

SUPREME COURT OF INDIA

K.K.Baskaran

Vs.

State Rep By Its

C.A.No. 2341 of 2011

(Markandey Katju and Gyan Sudha Misra,JJ.,)

04.03.2011

JUDGMENT

SLP(Civil) No.7285/2011

1. Delay condoned. Leave granted.
2. Heard learned counsel for the appellant.
3. Financial swindling and duping of gullible investors/depositors is not unique to India. It has been referred to in Charles Dicken's novel 'Little Dorrit', in which Mr. Merdle sets up a Ponzi scheme resulting in loss of the savings of thousands of depositors including the Dorrits and Arthur Clennam. In recent times there have been many such scandals e.g. the get-rich-quick scheme of the scamster Bernard Madoff in which the estimated losses of investors were estimated to be 21 billion dollars.
4. The present case illustrates what has been going on in India for quite some time. Non-banking financial companies have duped thousands of innocent and gullible depositors of their hard earned money by promising high rates of interest on these deposits, and then done the moonlight flit, often disappearing into another State or even foreign countries leaving the depositors as well as the State police high and dry.
5. This appeal has been filed against the impugned judgment and order of the Full Bench of the Madras dated 02.03.2007 in writ petition No. 26108/2005.
6. By means of the aforesaid writ petition, the petitioner and others challenged the constitutional validity of the Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997 (for short the Tamil Nadu Act). By the impugned judgment the Full Bench of the Madras High Court has held the aforesaid Act to be constitutional. Hence, this appeal.

7. Learned counsel for the appellant has relied on the Full Bench decision of the Bombay High Court in *Vijay C. Punjal vs. State of Maharashtra* (2005) 4 CTC 705 by which a similar Act of Maharashtra, being the Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999 was held to be unconstitutional. We are of the opinion that the impugned judgment of the Full Bench of the Madras High Court is correct, while the judgment of the Full Bench of the Bombay High Court in *Vijay's case* (supra) is not correct.

8. The main submission of the learned counsel for the appellant in challenging the Tamil Nadu Act, which was also the main submission in challenging the Maharashtra Act, 1999, was that the said Act is beyond the legislative competence of the State Legislature as it falls within entries 43, 44 and 45 of List I of the Seventh Schedule to the Constitution. It was also submitted that the impugned Act is liable to be struck down as the field of legislation is already occupied by legislation of Parliament being the Reserve Bank of India Act, 1934, Banking Regulation Act, 1949, the Indian Companies Act, 1956 and the Criminal Law Amendment Ordinance, 1944 as made applicable by Criminal Law (Tamil Nadu Amendment) Act, 1977. It was also contended that the Tamil Nadu Act was arbitrary, unreasonable and violative of Articles 14, 19(1)(g) and 21 of the Constitution.

9. We are of the opinion that none of these submissions have any merit.

10. A perusal of the Statement of Objects as well as the relevant provisions of the Tamil Nadu Act shows that its object was to ameliorate the situation of thousands of depositors from the clutches of financial establishments who had duped the investor public by offering high rates of interest on deposits and committed deliberate fraud in repayment of the principal and interest after maturity of such deposits. The Act provides for measures for attachment of the properties of the financial establishments as well as mala fide transferees and to bring these properties for sale for realization of the dues payable to the depositors speedily.

11. As per the statistics of July 2002, about Rs. 1945 crores were collected from over 19 lakhs of depositors. These depositors were either poor or middle class persons, retired government servants and pensioners and their dependants, senior citizens or economically backward sections of society etc. The deposits were either siphoned off or diverted mala fide by these fraudulent financial establishments. The commission and omission of these financial establishments was well-organized, and constitute an organized systematic white color crime which jeopardizes the safety and interest of the public.

12. As noted in the impugned judgment, the Tamil Nadu Act was not focused on the transaction of banking or acceptance of deposits, but it is designed to protect the public from fraudulent financial establishments who defraud the public by offering lucrative returns on deposits and then disappear with the depositors' money or refuse to return the same with interest. In our opinion, the impugned Tamil Nadu Act is in pith and substance relatable to Entries 1, 30 and 32 of the State List (List II) of The Seventh Schedule.

13. The Statement of Objects And Reasons of the Tamil Nadu Act states :

"There is mushroom growth of Financial Establishments not covered by the Reserve Bank of India Act, 1934 (Central Act II of 1934) in the State in the recent past with the sole object of grabbing money received as deposits from the public, mostly middle class and poor, on the promise of unprecedented high rates of interest and without any obligation to refund the deposits to the investors on maturity. Many of these Financial Establishments have defaulted to return the deposits on maturity to the public running to crores of rupees and thereby inviting the public resentment, which created law and order problems in the State. The Government has, therefore, decided to undertake suitable legislation, in the public interest, in order to regulate the activities of such Financial Establishments, other than those covered by the Reserve Bank of India Act, 1934 (Central Act II of 1934).

2. The Bill seeks to give effect to the above decision."

14. A reading of the Statement of Objects and Reasons of the Tamil Nadu Act would go to show that it does not concentrate on incorporation, regulation or winding up of banking corporations but, on the other hand, is basically concerned with returning money of the gullible depositors who had been defrauded. The words found in the Statement of Objects and Reasons, viz., "in the public interest, in order to regulate the activities of such Financial Establishments" would mean that the Tamil Nadu Act has been enacted to protect the interests of depositors.

15. An amendment was brought to the Tamil Nadu Act by the Protection of Interests of Depositors (In Financial Establishments) Amendment Act, 2003, Tamil Nadu Act 30 of 2003, the object being:

"The Tamil Nadu Protection of Interest of Depositors (in financial establishments) Act, 1977 (Tamil Nadu Act 44 of 1997) was enacted by the Government of Tamil Nadu to protect the interest of the depositors who have lost their hard earned money with the financial institutions. At present, there is no provision in the said Act for attaching the properties of the persons who borrowed money from the financial establishments and for the sale of attached property in public action and for the equitable distribution of the sale proceeds to the depositors. In order to overcome the shortcomings and to make the said Tamil Nadu Act 44 of 1997 more effective, the Government have decided to amend the said Act so as to-

(1) bring a company registered under the Companies Act, 1956 (Central Act 1 of 1956) and non-banking financial company within the purview of the Act;

(2) make the non-payment of interest and failure to render service for which deposit has been made, as offences under the Act;

(3) attach the properties of the person who has borrowed money from the financial establishments and failed to return the money;

(4) appoint more than one competent authority under the Act;

(5) constitute Special Courts for different areas and for different cases and to appoint Special Public Prosecutors for each of the Special Courts; (6) specify the time limit within which the Special Court shall pass the final order;

(7) compound the offences punishable under the Act; and (8) to sell the attached properties in public auction and to distribute the sale proceeds among the depositors.

2. The Bill seeks to give effect to the above decision."

16. By section 2 of the Tamil Nadu Act 30 of 2003, the definitions of "deposit" and "financial establishments" were amended as follows:

“(1).....

(2) " deposit means the deposit of money either in one lump sum or by installments made with financial establishments for a fixed period, for interest or for return in any kind or for any service;

(3)"financial establishment" means an individual, an association of individuals, a firm or a company registered under the Companies Act, 1956 (Central Act 1 of 1956) carrying on the business of receiving deposits under any scheme or arrangement or in any other manner but does not include a corporation or a co-operative society owned or controlled by any State Government or the Central Government or a banking company as defined in Section 5 (c) of the Banking Regulation Act, 1949 (Central Act X of 1949)"

17. Thus, by the Amendment Act 30 of 2003, the companies registered under the Companies Act, 1956 and the non banking financial companies, were also brought within the purview of the Act.

18. Learned counsel for the appellant relied on the Full Bench decision of the Bombay High Court in Vijay C. Punjal's case (supra) in support of his contention that the Tamil Nadu Act, like the Maharashtra Act, was unconstitutional being beyond the legislative competence of the State Legislature. We do not agree.

19. We have carefully perused the judgment of the Full Bench of the Bombay High Court in Vijay's case (supra) and we respectfully disagree with the view taken by the Bombay High Court.

20. It may be noted that though there are some differences between the Tamil Nadu Act and the Maharashtra Act, they are minor differences, and hence the view we are taking herein will also apply in relation to the Maharashtra Act.

21. The Bombay High Court has taken the view that the Maharashtra Act transgressed into the field reserved for Parliament. We do not agree. It is true that Section 58A of the Companies Act has been upheld by this Court in *Delhi Cloth Mills Ltd vs. Union of India* (1983) 4 SCC 166 and the provisions of Chapter IIIC of the Reserve Bank of India Act, 1934 was upheld by this Court in *T. Velayndhan Achari vs. Union of India* (1993) 2 SCC 582. However, we are not in agreement with the Full Bench decision of the Bombay High Court that the subject matter covered by the said Act falls squarely within the subject matter of Section 58A and 58AA of the Companies Act.

22. We are of the opinion that the impugned Tamil Nadu Act enacted by the State Legislature is not in pith and substance referable to the legislative heads contained in List I of the Seventh Schedule to the Constitution though there may be some overlapping. In our opinion, in pith and substance the said Act comes under the entries in List II (the State List) of the Seventh Schedule.

23. It often happens that a legislation overlaps both Lists I as well as List II of the Seventh Schedule. In such circumstances, the doctrine of pith and substance is applied. We are of the opinion that in pith and substance the impugned State Act is referable to Entries 1, 30 and 31 of List II of the Seventh Schedule and not Entries 43, 44 and 45 of List I of the Seventh Schedule.

24. It is well-settled that incidental trenching in exercise of ancillary powers into a forbidden legislative territory is permissible vide Constitution Bench decision of this court in *State of West Bengal etc. vs. Kesoram Industries Ltd & Ors etc.* (2004) 10 SCC 201 (vide paras 31(4), (5) and (6) and 129 (5)). Sharp and distinct lines of demarcation are not always possible and it is often impossible to prevent a certain amount of overlapping vide *ITC Ltd. vs. State of Karnataka*, 1985 (Supp) SCC 476 (para 17). We have to look at the legislation as a whole and there is a presumption that the legislature does not exceed its constitutional limits.

25. The 'financial companies' in the present case had not obtained any licence from the Reserve Bank of India. Hence they are not governed by the Reserve Bank of India Act nor the Banking Regulation Act, 1949.

26. The doctrine of pith and substance means that an enactment which substantially falls within the powers expressly conferred by the Constitution upon a Legislature which enacted it cannot be held to be invalid merely because it incidentally encroaches on matters assigned to another legislature. The Court must consider what constitutes in pith and substance the true subject matter of the legislation. If on such examination it is found that the legislation is in substance one on a matter assigned to the legislature then it must be held to be valid even

though it incidentally trenches on matters beyond its legislative competence vide *Union of India vs. Shah Goverdhan L. Kabra Teachers' College*¹(vide para 7).

27. For applying the doctrine of pith and substance regard is to be had to the enactment as a whole, its main objects and the scope and effect of its provisions vide *Bharat Hydro Power Corporation vs. State of Assam*² (vide para 15).

28. For this purpose the language of the Entries in the Seventh Schedule should be given the widest scope of which the meaning is fairly capable vide *State of West Bengal vs. Kesoram Industries Ltd* (supra) (para 31(4), *Union of India vs. Shah Goverdhan Kabra Teachers College* (supra) (para 6), *ITC Ltd. vs. State of Karnataka* (supra) (para 17).

29. Learned counsel for the appellant submitted that the subject-matter of the Tamil Nadu Act being banking, falls within the legislative competence of Parliament under Entry 45 of List I. We do not agree. Admittedly, none of the financial companies in question obtained any licence from the Reserve Bank of India. Hence they are not governed by the Reserve Bank of India Act or the Banking Regulation Act. The activities of these financial companies do not, in our opinion, come within the meaning of the term 'banking' as defined in the Banking Regulation Act, 1949 or the Reserve Bank of India Act, 1934.

30. The Tamil Nadu Act was enacted to find out a solution for the problem of the depositors who were deceived on a large scale by the fraudulent activities of certain financial establishments. There was a disastrous consequence both in the economic as well as social life of such depositors who were exploited by false promise of high return of interest. These financial institutions/establishments did not come either under the Reserve Bank of India Act or the Banking Regulation act, and hence they escaped from public control.

31. By the impugned Act the State not only proposed to attach the properties of such fraudulent establishments and the mala fide transferees, but also provided for the sale of such properties and for distribution of the sale proceeds amongst the innocent depositors. Hence, in our opinion, the doctrine of occupied field or repugnancy, has no application in the present case.

32. The object of the Tamil Nadu Act was to give a speedy remedy to the innocent depositors who were vulnerable to the temptation of earning high rates of interest and were victimized by the financial establishments fraudulently.

33. As regards Section 58A of the Companies Act, this prescribes the conditions under which the deposits may be invited or accepted by the companies. On the other hand, the aim and object of the Tamil Nadu Act is totally different.

34. The Tamil Nadu Act was enacted to ameliorate the conditions of thousands of depositors who had fallen into the clutches of fraudulent financial establishments who had raised hopes of high rate of interest and thus duped the depositors. Thus the Tamil Nadu Act is not focused on the transaction of banking or the acceptance of deposit, but is focused on

remedying the situation of the depositors who were deceived by the fraudulent financial establishments. The impugned Tamil Nadu Act was intended to deal with neither the banks which do the business or banking and are governed by the Reserve Bank of India Act and Banking Regulation Act, nor the non-banking financial companies enacted under the Companies Act, 1956.

35. The Reserve Bank of India Act, the Banking Regulation Act and the Companies Act do not occupy the field which the impugned Tamil Nadu Act occupies, though the latter may incidentally trench upon the former. The main object of the Tamil Nadu Act is to provide a solution to wipe out the tears of several lakhs of depositors to realize their dues effectively and speedily from the fraudulent financial establishments which duped them or their vendees, without dragging them in a legal battle from pillar to post. Hence, the decision of this Court in *Delhi Cloth Mills (supra)* has no bearing on the constitutional validity of the Tamil Nadu Act.

36. In the case of the Tamil Nadu Act, the attachment of properties is intended to provide an effective and speedy remedy to the aggrieved depositors for the realization of their dues. The offences dealt with in the impugned Act are unique and have been enacted to deal with the economic and social disorder in society, caused by the fraudulent activities of such financial establishments.

37. Under Section 3 & 4 of the Tamil Nadu Act, certain properties can be attached, and there is also provision for interim orders for attachment after which a post decisional hearing is provided for. In our opinion this is valid in view of the prevailing realities.

38. The Court should interpret the constitutional provisions against the social setting of the country and not in the abstract. The Court must take into consideration the economic realities and aspirations of the people and must further the social interest which is the purpose of legislation, as held by Justices Holmes, Brandeis and Frankfurter of the U.S. Supreme Court in a series of decisions. Hence the Courts cannot function in a vacuum. It is for this reason that Courts presume in favour of constitutionality of the statute because there is always a presumption that the legislature understands and correctly appreciates the needs of its own people, vide *Govt. of Andhra Pradesh vs. P. Laxmi Devi*³.

39. We fail to see how there is any violation of Article 14, 19(1)(g) or 21 of the Constitution. The Act is a salutary measure to remedy a great social evil. A systematic conspiracy was effected by certain fraudulent financial establishments which not only committed fraud on the depositor, but also siphoned off or diverted the depositor's funds mala fide. We are of the opinion that the act of the financiers in exploiting the depositors is a notorious abuse of faith of the depositors who innocently deposited their money with the former for higher rate of interest. These depositors were often given a small pass book as a token of acknowledgment of their deposit, which they considered as a passport of their children for higher education or wedding of their daughters or as a policy of medical insurance in the case of most of the aged depositors, but in reality in all cases it was an unsecured promise executed on a waste paper. The senior citizens above 80 years, senior citizens between 60 and 80 years, widows,

handicapped, driven out by wards, retired government servants and pensioners, and persons living below the poverty line constituted the bulk of the depositors. Without the aid of the impugned Act, it would have been impossible to recover their deposits and interest thereon.

40. The conventional legal proceedings incurring huge expenses of court fees, advocates' fees, apart from other inconveniences involved and the long delay in disposal of cases due to docket explosion in Courts, would not have made it possible for the depositors to recover their money, leave alone the interest thereon. Hence, in our opinion the impugned Act has rightly been enacted to enable the depositors to recover their money speedily by taking strong steps in this connection.

41. The State being the custodian of the welfare of the citizens as *parens patriae* cannot be a silent spectator without finding a solution for this malady. The financial swindlers, who are nothing but cheats and charlatans having no social responsibility, but only a lust for easy money by making false promise of attractive returns for the gullible investors, had to be dealt with strongly.

42. The small amounts collected from a substantial number of individual depositors culminated into huge amounts of money. These collections were diverted in the name of third parties and finally one day the fraudulent financiers closed their financial establishments leaving the innocent depositors in the lurch.

43. Learned counsel for the appellant submitted that the appellant was only a bona fide purchaser of some plots of land from one Arun Kumar and Smt. Sulochana, and not from any financial establishment. We are not going into this question as it can be raised in appropriate proceedings. In this case we are only concerned with the constitutional validity of the Tamil Nadu Act.

44. We are of the opinion that there is no merit in this petition. The impugned Tamil Nadu Act is constitutionally valid. In fact, it is a salutary measure which was long overdue to deal with these scamsters who have been thriving like locusts in the country.

45. The Appeal is, therefore, dismissed. No costs.

Judgment Referred.

¹(2002) 8 SCC 0228

²(2004) 4 SCC 0489

³(2008) 4 SCC 0720