the public. They can however receive loans from relatives. The appellants cannot claim a fundamental right to carry on the business of financing with other people's money. In other words, there can be no unrestricted fundamental right to accept deposits from the public. This Hon'ble Court has observed in *Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India*⁴ that there is no fundamental right to do any unregulated business with subscribers'/depositors' money. This Hon'ble Court in that case upheld the directions issued by RBI requiring residuary non-banking companies to invest the amount collected by them as deposits in a particular way. This Hon'ble Court further held that such companies should invest their own working capital and find such resources elsewhere with which Reserve Bank has no concern. Since the deposit acceptance by unincorporated bodies is incapable of being regulated by virtue of the large number of such bodies, the provisions in the nature of the amended Section 45-S are necessary and unincorporated bodies should do their business with their own money or institutional finance or money borrowed from relatives.

20. The amended Section 45-S further expands the provisions of Chapter III-B by making it necessary for all those, who mobilise public funds for deployment in the financial sector, to follow the norms of prudential management which is the internationally-accepted practice in relation to those handling public funds. In view of Chapter III-B, particularly in its revised form after the amendment, it would have been highly incongruous to permit people to sidestep the discipline of Chapter III-B by refusing to incorporate themselves. In view of this anomaly which has come about it was decided by the legislature not to permit such activities in the non-corporate sector. Nothing prevented the appellants who alleged to be the partners of



different firms from incorporating themselves as a company. The real grievance was that the appellants did not want to comply with the norms of prudential management and, therefore, sought to paint a picture as though their trade had been prohibited. There was no impediment in the trade as long as it was carried on within the norms of Chapter III-B. In fact, they would have greater latitude to do trade as a corporate body, in that the present restriction on the amount of money to be deposited would stand increased. In this context, it may be emphasised that there is absolutely no restriction on any person to utilise his own funds (including the funds received from his relatives) for any purpose he likes including parabanking or financial activity.

21. Historically, only banks have been allowed to accept deposits repayable on demand because they were subjected to maintenance of cash reserve requirement which would enable them to meet liabilities as and when they are called upon or when any demand is made for repayment. Since non-banking financial companies were not subjected to such cash reserve requirement, it was not desirable to allow non-banking financial companies to accept demand deposits. In any case, such bodies were nothing but parabanking institutions and either they had to be regulated on the lines of the

financial institutions and if that was not feasible, they should have appropriately been prohibited from accepting deposits from the public. After all, the right to raise public deposit could not be construed as a fundamental right. The restrictions imposed cannot be considered unreasonable or arbitrary.

22. RBI has not acted hastily. Before amending Section 45-S of the Act in 1997, it had the benefit of having with it the reports of a number of committees, all of whom had recommended that the unincorporated business firms/individuals be brought under certain discipline and, if possible, non-banking financial business was not to be permitted to be carried on by the unincorporated bodies. It will be useful in this regard to refer to the report of the study group on non-banking financial intermediaries appointed by the Banking Commission in 1971. The study group after making a detailed study of the then existing non-banking financial intermediaries stated in respect of unincorporated bodies in para 8.25 of its report as under:

"8.25. We, therefore, suggest that Reserve Bank's control may be extended to finance corporations and necessary enabling legislation be passed to that effect. We recognise that the administrative task of watching and regulating the operations of a large number of small firms will be difficult. We, therefore, suggest that if the law permits, only companies may be allowed to do the banking business in the sense of accepting deposits from the public for the purpose of lending or investment. In that case, the Banking Regulation Act would govern the operations of the Bangalore-type finance corporations. If, however, the law does not permit it, any scheme of regulation may have as one of its objections (*sic*) the reduction in the number of finance corporations besides, of course, the safeguarding of depositors' interest."



23. It was further submitted that the amendments were introduced after taking into account the recommendations of successive committees, appointed by the Bank and the Government of India, which had studied the functioning of these bodies. The question of restricting such financial activity by unincorporated bodies, is a question of economic policy as it involves regulation of economic activities by different constituents. In such matters of economic policy, this Hon'ble Court does not interfere with the decision of the expert bodies which have examined the matter. The following observations of this Hon'ble Court made in *R.K. Garg v. Union of India*⁵ at p. 969 are appropriate: (SCC pp. 690-91, para 8)

"8. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J. that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or straitjacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey v. Doud*⁶ where Frankfurter, J. said in his inimitable style:

'In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The

legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the Judges have been overruled by events — self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.’

The Court must always remember that ‘legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry’; ‘that exact wisdom and nice adaptation of remedy are not always possible’ and that ‘judgment is largely a prophecy based on meagre and uninterpreted experience’. Every legislation particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be crudities and inequities in complicated



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experimental economic legislation but on that account alone it cannot be struck down as invalid.”

At p. 988 it is further held: (SCC p. 706, para 19)

“That would depend upon diverse fiscal and economic considerations based on practical necessity and administrative expediency and would also involve a certain amount of experimentation on which the Court would be least fitted to pronounce. The Court would not have the necessary competence and expertise to adjudicate upon such an economic issue. The Court cannot possibly assess or evaluate what would be the impact of a particular immunity or exemption and whether it would serve the purpose in view or not.”

24. Even if these restrictions incorporated in the Act amount to a total prohibition, such action was necessary in the public interest as the mushroom growth of unincorporated bodies accepting deposits had gone beyond control calling for restriction of the nature imposed by the amended Section 45-S. In the case of *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.*⁷ this Hon'ble Court took judicial notice of and expressed concern about the mushroom growth of such bodies by referring to the advertisements issued by various such bodies in the press. While upholding the constitutional validity of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (*Srinivasa Enterprises v. Union of India*⁸) this Hon'ble Court pointed out that for saving the poor and unwary public from the unscrupulous racketeers who glamourise and prey upon the gambling instinct to get rich through prizes, banning was necessary. The Court observed “how can you save moths from the fire except by putting out the fatal fire?” On the same analogy for safeguarding or protecting the public from the loss which was likely to be caused to them by the failure of unincorporated bodies promising high returns, it was necessary to prohibit unincorporated bodies from accepting deposits from the public. Further, as observed by this Court in *Srinivasa Enterprises case*⁸

“it is a constitutional truism that restrictions, in extreme cases, may be pushed to the point of prohibition if any lesser strategy will not achieve the purpose”. (SCC p. 513, para 11)

25. It cannot be denied that shroffs have played an important role in providing finance in the rural sector and in small towns. But despite the services which they may have rendered, it is difficult to accept the contention that RBI was not justified in

imposing a ban on unincorporated bodies accepting deposits from the public while carrying on financing business. The inherent danger to the public specially in small towns and villages in permitting such business to be carried on unchecked and unregulated was ample justification for the impugned legislation, keeping in mind the experience of the public which had been dealing with such unincorporated bodies in Kerala and Tamil Nadu. It is open to the appellants to organise their



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business within the permissible legal set-up by forming non-banking financial corporations and functioning in accordance with Chapter III-B of the Act and the directives issued by the Bank from time to time. The prohibition on partnership firms to carry on their business like that of shroffs cannot be regarded as being an unreasonable restriction on the fundamental right of the appellants to carry on their trade. They can continue lending money as long as they do not borrow from the public.

26. The services rendered by certain informal sectors of the Indian economy could not be belittled. However, in the path of economic progress, if the informal system was sought to be replaced by a more organised system, capable of better regulation and discipline, then this was an economic philosophy reflected by the legislation in question. Such a philosophy might have its merits and demerits. But these were matters of economic policy. They are best left to the wisdom of the legislature and in policy matters the accepted principle is that the courts should not interfere. Moreover in the context of the changed economic scenario the expertise of people dealing with the subject should not be lightly interfered with. The consequences of such interdiction can have large-scale ramifications and can put the clock back for a number of years. The process of rationalisation of the infirmities in the economy can be put in serious jeopardy and, therefore, it is necessary that while dealing with economic legislations, this Court, while not jettisoning its jurisdiction to curb arbitrary action or unconstitutional legislation, should interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all.

27. Examining the validity of the amended Section 45-S of the Act by applying the principles enunciated over the years by this Court, and as encapsulated in the passage quoted in the earlier part of this judgment from this Court's decision in *Papnasam Labour Union case*³ we find that the said section is in no way illegal or bad in law. Section 45-S no doubt prohibits the conduct of banking business by an unincorporated non-banking entity like a shroff, but this prohibition has come about, inter alia, in the interest of unwary depositors and borrowers (from shroffs) and with a view to prevent them from committing financial suicide. Earlier attempts to adequately regulate the non-banking institutions not having achieved the desired result of protecting a large number of depositors from unincorporated financial institutions which would suddenly mushroom overnight and then vanish without a trace taking with them the depositors' money, left RBI with no alternative but to prohibit such unincorporated entities from conducting financial business which was more than akin to banking.

28. The restrictions imposed against acceptance of deposits by unincorporated bodies carrying on financial activity or the business of deposit acceptance or lending in any manner are in the larger interest of the general public vis-à-vis the few persons accepting such deposits. The need for such restrictions had become acute and imperative in view of large-scale mismanagement of public funds by such unincorporated bodies.

29. Accordingly, we hold that the provisions of Section 45-S of the Act are valid.



30. Before we conclude there is another matter which we must advert to. It has been brought to our notice that Section 45-S of the Act has been challenged in various High Courts and a few of them have granted the stay of provisions of Section 45-S. When considering an application for staying the operation of a piece of legislation, and that too pertaining to economic reform or change, then the courts must bear in mind that unless the provision is manifestly unjust or glaringly unconstitutional, the courts must show judicial restraint in staying the applicability of the same. Merely because a statute comes up for examination and some arguable point is raised, which persuades the courts to consider the controversy, the legislative will should not normally be put under suspension pending such consideration. It is now well settled that there is always a presumption in favour of the constitutional validity of any legislation, unless the same is set aside after final hearing and, therefore, the tendency to grant stay of legislation relating to economic reform, at the interim stage, cannot be understood. The system of checks and balances has to be utilised in a balanced manner with the primary objective of accelerating economic growth rather than suspending its growth by doubting its constitutional efficacy at the threshold itself.

31. While the courts should not abrogate (*sic* abdicate) their duty of granting interim injunctions where necessary, equally important is the need to ensure that the judicial discretion does not abrogate from the function of weighing the overwhelming public interest in favour of the continuing operation of a fiscal statute or a piece of economic reform legislation, till on a mature consideration at the final hearing, it is found to be unconstitutional. It is, therefore, necessary to sound a word of caution against intervening at the interlocutory stage in matters of economic reforms and fiscal statutes.

32. A number of petitions had been filed in this Court seeking transfer of writ petitions pending in different High Courts. By order dated 17-2-2000, those transfer petitions were dismissed as not pressed. Besides the writ petitions, in respect of which those transfer petitions had been filed, a number of other petitions are pending disposal in various High Courts. In quite a few of them the High Courts have granted an interim injunction staying the operation of the implementation of the amended Section 45-S of the Act. For the view we have taken now, it is imperative that these petitions, pending in the different High Courts, are formally disposed of at an early date. We, therefore, request all the High Courts, in which the petitions are pending challenging the provisions of Section 45-S, to dispose of them within a period of three months. Needless to say inasmuch as the validity of Section 45-S has been upheld by us, the said provision shall be liable to be enforced notwithstanding any interim orders to the contrary which may have been passed by any High Court, which interim order must necessarily now lose all its significance.

33. For the aforesaid reasons, this writ petition is dismissed. The respondents will be entitled to costs.

[†] Under Article 32 of the Constitution of India

¹ (1987) 62 Comp Cas 769 (Del)

² (1993) 2 SCC 582

^{††} Ed.: As substituted by Act 23 of 1997, S. 9

³ (1995) 1 SCC 501 : 1995 SCC (L&S) 339

⁴ (1992) 2 SCC 343

⁵ (1981) 4 SCC 675 : 1982 SCC (Tax) 30 : (1982) 1 SCR 947, 969

⁶ 354 US 457 : 1 L Ed 2d 1485

⁷ (1987) 1 SCC 424 : (1987) 61 Comp Cas 663

⁸ (1980) 4 SCC 507

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