KARNATAKA HIGH COURT

D.S. Gowda

Vs.

Corporation Bank

First Appeal No. 107 of 1981

(K. Jagannatha Setty and P.A. Kulkarni, JJ.)

22.10.1982

JUDGEMENT

Jagannatha Shetty, J

1.This appeal is directed against the judgment and decree dated December 12, 1980 passed by the City Civil Judge, Bangalore City in O.S. No. 2530 of 1980.

2. The appeal raises some questions of considerable importance as to the constraint on banking institutions to charge interest on loans/advances/overdrafts or any other financial accommodation and the power of Courts to examine the rigour of such transactions and give relief to the debtor by calling into aid the usury enactments.
The facts, in brief, are these :

3. One D.S. Gowda was allotted a site No. 132/4 at Rajamahal Vilas Extension, Bangalore by the Bangalore Development Authority. He wanted to construct some residential Flats in that site. He approached M/s. Corporation Bank Ltd., for financial help for his project. The Corporation Bank Ltd., which has since been nationalized and now called as "Corporation Bank" readily acceded to his request and gave advance and overdraft facilities D.S. Gowda took the loan and commenced construction The loan sanctioned was perhaps found insufficient. So he could neither finish the building nor could repay the loan. On Nov. 26, 1973, he executed an irrevocable power-of-attorney in favor of the bank manager authorizing him to supervise and/or to put up construction according to the sanctioned plan and to induct tenants and recover rents from them. Still the loan could not be cleared. It went on mounting with addition of compound interest, penal interest and service charges. In 1975, the building still remained unfinished with the outstanding loan and interest mounted up to rupees four lakhs and seventy one thousand. The bank then thought that it must have adequate security from D.S. Gowda. On Oct. 10, 1975, D.S. Gowda executed a deed of equitable mortgage in favor of the bank with deposit of title deeds of his site for total liability

of rupees five lakhs. It appears the bank gave him further accommodation at the time of executing the said deed. The material terms of the said deed are :

> "3 The mortgagor hereby covenants to repay mortgage loan of Rs. 5,00,000/- as above together with interest thereon at the rate of 16 1/2 per cent p.a. subject to such rate of interest as may be prescribed, within a period of two years. The mortgagor further agrees to pay interest on the mortgage amount at the end of each calendar month without default and that in the event of default overdue interest may be charged."

On Nov. 7, 1975, D.S. Gowda again at the instance of the bank, executed a promissory note evidently as a collateral security, undertaking to pay rupees five lakhs with interest at 161/2 per cent per annum, with quarterly rests. As on March 1, 1978, the balance payable by D.S. Gowda with penal interest and service charges stood at Rupees 7,56,934-17P.
On March 2, 1978, the bank instituted a suit to recover the said sum together with costs and future interest and for sale of the mortgaged property in terms of Order 34 of the Civil Procedure Code.

4. The defendant - D.S. Gowda - while admitting the execution of the said equitable mortgage deed and the promissory note resisted the suit contending inter alia; That the promissory note was executed as a collateral security and the quarterly rests prescribed thereunder was not one of the conditions of the loan granted to him. The amount actually borrowed under the mortgage was only about rupees four lakhs, but the bank got the deed executed for rupees five lakhs inclusive of the interest on rupees four lakhs earlier advanced. The defendant was not liable to pay compound interest or penal interest since it was not one of the terms of the loan transaction. The interest charged at any rate, was exorbitant and the transaction was substantially unfair and therefore, the defendant would be entitled to the relief under the provisions of the Mysore Usurious Loans Act, 1923.

5. Arising out of these pleadings, the Court below framed the following among other issues:

> (1) Whether the plaintiff is entitled to collect interest with quarterly rests?
> (2) Whether defendant proves that only Rs. 4,00,000/- was advanced and mortgage was taken for Rs. 5,00,000/- inclusive of interest and penal interest as alleged at para 5 of the written statement?
> (3) Whether the defendant proves that the suit transaction is hit by Usurious Loans Act (Karnataka Act) and whether defendant is entitled for the benefits thereunder as contended?

6. The bank in support of its case, has examined two witnesses, P.W. 1 and P.W. 2, while D.S. Gowda has examined himself as D.W. 1. The Court below after considering the evidence on record held :

D.S. Gowda was initially given Rs. 4,22,000/- as loan and the interest accrued on that sum was Rs. 78,000/-. He therefore, executed the equitable mortgage in respect of his site for rupees five lakhs. He has not proved that he was not liable to pay interest with quarterly rests; and the bank, therefore, was justified in charging interest as claimed in the suit. On the question of relief claimed under the Mysore Usurious Loans Act, 1923, it was held that D.S. Gowda has not established that his loan transaction was unfair or the interest charged was excessive or exorbitant. With these findings, the Court below made a preliminary decree directing D.S. Gowda to pay the suit claim along with costs and future interest at the rate of 16 1/2 per cent per annum within six months, failing which the bank was given liberty to realise the decretal amount by sale of the mortgaged property.

7. Being aggrieved by the said judgment and decree D.S. Gowda has appealed to this Court.

8. The first contention of Mr. Byra Reddy, Senior Advocate for the appellant related to the legality of the compound interest charged by the bank. According to the counsel, there was no banking practice to charge interest with quarterly or monthly rests, and the bank could not have collected such compound interest without statutory sanction by the Reserve Bank of India. His next contention was as to the interest charged at 16 1/2 per cent per annum on the secured debt. He urged that that rate of interest coupled with penal interest and service charge was excessive and unreasonable and should, therefore, be scaled down under the provisions of the Mysore Usurious Loans Act, 1923.

9. Mr. Shankar, for the respondent maintained that there was a banking practice accepted by all banking institutions to charge compound interest quarterly or monthly and also to collect penal interest and service charges from the defaulter. He said that during the material period, the Reserve Bank did not prescribe any ceiling on lending rate and only minimum lending rate at 12 1/2 per cent was prescribed and therefore the bank was justified in charging interest at 16 1/2 per cent and that interest cannot be scaled down by applying the norms under the Mysore Usurious Loans Act.

10. In the light of these contentions, the following two principal questions arise for our consideration:

> (1) Whether the terms of the mortgage deed providing for payment of interest at 161/2 per cent with monthly rests are valid under statutory directives of the Reserve Bank of India or could be supported by banking practice.

And

> (2) Whether the interest charged by the bank including penal interest and service charges

was excessive and whether the Court could call into aid the provisions of the Mysore Usurious Loans Act, 1923 to mitigate the rigour of the loan transaction, and if so, what relief defendant is entitled to?

11. Since the directives of the Reserve Bank issued to commercial banks have a great bearing on the questions to be considered, we issued notice to the Reserve Bank under Order I Rule 8-A of the Civil Procedure Code Mr. V. Krishna Murthy, Senior Advocate appeared for the Reserve Bank and submitted his opinion on the above question of law. He also made available to us all the relevant circulars and directives issued by the Reserve Bank.

12. As a preliminary to the consideration of the above questions, it would be necessary to advert to the relevant statutory provisions governing banks and also to outline briefly the structure of the Reserve Bank of India with its power of superintendence and control over all banking institutions.

THE RESERVE BANK OF INDIA.

In 1926, the Royal Commission on India Currency and Finance, by its report had recommended the setting up of a Central Bank. After much debate, the Reserve Bank of India was established on April 1, 1935 as a Shareholders' Bank with the objective of "regulating the issue of bank notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage". After independence, the Reserve Bank was nationalized by the Reserve Bank of India (Transfer to Public Ownership) Act, 1948. That Act empowered the Central Government to issue directions to the Reserve Bank as were deemed to be in public interest.

13. The general superintendence and direction of the Reserve Bank affairs are vested in the Central Board of Directors consisting of one Governor, 4 Deputy Governors, 4 Directors nominated under Section 8 (1) (c) and 1 Director nominated under Section 8 (1) (d) of the Reserve Bank of India Act. The Governor, Deputy Governors and Directors are nominated by the Central Government. For each of the four regional areas, Viz., western area, eastern area, southern area and northern area, there is a Local Board with headquarters in Bombay, Calcutta, Madras and New Delhi. The Local Boards consist of 5 members appointed by the Central Government to represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks. The Directors of the Central Board nominated under Section 8 (1) (b) represent the four Local Boards. The Local Boards advise the Central Board on such matters as may be generally or specially referred to them and perform such duties as the Central Board may delegate to them.

14. The Governor is the Chairman of the Central Board of Directors and also the Chief Executive of the Reserve Bank. He is assisted by 4 Deputy Governors and 2 Executive Directors each of

whom is in charge of distinct and different operations.

15. The Reserve Bank of India Act stipulates that the operations of the Bank relating to Note issue are conducted through the Issue Department and those relating to general banking business through the Banking Department. The Issue Department issues or receives bank notes only in exchange for other bank notes or such coins, bullion or securities as are permitted by the Act to form part of the reserve. The assets of the Issue Department consist of gold coin, gold bullion, foreign securities, rupee coin and rupee securities. The aggregate value of the gold coin, gold bullion and foreign securities should not, at any time, be less than Rs. 200 crores, the value of gold coin and gold bullion being not less than Rs. 115 crores. The bulk of the assets (about 90 per cent) consists of Government of India rupees securities

16. Sections 20, 21-A and 20-B of the Reserve Bank of India Act make it obligatory for the Reserve Bank to transact Government business. As a banker to the Central Government and State Governments, it accepts moneys makes payments, carries out exchange, remittance and other banking operations, including the management of public debt.
17. As a Central Bank, the Reserve Bank is responsible for maintaining an orderly monetary and credit system in the country. It discharges this responsibility through its statutory powers of superintendence and control over the commercial banking system which is the most important constituent of the country's market.

18. THE BANKING REGULATION ACT 1949 ("THE B.R. ACT")

HISTORY: The law relating to banking companies was dealt with in the Indian Companies (Amendment) Act, 1936 in a special part of the Act called part X-A. This part X-A was repealed by the Banking Companies Act, 1949, which was later amended by Banking Companies (Amendment) Act, 1950. There were series of amendments to that Act from 1956 to 1964. By Amending Act No. 23 of 1965, the name of the Act was changed to Banking Regulation Act ("The B.R. Act") from Banking Companies Act. This Act also has undergone amendments from time to time conferring more and more powers on the Reserve Bank with a view to have an effective control on all banking companies. A comprehensive amendment was introduced by Act No. 58 of 1968 which came into force on February 1, 1969.

19. There then came the nationalization of fourteen major banks by Act No. 5 of 1970 called "the Banking Companies

(Acquisition and Transfer of Undertakings) Act", which came into force on July 19, 1969.
Again, six more commercial banks were nationalized by Act No. 40 of 1980 which came into force with effect from July 11, 1980. The Corporation Bank Ltd., with which we are concerned in this appeal was one of those six banks nationalized.

20. Now, there are three categories of banks covered under the B.R. Act : -

(i) Banking Companies which are not nationalized;
(ii) Nationalized banks; and
(iii) Co-operative banks,

(The B.R. Act in its entirety does not apply to the nationalized banks, since they acquire their corporate characters not from any registration under the Companies Act, but they are established under the Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970 and 1980. So, only some of the provisions of the B.R. Act are made applicable to the nationalized banks. Section 3 (5) of the Nationalizing Act provides that every new bank shall carry on and transact the business of banking as defined in Section 5 of the B.R. Act and may engage in one or more forms of business specified in 6 (1) of the Act.
Section 20 of the Nationalizing Act makes Sections 34, 36AD and 51 of the B.R. Act applicable to the nationalized banks. Section 51 of the Nationalizing Act makes the following sections of the B. R. Act applicable to the nationalized banks: Sections 10, 13 to 15, 17, 19 to 21, 23 to 28, 29 (excluding sub-section (3), 31, 34, 35, 35A, 36 (excluding clause (d) of sub-section (1)), 46 to 48, 50, 52 and 53.

21. The provisions of the B.R. Act conferring power on the Reserve Bank of India:
The B.R. Act has conferred enormous powers on the Reserve Bank. Section 21 of the B.R. Act confers power to control advances by commercial banks and to regulate the interest rates structure on which advances or other financial accommodation may be made. Section 27 confers power on the Reserve Bank to call for returns and information before the close of every month. That return may also pertain to any information regarding the investment of a banking company and the classification of its advances in respect of industry, commerce and agriculture. Section 30 provides that where the Reserve Bank is of opinion that it is necessary in the public interest or in the interest of a banking company or its depositors, it may direct its auditor to audit the accounts of that bank in relation to any transaction or class of transactions. The auditor must examine whether the information and explanations required by him have been found to be satisfactory, whether or not the transactions of the bank which came to his notice have been within the powers of the Bank, whether or not the returns received from branch office of the bank have been found adequate, and whether profit and loss accounts show a true balance of profit or loss covered by such account. Section 35 confers power on the Reserve Bank to inspect any transaction or affairs of banking companies either suo motu or on being so directed so to do by the Central Government. Section 35A confers power to give directions to banks either in the public interest or in the interest of the banking policy and also to prevent the affairs of any bank being conducted in a manner detrimental to the interest or prejudicial to the interest of depositors or of the bank. The directions may also be for the purpose of securing the proper management of banking companies generally. Sub-section (4) of Section 46 of the B.R. Act imposes penalties for contravention of the provisions of the B.R. Act or for committing any default in not complying

with the requirements of the Act or any order, rule or directions made or condition imposed there under. The person guilty of such contravention or default shall be punishable with fine which may extend to Rs. 2,000/-. Where a contravention or default is a continuing one, there may be a further fine which may extend to Rs. 100/- for every day during which the contravention or default continues. Under Section 47A, the Reserve Bank itself may impose penalty for a contravention or default of the nature referred to in sub-section (3) or sub-section (4) of Section 46.

22. Directives and circulars on interest rate policy issued by the Reserve Bank.

A major instrument of credit control in the hands of the Reserve Bank has been the Bank Rate which may include, the rate at which banks get financial accommodation from the Reserve Bank, but also the rates of interest to be charged by banks in respect of advance or other financial accommodation and rates of interest to be allowed on fixed deposits.

In exercise of the powers conferred by Section 21 of the B.R. Act, the Reserve Bank issued a directive dated May 31, 1973 to be effective from June 1, 1973 stating that scheduled banks not being co-operative banks shall not charge interest less than 10 per cent per annum in respect of a loan or advance or other financial accommodation made or provided or renewed by it. Certain categories of loans and advances were, however, exempted from the operation of the said notification. This minimum lending rate of 10 per cent was raised to 12.5 per cent per annum by another notification dated July, 22, 1974. On March 13, 1976, the Reserve Bank issued a further notification the relevant portion of which runs as follows: -

> "CENTRAL OFFICE
> DEPARTMENT OF BANKING
> OPERATIONS AND DEVELOPMENT
> BOMBAY-1.
> Telegrams:
> "RESERVE BANK" Post Box
> No. 1030
> BOMBAY
> Ref: DBCD. No. Dir, BC.30/C.96.76 March 13, 1976 Phalguna 23, 1897 (Saka)
> In exercise of the powers conferred by Section 21 of the Banking Regulation Act, 1949, the Reserve Bank of India being satisfied that it is necessary and expedient in the public interest so to do, hereby direct that, with effect from the 15th March, 1976.
> 1. (i) no scheduled commercial bank incorporated in India and having aggregate demand and time liabilities of Rupees 50 crores or above as on the 12th March, 1976 or at any time thereafter and no scheduled commercial bank incorporated outside India shall charge interest on loans/Advances/cash credits/ overdrafts or any other financial accommodation made or provided by it or renewed by it, or discount usance bills at a rate, in either case, higher than 16.50 per cent per annum: interest shall be charged with quarterly rests.
> xx xx xx xx

xx xx xx xx"

On March, 17, 1976, a circular was issued reducing that 161/2 per cent maximum lending rate to 14 per cent in respect of long-term loans for period not less than seven years.
On June 26, 1976, a further directive was issued prohibiting banks from charging penal rate of interest in lieu of commitment charge or as a revenue raising measure. It, however, permitted, banks to charge penal interest to enforce discipline in the conduct of the account subject to one per cent to 2.5 per cent above the normal rates applicable to advances, but not to exceed 2 per cent over the ceiling rates on advances. On August 17, 1976, the Reserve Bank reiterated that its earlier policy that banks shall not charge quarterly rests and shall not compound interest on current dues on agricultural advances, shall continue even after the directive dated March 13, 1976. On November 15, 1976, the Reserve Bank issued a circular giving some guidelines with regard to service charges to be recovered by banks on their borrowal accounts. It was stated therein that some banks were recovering service charges on a percentage per annum basis and other banks were recovering them at a flat rate on a slab basis. The circular indicated that banks may at their discretion charge a flat rate with effect from January 1, 1978 at 1/20th of one per cent up to a maximum of Rs. 2,500/- on a once-for-all basis which should be termed as "processing fees". The circular also directed that the collection of service charges should cease altogether by January 1, 1978 and all banks should fall in line by charging "processing fees" at 1/20th of one per cent per annum on credit limits subject to a maximum of Rs. 2,500/-. On June 29, 1977, the Reserve Bank issued a circular directing banking institutions to charge interest on advances with monthly rests instead of quarterly rests with effect from July 1977. On July 5, 1977, an amendment to the directive dated March 13, 1976 was issued under Section 21 of the B.R. Act omitting the quarterly rests prescribed there under on the interest rate. On February 28, 1978, a further directive under Section 21 of the B.R. Act was issued in supersession of the earlier directive dated March 13, 1976 reducing the maximum lending rate to 15 percent with quarterly or longer rests. It thus put an end to the monthly rests prescribed by the circular dated June 29, 1977.
By directive dated Sept. 13, 1979, the maximum lending rate was raised to 18 per cent and by directive dated August 7, 1980, it was again raised to 19.40 per cent with the minimum lending rate raised to 13.5 per cent. Banks having demand and time liabilities below 25 crores, however, were permitted to charge one per cent more than the aforesaid ceiling rates. From these circulars and directives, it will be seen that the Reserve Bank prescribed the minimum lending rate at 10 per cent in 1973, 12.5 per cent in 1974 and 13.5 per cent in 1980. The maximum lending rate was prescribed at 16.5 per cent in 1976, 15 per cent in 1978, 18 per cent in 1979 and 19.40 per cent in 1980.

23. Similarly, there was realignment of bank rates charged by the Reserve Bank on the borrowings by banking institutions. It was 5 per cent at the close of the business on 25th September, 1964, 6 per cent on 17th February, 1965, 5 per cent on 2nd March 1968, 6 per cent on 8th January 1971, 7 per cent on 30th May 1974, 9 per cent on 22nd July 1974 and 10 per cent

from July 11, 1981. We have taken these figures from the circulars of the Reserve Bank, made available to us.

24. EFFECT OF THE DIRECTIVE OF THE RESERVE BANK.

Having seen the nature of directives and circulars of the Reserve Bank something more needs to be said about their effects and binding nature. It is an accepted principle that if the object of the Legislature in regulating the rate of interest was to the protection of the public or for the fulfillment of some object of public policy, then a contract that fails to comply with the directives was impliedly prohibited. It is also a well-established rule that the contracts that are expressly or impliedly prohibited by statute, orders, rules or regulations are illegal and void. In the Law of Contract by Cheshire and Fifoot, Ninth Edition, page 321, it is stated:

> "For instance, if the sole object of the statute is to increase the national revenue, as for instance by requiring a trader or to take out a license; or to punish the contracting party who fails to furnish certain particulars, the contract that he may have made is not itself prohibited and is in no sense tainted with illegality. On the other hand, if even one of the objects is the protection of the public or the furtherance of some other aspect of public policy, a contract that fails to comply with the statute is implicitly prohibited."

These principles are broadly found incorporated under Section 23 of the Indian Contract Act. It provides that the consideration or object of an agreement is unlawful, which if permitted would defeat the provisions of any law or the Court regards it as opposed to public policy. In the present case, one need not look beyond the provisions of Section 21 of the B.R. Act to find out the purpose for which the Reserve Bank could issue directives or circulars. Section 21 expressly provides that such directives could be issued in the public interest or in the interests of depositors or in the interests of banking policy. Section 5 (c) defines "banking policy" to mean "any policy which is specified by the Reserve Bank in the interest of the banking system ..... etc." Besides, the directives and circulars issued by the Reserve Bank also expressly state that they were issued in the public interest. They are, therefore, not only statutory directives but also statutory instruments of national policy. Banks are bound by the directives and circulars. Banks are impliedly forbidden from entering into contract to charge interest or other charges in contravention of the terms of the directives and circulars. Any contract to charge interest or other charges entered into by banks in disobedience to the terms prescribed by the Reserve Bank would, therefore, be illegal. The Reserve Bank could penalize such erring banks. The aggrieved party could recover such illegal collection.

25. In the United States, there is a statute governing the above aspects of the matter. Section 85 of the National Bank Act provides that, where no rate is fixed by the laws of the State, or territory, or District, the bank may take, reserve or charge a rate not exceeding 7per centum. (12 U.S.C.A.S.85) Section 86 (12 U.S.C.A.S. 86) provides penalty for taking excess interest and confers right on the aggrieved party to recover back twice the amount of interest thus paid. It

states:

> "The taking, receiving, reserving, or charging a rate of interest greater than is allowed by Section 85 of this title, when knowledgeably done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same; provided, that such action is commenced within two years from the time the usurious transaction occurred."

(See Pages 124 and 156 of the Banking Law, (1976) Edition, by James J. White, published by West Publishing Company.)

26. We may now revert to the facts of the case for a while in order to find out whether the terms of the mortgage deed are in contravention of the directives of the Reserve Bank. The deed provides for payment of interest at the rate of 16 1/2 per cent per annum and such rate of interest as may be prescribed. It also provides for payment of interest at the end of each calendar month and in the event of default, overdue interest would be charged. The meaning of the words "that in the event of default overdue interest may be charged" was understood by the bank executives as a right to charge compound interest with monthly rests. That has been so stated by Sadananda Shenoy (P.W. 1) and Shivarama Karant (P.W. 2). In Oct. 1975 in which month D.S. Gowda executed the deed of equitable mortgage, the Reserve Bank did not prescribed any ceiling on lending rate nor any periodical rests. It only prescribed the minimum lending rate at 12.5 per cent per annum. Apparently, the discretion was then given to banks to charge interest above the said minimum, but that does not mean that banks could charge unreasonable or excessive interest. Banks are public institutions and not just money lenders. In the absence of Reserve Bank directives, they are therefore required to follow the banking practice generally accepted by all banks.

27. The second part of the first question may now be examined whether the terms as to interest with monthly rests provided under the mortgage deed, or the interest with quarterly rests payable under the promissory note could be supported by any universally accepted banking practice is the question for consideration. We would not have ventured to express any opinion on this question, but for the confusion created by the witnesses examined on behalf of the bank. Sadananda Shenoy (P.W. 1) has stated that it was a banking practice to charge interest with quarterly rests and was guided by rules of business issued by his Head Office. He has not produced those rules of business. He has, however, admitted that he has no material to show that the ruling rate of interest on the date of defendant drawing the loan amount was 16.5 per cent. Shivaram Karanth (P.W. 2) has made the matter worse. He too has admitted that he has no material to place before the Court in support of the quarterly rests charged. He has however, asserted that that right was

derived from Clause 3 of the mortgage deed. When he was asked to explain what exactly the meaning of the term "That in the event of default overdue interest may be charged" provided in Clause 3 of the mortgage deed, he said categorically, "overdue interest means and means only penal interest." He has further stated that the bank has charged penal interest at 2 per cent over the agreed rate. The Court below appears to have accepted those statements and determined the issue No. 1 in favor of the Bank holding that there was a banking practice to charge interest with quarterly rests. The bank, in the instant case, has not only charged quarterly rests but also monthly rests for some period. It is now necessary to purge our minds of any doubt or confusion that might have been created in the matter. We have gone through almost all the standard books on law of banking. M.L. Tannan in his book "Banking Law and Practice in India" (1977), does not refer to any such custom or practice prevalent in our country. Lord Chorely in his book "Law of Banking", Sixth Edition (1974) does not also refer to any such banking practice prevalent in Britain. Sheldon in his book "The Practice and Law of Banking", Eighth Edition (1958), however, states at page 213:

> "A banker is entitled to charge interest on loans, either by express agreement or by right of custom. Moreover, owing to the banking practice of adding the interest to the principal debt each half year, he is usually enabled to charge compound interest. This right to charge compound interest is often further consolidated, at any rate so far as charges already incurred are concerned, by the customer's tacit acceptance of such charges in previous half-years." It is also stated at page 214:
> "Mortgages for fixed sums, apart from express agreement, only carry simple interest. It therefore, follows that the banker must keep the mortgage account separate from the current account, but money advanced on mortgage to secure a fluctuating balance may be merged in the general account, and compound interest charged. Interest on cheques paid on an overdrawn account is chargeable from the date of payment, whether by the drawee banker or his agent under advice, not the date of drawing."

The above passage indicates that bankers by right of custom or practice could add interest to the principal debt each half year or with half-yearly rests. Even that half-yearly rests, according to the author, was only on overdrafts and unsecured debts and not on secured debts. Mortgages for fixed, sums ordinarily carried only simple interest. In the Paget's "Law of Banking", Eighth Edition (1972), Chapter V. Page 133, it is stated:

> "There is no common law right to charge even simple interest on an overdraft but the claim could be supported on the ground of universal custom of bankers or on the basis of implied agreement. Where the customer has acquiesced in the system under which the interest is charged, that also would justify the claim. Such acquiescence will justify the charging compound interest or interest with periodical rests, so long as the relation of banker and customer exists, and the relationship is not changed into that of mortgagee and mortgagor." Here in this passage the author, no doubt, refers to the universal custom of

bankers to charge interest with periodical rests, but not given the period of rests. That period could be culled out from the following passage in the same book at page 610.

"Method of future advances.

The method by which future advances are to be made should be formulated in accordance with the intention of the parties, or in such general terms as to include all methods likely to be adopted, as for instance, the acceptance and discounting of bills. Interest, banking charges and costs should be provided for. With regard to the former, it is sometimes desirable to stipulate for the method in which it is to be, or may be, charged or reckoned, as by yearly or half-yearly rests."

28. Similar custom was also referred to with approval by the House of Lords in *Yourell v. Hibernian Bank*[1] wherein Lord Atkinson observed at page 384:

"The course of dealing actually followed by the parties, from the date of the mortgage down to the bringing of the action, was this: Interest was calculated from day to day on the mortgagor's overdraft on his current account. On the balancing of this account each half-year the amount of this interest was entered, on the debit side of the account, a balance was then struck, and interest was charged during the next half-year upon that balance. The bank, by taking the account with these half-yearly rests, secured for itself the benefit of compound interest. This is a usual and perfectly legitimate made of dealing between banker and customer."

In *Holder v. Inland Revenue Commissioners*[2] the House of Lords again referred to the said banking practice as follows :

"From the year 1920 onwards the company was continuously indebted to the bank in large amounts. In accordance with the ordinary custom of banks, the interest accruing on the overdraft amounts was added to the amount overdrawn by half-yearly rests, interest being thereafter charged on the amount so added."

29. It is thus clear that the ordinary practice or custom of banks was only to charge interest with yearly or half-yearly rests and that too only on overdraft amounts and unsecured loans. The monthly or quarterly rests, therefore, does not appear to be the recognized banking practice. It may be that some banks as in the present case, might have charged interest with quarterly rests or monthly rests on some transactions, but to state that it was a banking practice generally accepted or universally followed by all banks, in our opinion, is far from truth.

30. Let us now examine whether the Reserve Bank while prescribing quarterly rests by the directive dated March 13, 1976, has recognized any such banking practice. The accompanying letter of the Governor dated March 12,1976 gives us the reasons why that quarterly rests was prescribed. It reads :

"To ensure uniformity in practices, banks are advised to charge rates of interest on

[1](1918) AC 372)
[2](1932) AC 624)

credit with quarterly rests."

A note given to the Governor's meeting that took place on March 12,1976, in which meeting the decision as to the rate of interest with quarterly rests was taken, reads :

"While some banks still credit interest on deposits on half-yearly or even quarterly basis, there are a number of banks which credit interest on monthly rest basis.

It is desirable to have some uniform practice in this regard. It is therefore, proposed that the interest rates on advances should be charged on the basis of quarterly rests."

Even the proceedings of the Governor's meeting and his communication dated March 12, 1976 to banks do not indicate that all banks in our country were following the practice of charging interest on advances with quarterly or monthly rests. The basis for the Reserve Bank decision to prescribe the rate of interest with quarterly rests was to ensure uniformity in practice in all banks which in other words presupposes that there was no such uniform practice or custom.

31. On June 29, 1977, the Reserve Bank switched over from quarterly rests to monthly rests. It is again interesting to note the reason for that decision. That could be gathered from the circular of the Reserve Bank dated June 29, 1977 issued to all the scheduled commercial banks. It reads:

"xx xx xx xx

xx xx xx xx

2. The system of quarterly rests came up for discussions in the meeting which the Governor had with the bankers on May 27, 1977. In the light of the experience gained thus far, it was the general feeling that the method of payment and recovery of interests on deposits as well as advances should be uniform.

3. Taking into account that banks are already paying interest on term deposits on a monthly basis, the banks are advised that it has been decided that they should charge interest on advances at monthly rests effective from July 1977.

xx xx xx xx

xx xx xx xx."

The Reserve Bank has given two reasons for prescribing at monthly rests. First, to have parity in the method of payment and recovery of interest on deposits as well as advances. Second that some banks were already then paying interest on deposits on a monthly basis. It is difficult to discern any rational policy basis in the above reasoning. Banks do not give compound interest at monthly or quarterly basis on all deposits. There may be some special schemes with attractive interest rates prepared by some banks to invite more deposits, but it is not an accepted banking

practice at all. Fortunately, this monthly rests on advances did not last long. By circular dated February 28, 1978, the Reserve Bank prescribed a maximum lending rate at 15 per cent with quarterly or longer rests thus putting an end to monthly rests. From the above narration, one thing becomes very clear that the Reserve Bank did not pay adequate attention to the question of "rests" or the compound interest to be charged by banks on loan, advances and other facilities save those connected with agriculture. After nationalization, banking policy has been completely reoriented in the public interest and national interest; but so far as the evil practice of quarterly rests is concerned, it appears to have resisted all reform. We can, however, do no more than express a hope, and offer a proleptic welcome if the Reserve Bank takes a considered view in the matter to fall in line with the universal banking practice of half-yearly or yearly rests. That would give some breathing space to persons who are crushed by the debt weight.

32. This takes us to the second question. The question is, whether the Court could call into aid the provisions, of the Mysore Usurious Loans Act, 1923 to give relief to the appellant if the loan transaction was substantially unfair. Counsel on both sides submitted that it is not the Central Usurious Loans Act that is in force in the old Mysore area, but the Mysore Usurious Loans Act, 1923 which is till in operation. We, therefore, rely upon the Mysore Usurious Loans Act, 1923. This Act is more or less similar to the Central Act. Under Section 3 (1), the Court is empowered to exercise one or more of the powers conferred under Clauses (i), (ii) and (iii) of sub-section (1) there under. Section 3 (1) of the Mysore Usurious Loans Act, 1923 as amended by Act No. 14 of 1955, so far as it is relevant provides :

> "3 (1) Where in any suit to which this Act applies whether heard *ex parte* or otherwise, the Court has reason to believe that the transaction was as between the parties thereto, substantially unfair, the Court shall exercise one or mare of the following powers, namely -
>
> (i) re-open the transaction, take an account between the parties, and relieve the debtor of all liability in respect of any excessive interest;
>
> (ii) notwithstanding any agreement purporting to close previous dealings and to create a new obligation, re-open any account already taken between them and relieve the debtor of all liability in respect of any excessive interest, and if anything has been paid or allowed in account in respect of such liability, order the creditor to repay any sum which it considers to be repayable in respect thereof;
>
> (iii) set aside either wholly or in part or revise or alter any security given or agreement made in respect of any loan, and if the creditor has parted with the security, order him to indemnify the debtor in such manner and to such extent as it may deem just.
>
> Explanation-I: - If the interest is excessive the Court shall presume that the transaction was substantially unfair but such presumption may be rebutted by proof of special circumstances justifying the rate of interest.
>
> Explanation-II: - In the case of a suit brought on a series of transactions the expression 'the transaction' means, for the purpose of proviso (i) the first of such transactions.

II (a): - In the section 'excessive' means in excess of that which the Court deems it to be unreasonable having regard to the risk incurred as it appeared, or must be taken to have appeared, to the creditor at the date of the loan.
(b): - In considering whether interest is excessive under this section, the Court shall take into account any amounts charged or paid, whether in money or in kind, for expenses, inquiries, fines, houses, premia renewals or any other charges, and, if compound interest is charged, the periods at which it is calculated, and the total advantage which may reasonably be taken to have been expected from the transaction provided that in the case of loans to agriculturists if compound interest is charged the Court shall presume that the interest is excessive."

33. The above provisions may now be briefly summarized: When any money transaction is sought to be enforced through the Court of law, and the debtor complains that the interest charged was excessive and the transaction was substantially unfair, the Court shall analyze the transaction and the components of the interest charged. If the amount charged by way of interest is found to be excessive in the sense which the Court deems it to be unreasonable having regard to the circumstances of the case, then the Court shall presume that the transaction was substantially unfair. But such presumption may be rebutted by proof of special circumstances justifying the rate of interest charged. If there was no such justification, the Court could reopen the transaction, take an account between the parties and relieve the debtor of all liability in respect of any excessive interest. The Court could also order the creditor to repay any sum which it considers to be repayable in respect thereof. If the rate of interest charged is compound interest and the debtor is an agriculturist, the Court shall presume that the interest is excessive.

34. The appellant in the instant case appears to be not an agriculturist and the loan given to him was also not for agricultural purposes. There is, therefore, no scope for raising any presumption that the interest is excessive merely because it was charged with monthly rests or quarterly rests. The matter, therefore, has to be judged on the merits and the proper question that falls for determination is whether the interest charged at 161/2 per cent with monthly rests or quarterly rests on the secured debt with penal interest and service charges is not excessive in the circumstances of the case.

35. Before examining this question, it will be necessary to dispose of the principal contention urged in this behalf which, if accepted, would obviate the necessity to determine the aforesaid question. Mr. Shankar urged that the interest charged in this case was as per the directives of the Reserve Bank. The directives which are binding on banking institutions furnish proof of special circumstances justifying the rate of interest charged and this Court cannot embark upon an enquiry to find out whether that rate of interest is excessive or not. Mr. Krishna Murthy for the Reserve Bank went a step further and submitted that the Court cannot, at all apply the Usury Act when the transaction complained of is governed by the Reserve Bank directives. Both the counsel in support of their contentions relied upon the recent decision of the Madras High Court

in *Indian Bank v. V.A. Balasubramania Gurukal*[3], Since this decision is the sheet anchor of the contentions of the counsel, we will set out those facts and conclusions in a little more detail. The facts in brief are these : In 1971, the Indian Bank which is a nationalized Bank advanced a sum of Rs. 1,850/- to defendants therein as agriculture medium term loan with interest at 4 1/2 per cent over the bank rate subject to minimum of 10 1/2 per cent with quarterly rests. On the same date, bank also obtained from the defendants a promissory note for the said amount. The defendants did not discharge the loan in spite of repeated demands. So in 1977, the Indian Bank instituted, a suit in the Munsiff's Court for recovery of a sum of Rs. 2,233-10 P. said to be the balance due from that party. The defendants therein resisted the suit disputing the rate of interest claimed and also the amount calculated thereon. They also contended that they were agriculturists and had sustained loss in agricultural operations, and therefore, no liability could be fastened on

[3] AIR 1982 Mad 296

them. The learned District Munsiff before whom the suit came for trial, on a consideration of the evidence produced by the parties, held that as the defendants were agriculturists, the provisions of the Usurious Loans Act, 1918, as amended by Tamil Act No. 8 of 1937 ought to be applied and simple interest at 10 1/2 per cent would be fair and reasonable. On that basis, he reduced the interest payable and gave a decree to the Indian Bank for Rs. 1,651-25P. with proportionate costs. Aggrieved by that decree, the Indian Bank appealed to the Sub-Court claiming that the decree as prayed for in the suit ought to have been granted. The only point debated in the appeal was as regards the rate of interest claimed by the Indian Bank. The Sub-Court dismissed the appeal holding that notwithstanding the constraint on the nationalized banks by the Reserve Bank directives, since the defendants were agriculturists, the rate of interest charged was excessive and that 10 1/2 per cent simple interest as allowed by the trial Court would be fair and reasonable. The Indian Bank, thereupon approached the High Court of Madras with a revision petition which was finally placed before a Division Bench consisting at Gokulakrishnan, Officiating C. J. and Ratnam, J. in view of the importance of the question involved in the case. Ratnam, J. who spoke for the Bench, observed at paragraph 14, page 304:

> "It is obvious that the spheres of operation of these two enactments are very different, in that one is concerned with the control and regulation of the business of banking including the rate of interest on advances to be made by the banking companies, while the other is intended to secure relief from excessive claims for interest sought to be enforced through courts. On a consideration of the diverse scope of the operation of the provisions of these enactments, we are of the view that the provisions of the Banking Regulation Act, 1949, alone regulate the rate of interest on advances by nationalized banks and that there is no inconsistency between its provisions and the provisions of the Usurious Loans Act."

Then the learned Judge after considering the circulars of the Reserve Bank which were marked therein as Exts.A-17 and A-18, continued at pages 305 and 306:

"A conjoint reading of this integrated provision as a whole would establish that in the case of an advance to an agriculturist debtor where compound rate of interest is charged, the rate of interest is presumed to be excessive, but if that is rebutted, by proof of special circumstances justifying the rate, then the transaction will not be a 'substantially unfair' one despite the charging of excessive interest in order to enable the court to proceed under Section 3 (1) (i) to (iii) and afford relief.

xx xx xx xx xx xx xx xx

In the present case, the relevant circulars which have been issued by the Reserve Bank of India have been produced by the petitioner and they are marked as Exts.A-17 and A-18. These circulars do contain instructions issued by the Reserve Bank of India, with reference to the charging of a particular rate of interest. This would be a special circumstance justifying the nationalized bank in charging the rate of interest it did, as otherwise, the petitioner bank would have violated Section 21 (e) read with Section 21 (3) and the penalties provided for violation thereof under Section 46 (4) of the Banking Regulation Act would stand attracted. In addition, it must be remembered that the provisions of the Usurious Loans Act were enacted at a time when ordinary money-lenders exploited the needy agriculturists and imposed upon them onerous terms by way of compound interest while making available loans to them. But such a charge cannot be levelled against the nationalized banking institutions which are really in the nature of representative institutions governed by rules and regulations which do not change from debtor to debtor and which, if anything, are intended only to benefit the weaker sections of the society."

36. Upon reading the entire judgment, it appears to us that all the relevant circulars and directives of the Reserve Bank were not brought to the notice of that Court. The loan in that case was admittedly one given to agriculturists and the interest charged was undisputedly above the bank rate and with quarterly rests. Firstly, it is not known whether the bank rate referred, to therein, was the 'minimum lending rate' prescribed by the Reserve Bank or the rate at which the Reserve Bank lends money, to banks. The two are entirely different and one has nothing to do with the other. If there was a maximum lending rate prescribed by the Reserve Bank, then the Indian Bank had no power to charge any interest above the ceiling. Assuming that in 1971, the Reserve Bank prescribed only the minimum lending rate, there was, to our knowledge, no directive to charge interest with 'quarterly rests'. That apart, the Reserve Bank has issued circulars in 1972, 1974 and 1976 commanding all commercial banks including nationalized banks not to charge compound interest on agricultural loans. The circular dated August 17, 1976 is clear on this point. It reads:

RESERVE BANK OF INDIA
CENTRAL OFFICE
DEPARTMENT OF BANKING OPERATIONS AND DEVELOPMENT,
BOMBAY-400001.

Ref. DBOD, No. B.P.B.C.94/C-453 (A)-76 August 17, 1976 Sravana 26, (Saka)

To,

All Scheduled Commercial Banks.

Dear Sir,

Method of charging interest on agricultural advances.

Please refer to our directive DBOD. No. DIR. B.C. 30/C. 96-76 dated the 13th March, 1976 stipulating the maximum rate of interest that could be charged on loans, advances, etc., by scheduled commercial banks. It has been stated therein that interest shall be charged with quarterly rests. It is clarified that this aspect of the directive will not apply to agricultural advances in respect of which the instructions issued in our letters No. Nat. 389/C. 453(A)-72 dated the 14th March, 1972 and No. B.P.B.C. 107/C. 453 (A)-74 dated the 5th Oct. 1974 will continue to prevail. In other words, payment of interest on agricultural advances should be insisted upon only at the time of repayment of principal/instalment of principal and interest on current dues should not be compounded.

2. Please acknowledge receipt,

Yours faithfully,

Sd/- x x x

CHIEF OFFICER."

One does not know whether this circular was produced in the said case before the Madras High Court.

37. Even otherwise, we cannot, with respect, accept the soundness and tenability of all the steps in the reasoning of the Madras High Court. The principle declared therein is that the directives of the Reserve Bank would constitute a special circumstance within the scope of the Explanation-I to Section 3 (1) of the Usury Act and the Court in a case governed by such directives cannot give any relief to the debtor. It seems to us that this principle appears to have been too broadly carved out ignoring the terms and tenor of the circulars and directives. Section 21 of the B.R. Act confers power on the Reserve Bank to issue directives in relation to advances to be followed by banking companies generally or by any banking company in particular. The directives issued there under may broadly be classified into three categories: (i). The directives prescribing the minimum lending rate; (ii) The directives prescribing the maximum lending rate; and (iii) The directives prescribing a particular rate of interest to specified credit seekers. The short term and long term commercial and agricultural loans would fall into the first two categories and the advances to the Food Corporation of India as well as to the State Governments and their agencies for public procurement and distribution of food grains fall into the third category. These are not exhaustive and, there may be other credit seekers falling into one or the other category. Generally, though not always, when a minimum lending rate was prescribed, the Reserve Bank did not prescribe a maximum lending rate. The maximum was left to the discretion of bank's executive. When a maximum lending rate was prescribed it was only a ceiling beyond which banks could not charge and discretion was still left, to banks to charge any rate lesser than the maximum. Even if minimum and maximum lending rates were together prescribed, the

discretion still remained with banks to charge any rate within the prescribed parameters,

38. The 'special circumstance' under Explanation-I to Section 3 (1) of the Usury Act, in our opinion, should not be understood to mean oust a power or compelling circumstance to charge interest complained of by the debtor. It must be construed with reference to the meaning given to the word 'excessive' interest under Explanation II (ii) (a) of Section 3 (1) about which we will explain in detail a moment later.

39. Before analyzing the above aspect, the contention urged by Mr. Krishnamurthy regarding the scope of Section 5-A of the B.R. Act may be examined. The counsel urged that since the loan transactions entered into by banks with their customers are governed by statutory directives of the Reserve Bank, the transactions become statutory agreements and Court cannot apply the Usury Acts to scale down the interest charged in view of the overriding effect given to the B.R. Act under Section 5-A.

40. This contention, in our opinion, proceeded on the misconception of the provisions of Section 5-A. The directives issued by the Reserve Bank, no doubt, have statutory force. They lay down the guidelines about the methodology of operations, policy, procedure and rate of interest in financing or advancing loans to various classes of persons. But the loan transactions entered into by the executives of banking institutions in the usual course of their business are not statutory agreements. They are just commercial transactions governed by the guidelines laid down by the reserve Bank, Section- 5-A of the B.R. Act provides that the provisions of the B.R. Act shall have overriding effect over the Articles of Association of the banking company or any resolution passed by it or any agreement executed by it. In brief, the effect is that banks, as we have earlier stated, cannot assume power or cannot bargain with their customers contrary to the provisions of the B.R. Act or in disobedience to the terms of the directives of the Reserve Bank. The action of banks taken in contravention thereof would be illegal, void and unenforceable.

41. We may now give three more reasons in support of our conclusion that the directives of the Reserve Bank cannot by themselves constitute 'special circumstance' within the scope and meaning of the Explanation to Section 3 (1) of the Usury Act. First a little history: If one looks to usury statutes in general it will be clear that they were enacted to protect those unknowing borrowers or those with relatively weak bargaining positions regardless of the nature of the lender. The Acts make no distinction between private loans and bank loans. No rate of interest was prescribed under the Acts beyond which Courts should regard it as excessive Professor James J. White, of University of Michigan School of Law, in his book "Banking Law", (1976) puts across that concept at page 145 thus :

> "The justification for usury statutes may determine their scope in any given jurisdiction. If the statutes are enacted because the legislature deems the charging of excessive interest to be evidence of moral approbrium, then the law should, be applied regardless of the nature

> of the borrower or lender. If the drafters of usury laws, however, contemplate the protection of unknowing borrowers or those with relatively weak bargaining positions, perhaps more sophisticated borrowers should receive exemptions from laws which otherwise constrict their ability to obtain funds."

The said Professor also states that the Usury Acts enacted by many of the States in America are in line with the latter reasoning. They appear to have excluded the borrowers like incorporated Companies and Corporations with strength of Hercules and the wisdom of Solomon from the operation of Usury Statutes. Lord Crowther, Chairman of the Committee of Consumer Credit in England, observed :

> "The Moneylenders Act were passed for the protection of the private borrower and it was never contemplated that they would be capable of being invoked in relation to large-scale business transactions."

The learned Lord further observed :

> "Unfortunately the Acts completely failed to discriminate between private loans and, business loans. In the result, a large corporation borrowing a substantial sum of money is entitled to plead the Moneylenders Acts to the same extent as a private borrower receiving a small loan; and every technicality open to the latter is equally available to the former. It is clear that the Moneylenders Acts have in consequence substantially interfered with business loan transactions by non-banking companies and have placed quite unnecessary impediments on a legitimate form of business."

(See Consumer Credit Report of the Committee, Vol. I, Pages 176, 177, para 4.2.6).

42. Mr. Krishna Murthy relying upon the above observations urged that the general scheme of the usury enactments in our country too, was primarily intended to protect agriculturists and other borrowers belonging to the weaker sections of the community, but the Reserve Bank itself has taken care of such borrowers by prescribing concessional rates of interest for their benefits and Courts cannot further scale down such rates under the usury law. According to the counsel, if that power is conceded to Courts, then it would be antithesis to the policy of purpose-oriented extension of credit which banks are entitled, to follow. There are, in our opinion, at least two reasons for not accepting this submission. The directives of the Reserve Bank, in the first place, are general in terms and not directed in respect of any individual transaction. Secondly, even in a category of borrowers specified by the directives for whose benefit a concessional rate of interest has been prescribed, there may be persons who deserve more relief than what was bargained for regard being had to the norms laid down under the usury laws. The Court cannot, therefore, abdicate its duty to examine the grievance of such a debtor solely on the ground that the terms of the loan taken by him conform to the general or minimal requirements prescribed by the Reserve

Bank. Second, under Explanation 1 to Section 3 (1) of the Usurious Loans Act, the Court shall presume that the transaction was substantially unfair if the interest charged is found to be excessive, but such presumption may be rebutted evidently by the creditor by producing proof of special circumstances justifying the rate of interest. The Explanation covers not only the rate of interest charged on the borrower but also the total amount collected by way of interest. 'The excessive interest' has been defined under Explanations II and II(a) to mean, - in excess of that which the Court deems it to be unreasonable having regard to the risk incurred as it appeared, or must be taken to have appeared, to the creditor at the date of the loan. In other words, the Court must consider whether it was a secured debt; if not what was the risk incurred by the creditor and what was the special circumstances justifying the creditor to charge that interest complained of. Lord Crowther in the aforesaid report (at page 177, para 4.2.7) said:

> "That the lending of money and the taking of security for repayment of the loan are quite obviously integral parts of one and the same transaction."

The Court, therefore, has to analyze the entire transaction and also the components of the interest collected. In making that enquiry, the Court shall take into account the amounts charged or paid for expenses, enquiries, fines, premia, renewals or any other charges If compound interest is charged, the Court must examine the periods at which it is calculated and its burden on the debtor. If on the whole, the interest charged is found to be unreasonable and harsh, the Court shall reduce the rate of interest appropriately and give relief to the debtor. This is the paramount duty cast on all Courts, the exercise of which is neither controlled nor curtailed, by the provisions of the B.R. Act. Third, the major amendment to B.R. Act made in 1969 was for the purpose of exercising what has come to be known as "social control" over banking. This policy of social control was introduced as a measure to improve the banking system by removing the then prevailing excess or deficiencies in the banking system. The basic postulate of the social control scheme as stated by the then Deputy Prime Minister and Minister of finance in the Parliament on December 14, 1967 was:

> "To ensure that particular links or groups of clients are not favored in the matter of distribution of credit and whatever the character of the share holding its influence is neutralized in the constitution of the board of directors and in the actual credit decision taken at different levels of bank management."

To achieve this object and to bring about a reorientation in the outlook of the banking system, the Reserve Bank was conferred with power to exercise strict control over banks so that they do not fritter away funds in improper investments and injudicious advances. The Reserve Bank operates this control through the techniques of (a) fixing minimum margins for lending against specific securities, (b) placing ceilings on the amounts of credit for certain purposes, and (c) laying down rates of interest chargeable on certain types of advances. These monetary measures are also designed to mop up the excess liquidity in the banking system and to contain inflationary pressures. They are also intended to prevent the use of credit for speculative and other

unproductive purposes. They are also designed to increase the flow of credit to the priority sectors, agriculture, exports, small scale industries and small borrowers. But these general guidelines are not and indeed cannot impinge upon the power of Courts under the Usuary enactment to give relief to a deserving debtor in distress. The object of the B.R. Act is quite different from that of the Usury enactment. One is concerned with the control and regulation of the business of banking in the national interest, while the other is intended to give relief to a debtor where the interest claimed is found to be unreasonable or excessive in the light of the prescribed norms. This whole branch of the law is one similar to the equitable jurisdiction exercised by Chancery Division in England even when all usury laws were repealed in 1854. The Courts then held they have powers to reopen extortionate transactions and reduce the rate of interest to what they deem reasonable in the circumstances. (See "The Oxford Companion to Law" by David M. Walker (1980) page 1268). We, therefore, hold that the circulars and directives issued by the Reserve Bank cannot by themselves furnish a justification to silence such a debtor and deny him the relief if he is otherwise entitled to under usury laws.

43. With this conclusion, the transaction in question demands analysis. The equitable mortgage deed was executed on October 10, 1975 with a covenant to repay the loan of rupees five lakhs with interest at the rate of 16 1/2 per cent per annum with monthly rests. The sum total of rupees five lakhs was inclusive of the outstanding balance in the earlier overdraft account. Shivarama Karanth (P.W. 2) has stated that the plaintiff bank was charging 20 per cent interest on the overdraft outstanding balance, and that overdraft balance was converted into mortgage loan with 16 1/2 per cent interest on monthly rests. The bank has charged monthly rests for some period and quarterly rests for the remaining period. It has also charged two per cent penal interest and also some service charges.

44. We will consider the legality and reasonableness of the penal interest and the service charges a little later. Here we will examine whether the interest charged at 16 1/2 per cent per annum on secured debt with monthly and/or quarterly rests was not excessive. Compounding of interest on monthly basis on the secured debt is not shown to be recognized banking practice. There was also no directives from the Reserve Bank during the material period authorizing banks to charge interest with monthly rests. It seems to us, therefore, that charging interest with monthly rests in a case like this is nothing but usury; and it is usually the evil practice followed by some private money lenders.

45. Even charging interest with quarterly rests is, in our opinion, not warranted by the facts and circumstances of this case. Counsel for the appellant submitted that since the debt was secured there was no risk involved for recovering the amount and the simple rate of interest even at 16 1/2 per cent would be extortionate. He relied upon the decision of the Supreme Court in *S. Vardachariar v. Gopala Menon*[4], at p. 414. In that case, the Supreme Court while examining the principles of Usurious Loans Act, 1918, as amended by Madras Amendment Act No. 8 of 1937, observed:

> "It appears to us, therefore, that in the opinion of a number of Judges of the Madras High Court who were cognizant of the state of affairs prevailing in the State interest beyond the rate of 12 per cent per annum simple would be considered excessive by Courts of law where the security was not inadequate and the risk run by the creditor was not abnormal. There can be no dispute that interest payable at the rate of 10 per cent compoundable annually over a number of years would be more in the interest of the creditor than 12 per cent per annum simple for the same period. In our opinion, the learned Judges of the Division Bench of the Madras High Court were right in holding that 10 per cent compound interest with yearly rests would meet the justice of the case."

In *S. Rajagopalaswami Naidu v. Bank of Karaikudi Ltd*[5]*.,* at p. 885, the Supreme Court again observed :

> "On the question of interest we are of the view in the light of the provisions of the mortgage deed and all the circumstances that the rate of 12 per cent is unfair and penal. We are inclined, therefore, to give this relief that the interest should be calculated at the rate of 101/2 per cent (which was the original contractual rate) from the date of the mortgage to the date of the preliminary decree." (Underlining is ours)

The above case was also concerned with a bank loan and the Supreme Court reduced the rate of interest from 12 per cent to 10 1/2 per cent simple.

In *State Bank of Travancore v. C.T. George*[6]*,* the Kerala High Court by applying the provisions of the Usurious Loans Act, reduced the rate of interest charged by the bank from 9 per cent with quarterly rests to 9 per cent simple interest for some period and 12 per cent for the remaining period of the loan during which the contract provided a higher bank rate.

46. The rules of Courts, however, give no guidance as to what is a sufficient or reasonable rate of interest to be allowed under Usury laws. Any relief by Courts should not be arbitrary. It must be based on sound principles. The relief in a case like this, in our opinion, should be considered more appropriately as an integral part of the whole transaction and we must first consider the rate at which banks in general could borrow money and the rate at which banks ordinarily pay on fixed deposits. In *Tate and Lyie Food and Distribution Ltd. v. Greater London Council*[7] *Forbes*, J. in Queen's Bench Division, made some pertinent observations as to matters of principle at page 154 :

> "I feel satisfied that in commercial cases the interest is intended to reflect the rate at which the plaintiff would have had to borrow money to supply the place of that which was withheld. I am also satisfied that one should not look at any special

[4] AIR 1967 SC 412
[5] AIR 1971 SC 884
[6] AIR 1975 Ker 169
[7]((1982) 1 WLR 149)

position in which the plaintiff may have been; one should disregard, for instance, the fact that a particular plaintiff, because of his personal situation, could only borrow money at a very high rate or, on the other hand, was able to borrow at specially favorable rates. The correct thing to do is to take the rate at which plaintiffs in general could borrow money. This does not, however, to my mind mean that you exclude entirely all attributes of the plaintiff other than that he is a plaintiff. There is evidence here that large public companies of the size and prestige of these plaintiffs could expect to borrow at 1 per cent over the minimum lending rate, while for smaller and less prestigious concerns the rate might be as high as 3 per cent over the minimum lending rate. I think it would always be right to look at the rate at which plaintiffs with the general attributes of the actual plaintiff in the case (though not, of course, with any special or peculiar attribute) could borrow money as a guide to the appropriate interest rate. If commercial rates are appropriate I would take 1 per cent over the minimum lending rate as the proper figure for interest in this case." The learned Judge continued at page 155 :

"But in commercial cases it seems to me that the rate at which a commercial borrower can borrow money would be the safest guide. I should add, perhaps, that the proper question is : At what rate could the plaintiff borrow the required sum and not what return could the plaintiff have expected if he had invested it? It is immaterial, therefore, to consider, as Mr. Davies suggested, whether the plaintiff could have used the money profitably in his own business or what rate of profit he could have expected to achieve by so doing. I think, therefore, interest should be calculated at 1 per cent over the minimum lending rate (or bank rate)." This has been approved by Slade, J. in Chancery Division in *International Military Services Ltd. v. Capital and Counties P.L.C*[8].

The facts of the above two cases may be different, but observations as to matters of principle are of general application and deserve to be shared even in a case like this.

47. With this in mind, let us compare the bank rate payable on deposits and lending rate by the Reserve Bank to Banks :

(i) Deposit Rates : -

The interest rates on bank deposits were last revised on Sept. 13, 1979 when the rates on savings deposits and on fixed deposits with a maturity of nine months to one year were raised by half a percentage point and that on fixed deposits of one year and over by one percentage point. The changes made with effect from March 2, 1981 retained the maximum rate at 10 per cent. The rates on fixed deposits of one year and over were restructured to make the returns on this category more comparable with those offered on company deposits of like maturities. The category of deposits with maturity of 1 year and over and up to and inclusive of 3 years (on which interest was paid at 7 per cent) was abolished and in its stead, two new categories viz., 1 year and over but less than 2 years was given 7.5 per cent and 2 years and above but less than 3 years was given 8.5 per cent, while deposits of 3 years and above were allowed the maximum of 10 per cent. (See :

Reserve Bank of India, Annual Report 1980-81, page 14).

(ii) The Reserve Bank Rate : -

The bank rate charged by the Reserve Bank on the borrowings by banking

[8]((1982) 1 WLR 575)

institutions was 7 per cent on May 1974, 9 per cent on 22nd July 1974 and 10 per cent from July 11, 1981. This is in line with the bank rate payable on fixed deposits.

It is thus seen that as on today banks get advances from the Reserve Bank at 10 per cent and pay the interest on deposits not more than 10 per cent for deposits of three years and above.

48. Considering the facts and circumstances of the case, in the light of the above bank rates and authorities to which we have called attention, it seems to us that 12.5 per cent interest with annual rests from the date of equitable mortgage would meet the ends of justice in this case. That would be keeping in line with the minimum lending rate at 12.5 per cent prescribed by the Reserve Bank and also with the annual rests prescribed subsequently. In regard to future interest, we leave that matter to the Court below.

49. As to the penal rate of interest, it is admitted that there was no stipulation in the transaction to charge such penal interest. When there is no express stipulation in the transaction between the parties, it seems to us that the penal interest charged was unauthorized and illegal.

50. It remains only to deal with the validity of the service charges collected by the bank. The Reserve Bank by circular dt. Nov. 15, 1976 has directed that banks at their discretion could charge at a flat rate from January 1978 at 1/20th of one per cent up to a maximum of Rs. 2,500/- on a once-for-all basis and that service charges have to be termed as "processing fees". We may, therefore, allow the Bank to recover the processing fees at the said rate subject to the overall maximum of Rs. 2,500/- once-for-all.

51. In the result, we allow the appeal and in reversal of the judgment and decree, the matter stands remitted to the Court below to dispose of the suit on merits and in the light of the observations made. The parties to appear before the Court below on Nov. 29, 1982, to receive further orders. In the circumstances of the case, we make no order as to costs.

52. Issue refund certificate to the appellant as per law.

53. We cannot, however, part with this case without drawing the attention of the Reserve Bank of India to what seems to be a highly unsatisfactory state of affairs. In a large number of cases that have come up by way of appeals to this Court, it win be seen that banks have charged interest in contravention of the directive of the Reserve Bank. Invariably, banks not excluding some enlightened State Banks have charged compound interest at quarterly basis on agricultural loans

and advances notwithstanding the Reserve Bank circulars issued from time to time prohibiting such compounding of interest. It is not one or two isolated cases of inadvertence or mistake which troubled us, but it is persistent and widespread tardiness which caused serious misgivings in our minds. We do not know whether it is due to communication gap or any other contributing factor like lack of supervision or callousness. It is for the Reserve Bank which is charged with the duty to control banking transactions, to find out the cause and suggest remedies.

54. Let a copy of this judgment be transmitted to the Governor of the Reserve Bank.

55. Mr. Shanker for the bank seeks a certificate for appeal to the Supreme Court. We do not think that the case involves a substantial question of law of general importance which needs to be decided by the Supreme Court. The certificate prayed for is therefore refused.

Appeal allowed.