

Reserve Bank of India

Vs

Peerless General Finance and Investment Co. Ltd. and Others

Civil Appeals Nos. 3562, 3563, 3564, 3565, 3566, 3567 and 4459 of 1986

(O. Chinnappa Reddy, V. Khalid JJ)

22.01.1987

JUDGMENT

CHINNAPPA REDDY J. –

1. The question is : "Is a prize-less chit a prize chit ?" So posed, the answer appears to be self-evident. That is what it is in the ultimate analysis.

2. 'The Peerless General Insurance and Investment Co. Ltd.,' was incorporate in 1932. After the nationalisation of the business of life insurance the name of the company was changed to "The Peerless General Finance and Investment Co. Ltd.," For over a quarter of a century now, the business of the company has been that of "finance and investment". The company offers three schemes, the principal of which is the Endowment certificate scheme. Under this scheme, a subscriber is required to pay a fixed annual subscription for a fixed number varying between the minimum of 10 years and the maximum of 30 years. On the expiry of the period, the subscription will be paid by the company a sum of money called the Endowment sum which is the face value of certificate. The subscriber is also entitled to be paid a guaranteed fixed bonus. For example, an annual subscription of Rs. 77 for 10 years will fetch subscriber at the end of the 10 year period a sum of Rs. 1,000 as endowment sum and a sum of Rs. 100 as bonus, making a total of Rs. 1,100. If any installment, that is, any amount of annual subscription, is not paid within the stipulated period and period of grace, the certificate lapses unless it has acquired a surrender value. A Certificate acquires surrender value after the expiry of three years from the date of commencement if the subscription for two full years has been paid. A certificate which has not acquired surrender value lapses on non-payment of instalments and the amounts paid become forfeit to the company. A lapsed certificate may, however, be revived at any time before the expiry date of maturity on payment of all dues together with interest at one paisa per rupee per month. There is also provision in the scheme for conversion of the certificate into a paid up certificate, the paid-up amount to be paid at the end of the period, put without bonus. A person purchasing a certificate automatically becomes entitled to a free accident insurance policy under group insurance scheme.

3. A noticeable feature of the scheme is the remarkably low yield to the subscriber on his investment. In the example that we gave we said a subscriber investing Rs. 77 every year for ten years will get, at the end of the tenth year, a return of Rs. 1,000 by way of "Endowment sum" and Rs. 100 as bonus. Treating the total sum of Rs. 1,100 as the amount which the investor gets back on his ten-year annual investment of Rs. 77, the yield on his investment works out at compound interest of about 6% or simple interest of a little over 7%. This is on the assumption that he does not commit default but pays his annual subscription regularly. But consider what happens to the investments of those who commit default; a subscriber who defaults in payment subscription after payment of the

first subscription, forfeits the subscription previously paid by him. A subscriber who pays the first two subscription but commits default thereafter is entitled to have a refund of the subscriptions paid by him but only at the end of the full endowment period. That is to say, the amount invested by the subscriber up to the time of default will be with the company, earning interest for the company but nothing for the subscriber himself. The subscriber who commits default after payment of two annual subscriptions is entitled to have the surrender value paid to him after the expiry of three years from the date of the commencement. The surrender value is 90% of the subscriptions paid by him excluding the first years' subscription. In other words, if a subscriber who commits default after payment of two subscription opts for immediate payment after three years, he forfeits his first year's he forfeits his first year's subscription and 10% of the subsequent year's subscription. On the other hand, if he opts for payment at the end of the endowment period, he will get a refund of the subscriptions paid by him; but without interest and without bonus. If the commits default after paying three year' subscription but opts for payment at the end of the Endowment period, he will get back a proportionate part of the Endowment Amount and this without bonus. The yield will be very much lower than 6% compound interest or 7% simple interest that we mentioned earlier. The subscriber is always at the losing end. It is a perfect case of 'Heads I win, tails you lose'.

4. At this stage, it may be useful to refer to the business practices and the working results of the company. The company advertises its schemes widely in beguiling terms. The public are told : "The schemes are open to any person of Indian nationality without any restriction of caste, creed, sex, age or health, excepting physical disabilities, such as, loss of limbs, dumbness, deafness, or blindness". They are further told : "Investment under the schemes is highly profitable and the return is sure and guaranteed by the company. There is no element of uncertainty in the matter"; "the terms and conditions of the certificate are simple, liberal and attractive"; "No trouble of medical examination"; "Unique advantage of saving as well as earning decent profit", etc. A virtual publicity Blitz is carried on in the daily and weekly newspapers : "Peerless-an epitome of absolute security", "Save for your dear ones", "Saving throughout Peerless means savings for the progress of the Nation", "Peerless team works today for India's happy tomorrow", "Save through Peerless for national welfare", "Peerless the choice of the millions", etc.

5. The message of Peerless is made to penetrate the rural areas to tap the small saving of the poor ignorant villagers through a special structure of agents, special agents, sub-organizers, organizers, special organizers and so on. This field staff appears to be chosen for their social, political or official connections. What is of significance is that an agent's commission is 30% of the first year's subscription and 5% only of subsequent year subscriptions. Straightway, this offers an incentive to the agents to concentrate on securing fresh business and a disincentive to collect subscriptions of subsequent years. It is common experience and common knowledge that rural folk, particularly those belonging to the poorer section of people will not pay their subscription regularly, unless somebody takes the trouble of collecting their subscriptions from them showing the same enthusiasm in doing so as was shown in enrolling subscribers and collecting the first subscription. The incentive of 30% of the collection of the subscription of the first year automatically operates as a disincentive for collecting subscriptions of subsequent years. The results show it and perhaps it is intended to be so. As we have already seen, default after the payment of the first subscription result in forfeiture of the first year's subscription. The first subscription is literally shared between the company and its agent and one need not wonder that under the method of accountancy adopted by the company, it is treated as income and not as a liability of the company. We are told that the company has adopted the "actuarial" system of accountant followed by the Life Insurance corporation. Though we note here that the business of the life Insurance Corporation is insurance business and therefore different from the business of the company, we will have more to say about

the policies of the Life Insurance Corporation a little later. For the present, we note that the company does not and cannot carry on any insurance business and that it accepts no risk.

6. Let us now take a brief look at the result of the attractive incentive given to the agent to collect the first year's subscription. A compilation prepared by the Reserve Bank of India, which is found at page 457 of the paper book shows that the first year's subscription credited to the profit and loss account during the years 1978, 1979, 1980, 1981, 1982, 1983 and 1984 was 17.16, 27.59, 48.07, 85.70, 129.50 and 126.47 lakhs, while the commission paid to the field force during those years was 13.23, 21.73, 39.07, 69.82, 95.21, 95.17 and 93.92 lakhs respectively, and the renewal subscriptions collected during the years was 12.50, 15.95, 22.32, 33.34, 57.79, 80.35, and 101.40 lakhs respectively.

7. The striking fact that stares at us is that out of the total deposits collected during the years 1978 to 1984 amounting to Rs. 887.37 lakhs, a sum of Rs. 563.72 lakhs represents collections of first year subscriptions and Rs. 323.65 lakhs represents subsequent year's collections. First subscriptions far outweigh renewal subscriptions. This feature almost becomes sinister if we remember that the renewal subscriptions relate not to a single year's certificates but to Certificates issued during the 10,20, 30 year periods previous to the relevant year corresponding to 10,20,30 year certificates as the case may be. This clearly indicates that the majority of the subscribers commit default after the first year and only a few of the depositors continue their subscriptions and keep alive the certificates. This gives us an indication as to the class of depositors who are principally contacted and are perhaps intended to be so contacted. Having regard to the class of depositors and the incentives offered to agents for securing fresh business, neglect and default of renewal subscriptions is an inevitable result. The agents are interested in securing fresh business because of the high rate of commission in regard to the fresh business and are loathe to waste their time on collecting subsequent year's subscriptions fetching far less commission.

8. We are told that the terms of the scheme have now been revised and the forfeiture clause has been altogether deleted with the result that even a subscriber who commits default after the first year's subscriptions becomes entitled to get a refund of the amount at the end of the endowment period. While this may be an improvement on the original scheme, we find that agents are even now entitled to commission of 35% of the first year's subscriptions. This continued incentive for fresh business will naturally lead to the same result as before, that is, it will encourage agents to continue to concentrate on collecting first year's subscriptions to the total neglect of subsequent year's subscriptions.

9. At this point we may refer to one of the schemes marketed by the Life Insurance Corporation of India which appears to be familiarly known in circles connected with deposit schemes as "Table No. 21 Policy". We are referring to this Policy as it was argued before us that the endowment schemes of the Peerless company is better conceived in the interests of the investors than the "Table No. 21 Policy" of the Life Insurance of Corporation and yet no one has thought of stopping the Life Insurance Corporation of India from marketing the policy. For a better appreciation of the submissions which we will consider at a later stage, we desire to set out of the details of the policy at this juncture itself in order to compare it with the Endowment Scheme of the Peerless company. Two things have to be straightway noticed, first, the "Table No. 21 Policy" offered by the Life Insurance Corporation is not a life insurance policy, as we generally know it, second, it is a policy without profits. Under this policy no one need undergo medical examination and no one would be unacceptable for reasons of health only. Those two features are common to the Peerless Endowment Scheme and the "Table No. 21 Policy". Under the Policy the sum assured is payable on the

policyholder surviving the endowment term. No bonus is payable. To secure payment of sum of Rs. 1,000 at the end of 10 years, the annual premium to be paid is of Rs. 83.90. If the policy-holder dies during the first year of the policy 80% of the amount of the premium will be paid to the heirs. If he dies during the second year of the policy 90% of all the premiums will be paid. If the he dies during the third year of the policy, the total amount of all the premiums will be paid. If the death occurs after the third policy year the total amount of all the premiums paid together with compound interest at 2 1/2% will be paid. If a person commits default in payment of premiums after the expiry of three years, having paid the full premiums in the meanwhile, the policy becomes automatically paid up for a reduced amount bearing the same ratio to the assured sum as the number of premiums paid bears to the total number stipulated in the policy. If default is committed within the first three policy years, the amounts of premium paid are forfeited. We do not have the slightest doubt that the terms of the 'Table No. 21 Policy' of the Life Insurance Corporation are very stringent and much more to the disadvantage of the subscriber than the terms of the Endowment Schemes of the Peerless Company. We are told that the scheme is primarily devised to enable the subscribers to get tax benefits under various fiscal enactments. Whatever it is, it is certainly not intended to tap the savings of the rural poor not is it designed to benefit them. In fact, we find on an examination of some of the Life Assurance Schemes, which we were invited to do by the learned counsel, that the terms of the policies are heavily loaded against the poorer policy holders. The Manual for Agents describes the Endowment Assurance Policy (Tables 11, 14, 47, and 48) as the most popular form of the Life Assurance as it is supposed to make 'provision for the family of the Life Assured in the event of his early death 'and also 'assures a lump sum at any desired age'. Now, under this Policy, if payment of the annual premiums ceases after at least three year's premiums have been paid, a free paid-up Policy for an amount bearing the same proportion to the sum assured as the number of premiums actually paid bears to the total number stipulated in the Policy, will be automatically secured. The amount, of course, will be payable at the end of the Endowment period only. What is important is that if the policy-holders commits default and does not pay any one of the first three premiums the premiums already paid automatically stand forfeited to the Life Insurance Corporation, entitling the policyholders to no benefit. Since it is the poorer class of policy-holders that may ordinarily be expected to commit default in payment of premium, the forfeiture clause, in practice, operates harshly, specially against that class, the very class which requires greater security and protection. A perusal of the 'Report and Accounts' of the Life Insurance Corporation for the years ending March 31, 1983, and March 31, 1985 which have been placed before us shows that while 22,31,385 and 26,99,654 new policies were issued respectively during the two years the numbers of policies which lapsed or were forfeited were respectively 7,44,422 and 8,27,119. Thus the number of policies which lapses or are forfeited are roughly 30 per cent the number of new policies issued during a year. An analysis of the lapsed and forfeited policies is also given in the reports. From the report for the year ending March 31, 1983, we see that out of the 7,44,422 lapsed and forfeited policies, 4,37,004 were issued in the first year previous to the year under review, 1,98,949 in the second year previous to the year under review and 83,950 in the third year previous to the year under review. From the report for the year ending March 31, 1985, we see that out of the 8,27,119 lapsed and forfeited policies, 4,61,890 were issued in the first year previous to the year under review, 2,35,994 were issued in the second year previous to the year under the review and 99,589 in the third year previous to the year under review. We also notice that in the policies issued earlier than the third year before the reviewed year lapses or forfeitures were negligible. Thus we notice that the incidence of lapsing or forfeiture of policies is the highest and of a high order in the first three years after a policy is issued. It does not require much imagination to see that the victims of the forfeiture clause in the policies are bound to be persons belonging to the poorer sections of the people. It does not appear that any special errors are made by the Life Insurance Corporation to

persuade the poorer policy-holders not to allow their policies to lapse or be forfeited after paying one, two or three premiums. The incentives to agents appear to be for securing fresh business and not for continuing old policies.

10. We cannot help but feel distressed that despite articles 38,39,41 and 43 of the Constitution, the Life Insurance Corporation of India, an instrument of the State, which is given the monopoly of Life Insurance business in the country has taken no steps to offer proper security and protection to the needy, poor, rural folk. If the Life Insurance Corporation is really interested in treating the poorer policy-holders less harshly and more liberally the time has come for the Life Insurance Corporation to revise its terms and conditions and to think in the direction of deleting the forfeiture clause altogether as has now been done by the Peerless Company or to delete it at least from policies for small amounts. Perhaps the Life Insurance Corporation may think of short term, small amount policies with no forfeiture clause and with some incentive such as a reduced premium for continuing to pay premiums regularly. We are sure that with the management expertise at its command the Life Insurance Corporation of India can devise a myriad ways of serving the poorer sections of the people of our country, as also to tap the huge untapped savings resources, the existence of which has been brought home by companies like the Peerless however wrong-headed their business methods might be. It is a matter of common knowledge that the return to a policy-holder who survives the period of the policy is very poor. We are now told daily that the Life Insurance Corporation is paying higher bonus year after year. But the learned counsel for the Peerless charges that the bonus comes out of amounts of the forfeited policies and that it is really the poorer class of defaulting policy-holders whose policies are forfeited that are paying bonus to the class of policy-holders who are better off. One wonders if this is not so ! This surely is not what is contemplated by Article 38(2) of the Constitution which talks of minimising the inequalities in income, not only amongst individuals but also amongst groups of people and Article 39(c) which requires the State to secure that the operation of the economic system does not result in the concentration of wealth and means of production in to the common detriment.

11. In 1964, by Central Act 55 of 63 the Reserve Bank of India Act was amended by the addition of Chapter III(B) consisting of Sections 45-H to 45-Q. The title of the Chapter is "Provisions relating to Non- Banking Institutions receiving deposits and Financial Institutions". Section 45-I(c) defines Financial Institution as follows : 'financial institution' mean any non-banking institution which carries on as its business or part of its business any of the following activities, namely :

- (i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
- (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- (iii) letting or delivering of any goods to hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-purchase Act, 1972;
- (iv) the carrying on of any class of insurance business;
- (v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,

but does not include any institution, which, -

(i) is an industrial concern as defined in clause (C) of section 2 of the Industrial Development Bank of India Act, 1964, or

(ii) carries on as its principal business, -

(a) agricultural operations; or

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchase, constructions or sales of immovable property by other persons;

(d) "firm" means a firm as defined in the India Partnership Act, 1932;

(e) "non-banking institution" means a company, corporation or co-operative society.

12. Section 45-I(e) defines 'Non-banking Institution' as meaning 'a company, corporation, or co-operative'.

13. Section 45-K empowers the Reserve Bank to collect information from Non-Banking Institutions as to deposits and to give directions in the public interest, in particular 'in respect of any matters relating to or connected with the receipt of deposits, including the rates of interest payable on such deposits, and the periods for which deposits may be received'. Section 45-L empowers the Reserve Bank to call for information from financial institutions and to give directions, in particular directions relating to the conduct of business by them, etc.

14. In 1970 the Banking Commission constituted a study Group headed by Dr. Bhabatosh Dutta to review the role of various non-banking financial intermediaries. The Study Group confined their study to five classes of Finance Institutions which they considered were important Non-Banking Financial Institutions. They were :

1. Hire Purchase Finance Institutions;
2. Investment Companies;
3. Chit Funds/Kuris;
4. Nidhis or Mutual Benefit Funds; and
5. Finance Corporations.

15. Proceeding to consider Chit Funds and their working, the Study Group identified three classes of Chit Funds : (a) Simple Chits, (b) Prize Chits, and (c) Business Chits. The main features of the three classes of Chits were then described in the following terms :

(a) Simple Chits :

In the 'simple chit', members agree to contribute to the fund a certain amount at regular intervals. Lots are drawn periodically and the member whose name appears on the 'chit' gets the periodical collection. His name is then removed from the subsequent lots; he, however, has to continue to pay his subscriptions. Thus, every member gets the whole of the chit amount by turns. There is no loss of capital. Also there is no foreman or even if there is one, he does not charge any commission. This is a form of mutual held and co-operative effort at savings.

(b) Prize Chits. - In the 'prize chit', there is a foreman who ostensibly charges no commission and promises to return the whole of the contributions made by member back to him at the end of a certain period. Periodically, the names of 'non-prized' members are put to draw and the lucky member gets the prize either in cash or in the form of an article of jewelry or utility. Once a person gets a prize, he does not have to pay further instalments. The lucky member will get the prize irrespective of the number of instalments he has paid provided all the due instalments till the draw of prize have been paid; he will then be excepted from further liability to pay. On the contrary the majority of the members may not have got the prize when the scheme closes though they get back their total contributions without any deduction or its equivalent in the shape of an article. This is a scheme which is nothing short of lottery which is an offence punishable under Section 294-A of the Indian Penal Code. The name 'Chit Fund' is rather a misnomer in his case.

(c) Business Chits :

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 to pay his subscriptions 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 installment as prize. Depending on the terms of agreement, a fixed amount is also sometimes set aside for distribution among the non-prized members. After making provision 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 forgo 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 a case more than one person is prepared to offer the same discount or when there are no bidders, lots 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. Sometime with a view to catering to as many subscribers as possible, a chitty comprises a series expressed in terms of 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 installment). In such case the number of subscriber can exceed the number of instalments. In some case 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 study Group's view was that Chit Funds were not efficient as savings or lending institutions and that they encouraged consumption spending and in some cases hoarding of scarce commodities. The major reason for their popularity was stated to be ignorance of the risk and the disadvantages involved. The automatic solution, they said, lies in Commercial Banks weaning away the Chit Fund subscribers by offering attractive deposit and credit schemes. In the meanwhile, it was suggested that elimination of Chit Funds would leave a credit gap and therefore, they should be regulated by appropriate legislation to ensure safeguarding the interest of members and prevent the foreman from enjoying the wide powers that they did at that time.

16. Shortly after the report, the Reserve Bank of India purporting to exercise its powers under Section 45-J and 45-K of the Reserve Bank of India Act gave certain directions called "Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973". Paragraph 2 of the Directions stated :

Extent of the Directions - These directions shall apply to every non-banking institutions which is a company, not being a banking or an insurance company, and which carries on any of the following types of business :-

(1) collecting whether as a promoter, foreman, agent or in any other capacity, monies in one lumpsum or in instalments by way of contributions, or subscriptions or by sale of units, certificates or other instruments or in any other manner or as membership fees or admission fees or service charges to or in respect of any savings, mutual benefit, thrift, or any other scheme or arrangement by whatever name called, and utilising the monies so collected or any part thereof or the income accruing from investment or other use of such monies for all or any of the following purposes -

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

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

(2) managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, be entitled to the prize amount;

Explanation - For the purpose of this sub-paragraph, the expression "prize amount" shall mean the amount, by whatever a name it be called, arrived at by deduction from out of the total amount subscribed at each installment by all subscriber, (a) the commission charged by the company as service charges as a promoter or a foreman or an agent, and (b) any sum which a subscriber agrees to forgo, from out of the total

subscriptions of each installment, in consideration of the balance being paid to him.

(3) conducting any other form of chit or kuri which is different from the type of business referred to in sub-paragraph (2) above;

(4) undertaking or carrying on or engaging in or executing any other business similar to the business referred to in sub-paragraphs (1) to (3).

17. Paragraph 3(1)(i) defined a 'Miscellaneous Non-Banking Company' as meaning a company carrying on any of the types of business referred to in paragraph 2 of the directions. Paragraph 4 dealt with acceptance of deposits by Miscellaneous Non-Banking Companies. Paragraph 4(a) prescribed six months as the minimum period for which a Miscellaneous Non-Banking Company could accept a deposit, but no maximum period was prescribed. Paragraph 4(b)(ii) prescribed a ceiling of 25% of the aggregate of the paid-up capital and free reserves of the company in the case of deposits accepted by Miscellaneous Non-Banking Companies. Paragraph 13 enabled the Reserve Bank to exempt any company or class of companies from all or any of the provisions of the directions either generally or for a specified period, if it considered necessary for avoiding any hardship or for any other just and sufficient reason.

18. The Reserve Bank of India issued a circular letter bringing the directions to the notice of companies like Peerless. On September 14, 1973, the Peerless company addressed a letter to the Reserve Bank of India explaining the nature of their business and claiming that their business was outside the scope of the directions issued by the Reserve Bank. Most important of all, it was requested that, if it was thought that their business attracted the notification, they should be granted exemption from the applicability of the notification as provided by paragraph 13. It was pointed out that their business was of a special type, that it was carried on on scientific lines and actuarial principles and that the applicability of the notification would injuriously affect two hundred thousands of subscribers, that 20,000 persons would lose employment and that the potential for future employment would be destroyed. It was further pointed out that over 90% of the concerned Public Fund was invested in Government securities and in Nationalised Banks. The balance-sheet of the company, its brochure and a copy of its advertisement were enclosed. The Reserve Bank of India by their order dated December 3, 1973 exempted the Company from the provisions of paragraph 4 of the notification insofar as those provisions restricted the acceptance of subscriptions under the schemes up to 25% of the paid up capital and free reserve fund. Certain conditions were however, imposed. The Company was directed to transfer every year to the reserve fund a sum not less than 5% of the profit after taxes. The company was directed not to declare any dividend at rates higher than 6% and 7% on ordinary and preferential shares till the free reserve became equal to the paid-up capital. The Company was also required to maintain not less than 75% of its total assets in the form of investments and Government trustee-securities, etc. The company was directed to submit every year a certificate from their auditors in regard to compliance with the conditions imposed. The exemption was to be reviewed every two years. It appears that there was an inspection in 1974, but we have no information about the findings in the course of the inspection. Evidently, nothing objectionable was found. This is apparent from the affidavit filed on behalf of the Reserve Bank of India in the Calcutta High Court in Civil Rule No. 5941(W)/77, a writ petition filed by the Favorite Investment Company challenging the refusal of Reserve Bank to grant them exemption from the Miscellaneous Non-Banking Companies Directions, 1973 and complaining of discrimination in that such an exemption had been granted to Peerless. Comparing the schemes of the two companies, it was pointed out in the affidavit that the Endowment Certificates issued by Peerless Company were for periods ranging from ten to thirty years while the Endowment Certificates granted by the

Favorite Company ranged from five to thirty years. It was stated that the schemes of the Favorites Company which ranged for short periods from five to thirty years were unscientific inasmuch as interest payable by the Company on short term certificates was higher than 10% of the instalments or subscriptions collected by the Company which were invested in government securities and banks where filed (sic) was between five to ten per cent. It was noticed that Peerless maintained a fund based on actuarial principles to which the subscriptions received from each subscriber from the second year onwards were credited along with compound interest at 8 per cent per annum. It was also noticed that cash and bank balances in the current account of Peerless and investment in other Government securities on short term and fixed deposits were adequate to meet the contractual obligations of Peerless to its subscribers. It was noticed that while the paid-up capital and reserves of Peerless amounted at that time to Rs. 2.33 lakhs and its investment in government securities and fixed deposits amounted to Rs. 105.38 lakhs, its deposit liabilities amounted to Rs. 114.76 lakhs. This position was considered satisfactory by the Reserve Bank. It was finally stated : "having regard to the satisfactory financial position of the Peerless and the fact that it was a well established one and having regard to the certificate furnished by the actuarial consultant of the Peerless supported by data, it was granted exemption from the provisions of paragraph 4 of the 1973 Directions subject to its compliance with the following conditions." After the setting out the conditions it was stated that Peerless had been complying with the conditions and that its financial position continued to be satisfactory. We should mention here that whatever vices there may be in the Peerless Scheme and the business methods of Peerless, the financial position of Peerless, on the basis of the criteria mentioned in the affidavit of the Reserve Bank in the Favorite Bank case, is far sounder now than then.

19. In 1974, a Study Group headed by Dr. J. S. Raj was appointed by the Reserve Bank to examine the existing statutory provisions with a view to assessing their adequacy in regulating the conduct of business by non-banking companies in the context of the monetary and credit policy laid down by the Reserve Bank of India from time to time and to suggest measures for further tightening up the provisions so as to ensure that the activities of such companies, insofar as they pertained to the acceptance of deposits, investment, lending operations, etc. subserved the national interest and served more effectively as adjuncts to the regulations of the monetary and credit policies of the country, besides affording a degree of protection to the depositors' monies. The Study Group went into the matter in some depth. Chapter VI of their report was devoted to Miscellaneous Non-Banking Companies covered by the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973.

20. In paragraph 6.1 of the report, the Study Group identified two types of Miscellaneous Non-Banking Companies covered by the Miscellaneous Non-Banking Companies (Reserve Bank) Directions as :

(a) those conducting prize chits, benefit/savings schemes, lucky draws, etc.; the modus operandi of the types of schemes conducted by these companies has been set out in a subsequent paragraph (paragraph 6.3 extracted below); and

(b) those conducting conventional or customary chit funds whereunder the foreman companies enter into agreements with a specified number of subscribers that every one of them shall subscribe certain sum in instalments over a definite period and that every one of such subscriber shall in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreements, be entitled to the "prize amount". This prize amount is arrived at by deduction from out

of the total amount subscribed at each installment by all subscribers, (i) the to commission charged by the company or service charges as a promoter or a foreman or an agent and (ii) discount, i.e., any sum which a subscriber agrees to forego, from out of the total subscriptions of each installment in consideration of the balance being paid to him.

The business of the Miscellaneous Non-Banking Companies conducting prize chits, benefit/saving schemes or lucky draws etc. was described in paragraph 6.3 of the report as follows :

6.3 Companies conducting the above types of schemes are comparatively of a recent origin and of late, there has been a mushroom growth of such companies which are doing brisk business in several parts of the country, especially in big cities like Ahmedabad, Bangalore, Bombay, Calcutta and Delhi. They have also established branches in various States. They have also established branches in various States. These companies float schemes for collecting money from the public and the modus operandi of such schemes is generally as described below :

The company acts as the foreman or promoter and collects subscriptions in one lumpsum or by monthly instalments spread over a specified period from the subscribers to the schemes. Periodically, the numbers allotted to members holding the tickets or units are put to a draw and the member holding the lucky ticket gets the prize either in cash or in the form of an article of utility, such as motor car, scooter, etc. Once a person gets the prize, he is very often not required to pay further instalments and his name is deleted from further draws. The schemes usually provide for the return of subscriptions paid by the members with or without an additional sum by way of bonus or premium at the end of the stipulated period in case they do not get any prize. The principal items of income of these companies are interest earned on loans given to the subscribers against the security of the subscriptions paid or on an unsecured basis as also loans to other parties, service charges and membership fees collected from the subscribers at the time of admission to the membership of the schemes. The major heads of the expenditure are prizes given in accordance with the rules and regulations of the schemes, advertisements and publicity expenses and remuneration and other perquisites to the directors.

The Committee observed in the report that the Directions known as the Miscellaneous Non-Banking Companies (Reserve Bank of India) Directions, 1973 were applicable to companies conducting what were commonly know as prize chit schemes/benefit or savings schemes or lucky draws and also to those conducting conventional type of chits or those conducting any other from of chits/kuris. What is of importance and what requires to be noted here is that the Study Group which had investigated the business of various types of Non-Banking Companies was of the view, and their view must be taken to have been expressed with reference to those who a were well acquainted with the nature of business of Non-Banking Companies and those who were in charge of the enforcement of the 1973 Directions, that the 1973 Directions covers companies conducting prize chit schemes/benefit or saving schemes or lucky draws, as well as companies conducting conventional type of chits and other kinds of chits/kuris. Simple recurring deposit schemes do not appear to have been in the contemplation of either the Dutta Study Group or the Raj Committee, nor were such schemes considered at that stage as covered by the 1973 Directions.

21. The conclusion of the Study Group was stated in paragraph 6.11, as follows :

From the foregoing discussion, it would be obvious that prize chits or benefit

schemes benefit primarily the promoters and do not serve any social purpose. On the contrary, they are prejudicial to the public interest and also adversely affect the efficacy of fiscal and monetary policy. There has also been a public clamour for banning of such schemes; this stems largely from the malpractices indulged in by the promoters and also the possible exploitation of such schemes by unscrupulous elements to their own advantage. We are, therefore, of the view that the conduct of prize chits or benefit schemes by whatever name called should be totally banned in the larger interests of the public and that suitable legislative measures should be taken for the purpose if the provisions of the existing enactments are considered inadequate. Companies conducting prize chits, benefit schemes, etc., may be allowed a period of three years which may be extended by one more year to wind up their business in respect of such schemes and/ or switch over to any other type of business permissible under the law.

22. Finally, in paragraph 6.21 the Study Group made its recommendation for a total ban on the conduct of prize chits. If paragraph 6.21 is read along with paragraph 6.3 of the Report we must take it that the recommendations of the Committee was that prize chits of the kind described by them in paragraph 6.3 should be banned, irrespective of the name under which they were conducted. Simple Recurring Deposit Schemes were not contemplated.

23. Thereafter, as a follow up of the recommendations of the Raj Committee, in 1977 two sets of directions were issued by the Reserve Bank, called the Miscellaneous Non-Banking Companies(Reserve Bank) Directions, 1977 and the Non-Banking Financial Companies(Reserve Bank) Directions, 1977. Paragraph 2 of the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977 was more or less the same as paragraph 2 of the 1973 directions. As in the 1973 directions, so also in the 1977 directions a Miscellaneous Non-Banking Company was defined to mean a company carrying on all or any of the types of business referred to in paragraph 2 of the directions. Paragraph 5 of the Miscellaneous Non-Banking Companies (Reserve Bank) Directions which corresponded to paragraph 4 of the 1973 directions, however, made a ridiculous departure from the earlier provision. For the first time, a ceiling was fixed on the period for which deposits could be accepted. It was provided that the period of a deposit could not be more than six months. Paragraph 14 also vested in the Reserve Bank the power to grant exemption in suitable cases.

24. The Non-Banking Financial Companies (Reserve Bank) Directions 1977, were issued simultaneously with the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977 and Section 2 (f), (g), (h), (i), (k), (l) respectively defined the expressions 'hire-purchase finance company', 'housing finance company', 'insurance company', 'loan company', 'mutual benefit financial company' and 'non-banking financial company'. 'Non-Banking Financial Company' was defined to mean "any hire-purchase, finance, housing finance, investment, loan or mutual benefit financial company and an equipment leasing company but not to include an insurance company or stock exchange or stock-broking company." Paragraph 4 dealt with acceptance of deposits by mutual benefit financial companies. Paragraph 5(1) dealt with period of deposits for hire-purchase finance, loan and investment companies and provided that the period of deposits shall not be less than six months or more than thirty-six months. Paragraph 19 made the directions applicable to a loan company also applicable to every company which was a 'financial institution' but not belonging to any of the categories of companies mentioned in paragraph 2(1)(e) or which was not miscellaneous non-banking company within the meaning of the Miscellaneous Non-Banking Companies Directions, 1977. 'Financial institution' is defined in the Act itself (Reserve Bank of India Act) by section 45-I(c). Clauses (v) and (vi) which are relevant are to the following effects :

'financial Institution' means any non-banking institutions which carries on as its business or part of its business any of the following activities, namely :

(v) managing, conducting or supervising as foreman, agent or in any other capacity, of chits or kurisas defined in any law which is for the time being in force in any State, or any business, which is similar there to;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person."

It was suggested by learned counsel for the Reserve Bank that whether Peerless company was a Miscellaneous Non-Banking Company within the meaning of the expression as defined in the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973 or a 'financial institution' which was not such a Miscellaneous Banking Company, undoubtedly, there was a ceiling on the maximum period for which the company could accept deposits and that was thirty-six months. We will refer to the argument in due course.

25. Thereafter in 1978 the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 was enacted 'to ban the promotion or conduct of prize chits and money circulation schemes and for matters connected therewith or incidental thereto'. Section 2(a) defines 'Conventional Chits, on practically the same lines as the type of business covered by the second part of paragraph 2 of the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973, and the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977. Section 2(c) defines 'money circulation scheme' and is as follows :

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

Section 2(e) defines 'prize chit' and is as follows :

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

(i) giving or awarding periodically or otherwise to a specified number of subscriber as determined by lot, draw or in any other manner, prizes or gifts in cash or in kind,

whether or not the recipient of the prize or gift is under a liability to make any further payment in respect of such scheme or arrangement;

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

but does not include a conventional chit;

The primary question in the present case is whether the Endowment Scheme piloted by the Company falls within the definition of prize chit ? Sections 3 bans prize chit and money circulation schemes and is in the following terms :

No person shall promote or conduct any prize chit or money circulation scheme, or enrol as a member to any such chit or scheme, or participation in it otherwise, or receive or remit any money in pursuance of such chit or scheme.

It is important to notice here that the ban is not merely on promoting or conducting any prize chit or money circulation schemes but also on participation in the scheme. Section 4 makes contravention of the provisions of Section 3 punishable with imprisonment for a term which may extended to three years or with fine which may extend to five thousand rupees, or with both. Section 5 makes printing, publishing of any ticket, coupon or other document for use in the prize chit or money circulation scheme with a view to promotion of such scheme in contravention of the Act punishable with imprisonment etc. So also the printing, publication or distribution of any advertisement of the prize chit or money circulation schemes. The use of any premises for purpose connected with the promotion or conduct of the scheme is also punishable. Section 6 deals with offences by companies. Section 7 deals with the power of entry, search and seizure. Section 8 provides for the forfeiture of newspapers or other publications containing any material connected with any prize chit or money circulation scheme. Section 11 exempts from the operation of the Act prize chits or money circulation schemes promoted by a State Government or any officer or authority of its behalf, a company wholly owned by a State Government which does not carry on any business other than the conducting of a prize chit or money circulation scheme, a banking institution notified by the Central Government under Section 51 of the Banking Regulation Act, the State Bank of India or a subsidiary bank of the State Bank of India or a corresponding new bank, a Regional Rural Bank, a co-operative bank and any charitable or educational institution notified in that behalf by the State Government in consultation with the Reserve Bank of India. There is no general provision which empowers the Central Government or the Reserve Bank of India to exempt any other prize chit or money circulation schemes for from the applicability of the Act. Sections 12 contains transitional provisions relating to the winding up of the business relating to a prize chit or money circulation schemes which is being conducted at the commencement of the Act. The person conducting the prize chit or money circulation scheme is required to furnish to the State Government or the authorised officer and to the Reserve Bank in the prescribed form full information regarding the chit or scheme along with a winding up plan

prepared in accordance with the provisions of rules made by the State Government. The State Government, in consultation with the Reserve Bank, is invested with the power to permit such persons to continue to conduct the business relating to the chit or scheme for such further period as may be necessary in the circumstances of the case and in the interests of the members of the chit or the scheme. The State Government in consultation with the Reserve Bank may approve the winding up plan furnished by the person conducting the scheme with or without modifications or reject the same. Section 13 empowers the State Government to make rules for the purpose of carrying out the provisions of the Act. The Government of West Bengal has made the Prize Chits and Money Circulation Schemes (Banning)(West Bengal) Rules, 1979 in exercise of its powers under the section 13 of the Act.

26. The Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977 and the Non-Banking Financial Companies (Reserve Bank) Directions came into force on July 1, 1977. On March 3, 1978, the Reserve Bank informed the Peerless Company that under the Miscellaneous Non-Banking Companies Directions which applied to the company, the company was prohibited from accepting deposits for more than 36 months and since the deposits accepted by the Company were for periods exceeding 36 months, the Reserve Bank wanted to know what action the Company proposed to take to comply with the requirement stipulating the maximum period for which deposits might be accepted. In reply, the Company, by its letter dated March 31, 1978 pointed out the special feature of the Company which persuaded the Reserve Bank to grant exemption to the Company from the 1973 directions. The Company invited the attention of the Reserve Bank to the various elements of the scheme which made it impracticable to comply with the stipulation regarding the maximum period of 36 months as that would make the scheme wholly unviable. The Company requested that further exemption may be granted in public interest. The alternative, it was said, would be to close the business and that would mean loss of employment to several thousands employees and financial loss to millions of depositors. The Company suggested that the Reserve Bank might recommend to the Central Government to convert the undertaking into a joint sector enterprise. The letter ended with an appeal to the Reserve Bank to grant exemption from the restrictions relating to maximum period. It is not clear what precisely took place subsequently but there was an inspection of the Peerless Company's books by an inspection team appointed by the Reserve Bank of India. The team in its report pointed out various unhealthy features of the schemes managed by the Peerless Company. The principal unhealthy features pointed were :

- (a) the emphasis of the company was on attracting fresh business rather than collecting renewal subscriptions;
- (b) the agency structure and the rates of commission were conceived in the interest of the agents and not the depositors;
- (c) the 'owned funds ' of the Company were low and did not keep pace with the rapid expansion of its outside liabilities;
- (d) the Company followed the curious procedure of crediting the entire amount of first year's subscriptions to its profit and loss account treating it as income. This peculiar accounting procedure resulted in the profit and loss account published by the Company not representing a true picture of the real profits of the company;
- (e) certificates were treated as lapsed if any subscriptions was not paid in the first

three years;

(f) the savings scheme of the Company was basically in the nature of recurring deposit schemes of Commercial Banks and National Savings Organisations but the yield was very much lower;

(g) all sorts of the efforts were made by the company to capture public imagination.

Thereafter on July 23, 1979 the Reserve Bank of India purported to send a reply to the Company's letter dated March 31, 1978 to which we have made a reference above. By this letter the Reserve Bank pointed out to the Company that the schemes conducted by the Company were covered by the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, which had come into force with effect from December 12, 1978. As the company was banned from doing fresh business and was required to wind up its existing business under the Act, there, was no question of granting any exemption to the company. Nevertheless the Reserve Bank stated that they had considered the claim for exemption on merits and found that it was necessary to cancel the exemption already granted. The reasons for the proposed cancellation were set out and the Company was asked to show cause why the exemption should not be canceled. On August 30, 1979 the Company replied at great length stating how necessary it was in the public interest to grant exemption to the Company. Exemption was, however, refused by the Reserve Bank on March 19, 1980. On August 10, 1979 the Government of West Bengal addressed a communication to the Peerless Company pointing out that the Prize Chits/Money Circulation Schemes conducted by the Company came within the purview of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and, therefor, the Company was under an obligation to submit a winding up plan under Rule 4 of the Prize Chits and Money Circulation Schemes (Banning)(West Bengal) Rules, 1979.

27. In the meanwhile on September 3, 1979, the Company field a writ petition in the Calcutta High Court for a declaration that the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 did not apply to the business carried on by the company. A rule was issued and an interim order was made in favour of the company, first for a limited period and, later, till the disposal of the writ petition. A similar writ petition was field questioning a notice issued by the Madhya Pradesh Government on the same lines as that issued by the West Bengal Government. A rule and interim order were issued. A learned Single Judge of the High Court dismissed both the writ petitions but appeals preferred by the Company under the letter patent against the judgment of the learned Single Judge were allowed by a Division Bench of the Calcutta High Court. It was declared that the business carried on by the Company did not come within the mischief of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. Against the judgment of the Division Bench of the Calcutta High Court the Reserve Bank of India, the Union of India and the state of West Bengal have preferred Civil Appeals Nos. 3562, 3563, 3564, 3565 and 4459 of 1986. In the course of judgment, the Division Bench of the Calcutta High Court had observed that the Company was financial institution within the meaning of paragraph 11 of the Non-Banking Financial Companies (Reserve Bank) Directions, 1977 and, therefore, the directions contained therein applied to the business carried on by the Company. Against this observation of the Division Bench, the Company has also preferred Civil Appeals Nos. 3566 and 3567 of 1986. We may also mention here that after the judgment of the Division Bench of the Calcutta High Court, the Company, pursuant to the observation of the Division Bench that it was a financial institution within the meaning of paragraph 11 of the Non-Banking Financial Companies (Reserve Bank) Direction, applied afresh to the Reserve Bank of India for exemption from complying with the directions. The Reserve Bank of India by its order dated August 22, 1986 refused to grant the exemption sought. It appears that the

Company has filed another writ petition in the Calcutta High Court against the refusal of the Reserve Bank of India to grant exemption. In view of the pendency of the writ petition in the Calcutta High Court we do not desire to say anything on the merits of the claim of the Company for exemption or on the question whether the Company is a financial institution within the meaning of paragraph 11 of the Non-Banking Financial Companies (Reserve Bank) Directions. We leave that question open as we consider that the appeals preferred by the Reserve Bank of India, the Union of India and the State of West Bengal may be decided without expressing any opinion on the question. Appeals preferred by the Company are disposed of with these observations.

28. The question for our consideration is : "Is the Endowment Scheme of the Peerless Company a prize chit within the meaning of Section 2(e) of the Prize Chits and Money Circulation Schemes (Banking) Act ?" The particulars of the scheme are not in dispute. What is its nature ? It is not a gambling scheme. It is not a lottery scheme. There are no prizes, no gifts, no element of chance. It is just a plain recurring deposit scheme such as the many schemes floated by Commercial Banks and National Saving Organisation. This is admitted in the Inspection Report of the Reserve Bank of India. But, says counsel for the Reserve Bank, if money is received in a lump sum or in instalments and money is utilised either for payment of prizes or for refund of the whole or part of amount of subscription, the scheme is a prize chit as defined. Prize or gift is not an essential element and refund of the amount of subscription is sufficient to bring it within the mischief of Section 2(e). He says clause (i) and (ii) of the definition are disjunctive. He emphasises the words "for all or any of the following purposes". And, he stresses the fact that the definition is an 'Inclusive' one. He says that if Commercial Banks, the National Saving Organisation and others are permitted to receive deposits and to run recurring deposit schemes, they do so under special statutes. The learned Attorney-General and learned counsel for the Reserve Bank of India urge that the Act is aimed at protecting the interest of depositors generally and that the millions of depositors of Peerless need such protection sorely. On the other hand the learned counsel for Peerless would say that the history of the legislation and the mischief which the legislation seeks to prevent plainly indicate that the legislation is aimed at schemes involving the giving away of prizes or gifts and that the 'inclusive' definition is merely intended to take in all schemes or arrangements, whether called prize chits or by whatever other name. It is said that Parliament could never have intended to strike at all recurring deposit schemes, particularly when the Life Insurance Corporation of India, the Commercial Bank and National Savings Organisation offer such schemes. The learned counsel urges that Parliament could never have contemplated the closure of a pioneering business such as Peerless which has tapped hitherto untapped saving resources of the country. If there are any vicious features in the business, Peerless, he says, is ready to remove the vices and cure the defects. He says, for example, the forfeiture clause has now been deleted from the scheme and this is more than what the Life Insurance Corporation, a monolithic, Public Sector Corporation has done. He even hints that the Company may be nationalised and the Company would raise no protest. According to him the closure of the business of the Company will result in throwing out of employment tens of thousands of employees and putting in jeopardy the small savings of millions of little depositors. We must add here that both sides talked of the public interest and shed copious tears for the 'unfortunate depositors' but neither side appeared to have any ready plan or even a contingent plan to protect or benefit the depositors. On the one hand, there is a demand for the retributive pound of flesh, unmindful of the future of thousand of employees and the fate of the small savings of millions of depositors, all in the name of the interest of the depositors. On the other, having bled the depositors white, there is now a glib and make-believe offer of submission to strict regulation or even nationalisation for the protection, it seems, of employees and depositors.

29. In the ultimate analysis the question turns on the interpretation of the definition of 'Prize Chit' in

Section 2(e) of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. On this, we are not without guidance. We have it in *Srinivasa Enterprises v. Union of India* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464). The very provision was considered and construed there by a Bench of three judges of the court which included one of us. The court, fortunately, speaking through Krishna Iyer, J. after extracting Section 2(e), observed : (SCC pp. 509-10, paras 1-3)

The quintessential aspects of prize chit are that the organizer collects money in lumpsum or instalments, pursuant to a scheme or arrangement, and he utilises such moneys as he fancies primarily for his private appetite and for (1) awarding periodically or otherwise to a specified number of subscribers, prizes in cash or kind and (2) refunding to the subscribers the whole or part of the money collected on the termination of the scheme or otherwise. The apparent tenor may not fully bring out the exploitative import lurking beneath the surface of the words which describe the scheme. Small sums are collected from vast numbers of persons, ordinarily of slender means, in urban and rural areas. They are reduced to believe by the blare of glittering publicity and the dangling of astronomical amounts that they stand a chance-in practice, negligible, of getting a huge fortune by making petty periodical payments. The indigent agrestics and the proletarian urbanites, pressured by dire poverty and doped by the hazy hope of a lucky draw, subscribe to the scheme although they can ill afford to spare any money. This is not promotion of thrift or wholesome small savings because the poor who pay, are bound to continue to pay for a whole period of a few years over peril of losing what has been paid and, at the end of it, the fragile prospectus of their getting prizes are next to nil and even the hard earned money which they have invested hardly carries any interest. They are eligible to get back the money they have paid in dribblets virtually without interest, the expression 'bonus' in Section 2(a) being an euphemism for a nominal sum. What is more, the repayable amount being small and the subscribers being scattered all over the country, they find it difficult even to recover the money by expensive, dilatory litigative process.

Since there are a large number of prize chits all over the country which have almost become a Pan-Indian epidemic and since the total number of people victimized by these projects are considerable the injury to the community is substantial, so that a welfare State dedicated to the Directive Principles of Part IV has to awake and protect the vulnerable sector. Another weighty factor which has alerted the State into action is that the flood of funds flowing through prize chits benefit the organisers of such schemes who have no social responsibility for national productivity and in their hands is easy money with little developmental benefits or attractive returns for the poor investors.

The noxious net cast by the prize chit promoters was large and the State moved to stop this menace. Many a little makes a mickle, and those small sums collected from a substantial number of subscribers accumulated into huge resources which otherwise would ordinarily have been available for national development. The grim picture of the luckless many who were losing their money, appetized by gambling prospects, and the sterilization of people's resources which were siphoned off by private adventurers through prize chits to the detriment of national development ignited the impugned legislation.

The court identified the vice sought to be preserved by the Banning Act as the glitter of glamorous prizes, the lure of big money for small. What it sought to prevent was the exploitation of the ignorant poor by the glare of publicity of fabulous prizes. The court found that it was this mischief that was remedied by the Act. According to *Srinivasa* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464) the giving away or awarding prizes or gifts to a specified number of subscribers is an essential element of a Prize Chit, as also refunding to the subscribers the whole or part of the amount of subscription. The court then referred to the report of the Raj Study Group to emphasize,

in the words of Krishan Iyer, J. "the trauma inflicted by lucky draw schemes on the host of luckless illiterates succumbing .... to the prize mania". Dealing with alternate proposals to save prize chits the Court said : (SCC p. 514, para 12)

In many situations, the poor and unwary have to be saved from the seducing processes resorted to by unscrupulous racketeers who glamorize and prey upon the gambling instinct to get rich quick through prizes. So long as there is the resistless spell of a chance, though small, of securing a prize, though on paper, people chase the prospect by subscribing to the speculative scheme only to lose what they had. Can you save months from the free exact by putting out the fatal glow ?

Distinguishing the prize chit from the Conventional Chit, it was said : "Once the prize facet of the chit scheme is given up, it became substantially a 'conventional chit' and the ban of the law ceases to operate." Quoting from the Raj Committee they said : "Conventional chits' and 'Prize Chits' are different categories with different financial features and different damaging effect." Again the court, while pointing out that in its pith and substance the legislation was not aimed at banning lotteries which the State legislature had jurisdiction to do but was aimed at banning a "special specie of contracts with sinister feature" which Parliament was competent to do, further observed : (SCC p. 515, para 16)

So viewed, it is easy to accept the submission of the Union of India that Parliament wanted to restrict and prohibit certain types of contracts because of the noxious element of gambling and lottery implicitly therein and apt to entice the credulous and uncautious.

30. So, the court was of the view that the Prize Chits and Money Circulations Schemes (Banning) Act was designed to fight the baser human instinct of gambling aroused by the prize element involved in the banned transactions. The court concluded that it was the prize element that brought it within the mischief of the Act and that without the prize element it would be no different from a Conventional Chit, considered harmless by Parliament. We must notice here that in a 'Conventional Chit' as defined in the Act, though every subscriber is entitled to the prize amount, some get it sooner than the others depending on the results of the auction or the draw and to the extent that it depends on a draw there is a slight element of chance. In the recurring deposits schemes such as the ones we are concerned with, even that element of chance is lacking. If 'Conventional Chits' are not banned, it is a legitimate question to ask whether Parliament could have contemplated the banning of schemes not involving the element of the king of harm intended to be prevented, even to the slight degree as in Conventional Chits ?

31. Much argument was advanced on the significance of the word 'includes' and what an inclusive definition implies. Both sides relied on Dilworth's case (Dilworth v. Commissioner of Stamps, 1899 AC 99). Both sides read out the well known passage in that case where it was stated : (AC pp. 105-06)

The word "include" is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. But the word "include" is susceptible of another construction, which may become imperative, if the context of the Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to "mean and include", and in that case it may afford an exhaustive explanation of the meaning which, for the

purposed of the Act, must invariably be attached to these words or expressions.

Our attention was also invited to *Ardeshir H. Bhiwandiwalla v. State of Bombay* ((1961) 3 SCR 592 : AIR 1962 SC 29 : 1962 (1) Cri LJ 99), *CIT v. Taj Mahal Hotel* ((1972) 1 SCR 168 : (1971) 3 SCC 550 : AIR 1972 SC 168) and *S. K. Gupta v. K. P. Jain* ((1979) 3 SCC 54).

32. We do not think it necessary to launch into a discussion of either *Dilworth's case* (*Dilworth v. Commissioner of Stamps*, 1899 AC 99) or any of the other cases cited. All that is necessary for us to say is this : Legislatures resort to inclusive definitions (1) to enlarge the meaning of words or phrases so as to take in the ordinary, popular and natural sense of the words and also the sense which the statute wishes to attribute to it, (2) to include meanings about which there might be some dispute, or (3) to bring under one nomenclature all transactions possessing certain similar features but going under different names. Depending on the context, in the process of enlarging, the definition may even become exhaustive. We do not think that by using the word 'includes', in the definition in Section 2(a) of the Act, Parliament intended to so expand the meaning of prize chit as to take in every scheme involving subscribing and refunding of money. The word 'includes', the context shows, was intended not to expand the meaning of 'prize chit' but to cover all transactions or arrangements of the nature of prize chits but under different names. The expressions 'prize chit' had nowhere been statutorily defined before. The Bhabatosh Datta Study Group and the Raj Study Group had identified the schemes popularly called 'prize chits'. The Study Groups also recognised that 'prize chits' were also variously called benefit/savings schemes and lucky draws and that the basic common features of the schemes were the giving of a prize and the ultimate refund of the amount of subscriptions (vide para 6.3 of the Report of the Raj Study Group). It was recommended that prize chits and the like by whatever name called should be banned. Since prize chits were called differently, 'prize chits', 'benefit/savings schemes', 'lucky draws', etc., it becomes necessary for the Parliament to resort to an inclusive definition so as to bring in all transactions or arrangements containing these two elements. We do not think that in defining the expression 'prize chit', the Parliament intended to depart from the meaning which the expression had come to acquire in the world of finance, the meaning which the Datta and the Raj Study Groups had given it. That this is the only permissible interpretation will also be further evident from the text of the chit and the context as we shall presently see.

33. Interpretation must depend on the text and the context. They are the cases of interpretation. One may well say if the text is the texture, context is what gives the colour. Neither can be ignored. Both are important. That interpretation is best which makes the textual interpretation match the contextual. A statute is best interpreted when we know why it was enacted. With this knowledge, the statute must be read, first as a whole and then section by section, clause by clause, phrase by phrase and word by word. If a statute is looked at, in the context of its enactment, with the glasses of the statute-maker, provided by such context, its scheme, the sections, the sections, clauses, phrases and words may take colour and appear different than when the statute is looked at without the glasses provided by the context. With these glasses we must look at the Act as a whole and discover what each section, each clause, each phrase and each word is meant and designed to say as to fit into the scheme of the entire Act. No part of a statute and no word of a statute can be construed in isolation. Statutes have to be constructed so that every word has a place and everything is in its place. It is by looking at the definition as a whole in the setting of the entire Act and by reference to what preceded the enactment and the reasons for it that the court constructed the expression 'Prize Chit' in *Srinivasa* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464) and we find no reason to depart from the court's construction.

34. We have already referred to the Bhabatosh and Raj Study Groups' Reports and recommendations. In para 6.3 of the latter report the two common and basic features of prize chits by whatever name known were identified as the giving of prizes to the lucky ones and the refunding of subscription to everyone. These prize chits by whatever name known were recommended to be banned. It was this recommendation that was accepted by Parliament in enacting the Prize Chits and Money Circulation Schemes (Banning) Act. If this much is borne in mind it becomes evident that the two requirements mentioned in the two clauses (i) and (ii) of the definition are not to be read distinctively; they are two distinct attributes of 'Prize Chits', each of which has to be satisfied. It is important to notice here that the Conventional Chit satisfies both the requirements of the definition of 'Prize Chit', since, as we have already pointed out, it involves both the 'certain' and the 'chance' elements, the certain element being the refund of the amount of subscriptions less the deductions and the chance element being the time of such payment, dependent on the result of the draw or auction. Yet the definition of 'Prize Chit' expressly excludes the conventional chit obviously for the reasons that the 'chance' element is overshadowed by the 'certain' element. If so, why should any construction be placed on the definition so as to bring in all recurring deposit schemes, even if they do not involve a chance element? Such a construction would reduce the definition to a near absurdity and render the reference to the giving or awarding of a prize or gift, a meaningless superfluity. If a Conventional Chit is not a 'Prize Chit' by the definition, there appears to be no logic in constructing the definition to include a recurring deposit scheme. The argument is that the two clauses (i) and (ii) are to be read distinctively and that they should not be read as if they are jointed by the conjunction 'and'. We do not agree. There is no need to introduce the word 'or' either. How clauses (i) and (ii) of Section 2(e) have to be read depends on the context. The context requires the definition to be read as if both clauses have to be satisfied. There is nothing in the text which makes it imperative that it be read otherwise. The learned counsel urges that the expression "all or any of the following purposes" indicates that the purpose may be either the one mentioned in (i) or the one mentioned in (ii). We do not agree with this submission. Each of the clauses (i) and (ii) contains a number of alternatives and it is to those several alternatives that the expression "all or any of the following purposes" refers and not to (i) or (ii) which are not alternatives at all. In fact, a Prize Chit, by whatever name it may be called, does not contemplate the exhaustion of the entire fund by the giving of prizes; it invariably provides for a refund of the amount of subscription, less the deductions, to all the subscribers or to those who have not won prizes, depending on the nature of the scheme. Clauses (i) and (ii) refer to the twin attributes of a Prize Chit or like scheme and not to two alternate attributes.

35. Our constructions of section 2(e) is further reinforced by a reference to the other provisions of the Act. Section 3 prescribes : "No person shall promote or conduct any prize chit or money circulation scheme, or enrol as a member to any such chit or scheme, or participate in it otherwise, or receive or remit any money in pursuance of such chit or scheme." Section 4 makes a contravention of section 3 punishable with imprisonment extending to three years or fine extending of five thousand rupees subject to a minimum sentence of one year's imprisonment and fine of one thousand rupees. It is clear that even a subscriber is guilty of an offence punishable with an obligatory minimum sentence. While it is possible to say that Parliament desired to root out prize chits and schemes of like nature involving the vicious element of gambling, it is inconceivable that Parliament intended to visit even subscribers to recurring deposit schemes involving no such vice with such dire consequences. Section 5 makes printing, publishing of any ticket, coupon or other document for use in the Prize Chit or Money Circulation Scheme with a view to promotion of such scheme in contravention of the Act, the printing, publication or distribution of any advertisement of the Prize Chit or Money Circulation Scheme, the use of any premises for purposes connected with

the promotion or conduct of the scheme etc., punishable with imprisonment extending to two year years or fine extending to three thousand rupees subject to a minimum sentence of one year's imprisonment and fine of one thousand rupees. Section 8 provides for forfeiture of newspapers or other publications connected with any Prize Chit or Money Circulation Schemes. Surely these provisions are far too draconian to be applied to schemes which are but recurring deposits schemes.

36. Howsoever we look at it, we arrive at the conclusion that Section 2(e) does not contemplate a scheme without a prize and, therefore, the Endowment Certificate Scheme of the Peerless Company is outside the Prize Chits and Money Circulation Schemes (Banning) Act. The conclusion appears to us to be irresistible. The appeals filed by the Reserve Bank of India, the Union of India and the State of West Bengal are accordingly dismissed. It is open to them to take such steps as are open to them in law to regulate schemes such as those run by the Peerless Company to prevent exploitation of ignorant subscribers. Care must also be taken to protect the thousands of employees. We must also record our dissatisfaction with some of the schemes of the Life Insurance Corporation which appear to us to be even less advantageous to the subscribers than the Peerless scheme. We suggest that there should be a complete ban on forfeiture clauses in all savings schemes, including Life Insurance Policies, since these clauses hit hardest the classes of people who need security and protection most. We have explained this earlier and we do wonder whether the weaker sections of the people are not being made to pay the more affluent sections ! Robbing Peter to pay Paul ?

37. We should also like to query what auction the Reserve Bank of India and the Union of India are taking or proposing to take against the mushroom growth of 'finance and investment companies' offering staggeringly high rates of interest to depositors leading us to suspect whether these companies are not speculative ventures floated to attract unwary and credulous investors and capture their savings. One has only to look at the morning's newspaper to be greeted by advertisements inviting deposits and offering interest at astronomic rates. On January 1, 1987 one of the national newspaper published from Hyderabad, where one of us happened to be spending the vacation, carried as many as ten advertisements with 'banner headlines', covering the whole of the last page, a quarter of the first page and conspicuous spaces in other pages offering fabulous rates of interest. At least two of the advertisers offered to double the deposit in 30 months, 2,000 for 1,000, 10,000 for 5,000, they said. Another advertiser offered interest ranging between 30% to 38% for periods ranging between six months to five years. Almost all the advertisers offered extra interest ranging between 3% to 6% if deposits were made during the Christmas-Pongal season. Several of them offered gifts and prizes. If the Reserve Bank of India considers the Peerless Company with eight hundred crores invested in government securities, fixed deposits with National Banks etc. unsafe for depositors, one wonders what they have to say about the mushroom non-banking companies which are accepting deposits, promising most unlikely returns and what action is proposed to be taken to protect the investors. It does not require much imagination to realise the adventurous and precarious character of these businesses. Urgent action appears to be called for to protect the public. While on the one hand these schemes encourage two vices affecting public economy, the desire to make quick and easy money and the habit of excessive and wasteful consumer spending, on the other hand the investors who generally belong to the gullible and less affluent classes have no security whatsoever. Action appears imperative.

KHALID, J.

(supplementing). - I agree with my learned brother in his conclusion. However, I would like to add this short post-script of my own.

39. In the main judgment the sinister aspects of the Peerless Scheme have been brought out in great detail as well as the improvements attempted. What disturbed me most was the plight of the innumerable subscribers who lose their money by the operation of the scheme under consideration. When I say this, I feel concerned for those situated far and wide in the remote village of the country, uninitiated into the mysteries of financial schemes, who are lured by the promises of easy money and decide to pay the first installment by the encouraging words of the agents, who forget them thereafter, because of the distinctive commission they get after the first installment is paid, who, therefore, do not pursue these depositors to make subsequent deposits promptly. It is some consolation that the Peerless is trying to bring in reforms to reduce some of the vicious aspects of its scheme. While referring to the plight of the depositors I do not at the same time ignore the large number of employees employed by the company.

40. The only reason why the appeals are being dismissed is on the wording of Section 2(e) of the Act. A close study of the definition makes the conclusion inescapable that the Peerless Scheme does not come within it. Any attempt to bring the activities of the Peerless within the definition has only to fail. This position gets support from two judgments rendered by benches of three Judges of this Court viz., *Srinivasa Enterprises v. Union of India* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464) and *State of West Bengal v. Swapan Kumar Guha* ((1982) 1 SCC 561). Any attempt to distinguish the ratio of these two cases for the purposes of these appeals cannot succeed. In the case of *Srinivasa Enterprises* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464) this Court was considering the identical section. I do not think it would be proper to refer to the observations in this judgment on this section either as obiter or per incurium. The position canvassed before us thus strictly is not res integra and is covered by these two judgments, more particularly in *Srinivasa Enterprises* ((1981) 1 SCR 801 : (1980) 4 SCC 507 : 51 Com Cas 464).

41. Life Insurance Corporation is not a party before us. But its activities in certain spheres were brought to our notice by the learned counsel for the appellants. The Reserve Bank of India is the main appellant. The Union of India and the State of West Bengal have in tandem supported the Reserve Bank of India against the Peerless. When the activities of the Peerless and the Life Insurance Corporation are considered juxtaposed, one is tempted to observe that Peerless is less harsh than the Life Insurance Corporation. The Life Insurance Corporation enjoys many privileges. It has a duty to be above suspicion. It has a duty to serve people in the right manner. I am constrained to observe from my experience, that I have found the Life Insurance Corporation heartless whenever claims are made against it. I fully agree with the observations made by my learned brother regarding some of the aspects of the Life Insurance Corporation schemes. I wish only to emphasize that the Life Insurance corporation should at least in future be liberal and generous when claims are made by those unfortunate few, who when robbed of their bread-earners claim for the insured amount and who are invariably met on technical pleas, of concealment of ailment and the like. The Life Insurance Corporation does not come out with glory when some of its dealings are considered. I do not think it would be proper to make more harsh references about the Life Insurance Corporation when it is not a party before us. I felt it necessary to make these observations, with utmost restraint, since an opportunity afforded itself in this case.

42. I share my brother's concern about the mushroom growth of financial companies all over the country. Such companies have proliferated. The victims of the schemes, that are attractively put forward in public media, are mostly middle class and lower middle class people. Instances are legion where such needy people have been reduced penniless because of the fraud played by such financial vultures. It is necessary for the authorities to evolve fool-proof schemes to see that fraud is not allowed to be played upon persons who are not conversant with the practice of such financial

enterprises who pose themselves as benefactors of people.

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