M/S. Shriram Chits & Investment (P.) ... vs Union Of India And Others on 13 July, 1993

Equivalent citations: AIR1993SC2063, [1994]79COMPCAS298(SC), (1994)2COMPLJ430(SC), JT1993(4)SC399, 1993(3)SCALE125, 1993SUPP(4)SCC226, [1993]SUPP1SCR54, AIR 1993 SUPREME COURT 2063, 1993 AIR SCW 2443, 1993 (4) SCC(SUPP) 226, 1993 SCC (SUPP) 4 226, (1994) 2 COMLJ 430, (1993) 4 JT 399 (SC), (1994) 1 RRR 77, (1993) 3 SCJ 18, (1994) WRITLR 166, (1994) BANKJ 365, (1994) 79 COMCAS 298, (1993) 2 BANKCLR 185

Author: Yogeswar Dayal

Bench: J.S. Verma, Yogeshwar Dayal, N. Venkatachala

ORDER

Yogeswar Dayal, J.

1. This order will dispose of Civil Appeal No.448 of 1989 and the batch coupled with Writ Petition No.1092 of 1991 and the batch. Civil Appeal No.448 of 1989 arises from the judgment of the Karnataka High Court at Bangalore dated 29th April, 1989 passed in Writ Petition Nos.19321/86, 17110/84, etc.

2. The above appeals and writ petitions involve challenge to constitutional validity of the Chit Funds Act, 1982 (Central Act No.40 of 1982) (hereinafter called as 'the Act' or 'the impugned Act').

3. The various appellants/petitioners are either Public/Private Limited Companies incorporated under the Companies Act, 1956 or proprietary or partnership concerns or individual organisers. According to Section 1(3) of the Act is will come into force on such date as the Central Government may by Notification in the Official Gazette, appoint and different dates may be appointed for different States. In all these matters, apart from challenge to the vires of various provisions of the Act, the legislative competence of Parliament, which enacted the Act, has also been challenged.

4. In karnataka the impugned Act came into force on 2nd January, 1984. There was no Act in this State for regulating Chit fund business and as a result, some of the Chit Fund Companies in Tamil Nadu, Kerala, Maharashtra and Andhra Pradesh which came under their respective regulatory measures shifted their business to Karnataka State and carried on Chit fund business in that State

without being hampered by the regulatory measures of the respective enactments in such States. When the impugned Act was brought into force, the appellants were asked to comply with a number of requirements under the Act by the State of Karnataka, therefore, complaining of the violation of their constitutional rights to carry on business, they had filed writ petitions challenging the vires of the Act.

5. The competence of the Parliament to enact the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 (Act 43 of 1978) came up for consideration before this Court in Srinivasa Enterprises and Ors. v. Union of India etc.. This Court in the aforesaid case held that having regard to pith and substance of that Act, it fell within Entry 7 of List III and not in the ambit of Entry 34 of List II within the State List. While dealing with the constitutional validity of banning private prized chits, this Court drew support from the reports of Expert Committees. In the circumstances, before going to the question of legislative competence and reasonableness of the various provisions of the Act, it will be useful to refer to the recommendations of various expert bodies who had occasion to examine the matter The report of the Banking Commission prepared in the year 1972; report of the Study Group on Non-Banking Financial Intermediaries (dated 10.8.1971) constituted by the Banking Commission; the report of the Study Group of Non-Banking Companies headed by the Chairman J.S. Raj (otherwise known as Raj Committee) dated 14.7.1975 and the report of the Select Committee of Parliament. These reports give us an insight into the origin of Chit fund business in this country, the mechanism of Chit fund transcations, the benefits that accrued to the needy public who are not in a position to avail themselves of the credit facilities from the financing banks, the evils that flow from such Chit fund transactions on account of the unscrupulous and unethical methods employed by persons who run and control Chit fund business and need for the legislation in order to protect the interests of the subscribers to the Chit funds from some of the unscrupulous promoters and foremen.

(emphasis supplied)

6. The first report dated 10th August, 1971 was submitted by the Study Group of the Non-Banking Financial Intermediaries appointed by the Banking Commission. Chapter 6 of this report is devoted to Chit Funds. The introduction to this report is quoted in the judgment under appeal and reads as follows:

> In this chapter it is proposed to study the working and role of one of the oldest of the indigenous NBFIs, viz. Chit Funds. We have, in particular, examined the role of chit funds as a saving and lending institution. Our analysis and observations are based on published material, data collected by the Reserve Bank of India, memoranda received from various chit fund companies as well as material submitted by the representatives of some of the leading chit funds to the Banking Commission. The Annual reports of a few chit funds have also been made use of. The Study Group received in all twelve memoranda (listed in Appendix II). The Banking Commission had issued a questionnaire to commercial banks and the replies received in response thereto pertaining to their chit fund business have been analysed and used for our discussion.

(emphasis supplied) Paras 6.4 to 6.29 of the report deal with various aspects of Chit fund business. Paras 6.2. and 6.3 of the report deserve to be excerpted since they tell us about the origin of this financial institution in India. They read as:-

Chit Fund is perhaps the oldest indigenous financial institution in India. The origin of chitty or kuri or chit fund is traceable beyond more than a century in the rural parts of Southern India. Periodically, a fixed measure of grain could be deposited with a trustee and received back when sufficiently large quantity was collected. The needy person was ascertained through draw of lots. The word 'chit' suggests its origin. Chit means a written note on a small piece of paper. Since the winner of the Chit amount was to be ascertained though draw of lots, it involved writing of names of eligible members on separate chits, as in a lottery. The Scheme thus came to be known as 'chit funds'. Its equivalent in Malayulam 'kuri' is derived from 'Kurippu' which is a synonym of chit.

The trustee's reputation for honesty attracted more savers to him. In the earlier stages when the idea of modern banking had not reached the people, chit fund institutions developed quickly and spontaneously. It was an expression of co-operative efforts of mustering savings through instalments and advancing the pooled savings as loan to the members with facilities of repayment in instalment. With the growing importance of commerce and industry and the consequential rise in the population of towns and cities, chit fund was brought to the urban areas.

In paras (6.7, 6.8 and 6.9 the working of business chit is considered and we are concerned with this type of chit business. They read as:-

In this case, there is a promoter called foreman who enrolls a number of subscribers and draws up the terms and conditions of the scheme in the form of an agreement. Every subscriber has (o pay his subscription in regular instalments. The foreman charges, for his service, a commission on which there is a ceiling fixed by law in some States. He also reserves the right to take the entire chit amount at the first or second instalment as prize. Depending on the terms of the agreement, a fixed amount is also sometime set aside for distribution among the non-prized members. After making provisioin for the above deductions, the balance is put to auction (except at the last instalment) and given as prize to the member who is prepared to forego the highest discount. The amount of discount is distributed as dividend either among all the members or only among the non-prized members. In some States a ceiling has been fixed on the discount that a member can offer. In case more than one person is prepared to offer the same discount or when there arc no bidders, lets are drawn to choose the prize winning member. The number of subscribers in a chit series equals the number of instalments so that every member is assured of the opportunity of getting the prize. Sometimes with a view to catering to as many subscribers as possible, a chitty comprises a series expressed in terms of a sub-division or fraction of a full ticket (ticket means the share of a subscriber which entitles the holder thereof

to the prize amount at any one instalment). In such cases the number of subscribers can exceed the number of insalments. In some cases only auctions are held to determine the prize winner while there are chit funds in which prize winning tickets are determined both by lots and by auction.

The prize winner can get the prize only on furnishing security acceptable to the foreman for the payment of the remaining instalments. In the event of default by subscribers in payment of instalment on clue dates, penalties are imposed in various forms, e.g., forfeiture of dividends or levy of penal interest.

The above are the essential features of a business chit scheme although there are any number of variants. Chit fund can thus be described as a mutual recurring deposit scheme under which every member is entitled to receive prize amount as loan from the chit fund; for the last prize winner, however, the prize amount cannot be considered as loan. Although no rate of interest is specifically mentioned, the deductions on account of discount and the foreman's commission make the loan in a majority of the cases, an interest-bearing one, the interest rate depending on the specific terms and conditions under which the scheme operates. For the foreman, however, no interest rate is involved on his 'loan'.

Paras 6.13 to 6.18 deal with the role of the foreman, his actions legal and illegal and the risks and responsibilities in his intrepid role. They read as under :

At this stage it would be useful to study the foreman's role in the chit transactions. Subject to law, he decides practically everything about the chit - the number of members, the amount of instalments, the chit amount, his commission, the instalment at which he himself would remain the prize, the penalties to be imposed on defaulting members, etc. It is easy for him to exercise his powers because the number of subscribers is in many cases large and they are usually scattered over many places.

Some foremen, in addition to carrying on the business of chits, also accept deposits from third parties. These are utilised as working funds and lent at high rates of interest to subscribers and perhaps to others. According to Reserve Bank survey, the amount of deposits of 106 reporting chit fund companies at the end of March, 1968, was about 1.1 crores. In terms of Reserve Bank's directions, a chit fund company cannot accept deposits repayable after a period of less than 12 months from the date of receipt of such deposits nor can the amount of such deposits exceed 25 per cent of its paid-up capital and free reserves. It may be noted that the subscriptions received from the members of chit funds in terms of contract are not treated as 'deposits' for the purpose of Reserve Bank's directions. According to available information, one-third of the outstanding loans and advances as on 31st March 1967, given by the foremen of 100 chit fund companies were personal loans; 27 per cent were meant for the commerce sector and 15 per cent were professional loans. 'Industry' and

'agriculture' got a negligible proportion, these advances accounting respectively for 0.5. per cent and 0.1. per cent of the total.

The foreman derives his income in different ways, both legal and illegal. In the former category can be included items such as admission lee from members, penal interest or penalty fee from defaulting members and forfeiture of their dividend, interest on loans to non-prized chit holders, fees for transfer of shares in the chit, deduction from the subscription paid by a member who wants to resign, dividends on the chit reserved for himself, interest on the chit prize taken without deduction, interest on the chit prize which the prized member may not be in a position to collect immediately, and subscriptions paid by members who discontinue in the middle of the scheme but do not care to claim refund.

The unscrupulous among the foremen resort to so many unfair methods to secure illegal gains. A few of these methods are briefly mentioned below:

(i) Enrolment of factious members to complete the required number of members in a chit series. If a real and needy non-prized member is not able to come forward to offer a high discount at the auction, one of these benami members is shown to get the prize thereby depriving the real members of the opportunity, (ii) Similarly, it is possible to exploit needy non-prized member or a new member so that he gets the prize only at the maximum discount. (iii) The prized member is supposed to get the amount soon after the draw or auction is over of course on furnishing the security. But the foreman adopts tactics which delay the actual payment for a considerable time, meanwhile he uses the money interest-free. If he succeeds in delaying the payment till the succeeding draw, the earlier prize winner is given the prize out of the collections of the succeeding draw. Thus, one instalment is perpetually in the hands of the foreman to be utilised in any way he likes.

The above are only examples to illustrate the way in which some foremen maximise their profits. They do not take into account the cases where the foreman and his associates disappear from the scene and are untraceable. The police have many such cases on their record. During 1962-66, as many as 255 chitties collapsed in several districts of Kerala on account of such malpractices.

It may be noted that the foreman has to undertake some responsibilities and risks. He is responsible for regular collection of subscriptions from a widely scattered body of members. He has to conduct the draws or the auction and maintain accounts. He is under obligation to pay the prize amount on the due date whether or not all the members have paid their subscriptions. In case of defaults, he had often to make good the deficit out of his own resources. If the prized member defaults in his instalments, litigation follows to recover the amount. If the defaulter is a non-prized member, the foreman has to find out a suitable substitute or, in the alternative , has to take over the chit himself and continue the business. According to the memoranda submitted by some chit funds to the banking Commission, the foreman requires finance from banks as well as moneylenders and others private sources. Some companies have also pointed out that their profits are not very large in

relation to the risks involved. According to memoranda submitted to the Study Group, 15 to 18 per cent of the subscribers fail to pay their subscriptions after getting the prize amount.

(emphasis supplied) Paras 6.23 to 6.34 deal with the pecuniary aspects of the Chit Fund from the point of view to the subscribers. Some basic issues highlighted in the Report require to be noted. They are found in paras 6.30 and 6.31. They read as:

> As emphasised earlier, the rate of return on the savings of a subscriber to a chit fund and the interest rate that is involved for a subscriber joining the chitty as a borrower, will vary according to the terms and conditions of the chit fund. In fact, examples can be worked out on the basis of certain assumptions where the rate of return to prized subscribers at late stages will be quite high and the interest rate involved for a prize winner will be comparatively low. The essential it is that the rate of interest involved in chat funds is discriminatory and varies from person to person so that there is an irrational distribution of gains and losses. Ordinarily, the more needy a person, the higher will be the discount that he would be prepared to offer for winning a prize. Therefore, the more urgent his need the higher the rate of interest that a borrower has to pay. Another point is that there are institutions which offer savings schemes which are superior to the one involved in a chit fund. The savings and fixed deposits, recurring deposits, monthly income deposits schemes, cash certificate schemes, annuity or retirement schemes, insurance linked deposit schemes, small savings, provident funds and insurance schemes, cash certificate schemes, annuity or retirement schemes, insurance linked deposit schemes, small savings, provident funds and insurance schemes have features which are superior to those in chit funds. The popularity of chit funds can be explained by the fact a subscriber is entitled to borrow from it. Also, long standing social habits and the gaming element involved in the scheme, which perhaps provided an added attraction to some subscribers are also factors accounting for popularity of this institution.
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> So far as the end-use of the prize is concerned, there are conflicting views. It would appear the likelihood of productive use of the prize money is small. A prospective producer would not depend on the uncertainties involved for a chit fund .The rates of interest generally involved for a prize winner in a chit fund are so high that an inference can be drawn that the prize money is mostly used for consumption or speculative purposes. Sonic persons join chit funds and are prepared to pay high rates of interest by way of large discount for the purpose of hoarding certain scarce commodities. They are not only able to recover the interest but also earn a profit on account of the difference between the relatively low price at which they buy the goods and the High price at which they sell them later (emphasis supplied) The Study Group in paras 6.52 to 6.54 considered the legislative measures to be introduced for eliminating the malpractices usually prevalent in Chit Funds. It observed as followes:
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> We considered the above two suggestions, viz., starting of chit funds in the public sector and the commercial bank entering the chit fund business with a view to

eliminating, through competition, the malpractices, usually prevelant in private chit funds. It may be noticed that most of the unhealthy practices arise fro the lack of integrity of the foreman. It was, therefore, natural that the regulation of chit fund business assumed high priority in the States where the business is concentrated i.e., in the Southern States.

At present State legislation regulates the running of chit funds in the areas where such legislation is in force. The Tamil Nadu Chit Funds Act of 1961, seeks to regulate the chit fund business in the State of Tamil Nadu. With appropriate changes, this Act was adopted, with effect from 15th July, 1964, in the Union Territory of Delhi. The Union Territory of Pondicherry has the Pondicherry Chit funds Act, 1966, which came into force from 1st August, 1967. In Kerala, the Travancore Chitties Act of 1964, and Cochin Kuris Regulations 1932, are in force in some areas of the State. The question of introducing a uniform enactment in Kerala has been under the consideration of the Government for some lime. Some Sales are in the process amending or enacting laws to regulate chit fund activity. In Andhra Pradesh a bill on the lines of the legislation in the neighbouring Stale is under consideration. Mysore and certain other Stale Government are also contemplating passing of legislation for regulating chitties. Punjab Government is contemplating the starting of chit funds in the public sector on the lines of Kerala Government. In Uttar Pradesh, chit funds, lotteries etc., are regulated by the provisions of the Manual of Government Orders. According to these regulations, publication of advertisements in newspapers, of any proposals regarding lotteries not authorised by the Government is an offence under the Indian Penal Code. Also local authorities have been asked not to accord sanction for holding lotteries nor should they authorise advertisements regarding such undertakings.

The object of legislation is to regulate the conduct of chit funds by requiring the foreman to obtain permission of competent authorities before a chit fund can be started, stipulating security to be provided by the foreman to the Registrar, detailing his rights and obligations and providing for punishment for infringement of law. Wherever legislation is in force, no foreman can state a chit fun until the Registrar is satisfied about the bye-laws of the fund and the security offered by the foreman.

(emphasis supplied)

7. This report of the Study Group was incorporated in the report of the Banking Commission dated 31st January, 1972. The Banking Commission again emphasised the need for legislation in para 1.7.43 of its report thus:-

A few States have legislation on chit funds, the object of which is to safeguard the interests of the members. The Commission feels that it is essential to have a uniform chit fund legislation applicable to the whole country. Depending upon the constitutional position, whether chit funds come under the Union list, Concurrent list

> or the State list, either an All India Chit Fund Act may be enacted or a model law may be framed which may be adopted by all the States with such modifications as may be necessary. It will be desirable to provide in the legislation that only public limited Companies can run chit funds. Pending such uniform legislation, existing State laws regulating chit funds registered within the State should be made applicable to their branches in the States having no legislation. This will essentially be an interim measure because only the members of those chit funds which are registered in State where chit fund laws have been enacted will get protection. (emphasis supplied)

8. The report of the Banking Commission found favour in the report of the Raj Committee on Non-Banking Companies in its report dated 14th July, 1975. The terms of reference of the Raj Committee may he noted to appreciate its recommendations regarding Chit business. They are:

> I. To examine the relative provisions of the Reserve Bank of India Act, 1934, the Non-Banking Financial Companies (Reserve Bank) Directions, 1966 and the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973, with a view to assessing their adequacy in regulating the conduct of business by non-banking Companies covered by the said directions in the context of the monetary and credit policies laid down by the Reserve Bank from time to time; to suggest measures for further tightening up the provisions so as to ensure that the activities of such Companies, in so far as they pertain to the acceptance of deposits, investments, lending operations etc., subserve the national interest and serve more effectively as an adjunct to the regulation of the monetary and credit policies of the country besides affording a degree of protection to the depositors' monies. In this connection, the Study Group may examine and make recommendations for regulating the conduct of the business of non-banking companies governed by the above sets of directions generally, and in particular, in regard to -
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> (a) the norms which may be adopted in respect of the capital structure and debt-equity ratio that may be maintained by the various classes of non-banking companies covered by the said directions;
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> (b) the extent to which and the periods for which such companies may borrow by way of deposits/unsecured loans and the distinctions, if any, to be made between public and private Companies:
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> (c) the maintenance of cash reserves and/or a percentage of their deposit liabilities in the form of liquid assets by such Companies.
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> (d) the norms which may be adopted in respect of the rates of interest payable by such companies on their borrowings by way of deposits/unsecured loans and also those which may be charged on loans and advances made by them;

(e) the extent to which any of the activities carried on by these companies through their subsidiaries can or should be controlled;

(f) the need for the imposition of a ceiling on risk assets to be acquired or loans to be granted by the companies;

(g) the restrictions, if any, on the grant of loans to directors and their friends and relations and companies in which they are interested;

(h) the manner in which the loopholes, if any, in the existing directions taken advantage of by private limited companies in the context of certain concessions enjoyed by such companies under the provisions of the Companies Act, 1956, could be plugged; and

(i) the need to empower the Bank to apply for compulsory winding up of non-banking financial companies under certain circumstances.

II. To make recommendations on any other related topic which the Study Group may consider germane to the subject matter of the enquiry.

The Committee discussed the terms of the reference with various individuals of eminence and learned and also the representatives of companies, Associations all over India and in Bangalore.

9. During arguments we were referred to paras 6.17, 6.18 and 6.19 of the Raj Committee where the Raj Committee noticed the legal opinion as to the competence of Parliament which enacted the chit legislation in view of the provisions contained in Entry'7 of List III of Schedule VII of the Constitution of India and observed as follows:-

It will be seen from the foregoing that chit fund legislation has been enacted only in a few States/Union Territories. There is also a diversity of the regulatory provisions made in the various enactments. It is not, therefore, unlikely that unscrupulous promoters or chit companies might exploit the situation by conducting chits in such of the States as have no chit legislation or in States where the provisions of such legislation are less rigorous. In fact, it was brought to the notice of the Group during the course of its discussions in New Delhi that a number of chit fund companies had shifted their registered offices from the Delhi area to the nearby places in Haryana (where there is no chit legislation) with a view to avoiding compliance with the provisions of the Tamil Nadu Chit Funds Act, 1961 as extended to the Union Territory of Delhi. In the circumstances, the need for enactment of a uniform legislation applicable to chit fund institutions throughout the country cannot be underestimated.

In the context of the recommendations of the Banking Commission in regard to regulating activities of non-banking financial intermediaries, the Central Government

has, inter alia, decided that a model law to regulate chit business may be formulated for adoption by all the State which have no such legislation. It has also decided that the question of making it a requirement of law that only public limited companies should run chit funds should be examined. Pursuant to the above decisions, the Reserve Bank has, at the instance of the Central Government, drafted a Model Bill which was referred to the Group for its comments in October 1974. The draft Bill is generally on the lines of the Andhra Pradesh Chit Funds Act, 1971 (which itself follows the pattern of the Tamil Nadu Chit Funds Act, 1961) and the Kerala Chittis Bill 1972 as reported by the Select Committee. Besides the usual provisions found in the existing State enactments, certain additional provisions have been made therein. We have examined the provisions of the Model Bill and after taking into account the opinions expressed by the representatives of some of the State Governments which have enacted legislation regulating chit funds in their respective States as also certain individuals having intimate knowledge of the running of chits, our views in this regard have already been conveyed to the Reserve Bank by a letter dated June 30, 1975 addressed by the Chariman of the Group to Shri S.S. Shiralkar, Deputy Governor of the Reserve Bank of India. It will be seen therefrom that the main recommendations of the Study Group are as under:

(a) Since the legal opinion is that Parliament is competent to enact the chit legislation in view of the provision contained in Entry 7 of List III (Concurrent List) of Schedule VII to the Constitution of India, the proposed Bill should be enacted as a Central legislation. Such a step would, besides ensuring uniformity in the provisions applicable to chit fund institutions throughout the country, also prevent such institutions from taking undue advantage either of the absence of any law governing chit funds in any law governing chit funds in any State or exploit benefits of any lacuna or relaxation in any State law by extending their activities to such States;

(b) While the Bill should be enacted as a Central Act, its administration should be left to the State Governments concerned which, in turn, may seek the advice of the Reserve Bank on policy matters. (For the purpose of tendering advice to the Central or State Governments, the Reserve Bank may have to inspect chit fund institution on a selective basis to have an idea of their working including their methods of operation. Chit funds are "financial institutions" as defined in Clause (c) of Section 45 of the Reserve Bank of India Act, 1934. Hence, it would be open to the Reserve Bank to undertake inspections of chit fund institutions whenever deemed necessary in exercise of the powers vested in it under Section 45N ibid);

(c) as regards the question whether only public limited companies should be allowed to conduct chit funds, the Group is of the view that there should be no objection, in principle, to chits being conducted by private limited companies also, and on a limited companies also, and on a limited companies also, and on a limited scale, even by unincorporated bodies such as individuals/sole proprietorships/partnership firms. It might be of relevance to note in this connection that the enactments

regulating chit funds in force in certain States do not prohibit chit funds being conducted by unincorporated bodies; and

(d) having regard to the nature of their business, there is no necessity for chit fund institutions to borrow from the public by way of deposits and as such they may be prohibited from accepting deposits except as advance payment of subscription or deposits from prized subscribers by way of security towards payment of their future instalments.

The views of the Group on certain other issues which arose for consideration are given in the Annexure to the above letter dated June 30, 1975. These are summarised below-

(i) Conduct of other business by chit fund institutions: Chit fund institutions may be prohibited from conducting any other type of business except chit business or granting of loans to subscribers against their paid-up subscriptions.

(ii) Utilisation of funds: Chit fund institutions should utilise their surplus funds only for giving loans or advances to non-prized subscribers against the security of the subscriptions paid by them or investing in trustees securities or in deposits with the approved banks.

(iii) Restriction on the opening of new places of business: Chit fund companies should obtain the prior approval of the Director of Chits within whose jurisdiction their registered offices are situated. The Director of Chits should take certain criteria into account before granting permission for the opening of offices. Unincorporated bodies should not be allowed to conduct business at more than one place.

(iv) Maximum duration of chits : The duration of chits should not ordinarily exceed five years; but chits of a longer duration upto ten years may be started in very special cases only by chit fund companies/banks with the prior approval of the State Government concerned which should take into account factors such as the financial position and methods of operation of the company in question, interests of the prospective subscribers, requirements as to security, etc. The security deposit to be kept by the foreman of company in the case of chits of longer duration may be proportionately higher.

(v) Mode of settlement of disputes : The machinery for settle-merit of disputes arising between the foreman and the subscribers relating to the adequacy of security offered by prized subscribers to the foreman for payment of future instalments, substitution of subscribers in case of default, etc. should be self-contained, cheap and expeditious on the lines of the machinery prescribed under the State Co-operative laws for settlement of disputes by arbitration.

(vi) Ceilings in respect of the aggregate amount of chits that may he conducted at any point of time The aggregate amount of chits conducted by a chit fund company at any point of time may not exceed 50 per cent of the net worth of company, i.e., the paid-up capital plus free reserves less the balance of accumulated loss and other intangible assets such as deferred revenue expenditure and goodwill, if any. In the case of commercial banks conducting chit funds, no ceiling on the aggregate amount of chits that may be conducted at any point of time need be prescribed since these chits are subject to the close scrutiny of the Reserve Bank. As regards chit funds conducted by unincorporated bodies such as individuals, sole proprietorships and partnership, the aggregate amount of chits should not, at any point of time, exceed Rs. 10,000.

(vii) Minimum capital requirement and the creation of a reserve fund : The minimum paid-up capital of chit fund companies incorporated under the Companies Act, 1956, whether private or public, should be Rs. 1 lakh. Companies having paid-up capital of less than Rs.l lakh may be allowed time up to three years to increase their paid-up capital to the minimum referred to above. The State Government concerned may be authorised to grant extension of time for a period not exceeding two years in appropriate cases. These companies should also be required to credit 20 per cent of their annual net profits to a reserve fund. (emphasis supplied)

10. It was in view of these recommendations of expert bodies that the Parliament enacted the impugned Act in 1982 and the same was brought into force in various States on different dates.

LEGISLATIVE COMPETENCE.

11. The impugned Act regulates the Chit fund business. The Scheme of Act, at this stage, may also be noticed.

Chapter II of the Act deals with Registration of Chits, Commencement and conduct of Chit business. Chapter III deals with the Rights and Duties of Foreman. Chapter IV deals with the rights und duties of non-prized subscribers. Chapter V deals with the Rights and Duties of Prized subscribers. Chapter VI deals with the restrictions on Transfer of Rights of Foreman, etc. Chapter VII regulates the Meetings of General Body of Subscribers, Chapter VIII provides for continuation of chits in certain eases and termination of chits. Chapter IX provides for inspection of documents. Chapter X provides for winding up of chits. Chapter XI provides for appointment of Officers and levy of fees for the purpose of discharging the duties imposed on the Registrar under the Act. Chapter XII deals with the disputes touching the management of Chit business by arbitration. Chapter XIII provides for miscellaneous provisions, viz., advisory role of Reserve Bank, Appeals from the order of the Registrar, Power of Registrar to give extension of time for filing documents, penalties, offences by companies, etc.

12. The submission of Union of India before the High Court was that the legislation in question falls in Entry 7 of List III (Concurrent List) of VIIth Schedule to the Constitution of India. Union of India

also relied on the aforesaid reports of various Study Groups. The High Court accepted the contentions of the Union of India about the legislative competence of the Parliament to enact the impugned Act and dismissed the writ petitions. The point raised in the Civil Appeals inter alia is that the Parliament has no legislative competence on the subject matter as according to the appellants, the Act deals with the money lending and the same falls within Entry 30 of List II (State List) of VIIth Schedule to the Constitution of India. It was, however, submitted in reply by the Union of India that the Act falls within Entry 7 of List III of VIIth Schedule to the Constitution of India Section 2(b), 2(c), 2(d), 2(e) and 2(j) defines 'chit', 'chit agreement', 'chit amount', 'chit business' and 'foreman' respectively which read as follows:

> 2(b) - "chit" means a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe of certain sum of money (or a certain quantity of grain instead) by way of periodical instalments over 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 specified in the chit agreement, be entitled to the prize amount.
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> Explanation - A transaction is not a chit within the meaning of this clause, if in such transaction. -
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> (i) some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or
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> (ii) all the subscribers get the chit amount by turns with a liability to pay future subscriptions;

2(c) - "chit agreement" means the document containing the articles of agreement between the foreman and the subscribers relating to the chit;

2(d) - "chit amount" means the sum-total of the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount or otherwise;

2(e) - "chit business" means the business of conducting a chit;

2(j) - "Forman" means the person who under the chit agreement is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under Section 39.

13. Section 6 provides that the agreement shall be signed by each of the subscribers or by any person authorised by him in writing and the foreman and attested by at least two witnesses and the particulars that has to be stated in the said agreement have also been provided in Section 6 of the Act. This clearly shows that a contract has to be entered into between the subscribers and the foreman and in view of the definitions provided in Sections 2(b), 2(c), 2(d), 2(e) and 2(j) enforceable contract comes into existence and the Act provides how the contract has to be implemented and

acted upon by the parties to the contract. Therefore, it is a special form of contract contemplated by Entry 7 of List III of VIIth Schedule of the Constitution of India and it cannot be termed as money lending business. It is clear that the foreman does not lend his money to any of the subscribers. The foreman acts only as person to bring together the subscribers and certain obligations are cast upon him with a view to protect the subscribers from the mischief and fraud committed by the foreman in view of his position. The amounts are paid to the subscribers as per the chit and in accordance with the provisions of Act. It will not be correct to state that each subscriber lends money to the person who gets chit earlier. It cannot also be construed that the person who gets chit later should be treated as the money lender. The agreement between the parties that is entered as per Section 6 of the Act, only provides for distribution of the chit amount. This agreement has to be treated as contract between the subscribers and the foreman and it is the foreman who brings the subscribers together and therefore the Act provided for payment of commission for the services rendered by the foreman as he does not lend money belonging to him. The dominant purpose of the Act is to regulate the chit and control the activity of the foreman and protect the interests of the subscribers. The pith and substance of the Act is that it provides for a special contract. The legislation provides for a special kind of contract and thus squarely falls within Entry 7 of List III of Schedule VII. If any support thereof is required the reference may be made to the decision of this Court in Srinivasa Enterprises' case (supra). That decision was involved with the power of the Parliament to enact the Prize Chits and Money Circulation Schemes (Baning) Act, 1978 and this Court held that the legislation fell within Entry 7 of List III of the VIIth Schedule as opposed to the claim of the petitioners therein that the legislation fell within State List Entry 34 of List II. That was a case which dealt with prohibition of dealing in private prized chits and the Court fund that the pith and substance of the legislation therein was not one against lotteries and it dealt with a special species of contracts. Similar view was taken by the Madras High Court while dealing with the Pondicherry Chit Funds Act, 1966 and held that the legislation fell within Entry 7 of List III of the VIIth Schedule and not under Entry 45 of List I or Entry 30 of List II (see) Chock Nathan Chit Fund and Finance (P) Ltd., Pondicherry and Ors. v. Union Territory of Pondicherry and Ors. .

14. The question as to the nature of chit agreement came up for consideration before a Full Bench of five Judges of the Kerala High Court in Janardhana Mallan and Ors. v. Gangadharan and Ors.. The Full Bench there was concerned with the chit agreement under the Kerala Chitties Act (Act 23 of 1975) where the Kerala High Court speaking through Poti, Acting Chief Justice, took the view that on entering into the chitty agreement a debt is not incurred by the subscriber for the amount of all the future instalments and in respect of such amount there is no debtor-creditor realationship. The chitty variola only embodies a promise to pay on future dates. That is not a promise to repay an existing debt, but to pay in discharge of a contractual obligation. For similar reasons neither the prizing of the chitty nor the execution of the security bond would give rise to a debt, for , the prize amount is not received as a loan, but as of right by virtue of the terms of the contract between the parties. Therefore, no debt due to the foreman arises by reason of the receipt of the price amount or of the execution of the security bond for securing future subscriptions. The Full Bench in this decision over-ruled its earlier decision in the case of P.K Achutan v. State Bank of Travancore,Calicut: . While rendering the decision in Janardhana Mallan and Ors. (supra) the Full Bench of the Kerala High Court considered a catena of decisions starting from 1937 in the matter of Ramanatha Iyyar v. Narayanaswami . The Andhra Pradesh High Court also, while dealing with the

transaction of a chit fund organisation, in the matter of Dhoosa Narsimloo v. Yelala Rajanna and Anr. I.L.R. (1958) Andhra Pradesh 409, where the petitioner had filed a suit in the Court of the District Judge against the respondents on a promissory note executed by them for the amount they drew in a pool from a chit fund organisation and where the District Judge had dismissed the suit for want of a licence under Section 9(2) of the Hyderabad Money Lenders Act (Act V of 1349 F.) and on revision, the question that came for consideration was whether the chit fund organisation could be regarded as a money lender within the meaning of the said Act and whether its transaction partake the nature of a loan. Srinivasachari, J. speaking for the Court held that the amount drawn by a member of a chit fund who bid at the periodical auction giving the largest discount could not come within the definition of a loan within the meaning of the Money Lenders Act nor could such a transaction be regarded as a money lending transaction be and in the circumstances Section 9 of the Hyderabad Money Lenders Act (V of 1349 F.) could have no application to such a case. At page 415 of the aforesaid report it has been observed "in our opinion there is nothing in the chit fund transaction which could be called the business of money lending. It is in essence an organisation for mutual benefit." It approved the decision of the Madras High Court in Raghavan v. Armugham: (1934) 38 M.L..I. 283. That was also a case of chit fund transaction and the question for decision was whether a provision in the bond for payment of the whole amount in default of any one instalment was in the nature of a penalty coming within Section 74, Illustration (g) of the Contract Act. The learned Judges ruled that a chit fund transaction was not a case of borrowing at all and it was entirely different from a loan transaction. The learned Judges further held that "a loan envisages the relationship of a creditor and debtor in so tar as the lender and the borrower are concerned. There cannot be the relationship of a creditor and debtor between the stake holder and a subscriber, in a chit fund transaction. If the stake-holder advances any amount he advances only to one of the members, the funds of the whole body of the chit fund, as the funds belong to the whole lot of subscribers, the members, borrower is as much a creditor as a debtor. The amounts are in deposit with the stake-holder only as a trustee for the benefit of the members of the fund." Srinivasachari, J. noticed the observations of Srinivasa Iyengar, J. in Tim-marsa Pai v. Subba Rao : AIR (1928) Madras 256 where Srinivasa lyengar, J. regarded the position of the Manager of a kuri chit as a trustee for all the subscribers of the chit fund.

15. We were referred to the decision of this Court in K.P. Subbarama Sastri and Ors. v. K.S. Raghavan and Ors. wherein a contract providing for payment of money in instalments and stipulating that on default in payment of any of the instalments all the future instalments shall be payable at a time with interest was held not penal in nature in the case of kuri transaction under the Kerala Chitties Act, 1975. While upholding the transaction a Bench of this Court approved the decision of the earlier Full Bench decision of the Kerala High Court in the case P.K. Achuthan (supra) wherein the Kerala High Court had upheld such a transaction and held it, to be of not a penal nature. In this context Eradi, J. (as His Lordship then was) speaking for the Full Bench observed that a subscriber truly and really becomes a debtor for the prized amount paid to him. It will be noticed that the later Full Bench decision of the Kerala High Court in Janardhana Mallan and Ors. (supra) was not brought to the notice of this Court and the Court was referred to the over-ruled decision of the Kerala High Court. The fact remains that the question involved before us as to the true nature of transaction for the purpose of finding out the relevant entry in the Constitution into which it may fall, was not involved in that case.

16. It appear to us, but for the discordant note struck by the other Full Bench of the Kerala High Court in the aforesaid case of P.K. Achuthan (Supra), the consistent view of all the High Courts has been that it is not a moneylending transaction and that there is no relationship of debtor and creditor for the purpose of it being treated as a money lending transaction.

17. Before the Act came into force, the deposits acceptance activities of the chit companies were controlled by the directions issued by the Reserve Bank of India under Sections 45K, 45L, 45M etc. of Chapter III-B of the Reserve Bank of India Act. Chapter III-B dealing with non-banking institutions and financial institutions receiving deposits from third parties was introduced in the Reserve Bank of India Act, 1934 by the Amending Act (Act 55 55 of 1963) in the year 1963. In the case of Mayavaram Finance Corporation Ltd. v. Reserve Bank of' India reported in (1971) 41 Company Cases 890 Before the Madras High Court, the constitutional validity of Non-Banking Financial Companies (Reserve Bank) Directions, 1966, which were made applicable to 'chit fund' also were challenged on the ground that the impugned Reserve Bank of India (Amendment) Act and the Directions issued thereunder were beyond the legislative competence of the Parliament. At page 902 of the report the Madras High Court observed that "this special kind of contract falls under Entry 7 of List III. After the subscriptions are received and funded, it is no longer in the region of money lending and money lenders.... We are of the opinion that the contract entered ito by the former with the subscriber is a special contract falling under Entry 7 of List III of the Seventh Schedule. The President's assent to the Act confirms our view.... "The question considered by the Madras High Court was whether the Directions could be fairly covered under the entry 'moneylending' or 'banking' of the List II or List I respectively. The learned Judges of the High Court after considering the various rulings observed that "we are, therefore, of the opinion that the impugned provisions falling under Chapter III-B of the Reserve Bank of India Act, 1934 and the Notification dated October 29, 1966 issued by the Reserve Bank of India are valid and that there is no substance in any of the contentions raised by the petitioners".

18. The above judgment in the case of Mayavaram Finance Corporation Ltd. (Supra) was followed by the Madras High Court in the case of A.S.P. Aiyar and Anr. v. Reserve Bank of India and Anr. (1984) 56 Company Cases 352 and P. Suahmaniam and Anr. v. Reserve Bank of India and Ors. (1985) 57 Company Cases 755. In these two judgments the Madras High Court followed the ratio laid down in Mayavaram Financial Corporation Ltd. (supra) case. The decisions in A.S.P. Aiyar (supra) case, and P. Subrahmaniam's case which approved the decision in Mayavaram's case, were also approved by this Court in S.L.P. (Civil) No. 4015 of 1985 decided on 20th August, 1990 and Civil Appeal No. 2194 of 1985 on 16th January, 1990 respectively.

19. The judgment of this Court in Srinivasa Enterprises (supra) fairly covers the present Act as well. The prized chit is covered by entry 7 of List III as observed by the Court in that case. Conventional chits are also matter of contract with an added element of chance of draw of lot to choose the successful bidder. The prized chits are chits with an element of draw of luck. Otherwise prized chits and conventional chits are forms of contract and arise out of contracts only. They are not money lending business. Applying the ratio laid down in the case of Srinivasa Enterprises (supra) it has to be held that the Chit Funds Act, in pith and subtance, deals with special contract and consequently falls within Entry 7 of List III of the Third Schedule. It must, therefore, be held that the Chit Funds

Act is within the legislative competence of the parliament.

20. Learned Counsel appearing for various sets of appellants/petitioners before us including Mr. Narasimhamurthy, Mr. Chidambaram, Mr. T.S. Krishnamurti, Mr. .S. Poti and Mr. K. Chandramouli challenged inter alia Sections 4(3)(b); 6(3); 9(1); 12; 13; 16(2); 16(3); 17(1); 20; 21(1)(a); 21(1)(b); 21(1)(c); 25 and 48 of the Act.

21. Before we consider the contentions of the appellant/petitioners in detail, the report of the Select Committee which considered the Chit Funds Bill, 1980, deserves to be noticed because the impugned Act incorporates all the recommendations of the Select Committee. In this regard the High Court observed as under :-

> The Committee held as many as 25 sittings after issuing notices to the State Government, Chit Companies, Public bodies and organisations, individuals etc. interested in the subject-matter of the Bill and also decided to hear oral evidence on the provisions of the Bill from interested parties. The Committee also issued Press communique fixing 21st February, 1981, as the last date for receipt of memoranda and requests for oral evidence. Wide publicity was given on three successive days by broadcasting the matter from all stations of All India Radio and telecast from all Door darshan Kendras. Several requests were received from various parties for being heard by the Committee and accordingly several sittings were held at Madras on 28th, 29th and 30th of May, 1981, at Bangalore on 1st and 2nd June, 1981 and at Trivandrum on 4th and 5th of June, 1981. Oral evidence was taken from the representatives of various Chit Companies, Associations, Federations, individuals etc. and the Committee also heard the representatives of the State Government of Tamil Nadu, Karnataka, Kerala and the Union Territory of Pondicherry. Since the Committee felt that sufficient number of subscribers were not forthcoming for tendering oral evidence, they decided to extend the time for receiving memoranda and receiving oral evidence upto 30th June, 1981. Further, a series of sittings were held at Ahmedabad, Hyderabad, Calcutta and New Delhi and the Committee, in all, examined 101 witnesses who appeared before the Committee for giving oral evidence. The Bill was considered clause by clause and the report of the Committee was adopted on 18th November, 1981. The recommendations of the Committee in respect of the following clauses in the Bill are :-
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> Clause 4 : The period of 12 months was substituted for the period of six months in the proviso to the said clause since the Committee felt that the period of 6 months was not sufficient, for registering the chit from the date of sanction. Under Clause 6(i)(c) the words 'interest or penalty' were included for any default in the payment of instalments. Likewise, in Clause 6(i)(d) amendment was proposed to specify the probable date of commencement of the chit agreement. Clause .7(3) : The words 'within a period of three months' were incorporated with a view to ensure that the foreman did not take unduly long time to start the chit and did not misappropriate the subscribers' money. Clause 8 : Instead of the figure 20 percent, 10 percent was

suggested as the amount to be transferred to the Reserve Fund Clause 11(2) : A period of one year was incorporated for complying with the requirements of Clause 11(1) to avoid any hardship being caused to such persons carrying on business on the commencement of the proposed legislation. Clause 13 : The Committee considered the aggregate amount of chit to be conducted by an individual foreman, partnership foreman and foreman-Company. The Committee felt that in order to ensure that the foreman has sufficient stake in the chit business conducted by him, recommended an increase of the amount from Rs. 10,000 to Rs. 25,000 in the case of individual foreman, from Rs. 40,000 to Rs. 1 lakh in case of partnership foreman. As regards the foreman-Company, the Committee recommended for the words 'net assets' the words 'net owned funds' to be substituted and that should be made applicable also to co-operative Societies. This recommendation was because of the fact (hat the concept of net owned funds will be in tune with the Reserve Bank of India directions to financial Companies which would mean the aggregate of the paid-up capital and free reserves reduced by the amount of accumulated balance of loss, deferred revenue expenditure and other intangible assets, if any, as per the latest audited balance sheet of the Company. Clause 14 : The representation for extension of the period of 2 years was rejected as the Committee felt that the period of three years was sufficient for securing the money invested by the person carrying on chit business in any other business. The Committee was also of the view that the State Government's power to extend the period of two years should be limited to one year only and proviso to Sub-clause (2) was accordingly amended. Clause 15 : by substitution of a new clause it was provided that chit agreement shall not be altered, added to or cancelled except with the consent in writing of the foreman and all the subscribers in the chit. The Committee felt that since the foreman was a party to the agreement, his consent must be obtained before altering the agreement. Clause 16 was suitably amended by the Committee in order to ensure that there was no mischief in conducting the chits by making it obligatory for the Chairman to issue notices to all the subscribers and the draw should be held in the presence of at least two subscribers. Clause 18 : 21 days' time was granted to the foreman to file the returns instead of 14 days. Clause 19 : A new Sub-clause (3) was added to enable the subscribers to know the State where the new business is opened by approaching the Registrar of that State instead of the Registrar of that State where the main office is situated for making any complaints with regard to the conduct of chit business at the new place of business. Clause 20 : Sub-clause (1) was amended as the committee was of the view that in order to ensure that the foreman docs not utilise the subscriptions so collected for the purpose of depositing the security and also to ensure further that the financial position of the foreman is sound to conduct the chit, he should be required to furnish security before he applies for previous sanction of the State Government under Clause (4) of the Bill. Clause 21: The provisions of Sub-clause (1)(a) was amended since the Committee was of the view that where a foreman has subscribed to more than one ticket, he should be allowed to get more than one chit amount in a chit without discount. Clause 22 : Sub-clause (2) was amended since the Committee felt that the existing clause would cause hardship to the foreman and therefore, he may be required to make deposit of

the Prize money in respect of the drawn only if it remains unpaid before the date of the next succeeding instalment in a separate account in an approved Bank. A new proviso to Sub-clause (2) was added to avoid any hardship to the foreman by such contingencies by allowing the foreman to hold another draw in respect of the instalment if the prize amount is not drawn by the prized subscriber for a period of two months from the date of draw. Clause 23 : The Committee made the necessary amendment, on the representation that inspection of records of the foreman by the Registrar should be made permissible not only at the registered office of business but also at the place where the foreman is carrying on business, so that the Registrar in such cases will be able to exercise proper control and supervision over the business carried on by the foreman. Clause 40 : Clause (b) of this clause was amended by the Committee since the Committee was of the view that termination of a particular chit, as contemplated in Part (b) of this clause, should be with the consent of all the non-prized, unpaid prized subscribers and the foreman who is also a party to the chit. Clause 66 : The Committee was of the view that allowing the disputes to be taken to the Civil Courts will cause considerable delay in the settlement of dispute because of the long procedure in the Courts and this would particularly go against the interest of the subscribers and hence, Sub-clause (3) of the Bill was omitted. Clause 77 : The Committee felt that a provision for punishing the commission of second and subsequent offences should be included and the penalty of imprisonment and fine should be provided for. Accordingly, a new Clause 77 was added. These clauses in the Bill correspond to the respective sections in the Act. The other amendments proposed by the Committee are of a clarificatory nature and are only consequential, therefore, there is no need to refer to them. This Report of the Select Committee but for a lone dissenting member who was totally opposed to the continuance of chit business, was unanimous.

22. The Report 01 me Select Committee was brought to our notice and we thought it fit to look into it and the reports of the expert bodies with a view to satisfy ourselves that when Parliament enacted the Act, it had given its careful consideration to the various suggestions made by the State Governments, by the financial institutions, by the Companies, by the Cooperative Societies and by individuals; to the interests of the subscribers; to the risks of the foreman and to his difficulties in complying with certain regulatory measures, as found in the Bill; and passed the impugned Act. Almost all the recommendation of the Select Committee were incorporated in the impugned Act. Most of the appellants/petitioners had to opportunity of presenting their views before the Select Committee as could be seen from its report. Therefore, we have to examine whether the onus cast of the State to sustain the constitutional validity of the various provisions of the Act is discharged by it.

23. The impugned provisions of the Act, it was contended, were violative of Article 19(1)(g) of the Constitution of India. This appears to be the main contention of the appellants/petitioners in all these matters. According to some of them their Companies are registered under the Companies Act and the Companies Act provides sufficient regulatory measures over their business by prescribing provisions for running the day-to-day business through Board of Directors who are responsible to the shareholders, maintenance of various statutory returns which have to be submitted to the

Registrar of Companies from time to time for enabling the Registrar of Companies to have an effective control over the business of the appellants/petitioners and annual statutory audit proceeded by internal audits. Therefore, it is submitted that an additional control by the Registrar of Societies under the Act makes a serious inroad into their rights to carry on their business and it would, therefore, be violative of Article 19(1)(g) of the Constitution. They have complained that the provisions of Section 3 of the Act has an over-riding effect. It imposed unreasonable restrictions on the existing rights of the appellants/petitioners to carry on chit fund business. It will be noticed that Section 3 of the Act which overrides other laws, memorandum or articles of association or bye-laws, or any agreement concerning the chit fund business, s a result, to the extent to which it is repugnant to the provisions of this Act, become void. The Act itself is one of the socio-economic legislations which had been enacted primarily and predominantly to safeguard the interests of the chit subscribers who are gullible and unwary public and who have been subjected to exploitation by chit foremen. The Act is intended to regulate and to bring in financial discipline in the chit business, as the foremen deal in and dabble with the funds of the subscribing public. In this context it will be noticed that the banks, financial institutions and non-banking financial institutions, who accept deposits or deal with moneys of the public are disciplined and regulated by the various legislations. Banking Regulations Act, 1949 is applicable to commercial banks, both in the public sector and private sector registered under the Companies Act, 1956. Banking activities of the Regional Rural Banks (Banks in rural sector) are regulated under the regulatory mechanism of Regional Rural Banks Act, Non-Banking Financial Companies (Reserve Bank) Directions, 1977 apply to the deposit-taking activities of non-banking financial companies like loan, investment, hire purchase finance and equipment leasing companies. Misc. Non-Banking Companies (Reserve Bank) Directions, 1977 apply to deposit acceptance by conventional chit companies but do not cover their chit subscription activities. The deposit acceptance activities by the remaining financial companies are regulated by the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987. These directions have been issued under the provisions of Chapter III B of the Reserve Bank of India Act, 1934, as amended. Section 45S of Chapter III C of the Reserve Bank of India Act deals with acceptance of deposits from the public by unincorporated bodies such as individuals, firms and associations of persons. Acceptance of deposits by non-banking non financial companies, like trading and manufacturing companies, are regulated by the Companies (Acceptance of Deposits) Rules, 1975 framed under Section 58A of the Companies Act, 1956.

24. The Chit Fund Companies are financial intermediaries and the State Acts (which were enacted in some of the States) were not uniformally observed and were not found to be adequate to meet the nefarious activities of the foremen. In order to protect the interests of chit subscribers and having regard to volatile and vulnerable nature of chit transactions, authorities sought expert opinions and Expert Committees went into the matter and submitted the various reports, which we have noticed earlier. The report of the Banking Committee, which considered the types of chit funds, had indicated that conventional chit funds might be permitted to be conducted by public limited companies. The Commission opined that the individuals should not be allowed to conduct chits. The recommendations of the Banking Commission and Dutta Committee were examined and a model Bill was prepared by the Reserved Bank of India. At that stage Raj Committee was appointed. The Model Bill was also referred to Raj Committee for opinion. Raj Committee discussed Chit Funds in Chapter 6 of its report and recommended a uniform Central Legislation for regulating the

conventional chit funds. The Committee also considered the model Bill and suggested some modifications. The Bill duly amended was introduced in the Lok Sabha on 23.2.1979 (Bill No. 5 of 1979) but lapsed. The Bill was re-introduced in the Lok Sabha on 20.11.1980 as Bill No. 186 of 1980. Bill No. 186 of 1980 was referred to the Select Committee of the Lok Sabha. The Select Committee gave wide publicity to the Bill, invited suggestions, received as many as 529 representations/memoranda from chit companies, Associations, Federations, State Governments, Co-operative Banks, individuals etc., examined 101 witnesses and had 25 sittings at important centers. The Select Committee submitted its report on 24.11.1981 and in the light of the representations suggested certain modifications in the Bill. The amendments, as suggested by the Select Committee, were incorporated in the Bill and the Bill was passed by the Lok Sabha on 19.7.1982. The Bill as passed by the Lok Sabha was introduced in the Rajya Sabha on 2.8.1982 and was referred to a Select Committee of the Rajya Sabha. The Select Committee of the Rajya Sabha submitted its report on 5.8.1982 and suggested some amendments. The amendments were incorporated in the Act.

25. It will thus be seen that it is not a hasty legislation. It was conceived and legislated after a lot of deliberations and discussions and is the outcome of the views of the Expert Committees and Select Committees and prevalent State legislations on chits were also taken into account.

26. In its sitting at Ahmedabad on 2.7.1981 the Select Committee of the Lok Sabha was informed that the subscribers in various States had been cheated of their hard-earned money by Chit Fund Companies by adopting dubious means and the subscribers were not being paid their prize money or dues back. The subscribers requested the Committee to do something to enable them to get their money back (page 55 of the Lok Sabha Select Committee's Report).

27. In the case of Srinivasa Enterprises and Ors. (supra) this Court observed thus :

> In matters of economics, sociology and other specialised subjects, courts should not embark upon views of half-lit infallibility and reject what economists or social scientists have, after detailed studies, commended as the correct course of action. The final word is with the Court in constitutional matters but judges hesitate to 'rush in' where even specialists 'fear to tread'. If experts fall out, court, perforce, must guide itself and pronounce upon the matter from the constitutional angle, since the final verdict, where constitutional contraventions are complained of, belongs to the judicial arm.
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> When a general evil is sought to be suppressed some martyrs may have to suffer for the legislature cannot easily make meticulous exceptions and has to proceed on broad categorisations, no singular individualisations.
>
> Judicial validation of a social legislation only keeps the path clear for enforcement. Spraying legislative socio-moral pesticides cannot serve any purpose unless the target area is relentlessly hit. This legislation enacted in response to expert recommendation and popular clamour is to be implemented by dynamic State

Action.

Section 4(3)(b)

28. Section 4(1) contemplates that no chit shall be commenced without the previous sanction of the State Government. Sub-section (3) gives guidance to the State Government for granting and/or refusing to grant previous sanction. Clause (b) like Clause (a) gives guidance to the State authorities conferred on them discretion to grant or refuse to grant the sanction. We notice that the provisions is discretionary and merely gives guidelines to grant or refuse to grant sanction as per various clauses and is regulatory in nature and not violative of Article 19(1)(g) of the Constitution.

Section 6(3) of the Act reads thus :

> 6. (3) The amount of discount referred to in Clause (I) of Sub-section (1) shall not exceed thirty per cent of the chit amount.

29. It was submitted that the ceiling of the discount is highly arbitrary and imposes unreasonable restriction on the business of the petitioners. It appears to us that the ceiling of discount is on the higher side and the subscribers, who are in need of money, per force, have to give the discount to that extent and cannot be expected to take care of their own interest when they bid at the tie of chit auction. The restriction is neither arbitrary nor unreasonable.

30. Section 9(1) of the Act provides for commencement of chit. It contemplates that the foreman shall, after all the tickets specified in the chit agreement are fully subscribed, file a declaration to that effect with the Registrar. It will be noticed that this provision too is merely regulatory and is in the interest of the subscribers and cannot seriously be challenged under the provisions of Article 19(1)(g) of the Constitution of India.

Section 12 This Section reads thus :

> 12. Prohibition of transacting business other than chit business by a company.-(1) Except with the general or special permission of the State Government, no company carrying on chit business shall conduct any other business.

(2) Where at the commencement of this Act, any company is carrying on any business in addition to chit business, it shall wind up such other business before the expiry of a period of three years from such commencement :

> Provided that the State Government may, if it considers it necessary in the public interest or for avoiding any hardship, extend the said period of three years by such further period of periods not exceeding two years in the aggregate.

31. This Section creates a bar for a Company carrying on chit to desists from carrying on any other business. Similar provisions in regard to the ban are contained in Section 8 of the Banking

Regulation Act, 1949 which restrain the banks from carrying on any other business. Sub-section (1) of Section 12 of the Act, however, provides that "with the general or special permission of the State Government" the chit company can carry on any business other than the chit business. This section is intended to leave discretion with the State Government to decide whether or not to allow the chit company to do any other business. It was pointed out that certain State Enterprises like Kerala State Financial Enterprises Ltd., were, in addition to chit business, engaged in other types of activities. The Datta Committee and banking Commission had suggested that the public section enterprises may be encouraged to do chit fund business.

32. It was submitted on behalf of the Union of India that it was found that some of the Companies which were carrying on chit business in association with other businesses had diverted chit funds by way of advances to allied firms of the foreman or financing activities unconnected with chit business. Many of those advances had become irrecoverable which in turn affected the liquidity of the chit fund companies and as a result the chit fund companies failed to pay the dues to the subscribers. Some of the companies had utilised the funds for shipping business, producing cinemas and also utilised the funds for venturing into fields with high degree of risk. Some of those ventures had flopped, the chit fund companies, had come to grief and consequently defaulted in the payment of dues to the subscribers i.e. subscribers were left high and dry to suffer in silence in view of the prohibitive cost and time consuming nature of litigations. In regard to policy guidelines for exemption i.e. permission to carry on other business the highest authority in Administration has been given the power to determine and the guidelines, of course, are "public interest" and "the interest of the subscribers to the chit". The provisions of the Act gives sufficient guidelines to ensure subscribers' interest. This Section, therefore, is again regulatory and is not hit by Article 19(1)(g) of the Constitution.

Section 13 Section 13 of the Act reads thus :

> 13. Aggregate amount of chits.-(1) No foreman, other than a firm or other association of individuals or a company or a co-operative society, shall commence or conduct chits, the aggregate chit amount of which at any time exceeds twenty-five thousand rupees.

(2) Where the fore man is a firm or other association of individuals, the aggregate chit amount of the chits conducted by the firm or other association shall not at any time exceed

(a) where the number of partners of the firm or the individuals constituting the association is not less than four, a sum of rupees one lakh;

(b) in any other case, a sum calculated on the basis of twenty-five thousand rupees with respect to each such partner or individual.

(3) Where the foreman is a company or co-operative society, the aggregate chit amount of the chits conducted by it shall not at any time exceed ten times the net owned funds of the company or the co-operative society, as the case may be.

Explanation, - For the purposes of this Sub-section, "net owned funds" shall mean the aggregate of the paid up capital and free reserves as disclosed in the last audited balance sheet of the company or co-operative society, as reduced by the amount of accumulated balance of loss, deferred revenue, expenditure and other intangible assets, if any, as disclosed in the said balance sheet.

33. The main challenge to Section 13 is in regard to the criteria fixed for chit business for individual firms on the one hand and co-operative societies and companies on the other. Whereas in the case of individuals the maximum permissible chit business is Rs. 25,000, in the case of firms for each partner Rs. 25,000 subject to the limit of rupees one lakh; in the case of companies the maximum business is linked with its 'net owned funds' which has been defined in the explanation thereto. At the outset it may be noticed that the main purpose for laying down the ceiling on the limited amounts of chits, that may be conducted by the foreman, is to ensure that the foreman does not overtrade to the detriment of the chit subscribers and at the same time to see that the foreman has a sufficient stake in the chit business. It is in the context of these factors that the aggregate chit fund which could be considered as reasonable in respect of the chit conducted by individual or partnership concerns and as a multiple of 'net owned funds' in the case of limited companies, came to be fixed. In the case of individuals and partnership concerns or association of individuals, it is not unlikely that the individuals/partnership firms etc., may do other types of business and divert portion of chit business funds for such business. Moreover, it is also not feasible to lay down the aggregate chit amount of chits to be conducted by such bodies with reference to their net means or individual's worth since it would be very difficult to assess and monitor such net worth and even if such assessment could be made, the position could change rapidly. On the other hand in the case of companies it is not difficult to arrive at the net worth having regard to the balance sheet position of the company. Hence it was thought desirable to fix the aggregate chit amount of chits which may be conducted by the limited companies with reference to their net owned funds while in the case of individuals, partnership firms etc., the amounts were fixed in absolute terms. As regards the fixing of limit of Rs. 25,000 in the case of individual and Rs. 1 lakh in the case of a firm having not less than four partners, we have already noticed that the Dutta Committee and the Banking Commission had recommended that only public limited companies should be allowed to do chit business (para 17.49). The Raj Committee, however, suggested (para 6.18(c)) that individuals/sole proprietorship concerns/partnership firms may be allowed to conduct chit business on a limited scale. In the light of the above it was thought fit to allow individuals/partnership firms to do chit business in a limited way. Unlike companies, the individuals and partners are not precluded from carrying on other business which will supplement their income. Again the risk in the case of partnership firms and individuals is in a way minimised as the chit fund business in these cases can be set out in absolute term. The risk factor related to the amounts involved and the vulnerability of individuals/partners disappearing from the mid-stream of the business would be to the detriment of the subscribers, more the quantum of amount, greater the sufferance of the subscribers in case there were to be a collapse of chit fund business of the individuals and partnership firms. The offences under the Act, in terms of Section 81, are compoundable. The various rules relating to compounding are set out in Rule 62 of the Tamil Nadu Chit Funds Rules, 1984; Rule 63 of the Chit Fund (Pondicherry) Rules, 1906. In the Lok Sabha Select Committee tenth sitting at Ahmedabad held on 2nd July, 1981 it was stated as under :-

> 3. During the course of evidence, the Committee was informed that the subscribers in various States had been cheated of their hard earned money of Chit Fund Companies by adopting dubious means and the subscribers were not being pid their prize money or dues back. The subscribers requested the Committee to do something to enable them to get their money back.

34. We do not find that the limits put arc violative of Article 19(1)(g) of the Constitution. In any case they are in the interests of the subscribers. However, we have no doubt that in view of the inflation in the country, the appropriate authorities, in case a demand is so raised, from time to time increase the limits. However, we do not find it necessary to give any direction in this behalf.

SECTION 16(2), 16(3) AND 17(1) Section 16(2), 16(3) and 17(1) of the Act read as under : -

> 16. Date, time and place of conducting chits.-
>
> (1)....
>
> (2) Every such draw shall be conducted in accordance with the provisions of the chit agreement and in the presence of not less than two subscribers.
>
> (3) Where any draw was not conducted on the ground that two subscribers required to be present at a draw under Sub-section (2) were not present or on any other ground, the Registrar may, on his own motion or on an application made by the foreman or any of the subscribers, direct that the draw shall be conducted in his presence or in the presence of any person deputed by him.

17. Minutes of proceedings. - (1) The minutes of the proceedings of every draw shall be prepared and entered in a book to be kept for that purpose immediately after the closure of the draw and shall be signed by the foreman, the prized subscribers, if present, or their authorised agents, or their authorised agents, and at least two other subscribers who are present, and where a direction has been made under Sub-section (3) of Section 16, also by the Registrar or the person deputed by him under that Sub-section.

35. These provisions are again regulatory and are with a view to avoid fraud on the subscribers by delaying their payments.

SECTION 20

36. It was contended that there is no provision in Section 20 of the Act to pay interest to the Foreman on the bank deposits/Government or approved securities that he is required to keep in the name of the Registrar of Chits. In law, the beneficial owner would be entitled to the refund of the securities/cash deposited with the Registrar or with the Bank as also the accrued interest thereon, if any, and undrawn on the Registrar being satisfied that there is no outstanding amount payable to the subscribers. It was submitted that when there is no liability to the subscribers, the Registrar is

not entitled to retain the accrued interest or benefits accrued to the securities.

37. It was submitted on behalf of the Union of India that the Reserve bank of India has advised the State Governments to amend their Chit Rules stipulating payment of interest accrued on the remaining unpaid to the foreman while releasing the securities. The circular dated 28th February, 1990 issued by the Reserve Bank India is extracted below:-

> RESERVE BANK OF INDIA DEPARTMENT OF FINANCIAL COMPANIES CENTRAL OFFICE CELL BOMBAY 400 023 DFO(COC) No. 352/50(1)/89-90 February 28, 1990 Phalguna 9, 1991 (saka) To, All State Governments/Union Territories.
>
> Dear Sir, Chit Funds Act, 1982 (Central Act 40 of 1982) Rules to be made thereunder.
>
> _____ The State Government arc aware that a batch of writ petitions challenging the validity of the provisions of Chit Funds Act before the Kurnataka High Court. Bangalore was dismissed by the Division Bench of that Court in April, 1988. The Division Bench has inter alia observed that with the view of providing relief to a foreman Section 20 of the Act dealing with the security to be obtained from a foreman may he amended so as to provide for payment of interest on the securities lodged by a foreman. (This judgments reported in AIR (1989) Karnataka page 125 - (1990) 67 Company Cases p.203). The matter was examined in consultation with the Central Government and it has been decided not to amend Section 20 of the Chit Funds Act, 1982 but only to amend the rules framed thereunder (which deal with the release of securities) to comply with the directions of Karnataka High Court. A copy of the draft amendment to Rule 24 of the Model Rules dealing with the release of security is enclosed (Draft) for your consideration. It is requested that the State Government may please arrange to incorporate the same in Rule 24 ibid if the Rules have been framed on the lines of the Model Rules furnished by the Reserve Bank of India; otherwise a suitable amendment may be made to reflect compliances of the directives of the Karnataka High Court. For your information an extract of Rule 16 as it is at present and the new Rule 16 of the Chit Funds (Karnataka) Rules, 1983 as proposed to be amended is enclosed for reference and notify the same in the Gazette. Six copies of the notification may please be furnished to us for our records in due course.
>
> Your faithfully, Sd/-
>
> (B. Subramanian) Joint Chef Officer

38. In view of this submission on behalf of the Union of India no further discussion is required in regard to the objection of the appellants/petitioners on non-payment of interest.

SECTIONS 21(1)(a), (1)(b) and (1)(c) Sections 21(1)(a), (1)(b) and (1)(c) read thus:-

21. Rights of foreman - (1) The foreman shall be entitled. -

(a) in the absence of any provision in the chit agreement to the contrary, to obtain the chit amount at the first instalment without deduction of the discount specified in the chit agree-merit, subject to the condition that he shall subscribe to a ticket in the chit:

Provided that in a case where the foreman has subscribed to more than one ticket, he shall not be eligible to obtain more than one chit amount in a chit without discount;

(b) to such amount not exceeding five per cent of the chit amount as may be fixed in the chit agreement, by way of commission, remuneration or for meeting the expenses of running the chit:

(c) to interest and penalty, if any, payable on any default in the payment of instalments and to such other amounts as may be payable to him under the provisions of the chit agreement;

39. We find no reason for the appellants/petitioners to have any objection to Clause (a) or (c) of Section 21. As regards maximum commission of 5% of the chit amount, the objection does not appear to be legitimate because any foreman is not debarred from doing any other business and he is not supposed to incur the expenditure at the cost of the subscribers and then claim higher commission. Expert Bodies have only recommendation two per cent commission whereas the Act provided for 5 per cent commission. We do not find any thing unreasonable in respect of the commission.

40. Again objection to Section 25 is meaningless. This is a normal duty of the foreman which has been converted into a statutory duty. We do not find anything unreasonable. The provision is in subscribers' interest.

SECTION 48

41. The objection to the vires of Section 48 as to the circumstances in which chits are to be wound up is merely staled to be rejected.

42. All the provisions are in the interest of the subscribers and are very material. In any case if the order is unreasonable a party has a right of appeal under Section 59 of the Act.

43. We thus find no merit in the appeals as well as the petitions. The result is that all the appeals and the petitions are dismissed with costs.