

## **Delhi Cloth & General Mills Co. Ltd. And ... vs Union Of India (Uoi) And Ors. on 21 July, 1983**

**Equivalent citations:** AIR1983SC937, [1983]54COMPCAS674(SC), (1983)2COMPLJ281(SC), 1983(2)SCALE16, (1983)4SCC166, [1983]3SCR438

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**Bench:** D.A. Desai, V. Balakrishnan Eradi

### **JUDGMENT**

D.A. Desai, J.

1. In this group of writ petitions under Article 32 and appeals by special leave under Article 136 of the Constitution, constitutional validity of Rule 3A of the Companies (Acceptance of Deposit) Rules, 1975 ('Deposits Rules' for short) introduced by Companies (Acceptance of Deposits) Amendment Rules, 1978 which became operative from April 1, 1978 and incidentally of Section 58A of the Companies Act, 1956 ('Act' for short) inserted by Companies (Amendment) Act, 1974 which came into force on February 1, 1975 is challenged. The challenge proceeds on diverse grounds which may be briefly summarised.

2. At the very outset, it must be noticed that the factual matrix has little or practically no relevance in this case.

3. The contention put in the forefront was that in the absence of guidelines both Section 58A and the Rule 3A of the Deposits Rules enacted in exercise of the power conferred by Section 58A confer arbitrary and uncanalised powers and hence are violative of Article 14. Contravention of Article 14 was canvassed for the additional reason that the power to exempt from the application of the rule confers wide discretion so that it can be used arbitrarily to pick and choose with the result that equality before law is denied. Further the obligation to deposit 10% of the deposits maturing during the year ending 31st March next following has no rational nexus to the object sought to be achieved by the provisions and is either in excess of the requirement or irrelevant and in any case arbitrary. The next in order of priority came the challenge that having regard to the numerous inbuilt safeguards provided in Section 58A, the imposition of a liability to deposit 10% of the total deposits maturing in a year in the manner as required by the impugned rule, if it was enacted for the protection of the depositors, the protection is illusory and does not subserve the purpose for which it is enacted and therefore, requirement is wholly unreasonable and imposes an unreasonable restriction on the freedom to carry on business conferred by Article 19(1)(g). As a corollary, it was submitted that if Rule 3A is enacted not for the limited purpose of protecting depositors, but has a

wider aim particularly with regard to the regulation of credit system of the country, control of circulation of money in India's economy and imposing financial discipline, it is clearly ultra vires Section 58A. As a second string to the bow, it was contended that if Section 58A enacts a legislative policy, a rule framed to carry out the policy must be relevant to the implementation of the policy so laid down, but the provision contained in Rule 3A is neither relevant nor capable of being regarded as relevant for implementation of the policy and therefore, it is ultra vires Section 58A.

4. Mr. S.T. Desai, who appeared in some matters further contended that if Section 58A is widely construed to encompass the mode or manner of utilisation of the funds of the company which will include the depositors made with the company, obviously Section 58A itself will be rendered unconstitutional as transgressing the permissible limits of delegated legislation and it would appear that the Legislature was guilty of abdication of its essential legislative functions. It was said that Rule 3A cannot be saved as a regulatory measure because the regulatory measure must subserve some purpose which Rule 3A fails to achieve, namely, protection of depositors and in examining the matter, the Court should eschew a dogmatic or doctrinaire approach.

5. Mr. O.P. Malhotra, learned Counsel appearing in some matters raised an additional contention that Parliament did not have legislative competence to enact Section 58A and ipso facto Rule 3A because the legislation is referable to Entry 30 in the State List: Money lending and money lenders; relief to agricultural indebtedness and not to Entries 43 and 44 of the Union List.

6. Mr. G.A. Shah, appearing in some matters raised an additional contention that to the extent limited retrospectivity is given to Rule 3A, it is ultra vires Section 58A and the Constitution.

7. Mr. A. Subba Rao, learned Counsel appearing in some other matters canvassed one more contention when he urged that the obligation to deposit 10% of the amount of deposits maturing in the year constitutes temporary deprivation of property without any countervailing obligation or benefit and therefore it is ultra vires the Constitution.

8. The learned Attorney General appearing for the Union of India raised a preliminary objection that the writ petitions under Article 32 or those filed in the High Court under Article 226 were not maintainable because the incorporated company being not a citizen, freedom guaranteed by Article 19(1)(g) is not secured to it, and situation would not be improved by merely impleading a Director or a shareholder as one of the petitioners because company has a juristic personality independent of the shareholders and the Directors and trade or business carried on by the company cannot be said to be the trade or business carried on by the Director or Shareholders. And to keep Article 14 out of the way, it was urged that it is merely a facade to invoke the jurisdiction of this Court. It was next urged that Section 58A enacts a legislative policy, and wisdom or necessity of the policy is in the domain of the Legislature and the Court never undertakes to examine the wisdom or otherwise of the legislative policy. Proceeding along this line, it was said that if Rule 3A is enacted for the implementation of the legislative policy, the Court is precluded from examining the wisdom or otherwise of the policy; because legislature is the best Judge in this behalf. It was urged that the charge of excessive delegation is unsustainable because the legislative policy underlying the provision was devised after consulting and obtaining guidance of an expert body like the Reserve

Bank of India and the relevant rules were placed before the Parliament which had complete control over the rules and exemption or exclusionary clause can be properly implemented because of the guidance available from the scheme of the Act as also the purpose and object underlying the impugned provision. An alternative submission was that the Court need not undertake the examination of the validity of the exemption provision because it is severable and its invalidity will not affect the rest of the scheme if it was otherwise valid. In answer to the contention whether the impugned rule has nexus to the objects sought to be achieved and the effectiveness of the rule, it was submitted that firstly Section 58A must receive such interpretation as would suppress the mischief and advance the remedy. It was pointed out that the mischief which was sought to be remedied is clearly discernible from the Statement of Objects and Reasons as also the notes on clauses published while introducing 1974 Amendment Act. It was next urged that if the rule imposes a restriction on the fundamental freedom to carry on trade or business, the same is reasonable because it is of a regulatory nature enacted with a view to protecting depositors coming from a socially and economically weaker section who may be tempted by the alluring promises made in an advertisement inviting deposits with no umbrella of protection when the company folds up its tent; becomes sick and in winding-up, the depositor has to stand in a queue as an unsecured creditor. It was lastly submitted that even if it can be said that there was limited retrospectivity, the same is permissible because the mere fact that a part of the requisite for the application of the rule is derived from an anterior date by itself will not make it retrospective.

9. Before we examine the various contentions summarised here, a brief review of the relevant provisions of the Act and the Deposits Rules would be advantageous. The Companies Act, 1956 was enacted to consolidate and amend the law relating to companies and certain other associations. Section 58A was introduced by the Companies (Amendment) Act, 1974. The relevant portion of Section 58A is extracted hereunder :

58A: Deposits not to be invited without issuing an advertisement: (1)....

(2) No company shall invite, or allow any other person to invite or cause to be invited on its behalf any deposit unless:

(a) such deposit is invited or is caused to be invited in accordance with the rules made under Sub-section (1) and

(b) an advertisement, including herein a statement showing the financial position of the company, has been issued by the company in such form and in such manner as may be prescribed.

(3) (a) Every deposit accepted by a company at any time before the commencement of the Companies (Amendment) Act, 1974 in accordance with the directions made by the Reserve Bank of India under Chapter IIIB of the Reserve Bank of India Act, 1934(2 of 1934), shall, unless renewed in accordance with Clause (b) be repaid in accordance with the terms of such deposit.

(b) No deposit referred to in Clause (a) be renewed by the company after the expiry of the term thereof unless the deposit is such that it could have been accepted if the rules made under Sub-section (1) were in force at the time when the deposit was initially accepted by the Company.

(c) Where, before the commencement of the companies (Amendment) Act, 1974, any deposit was received by a company in contravention of any direction made under Chapter III B of the Reserve Bank of India Act, 1934 (2 of 1934), repayment of such deposit shall be made in full on or before the 1st day of April, 1975 and such repayment shall be without prejudice to any action that may be taken under the Reserve Bank of India Act, 1934 for the acceptance of such deposit in contravention of such direction.

(4) Where any deposit is accepted by a Company after the commencement of the Companies (Amendment Act, 1974, in contravention of the rules made under Sub-section (1), repayment of such deposit shall be made by the company within thirty days from the date of acceptance of such deposit or within such further time, not exceeding thirty days, as the Central Government may, on sufficient cause being shown by the company, allow.

.....

.....

(7) (a) Nothing contained in this section shall apply to :

(i) a banking company, or

(ii) such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(b) Except the provisions relating to advertisement contained in Clause (b) of Sub-section (2), nothing in this section shall apply to such classes of financial companies as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

10. In exercise of power conferred by sec 58A read with Section 642 of the Act, Central Government enacted and promulgated the Companies (acceptance of Deposits) Rules, 1975. Rule 2B defines 'deposit' to mean any deposit of money with, and included any amount borrowed by a company; but does not include what is set out in Sub-clause (i) to (x). Rule 3 prescribes conditions subject to which the deposits may be accepted. Deposits against unsecured debentures or deposits from share-holders of a public company or deposits guaranteed by any person, who at the time of giving the guarantee, is a director of the company, together with short-term deposits, if any, accepted shall not exceed 10% of the paid-up capital and free reserves of the company. Any deposit other than

those mentioned herein before shall not exceed 25% of the paid-up capital and free reserves of the company. No deposit for a term less than six months and exceeding thirty-six months can be accepted save what is called short-term deposit as set out in the proviso to Rule 3(1)(b). A ceiling on the rate of interest was imposed at 15% per annum (See Rule 3). Then comes Rule 3A which is the center of this fierce controversy. It may be reproduced in extenso :

3A. Maintenance of liquid assets:

(1) Every company shall, before the 30th day of April of each year deposit or invest, as the case may be, a Sum which shall not be less than ten percent of the amount of its deposits maturing during the year ending on the 31st day of March next following, in any one or more of the following methods, namely :

(a) in a current or other deposit account with any scheduled bank, free from charge or lien;

(b) in unencumbered securities of the Central Government or of any State Government;

(c) in unencumbered securities mentioned in Clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882(2 of 1882).

Provided that with relation to the deposits maturing during the year ending on the 31st day of March, 1979, the sum required to be deposited or invested under this sub-rule shall be deposited or invested before the 30th day of September, 1978.

Explanation : For the purposes of this sub-rule, the securities referred to in Clause (b) or Clause (c) shall not be reckoned at their market value.

(2) The amount deposited or invested, as the case may be, under Sub-rule (1), shall not be utilised for any purpose other than for the repayment of deposits maturing during the year referred to in that sub-rule, provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below ten percent of the amount of deposits maturing until the 31st day of March of that year.

11. Rule 4 prescribes form and particulars of advertisement which must be issued for inviting deposits. Rule 5 prescribes the form of application to be made for deposits and Rule 6 makes it obligatory to furnish a receipt for the deposit. Rule 7 obligates the company to maintain register of deposits. Rule 10 requires the company to file a return of deposits with the Registrar. These are the conditions prescribed by rules subject to which deposits can be invited and accepted. The challenge is confined to Rule 3A only which obligates the company to deposit 10% of the deposits maturing during the prescribed year in the manner set out in Clause (a), (b) and (c) of Sub-rule 1 of Rule 3A.

12. The learned Attorney General raised a preliminary objection to the maintainability of the writ petitions filed in this Court under Article 32 and those filed in the High Court under Article 226 of the Constitution. The submission was founded on the ground that an incorporated company being not a citizen for the purposes of Article 19 and therefore it cannot complain of the denial or deprivation of fundamental freedom guaranteed by Article 19(1)(g) of the Constitution and the situation is not improved by joining either a share-holder or a Director as co-petitioner. It was said that the company has a juristic personality independent of the Director or a shareholder and the business or trade carried on by the company is not that of either the shareholder or the Director. As the corollary, it was urged that even if the impugned Rule 3A imposes an unreasonable restriction on the fundamental freedom to carry on trade or business, this Court cannot entertain a petition under Article 32 nor the High Court can entertain one under Article 226 of the Constitution. Frankly speaking, this is an oft repeated contention whenever the petitioner is an incorporated company but the law in this behalf is in a nebulous state and therefore, it is not possible to throw out the petition at the threshold. More so because a petition under Article 226 of the Constitution can be filed by the company for any other purpose and also the petitioners complain of violation of Article 14 of the Constitution. The reasons for stating that the law is in a nebulous state may briefly be mentioned. In *State Trading Corporation of India Ltd. v. The Commercial Tax Officer, Visakhapatnam* and *Tata Engineering & Locomotive Co. v. State of Bihar* this Court held that a Corporation not a citizen within the comprehension of Article 19 and therefore, could not complain of denial of fundamental freedom guaranteed by Article 19 to a citizen of this country. These two decisions are an authority for the proposition that an incorporated company being not a citizen could not complain of violation of fundamental freedom guaranteed to citizens under Article 19. But a different note was struck in *R.C. Cooper v. Union of India* when it was held that a measure executive or legislative may impair the rights of the company alone, and not of its shareholders; it may impair the rights of the shareholders as well as of the company. It was further held that jurisdiction of the Court to grant relief cannot be denied, when by State action the rights of the individual shareholder are impaired, if that action impairs the rights of the company as well. In that case, the Court entertained the petition under Article 32 of the Constitution at the instance of a Director and the shareholder of a company and granted relief. The two conflicting trends in this behalf were noticed by this Court in *Bennett Coleman & Co. and Ors. v. Union of India and Ors.* where after review of the afore-mentioned decisions and several others, it was held as under :

As a result of the Bank Nationalisation case (supra) it follows that the Court finds out whether the legislative measure directly touches the company of which the petitioner is a shareholder. A shareholder is entitled to protection of Article 19. That individual right is not lost by reason of the fact that he is a shareholder of the company. The Bank Nationalization case (supra) has established the view that the fundamental rights of share-holders as citizens are not lost when they associate to form a company. When their fundamental rights as shareholders are impaired by State action their rights as shareholders are protected. The reason is that the shareholders' rights are equally and necessarily affected if the rights of the company are affected. The rights of shareholders with regard to Article 19(1)(a) are projected and manifested by the newspapers owned and controlled by the shareholders through the medium of the corporation.

Our attention was, however, invited to two later decisions : (1) The Divisional Forest Officer v. Bishwanath Tea Co. Ltd. and (2) Western Coalfields Ltd. v. Special Area Development Authority. Korba and another . But we can draw no assistance from the aforementioned two cases because in the first case the question this Court considered was whether a petition merely for refund of a tax paid under a mistaken impression at the instance of a company can be entertained under Article 226 and the question in the second case was whether the properties of a Govt. company are exempt from levy of tax imposed by state or its delegate under Article 285(1). The contention raised in these two cases does not touch the question under examination. Thus apart from the law being in a nebulous state, the trend is in the direction of holding that in the matter of fundamental freedoms guaranteed by Article 19, the rights of a shareholder and the company which the shareholders have formed are rather co-extensive and the denial to one of the fundamental freedom would be denial to the other It is time to put an end to this controversy but in the present state of law we are of the opinion that the petitions should not be thrown out at the threshold. We reach this conclusion for the additional reasons that apart from the complaint of denial of fundamental right to carry on trade or business, numerous other contentions have been raised which the High Court had to examine in a petition under Article 226. And there is a grievance of denial of equality before law as guaranteed by Article 14. We accordingly overrule the preliminary objection and proceed to examine the contentions on merits.

13. Let the camouflage of alleged violation of fundamental right in these petitions not deceive any one; let no one be in doubt that the petitions are filed to vindicate some fundamental rights encroachment on which is resented. At the root lies the fierce and unending battle royal between political power and economic power to gain ascendance one over the other. Piercing the veil of legalese the core-question is the degree of social control imposed by the State and resisted at every turn by the corporate sector in the internal administration of corporate sector. Therefore, a bird's eye-view of the development of company law which represents the State intervention in management of companies would be advantageous.

14. Any scientific attempt at presenting the history of company law in our country inevitably telescopes into the history of company law in U.K. because more or less the framers of the company law in India followed in the shadow of the development of the law in U.K. Corporate sector wields tremendous economic power and this organised sector has throughout challenged by all the means at its command, social control by political institutions and more particularly the State. The law developed in the footsteps of abuse by the corporate sector of its economic power and dominating influence in the world of national and international industry, trade and commerce. If uncontrolled, the result is disastrous and the infamous South-Sea Bubble should be an eye-opener. The first and second decades of the 18th century were marked by an almost frenetic boom in company flotations. When the flood of speculative enterprises was at its height, Parliament in U.K. decided to intervene to check the gambling mania when it drew attention to the numerous undertakings which were purporting to act as corporate bodies without legal authority, practices which manifestly tend to the prejudice of of the public trade and commerce of the kingdom (See Modern Company Law by Government 4th Edn. page 28-29) That which governs the least, governs the best, the laissez faire

doctrine was firmly entrenched. Since then at regular intervals, the State control became more or less discernible in successive company acts.

15. The State intervention into the functioning of the corporate sector initially took the form of the prosecution for breach of some of the laws, the first notable case being the one in November, 1807. The Attorney General at the instance of a private relator sought criminal information against two unincorporated companies both of which had freely transferable shares and advertised that the liability of the members would be limited. Lord Ellenborough in *R. v. Dad* 1808 (9) East 565 dismissed the application because of the lapse of 87 years, since the Act was previously invoked but he issued a stern warning that no one in the future could pretend that the statute was obsolete and indicated that a speculative project founded on joint stock or transferable shares' was prohibited.

16. Returning to the native soil, the first legislative measure to regulate the companies in India was the enactment of the Joint Stock Companies Act of 1850. It was amended in 1857, a notable feature of the amendment being extension of limited liability benefit to insurance and banking companies. The Amending Acts, one in 1866 and the other in 1913 followed. The Indian Companies Act of 1913 was a fairly comprehensive measure taking into its stride the amendments in U.K. Companies Act till then made. This Act was extensively amended in 1936 and again at regular intervals thereafter. The Government of India appointed a Committee in 1950 under chairmanship of Shri Bhabha to consider amongst other things the extent to which it was possible to adjust the structure and methods of the corporate form of business management with a view to weaving an integrated pattern of relationships as between promoters, investors and the management, principal among them being the legitimate rights of investors and the interest of creditor, labour and other partners in production and distribution may be duly safeguarded and the attainment of the ultimate end of social policy towards which the corporate sector must work. A comprehensive statute being Companies Act of 1956 was enacted pursuant to the recommendations of the Bhabha Committee. The two notable features of the 1956 Act from the point of view of the present discussion are compulsory maintenance and audit of company accounts, and power of inspection and investigation by the Central Government. When the Act of 1956 functioned for a period of about a year and some, difficulties surfaced in its actual implementation, the Government of India appointed a committee under the chairmanship of Justice A.V. Vishwanatha Sastri, retired Judge of the Madras High Court in May 1957 to examine the working of the Companies Act, 1956. The terms of reference of the committee were quite wide. This Committee submitted its Report in 1957, which led to the Companies (Amendment) Act, 1960. This amendment was specifically directed to the safeguarding of the private investment in the corporate sector. The Government of India acquired extensive powers for regulation of the financial management of the private sector companies, under the 1960 (Amendment) Act. In the meantime, the Government of India having received numerous complaints of fraud, embezzlement of funds and gross irregularities in the companies controlled and managed by Dalmia-Jain combine, appointed a Commission of Enquiry first presided over by Justice S.R. Tendulkar and subsequently by Shri Vivian Bose, a retired Judge of the Supreme Court of India. This Commission submitted its report in the fall of 1962. Vivian Bose Enquiry Commission Report unearths the intrigue, abuse of trust jugglery of company funds, misuse and abuse of positions of power in the management of the affairs of Dalmia-Jain Group of Companies as also criminal breach of trust in respect of the funds of the Company reposed in the promoters and controllers of the



private companies and how they utilised the corporate finances for their personal advancement. This report, led to the enactment of Companies (Amendment) Act, 1965 which vastly increased the Governmental control of the private sector companies. The Companies (Amendment) Act, 1974 which inter alia introduced Section 58A simultaneously ushered in vast changes in the 1956 Act making greater inroads by Central Government in the management of companies governed by 1956 Act. A step by step study of the various amendments would unmistakably reveal the greater and greater intervention and control by State and this control was in direct proportion to the abuse of the economic power wielded by the corporate sector.

17. The Companies Act of 1956 to some extent also attempts to translate into action Article 38 and 39 in Part IV of the Constitution by which the State was directed that the ownership and control of the material resources of the community are so distributed as best to subserve the common good and the operation of the economic system does not result in concentration of wealth and means of production to the common detriment. Further Article 46 mandates the State to promote economic interests of weaker sections of the people from all forms of exploitation. A fortiori every provisions of the Companies Act must receive such interpretation as to suppress the mischief to remedy which it was enacted and advance the object as also to achieve and translate into action the underlying intentment of the enactment for the realisation of the constitutional goals as set out in Part IV of the Constitution.

18. As a high priority promise of independence laws directed to agrarian reforms rolled out from State legislatures in quick succession Urban elite found it disadvantageous to invest their savings in agricultural land. It is said that rent Restriction Acts were a disincentive for investment in urban house property. Gold control measure dried up gold as a venue of investment of savings. Bank interests were discouraging. Social security in old age being niggardly or nonexistent there was fascinating attraction for deposits in non-banking companies. There was such tremendous rush in this direction that even Banks stood aghast at this phenomenon. This point can be buttressed by a mere reference to the fact that in the year 1973-74 deposits of non-banking companies rose from 747.8 crores to Rs. 1028 crores and by 1978 it rose to 1313.0 crores (Project Report on Government Regulation of Financial Management of the Private Sector Companies in India by V. D. Kulshrestha). And failure to meet obligation by companies the consequent misery of middle and lower middle classes as tragically illustrated by Sanchaita syndrome attracted the attention of Parliament. This additional aspect has to be kept in view while examining the contentions canvassed in these petitions and appeals.

19. Before we turn to Section 58A and the rules framed thereunder, a reference to the earlier attempts to exercise some degree of control over non-banking companies attracting and inviting depositors from public would be advantageous. Chapter III-B was introduced in the Reserve Bank of India Act, 1934 by Act No. 55 of 1963 which came into force on Feb. 1, 1964. Fasciculus of sections in Chapter III-B bears the title 'Provisions relating to non-banking institutions receiving deposits and financial institutions.' Sec. 45(1) denoted company to mean a company as defined in Section 3 of the Companies Act and includes a foreign company within the meaning of Section 591 of that Act. Deposit was defined to include any money received by a non-banking institution by way of deposit etc. There was an exclusionary clause in pari materia with the exclusionary clause in Section 2(b) of

the Deposit Rules of 1975. Section 45 J conferred power on the Reserve Bank to regulate or prohibit the issue by any non-banking institution of any prospectus or advertisement soliciting deposits of money from the public and to specify the conditions subject to which any such prospectus or advertisement if not prohibited may be issued. Section 45 K conferred power on the Reserve Bank to collect information from non-banking institution as to deposits and also to give directions in this behalf. There were other provisions incidental to these substantive provisions. In exercise of this power, Reserve Bank issued various directions upto and inclusive of 1977 which included ceiling of maximum deposits that can be accepted, the minimum and maximum period for which the same can be accepted and other incidental provisions. These legal provisions are the prelude to the provisions impugned in these petitions and they would unravel the intendment, object, purpose, the mischief prevalent and attempt at remedying the same by Section 58A and the Deposit Rules of 1975.

20. Sec 58A conferred power on the Central Govt. to be exercised in consultation with the Reserve Bank of India to prescribe the limits upto which, the manner in which and the conditions subject to which the deposits may be invited or accepted by a company either from public or from its members. The challenge is directed to Rule 3A which obligates the company inviting deposits to deposit or invest, as the case may be, before the 30th day of April of each year, a sum which shall not be less than ten percent of the amount of its deposits maturing during the year ending on the 31st day of March next following according to any one or more of the methods set out in the rule. Sub-Rule (2) imposes a fetter on the power of the company to use the amount so deposited and invested for any purpose other than for the repayment of deposits maturing during the year referred to in Sub-rule (1). And this is subject to a further condition that deposit shall not any time fall below ten percent of the amount of deposits maturing until the 31st day of March next following. The deposit herein contemplated is to be made with any scheduled bank free from charge or lien or in unencumbered securities of the Central Government or of any State Government or in unencumbered securities mentioned in Clauses (a) to (d) and (ee) of Section 20 of the Indian Trust Act, 1882.

21. The first contention is that having regard to the numerous inbuilt safeguards provided in Section 58A and the rules made thereunder, the imposition of 10% deposit under Rule 3A is unreasonable and arbitrary particularly because the provision does not effectively protect the depositors if that was the underlying intendment. Even prior to introduction of Section 58A, the Reserve Bank of India was empowered to regulate the acceptance and repayment of deposits by the non-banking companies. The legislature having become aware that the regulatory measures introduced by the Reserve Bank of India have not effectively protected the depositors, felt needs of the time necessitated introduction of statutory provisions enabling the Central Government to take effective measures for the protection of the depositors. This becomes manifest from the Statement of Objects and Reasons wherein it was stated that: 'experience has shown that in many cases deposits so taken by the companies have not been refunded on the due dates. In many such cases, either the companies have gone into liquidation or the funds with the companies are depleted to such an extent that the companies are not in a position to refund the deposits. It is accordingly considered necessary to control companies inviting deposits from the public'. The Legislature conferred wide power on the Central Government to introduce regulatory and remedial measures by which the

depositors can be given some protection. To say that the protection is neither adequate nor sufficient and therefore of doubtful utility and accordingly must be rejected as arbitrary is to put a premium on these practices which necessitated a further measure of social control, taking more effective steps to checkmate the abuse of this powerful corporate sector and to leave the mischief unrepaired. Any interpretation of Section 58A has to be such as to achieve the purpose of imposing a measure of social control to remedy the mischief, to suppress which the provision was enacted. To revert to the language of Section 58A, the Central Government was authorised to prescribe the limits subject to which, the manner in which and the conditions subject to which the deposits may be invited or accepted by the company. The Deposit Rules viewed as a whole amongst others prescribe the limits upto which a company can invite and accept deposits (Rule 3(1) & (2)). The obligation to issue an advertisement on par with the prospectus (Rule 4), obligation to furnish receipt to the depositors (Rule 7), all necessarily prescribed the manner in which deposits may be invited or accepted. Rule 3A makes it obligatory to keep 10% of the deposits maturing in a year, and it thus provides one of the conditions subject to which deposits can be invited or accepted. And indisputably, Section 58A confers power on the Central Government to prescribe all the three things by rules made in this behalf.

22. It was, however, urged that this Rule 3A is arbitrary for more than one reason : (1) that it deprives the company the use of 10% of its funds even though the company is obliged to pay interest to the depositors as contracted between the parties and (2) if the rule was intended to afford some safeguard in the interest of the depositors or protect them, the protection is illusory because in winding-up proceedings, the depositors will have to stand *pari passu* with other unsecured creditors while secured creditor and preferential creditor will score a march over them even in regard to the 10% deposit because that would be treated as an asset of the company available for distribution amongst various persons entitled to recover claims from the company.

23. Undoubtedly, depositors with a company unless otherwise indicated would be unsecured creditors. Secured creditors and preferential creditors in the event of winding up of the company would score a march over them in distribution of the assets of the company. But every measure cannot be viewed or interpreted in the event of a catastrophe over-taking the company. The provision for deposit of 10% of deposits ensnares repayment of deposits maturing in the year and in order to enable the company to meet its obligation, a provision is made in Sub-rule (2) of Rule 3A itself that the amount deposited or invested, as the case may be, under Sub-rule (1), shall not be utilised for any purpose other than for the repayment of deposits maturing during the year referred to in Sub-rule (1). This necessarily implies that this 10% deposit can be utilised for refunding the deposit maturing in a year and that itself is an obligation of the company and in order to provide the company with liquid finance to meet its obligation, the provision of compulsory deposit is introduced. The same cannot be questioned on the ground that it constitutes deprivation of property of a company or is of a confiscatory nature. The amount deposited to meet with the obligation of Rule 3A is and remains the property of the company nor anyone else has any access to it. One has to see the immediate object in view to achieve which the provision is made and not its remote consequences. And it would be an interesting question of law to be decided in an appropriate case as to the position and character of this statutory 10% deposit in distribution of assets of a company in winding-up proceedings. The argument that this provision was made for increasing the deposits in

Nationalised Banks or augmenting the investment in the Central and State securities, is so far fetched that it leaves us unconvinced.

24. The second limb of the submission is that this provision fails to accord reliable protection to the depositors. We are at a loss to appreciate this submission. Undoubtedly, it is not so effective as admitted by the Minister of Law, Justice and Company Affairs while replying to a question in Parliament on September 15, 1981 to ensure every depositor whose deposit is maturing in the year to be fully paid out of the deposit amount. But no regulatory or protective measure can be rejected as arbitrary on the short ground that it fails to fully protect the person for whose benefit it is enacted. It is an argument of despair that let there either be full protection or no protection. This is the fatalist attitude which the court can neither encourage nor appreciate. One has to keep in view the cumulative effect of protective and regulatory measures.

25. Anything English has such an over-powering attraction that Without any attempt at assimilating the developmental stage of two wholly dissimilar societies, provisions of English Act were held out as a model and the impugned provision attacked by impermissible comparisons. Reference was made to Protection of Depositors Act, 1963 of U.K. and it was urged that to afford real protection, provision similar to U.K. Act should have been enacted. The submission leaves us cold. What form a regulatory measure must take is for the legislature to decide and the court would not examine its wisdom or efficacy except to the extent that Article 13 of the Constitution is attracted. Having said this, it may be stated that except a little more detailed provision there is nothing very useful or of such innovative nature as would be impressive even for a recommendation.

26. Requiring the company to invest 10% of its deposits maturing in a year in deposit with prescribed institutions or in trust securities cannot be termed as deprivation of the funds of the company. It is a measure to ensure that part of the funds of a company are kept as liquid assets available for use for specified purpose. This is clearly discernible from the marginal note of Rule 3A. Regulatory measure ensuring availability of liquid asset cannot be termed as deprivation of property. It becomes an earmarked fund and it is well-known that the economic planning may provide for earmarked funds and if by voluntary self-discipline and sound economic planning financial viability is not maintained, a Welfare State with planned economy may impose statutory discipline in larger public interest. Such disciplinary measures cannot be termed deprivatory in character. Even when the money is kept in deposit, it remains the property of the company and available for its use albeit as provided in the statute. The Legislature was not unaware of a known malady that the private sector companies were becoming sick after incurring huge debts, rendering small investors destitute, heaping miseries on the weaker sections of the society and therefore if by a measure a company which is permitted to attract deposits from the public generally described as gullible simultaneously, an obligation is imposed to keep an infinitesimally small portion of assets as liquid finance available for meeting the obligations, namely repayment of deposits maturing in a given year, it cannot be said that this constitutes deprivation of company's fund. If a trust can be compelled to deposit trust funds in a manner prescribed by the statute, if a nationalised or scheduled bank is compelled to maintain requisite liquidity in respect of which a charge of deprivation of property cannot be validly made, it is difficult to entertain the submission that as a regulatory measure if a company for the benefit it enjoys of an enabling power to invite deposits

from public is asked to keep in deposit 10% of the deposits maturing in a year the same would be deprivatory and therefore arbitrary.

27. In passing it was stated that having regard to the numerous inbuilt safeguards in Section 58A of the Companies Act, the imposition of 10% compulsory deposit under Rule 3A is in excess of the requirements of the protection and therefore unreasonable and arbitrary. Having had the legacy of the laissez faire doctrine imposed by foreign rulers till the end of 19th century, and even with the tormenting experience of South-Sea Bubble, the State was least inclined to interfere with the working of the incorporated companies. But as noticed in the Statement of Objects and Reasons while introducing the 1974 Amendment Act which incorporated Section 58A in the Companies Act, it was designed to meet cases of abuse or distortion of system which have, of late, assumed comparatively serious proportion and a stringent measure of control has become inevitable. This is in accord with the report of the Jenkin's Committee in the United Kingdom in which it was observed that the Company is not a field of legislation in which finality is to be expected, as the law falls to be applied to a growing and challenging subject matter and growing use of the company system as an instrument of business and finances and the possibilities of abuse inherent in that system. A vigilant Parliament keeping a close watch over this corporate sector wielding considerable economic power has to take steps by doses to eradicate the abuses of the economic power by these corporations. More insidious the abuses of economic power greater social control became unavoidable for the health of national economy and protection of the persons dealing with corporations. No legal step can be said final or unnecessary because social control has inevitably to follow to defuse abuses of economic power. In such a situation, to say, that a further measure of protection is arbitrary in view of the protection already afforded is begging the issue and the contention must be negatived on this short ground.

28. Having cleared the ground, we must now turn to the main challenge posed on behalf of the petitioners to the constitutional validity of Rule 3A. It was urged that when a regulatory measure imposes conditions the same must fairly and reasonably relate to the objects sought to be achieved. Developing the argument it was submitted that if Rule 3A enacted in exercise of power conferred by Section 58A imposes a statutory condition to deposit 10% of the amount collected by way of deposits by a non-banking company and maturing in a given year in the manner prescribed, this condition bears no relevance to the objects sought to be achieved, the object being the protection of the depositors. And if it does not bear relevance to the object it is arbitrary. Reliance was placed on *Pyks Granaide Co. v. Ministry of Housing and Local Govt. and Anr.* [1958] 1 All England Reports page 625 at 633. Lord Denning posed the question whether if the permission of the planning authority before breaking fresh surface is necessary, what conditions can the planning authority lawfully impose. Answering the question the learned Law Lord observed :

The principles to be applied are not, I think, in doubt. Although the planning authorities are given very wide powers to impose "such conditions as they think fit", nevertheless the law says that those conditions, to be valid must fairly and reasonably relate to the permitted development. The planning authority are not at liberty to use their powers for an ulterior object, however desirable that object may seem to them to be in the public interest.

29. Lord Reid in *Chertsey Urban District Council v. Mixnam's Properties Ltd.* [1965] Appeal Cases 735 approved the statement of law by Lord Denning reiterating that the same was already approved in *Faweett Properties Ltd. v. Buckingham County Council.* [1961] A.C. 636. There cannot be any quarrel with the proposition that where power is conferred to effectuate a purpose and for that end in view to impose conditions, the conditions to be valid must fairly and reasonably relate to the object sought to be achieved. In the absence of this causal connection, the conditions may be rejected as superfluous or arbitrary unrelated to purpose. The power conferred by Section 58A on the Central Government to prescribe the limits up to which, the manner in which and the conditions subject to which deposits may be invited or accepted by non-banking companies had a definite object; namely, to check the abuse by the G corporate sector and to protect the depositors/investors. Mischief was known and the regulatory measure was introduced to remedy the mischief. The conditions which can be prescribed to effectuate this purpose must a fortiori, to be valid, fairly and reasonably, relate to checkmate tin abuse of juggling with the depositors/investors' hard earned-money by the corporate sector and to confer upon them a measure of protection namely availability of liquid assets to meet the obligation of repayment of deposit which is implicit in acceptance of deposit. Can it be said that the conditions prescribed by the Deposit Rules are so irrelevant or have no reasonable nexus to the objects sought to be achieved as to be arbitrary? The answer is emphatically in the negative. Even at the cost of repetition, it can be stated with confidence that the rules which prescribed conditions subject to which deposits can be invited and accepted do operate to extend a measure of protection against the notorious abuses of economic power by the corporate sector, to the detriment of depositions/investors, a segment of the society which can be appropriately described as weaker in relation to the mighty corporation. One need not go so far with Ralph Nadar in 'America Incorporated' to establish that political institutions may fail to arrest the control this ever-widening power of corporations. And can one wish away the degree of sickness in private sector companies ? To the extent companies develop sickness, in direct proportion the controllers of such companies become healthy. In a welfare state, it is the constitutional obligation of the state to protect socially and economically weaker segments of the society against the exploitation by corporations. We therefore, see no merit in the submission that the conditions prescribed bear no relevance to the object or the purpose for which the power was conferred under Section 58A on the Central Government.

30. Basing the submission on the assumption that Rule 3A cannot extend even a semblance of protection to depositor, it was urged that if it was to be viewed in the wider spectrum of regulation of credit system of the country, control of the circulation of the money in India's economy and imposing financial discipline on corporate sector, Rule 3A is clearly ultra vires Section 58A being far in excess of the requirements of Rule 58A. The submission ought to be rejected on the short ground that Rule 3A does extend some protection to a depositor howsoever minimal it may be. When Rule 3A is viewed in the context of various other provisions devised to extend protection to depositors and investors it does play a small but effective part whereby liquid finance would be available to the company accepting deposits for meeting its obligation of repaying the deposits maturing during the year. Therefore, there is no merit in the submission.

31. It was next contended that Rule 3A is ultra vires the provision of Section 58A of the Companies Act as it is beyond the scope and ambit of the section. Developing this argument, it was submitted

that if Section 58A is widely construed to encompass the mode or manner of utilisation of the funds of the company which will include the deposits made with the company, obviously Section 58A itself will be rendered unconstitutional as transgressing the permissible limits of delegated legislation. While tracing the history of the gradually increasing State control over the activities of corporate sector, it was noticed that if the State would not effectively control the activities checkmating the possible abuses individuals dealing with these economic giants would be at the mercy of the latter. May be that this 'hands off' attitude was respectable when laissez faire dictated the state approach, but a welfare state cannot remain indifferent to this sensitive field of exploitation of the weaker section. Section 58A amongst various other things was designed to introduce some measure of control over the non-banking companies inviting and accepting deposits in the ultimate interest of the depositors, and by compelling limited liquidity in resources, the society at large was sought to be protected from the ever haunting specter of sickness in industry often conveniently resorted to by the private sector companies. Section 58A must receive its legitimate construction in the back-drop of this fact situation. Viewed from this angle, Section 58A will enable the Central Government to prescribe conditions subject to which deposits can be accepted and one such condition would be how to readily make, a small portion of the deposit, available for repayment because while inviting and accepting deposits, it is implicit therein that repayment would be assured on the date of maturity.

32. The next limb of the submission is : is there an excessive delegation of essential legislative functions without prescribing any guidelines ? It is indisputable that the Companies Act as a whole and Section 58A in part lays down a legislative policy, namely, gradual ever-widening and effective control of the corporate sector so as to ensure a measure of protection to the persons dealing with it. The wisdom of the legislative policy is not for Court to examine. And in economic legislation, the Court should feel more inclined to judicial deference to legislative judgment. (See R. K. Garg etc. v. Union of India and Ors. etc. [1982] 1 S.C.R. 947. Prag Ice & Oil Mills and Anr. etc. v. Union of India [1978] 3 S.C.R. 292 and R. C. Cooper v. Union of India .

33. The charge of excessive delegation of essential legislative functions is wholly untenable. The history of the Company Law in India, the Object and Reason Statement while introducing 1974 Amendment, regulatory measures undertaken by the Reserve Bank of India' prior to the introduction of Section 58A, all point in the direction of taking gradual steps with a view to introducing greater State intervention and control so as to minimise the abuses by the corporate sector, an inescapable evil directly attributable to concentration of economic power. The test which Prof. Willis has set-down in his 'Constitutional Law' pages 586 & 587 may be recalled :

If a statute declares a definite policy, there is a sufficiently definite standard for the rule against the delegation of legislative power, and also for equality if the standard is reasonable. If no standard is set up to avoid the violation of equality, those exercising the power must act as though they were administering a valid standard.

The policy is definite, guidelines are available from the history of the legislation and Companies Act taken as a whole and one cannot shut one's eye to articulated sickness in private sector undertakings all around so that this feeble measure extending only a

semblance of protection can be struck down as arbitrary or a violating the permissible limits of delegated legislation. Add to this the fact that Deposit Rules have been framed in exercise of power conferred by Section 58A and 642 of the Companies Act. Section 642 requires that every rule enacted in exercise of the power conferred by it, must be placed before each House of Parliament for a period of thirty days and both Houses have power to suggest modification in the proposed rules. This control of Parliament is sufficient to check any transgression of permissible limits of delegated legislation by the delegate. In *D. S. Garewal v. State of Punjab and Anr.* [1959] Suppl. S.C.R. 792 at 803 the Constitution Bench of this Court observed that the requirement that the rules are to be placed before both Houses of Parliament with power to suggest modification would make it perfectly clear that Parliament has in no way abdicated its authority, but is keeping strict vigilance and control over its delegate.

34. Mr. O. P. Malhotra raised a contention as to the legislative competence of the Parliament to enact Section 58A and the Deposit Rules enacted in exercise of the power conferred by Section 58A read with Section 642 of the Companies Act, 1956. This is only to be mentioned to be rejected. Mr. Malhotra urged that when a company invites and accepts deposits, there comes into existence a lender borrower relationship between the depositor and the company, and therefore the legislation dealing with the subject squarely falls under Entry 30 of the State List, 'money-lending and money lenders'. If this submission were to carry conviction, every depositor in the bank would be a money-lender and the transaction would be one of money-lending. Is the banking industry to be covered under Entry 30 ? On the other hand, Entry 45 in Union List is a specific Entry 'Banking' and therefore any legislation relating to banking would be referable to Entry 45 in the Union List. Entry 43 in the Union List is : 'incorporation, regulation and winding-up of trading corporations, including bank, insurance, financial corporations but not including co-operative societies'. Entry 44 refers to incorporation, regulation, and winding up of the corporation whether trading or not when business is not confined to one State but not including universities. Obviously the power to legislate about the companies is referable to Entry 44 when the objects of the company are not confined to one State and irrespective of the fact whether it is trading or not. When a law is impugned on the ground that it is ultra vires the powers of the legislature which enacted it what has to be ascertained is the true character of the legislation. To do that one must have regard to the enactment as a whole, to its objects and to the scope and effect of its provisions (See *A. S. Krishna v. State of Madras* [1957] S.C.R. 399 at 410. To resolve the controversy if it becomes necessary to ascertain to which entry in the three lists, the legislation is referable, the Court has evolved the doctrine of pith and substance. If in pith and substance, the legislation falls within one entry or the other but some portion of the subject-matter of the legislation incidentally trenches upon and might enter a field under another list, then it must held to be valid in its entirety, even though it might incidentally trench on matters which are beyond its competence. (See *Ishwari Khaitan Sugar Mills v. U.P. State and Anr.* at 343, *Union of India v. H. S. Dhillon* , *Kerala State Electricity Board v. Indian Aluminium Company and State of Karnataka and Anr. etc. v. Ranganath Reddy and Anr.* . Applying this doctrine of pith and substance, Section 58A which is incorporated in the Companies Act is referable to Entry 43 and 44 in the Union List and the enactment viewed as a whole cannot be said to be legislation on money-lenders and money-lending or being referable to Entry 30 in the State List. Undoubtedly,



therefore the Parliament had the legislative competence to enact Section 58A.

35. Mr. G.A. Shah canvassed one more contention. After stating that Rule 3A became operative from April 1, 1978, he specifically drew attention to the proviso to Rule 3A (1) which required that with relation to the deposits maturing during the year ending on the 31st day of March, 1979, the sum required to be deposited or invested under Sub-rule 3A (1) shall be deposited or invested before the 30th day of September, 1978. It was then contended that this provision would necessitate depositing 10% of the deposits maturing during the year ending with 31st March, 1979 which may have been accepted prior to the coming into force of Rule 3A and to this extent the rule has been made retrospective and as there was no power conferred by Section 58A to prescribe conditions subject to which deposits can be accepted retrospectively Rule 3A is ultra vires Section 58A. Unquestionably, Rule 3A became operative from April 1, 1978. The obligation cast by Rule 3A 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* 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.

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

36. It was next contended that while giving definition of the expression 'deposit in the dictionary clause of the Deposit Rules, the exclusionary clause is so widely worded that it has successfully kept a large number of similarly situated corporations outside the purview of the Act and the picking and choosing is so arbitrary that one can say with confidence that only private sector companies are singled out for this regulatory treatment. The submission overlooks' the object and purpose underlying enacting Section 58A and the Rules made thereunder. As has been repeatedly noted, it is a regulatory measure to checkmate the abuses, which private sector corporations are prone to. If this object is kept in view, the exclusionary clause explains itself. To enumerate briefly, the bodies excluded from the operation of the rules are Central and State Govt., State Bank of India Nationalised Banks, Industrial Finance Corporation of India, State Financial Corporations established under the State Financial Corporations Act, Industrial Development Bank of India, Electricity Boards constituted under the Electricity (Supply) Act, Life Insurance Corporation of India and such other bodies which if viewed properly disclose a perspective in enacting the exclusionary clause. The perspective is that the bodies which are accountable to public and Parliament as also those whose failure to meet with obligation is inconceivable such as the Central and the State Govt. are excluded from the regulatory measure. This perspective, in fact, reinforces the conclusion that the control was to be exercised over those corporations which are prone to abuse the economic power enjoyed by them. We therefore see nothing arbitrary or unreasonable in the exclusionary clause.

37. A detailed analysis of the provisions, in the light of submissions would clearly negative any contention of the violation of Articles 14 and 19(1)(g) and we must reject the challenge to the constitutionality of Section 58A and the rules made thereunder.

38. Not a single contention canvassed on behalf of the petitioners, individually or collectively, bears the scrutiny and therefore the petitions and the appeals must fail and are dismissed with costs in each matter.