KARNATAKA HIGH COURT

Sri Visalam Chit Fund Ltd

Vs.

. Union of India

Writ Petn. Nos. 17110 of 1984

(P.P. Bopanna and K.A. Swami, JJ.)

29.04.1988

JUDGEMENT

P.P Bopanna, J.

1. Constitutional validity of the Chit Funds Act, 1982 (Act No. 40 of 1982) (in short 'the Act') is challenged in this batch of writ petitions.

2. In Writ Petition No. 17110 of 1984 the petitioner is a Chit Fund Company registered in Tamil Nadu under the Tamil Nadu Chit Funds Act. But it is carrying on the business in Bangalore through its branch office. The business in Bangalore is part of the total business carried on in Tamil Nadu and no separate balance sheet or audit report for the Bangalore branch is prepared and drawn up for the purpose of the Companies Act, 1956.
Petitioner in Writ Petition No 8744 of 1986 is a registered partnership firm and it has averred that its main o object is to promote the business of chit for the benefit of the common people. All the members of the partnership firm are alleged to be financially sound with good financial background and necessary experience in the Chit Fund business. Petitioner in Writ Petition No. 15062 of 1985 is a private limited Company registered under the Companies Act and it carries on Chit business only, within the framework of the Companies Act and claims that its business is subject to inspection by the Reserve Bank of India and also by the Registrar of Companies. Its accounts are audited regularly by a Chartered Accountant and it has been complying with all the provisions of the Companies Act. It claims that so far there is no complaint from any quarters and it is also paying Income-tax regularly. Petitioner in Writ Petition No. 16016 of 1986 is a registered Association of piece goods merchants carrying on business in the City of Mysore. The second petitioner in this writ petition is a member of the 1st petitioner/Association. That Association is formed with the object of fostering and encouraging friendly feeling, unity, mutual help and co-operation among the cloth, merchants in Mysore City and to safeguard their trading interest by combined action. It has a Managing Committee of 15 members, elected by the

members for the day-to day administration and the affairs of the Association. It was conducting chits confined to the members of the Association continuously from 1953 to 1985 without any difficulty or disputes either amongst the members or between the members and the Association. It is averred that it is not carrying on any other business and it has not experienced any difficulty in realizing the amounts from the successful bidders of the chit. However, consequent upon coming into force of the Act in this State, it has been asked to comply with the requirements of the Act and on account of the threats held out by the 3rd respondent/Registrar of Co-operative Societies it has stopped its business from September 1985 thus subjecting its members to various financial constraints. Its contention is that, since the chit business is conducted by the Association only for the benefit of its members and it is not thrown open to the general public, the provisions of the impugned Act and the Rules framed thereunder are not applicable to it and, if they are applicable, they are constitutionally invalid and therefore, they are liable to be struck down. Petitioner in Writ Petition No. 13393 of 1987 is also a registered Association of Jewellers carrying on business in the District, of Mysore. This Association is conducting chit business among its members only for their mutual financial benefit and outsiders or non-members are not permitted to be members of the chit group by participating in the same. Its grievance is similar to the grievance of the petitioner - Piece Goods Merchants' Association. Petitioner in Writ Petition No. 4835 of 1985 is the Pawn Brokers' Association formed with the object of safeguarding the interest of the Pawn Brokers and to render mutual help and assistance and co-operation amongst its members. No outsiders are permitted to become members of the chit group and the income derived by conducting the chit is utilized for the maintenance and development of the Association.

3. The facts in the other writ petitions are not very relevant. It may be noted that the petitioners therein are either private limited Companies or Public Limited Companies registered under the Companies Act or proprietary concerns or partnership concerns carrying on chit fund business in this State. Some of them have their registered offices outside the State like Kerala, Tamil Nadu, etc., and they are carrying on chit fund business through their branch office in this State.

4. In all these petitions, the constitutional validity of the provisions of the impugned Act is challenged on various grounds viz., they are violative of the provisions of Article 19(1)(g) read with Article 301-A of the Constitution and some of them are also violative of the provisions of Article 14 of the Constitution. The impugned Act came into force on 2-1-1984. There was no Act in this State for regulating Chit fund business and as a result, some of the Chit Fund Companies which came under the regulatory measures of the Tamil. Nadu Act, Kerala Act, Maharashtra Act and Andhra Pradesh Act shifted their business to this State and carried on Chit fund business in this State without being hampered by the regulatory measures of the respective enactments in other States. When the impugned Act was brought into force, the petitioners were asked to comply with a number of requirements under the Act by Respondent-3, therefore complaining of the violation of their constitutional right to carry on business they have filed these petitions challenging the vires of the Act.

5. Before we go into the individual contentions of the petitioners in these petition it would be necessary to trace the genesis of the impugned legislation and our task in this regard is made easy by the Report of the Banking Commission prepared in the year 1972, Report of the Study Group on Non-Banking Financial Intermediaries (dated 10-8-1971) constituted by the Banking Commission, the Report of the Study Group of Non-Banking Companies headed by the Chairman J.S. Raj (otherwise known as Raj Committee Report) dated 14-7-1975 and the Report of the Select Committee. These Reports have given us an insight into the origin of Chit Fund business in this country, the mechanism of Chit fund transactions, the benefits that accrued to the needy public who are not in a position to avail themselves of the credit facilities from the Financing Banks, the evils that flow from such Chit fund transactions on account of the unscrupulous and unethical methods employed by persons who run and control Chit Fund business and the need for legislation in order to protect the interests of the subscribers to the Chit fund from the unscrupulous promoters and foremen. We will first consider the earliest report dated 10-8-1971 submitted by the Study Group of the Non-Banking Financial Intermediaries appointed by the Banking Commission. Chapter 6 of this report is devoted to Chit Funds. The introduction to this report reads as:

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

(emphasis supplied)

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

> "Chit Fund is perhaps the oldest indigenous financial institution in India. The origin of chitty or kuri or chit fund is traceable beyond more than a century in the rural parts of Southern India. Periodically, a fixed measure of grain could be deposited with a trustee and received back when sufficiently large quantity was collected. The needy person was ascertained through draw, of lots. The word 'chit' suggests its origin. Chit means a written note on a small piece of paper. Since the winner of the Chit amount was to be ascertained

through draw of lots, it involved writing of names of eligible members on separate chits, as in a lottery. The Scheme thus came to be known as 'chit funds'. Its equivalent in Malayalam 'kuri' is derived from 'Kurippu' which is a synonym of chit.

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

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

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

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

The above are the essential features of a business chit scheme although there are any number of variants. Chit fund can thus be described as a mutual recurring deposit scheme under which every member is entitled to receive prize amount as loan from the chit fund;

> for the last prize winner, however, the prize amount cannot be considered as loan. Although no rate of interest is specifically mentioned, the deductions on account of discount and the foreman's commission make the loan in a majority of the cases, an interest-bearing one, the interest rate depending on the specific terms and conditions under which the scheme operates. For the foreman, however, no interest rate is involved on his 'loan'.

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

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

Some foremen, in addition to carrying on the business of chits, also accept deposits from third parties. These are utilized as working funds and lent at high rates of interest to subscribers and perhaps to others. According to Reserve Bank survey, the amount of deposits of 106 reporting chit fund companies at the end of March, 1968 was about 1.1 crores. In terms of Reserve Bank's directions, a chit fund company cannot accept deposits repayable after a period of less than 12 months from the date of receipt of such deposits nor can the amount of such deposits exceed 25 per cent of its paid-up capital and free reserves. It may be noted that the subscriptions received from the members of chit funds in terms of contract are not treated as 'deposits' for the purpose of Reserve Bank's directions. According to available information, one-third of the outstanding loans and advances as on 31st March 1967, given by the foremen of 100 chit fund companies were personal loans; 27 per cent were meant for the commerce sector and 15 pet cent were professional loans. 'Industry' and 'a agriculture' got a negligible proportion, these advances accounting respectively for 0.5 per cent and 0.1 per cent of the total. The foreman derives his income in different ways, both legal and illegal. In the former category can be included items such as admission fee from members, penal interest or penalty fee from defaulting members and forfeiture of their dividend, interest on loans to non-prized chit holders, fees for transfer of shares in the chit, deduction from the subscription paid by a member who wants to resign, dividends on the chit reserved for himself, interest on chit prize taken without deduction, interest on the chit prize which the prized member may not be in a position to collect immediately, and subscriptions paid by members who discontinue in the middle of the scheme but do not care to claim refund.

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

> (i) Enrolment of fictitious members to complete the required number of members in a chit series. If a real and needy non-prized member is not able to come forward to offer a high

> discount at the auction, one of these benami members is shown to get the prize thereby depriving the real members of the opportunity, (ii) Similarly, it is possible to exploit needy non-prized member or a new member so that he gets the prize only at the maximum discount (iii) The prized member is supposed to get the amount soon after the draw or auction is over of course on furnishing the security. But the foreman adopts tactics which delay the actual payment for a considerable time. Meanwhile he uses the money interest-free. If he succeeds in delaying the payment till the succeeding draw, the earlier prize winner is given the prize out of the collections of the succeeding draw. Thus, one installment is perpetually in the hands of the foreman to be utilized in any way he likes.

The above are only examples to illustrate the way in which some foremen maximise their profits. They do not take into account the cases where the foreman and his associates disappear from the scene and are untraceable. The police have many such on their record. During 1962-66, as many as 255 chitties collapsed in several districts of Kerala on account of such malpractices. It may be noted that the foreman has to undertake some responsibilities and risks. He is responsible for regular collection of subscriptions from a widely scattered body of members. He has to conduct the draws or the auction and maintain accounts. He is under obligation to pay the prize amount on the due date whether or not all the members have paid their subscriptions. In case of defaults, he has often to make good the deficit out of his own resources. If the prized member defaults in his installments, litigation follows to recover the amount. If the defaulter is a non-prized member, the foreman has to find out a suitable substitute or, in the alternative, has to take over the chit himself and continue the business: According to the memoranda submitted by some chit funds to the Banking Commission, the foreman requires finance from banks as well as moneylenders and other private sources. Some companies have also pointed out that their profits are not very large in relation to the risks involved. According to memoranda submitted to the Study Group, 15 to 18 per cent of the subscribers fail to pay their subscriptions after getting the prize amount.

(emphasis supplied)

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

> "As emphasized earlier, the rate of return on the savings of a subscriber to a chit fund and the interest rate that is involved for a subscriber joining the chitty as a borrower, will vary according to the terms and conditions of the chit fund. In fact, examples can be worked out on the basis of certain assumptions where the rate of return to prized subscribers at late stages will be quite high and the interest rate involved for a prize winner will be comparatively low. The essential point is that the rate of interest involved in chit funds is discriminatory and varies from person to person so that there is an irrational distribution

of gains and losses. Ordinarily, the more needy a person, the higher will be the discount that he would be prepared to offer for winning a prize. Therefore, the more urgent is need the higher the rate of interest that a borrower has to pay. Another point is that there are institutions which offer savings schemes which are superior to the one involved in a chit fund. The savings and fixed deposits, recurring deposits, monthly income deposits schemes, cash certificate schemes, annuity or retirement schemes, insurance linked deposit schemes, small savings, provident funds and insurance schemes, cash certificate schemes, annuity or retirement schemes, insurance linked deposit schemes, small savings, provident funds and insurance schemes have features which are superior to those in chit funds. The popularity of chit funds can be explained by the fact that a subscriber is entitled t borrow from it. Also, long standing social habits and the gaming element involved in the scheme, which perhaps provide an added attraction to some subscribers are also factors accounting for popularity of this institution.

So far as the end-use of the prize is concerned, there are conflicting views. It would appear that the likelihood of productive use of the prize money is small. A prospective producer would not depend on the uncertainties involved in a chit fund. The rates of interest generally involved for a prize winner in a chit fund are so high that an inference can be drawn that the prize money is mostly uses for consumption or speculative purposes. Some person joint chit funds and are prepared to pay high rates of interest by way of large discount for the purpose of hoarding certain scarce commodities. They are not only able to recover the interest but also earn a profit on account of the difference between the relatively low price at which they buy the goods and the high price at which they sell them later.

(emphasis supplied)

The Study Group in paras 6.52 to 6.54 considered the legislative measures to be introduced for eliminating the malpractice usually prevalent in Chit Funds. It observed as follows :

"We considered the above two suggestions, viz., starting of chit funds in the public sector and the commercial bank entering the chit fund business with a view to eliminating, through competition, the malpractice, usually prevalent in private chit funds. It may be noticed that most of the unhealthy practices arise from the lack of integrity of the regulation It was, therefore, natural that the regulation of chit fund business assumed high priority in the States where the business is concentrated, i. e., in the Southern States.

At present State legislation regulates the running of chit funds in the areas where such legislation is in force. The Tamil Nadu Chit Funds Act of 1961, seeks to regulate the chit fund business in the State of Tamil Nadu. With appropriate changes, this Act was adopted, with effect from 15th July 1964, in the Union Territory of Delhi. The Union Territory of Pondicherry has the Pondicherry Chit Funds Act, 1966, which came into force from 1st August, 1967. In Kerala, the Travancore Chitties Act of 1964, and Cochin Kuris Regulations 1932, are in force in some areas of the State. The question of introducing a uniform enactment in Kerala has been under the consideration of the Government for

some time. Some States are in the process amending or enacting laws to regulate chit fund activity. In Andhra Pradesh a bill on the lines of the legislation in the neighbouring State is under consideration. Mysore and certain other State Governments are also contemplating passing of legislation for regulating Chitties. Punjab Government is contemplating the starting of chit funds in the public sector on the lines of Kerala Government. In Uttar Pradesh, chit funds, lotteries etc., are regulated by the provisions of the Manual of Government Orders. According to these regulations, publication of advertisements in newspapers, of any proposals regarding lotteries not authorised by the Government is an offence under the Indian Penal Code. Also local authorities have been asked not to accord sanction for holding lotteries nor should they authorise advertisements regarding such undertakings.

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

(emphasis supplied)

6. This report of the Study Group was incorporated in the Report of the Banking Commission dated 31-01-1972. The Banking Commission emphasized the need for legislation in para 17.43 of its report thus :

"A few States have legislation on chit funds, the object of which is to safeguard the interests of the members. The Commission feels that it is essential to have a uniform chit fund legislation applicable to the whole country. Depending upon the constitutional position, whether chit fund come under the Union list, Concurrent list or the State list, either an All-India Chit Fund Act may be enacted or a model law may be framed which may be adopted by all the States with such modifications as may be necessary. It will be desirable to provide in the legislation that only public limited Companies can run chit funds. Pending such uniform legislation, existing State laws regulating chit funds registered within the State should be made applicable to their branches in the States having no legislation. This will essentially be an interim measure because only the members of those chit funds which are registered in States where chit fund laws have been enacted will get protection."

(emphasis supplied)

7. The same view is expressed by the Raj Committee Report on Non Banking Companies in its report dated 14-7-1975. The terms of reference of the Raj Committee should be noticed to appreciate its recommendations regarding chit business. They are :

"I. To examine the relative provisions of the Reserve Bank of India Act, 1934, the Non-Banking Financial Companies (Reserve Bank) Directions, 1966 and the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973, with a view to assessing their adequacy in regulating the conduct of business by non-banking Companies covered by the said directions in the context of the monetary and credit policies laid down by the Reserve Bank from time to time; to suggest measures for further tightening up the provisions so as to ensure that the activities of such Companies, in so far as they pertain to the acceptance of deposits, investments, lending operations etc., subserve the national interest and serve more effectively as an adjunct to the regulation of the monetary and credit policies of the country besides affording a degree of protection to the depositors' monies. In this connection, the Study Group may examine and make recommendations for regulating the conduct of the business of non-banking companies governed by the above sets of directions generally, and in particular, in regard to -

(a) the norms which may be adopted in respect of the capital structure and debt-equity ratio that may be maintained by the various classes of non-banking companies covered by the said directions;

(b) the extent to which and the periods for which such companies may borrow by way of deposits/unsecured loans and the distinctions, if any, to be made between public and private Companies;

(c) the maintenance of cash reserves and/or a percentage of their deposit liabilities in the form of liquid assets by such Companies.

(d) the norms which may be adopted in respect of the rates of interest payable by such companies on their borrowings by way of deposits/unsecured loans and also those which may be charged on loans and advances made by them;

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

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

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

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

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

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

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

8. In Paras 6.17, 6.18 and 6.19, the Raj Committee observed as follows :

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

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

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

States;

(b) While the Bill should be enacted as a Central Act, its administration should be left to the State Governments concerned which, in turn, may seek the advice of the Reserve Bank on policy matters. (For the purpose of tendering advice to the Central or State Governments, the Reserve Bank may have to inspect chit fund institutions on a selective basis to have an idea of their working including their methods of operation. Chit funds are "financial institutions" as defined in clause (c) of section 451 of the Reserve Bank of India Act, 1934. Hence, it would be open to the Reserve Bank to undertake inspections of chit fund institutions whenever deemed necessary in exercise of the powers vested in it under Section 45N ibid);

(c) as regards the question whether only public limited companies should be allowed to conduct chit funds, the Group is of the view that there should no objection, in principle, to chits being conduct by private limited companies also, and on a limited scale, even by unincorporated bodies such as individuals/sole proprietorships/partnership firms. It might be of relevance to note in this connection that the enactments regulating chit funds in force in certain States do not prohibit chit funds being conducted by unincorporated bodies; and

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

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

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

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

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

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

company in the case of chits of longer duration may be proportionately higher).

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

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

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

(emphasis supplied),

9. Keeping these recommendations of these expert bodies in view, Parliament enacted the impugned Act on 19-8-1982 and the same was brought into force in this State on 2-1-1984. The Scheme of the Act briefly stated is : Chapter II of the Act deals with Registration of Chits, Commencement and conduct of Chit business. Chapter III deals with the Rights and Duties of Foreman. Chapter IV deals with the rights and duties of non-prized subscribers. Chapter V deals with the Rights and Duties of Prized subscribers. Chapter VI deals with the restrictions on Transfer of Rights of Foreman, etc. Chapter VII regulates the Meetings of General Body of Subscribers. Chapter VIII provides for continuation of chits in certain cases and termination of chits. Chapter IX provides for inspection of documents. Chapter X provides for winding up of chits. Chapter XI provides for appointment of Officers and levy of fees for the purpose of discharging the duties imposed on the Registrar under the Act. Chapter XII deals with the disputes touching the management of Chit business by arbitration. Chapter XIII provides for miscellaneous provisions, viz., advisory role of Reserve Bank, Appeals from the orders of the

Registrar, Power of Registrar to give extension of time for filing documents, penalties, offences by companies, etc. Though the petitioners have challenged the vires of the entire Act, in the course of their arguments, they have confined their challenge only to a few provisions of the Act which are :

Sections 3, 4, 5, 6(o), 7, 8, 12, 16, 19 and 20.

10. It should be noted that many of the petitioners did not challenge the legislative competence of the Parliament to pass the Act. But, learned counsel for a couple of petitioners having questioned the legislative competence, the same should be considered first.

10.1. Legislative Competence : The impugned Act regulates the chit fund business. Chit is a contract between the parties, though an element of luck is also there in that the winner of the prize h decided by lots. So, the relevant entry is Entry 7 in List III to Schedule VII to the Constitution of India which reads as under :

> "Contracts including partnership, agency, contracts of carriage, and other special forms of contracts, but not including contracts relating to agricultural land."

The petitioners have not placed any material to show that chit transactions are not contracts and as such they do not come within the ambit of Entry 7 in List III.
The legislative competency of the Parliament to pass the impugned enactment is no more open to challenge in the light of the decision of the Supreme Court in *Srinivasa Enterprises v. Union of India, etc*[1]. If the prize chit fund is covered by Entry 7 in List III as observed by the Supreme Court in that case, conventional chits are also matters of contract, with an added element of chance by the drawing of lots to choose the successful bidder. Further the other argument that the impugned Act is bad because it covers both bad and good chit funds is also no more tunable in the light of the very same decision of the Supreme Court. A similar argument advanced in that case was rejected by the Supreme Court with the following observations :

> "We may not be taken to mean that every prize chit promoter is a blood-sucker. Indeed, Shri Venugopal persuasively presented the case of his client to make us feel that responsible business was being done by the petitioner. May be. But when a general evil is sought to be suppressed some martyrs may have to suffer or the legislature cannot easily make meticulous exceptions and has to proceed on broad categorizations not singular individualization."

(emphasis supplied)

While examining legislative competence of an enactment the rule of interpretation of pith and substance of the enactment has to be applied. Even otherwise no provision in the Act is brought

to our notice which falls outside the purview of Entry 7 of List III of Schedule VII. The Act provides for the regulation of chit funds and matters connected therewith. The chit comes into existence as a result of an agreement between the parties concerned with the chit. Thus it is a matter of contract. The contracts relating to agricultural lands

[1] AIR 1981 SC 504

are excluded from the purview of Entry 7 of List III of Schedule VII. The contracts relating to chits do not relate to and have nothing to do with agricultural lands. Thus the Act squarely falls under Entry 7 of List III of Schedule VII. As such the Act does not suffer from lack of legislative competence of the Parliament to enact it.

11. Before we consider the contentions of the petitioners in detail, the Report of the Select Committee which considered the Chit Funds Bill, 1980, should be briefly noticed because the impugned Act incorporates almost all the recommendations of the Select Committee.

The Committee held as many as 25 sittings after issuing notices to the State Government, Chit Companies, Public bodies and organisation, individuals etc., interested in the subject- matter of the Bill and also decided to hear oral evidence on the provisions of the Bill from interested parties. The Committee also issued Press communique fixing 21st February, 1981, as the last date for receipt of memoranda and requests for oral evidence. Wide publicity was given on three successive days by broadcasting the matter from all stations of All India Radio and telecast from all Doordarshan Kendras. Several requests were received from various parties for being heard by the Committee and accordingly several sittings were held at Madras on 28th, 29th and 30th of May, 1981, at Bangalore on 1st and 2nd of June, 1981 and at Trivandrum on 4th and 5th of June, 1981. Oral evidence was taken from the representatives of various Chit Companies Associations, Federations, individuals etc. and the Committee also heard the representatives of the State Government of Tamil Nadu, Karnataka, Kerala and the Union Territory of Pondicherry. Since the Committee felt that sufficient number of subscribers were not forthcoming for tendering oral evidence, they decided to extend the time for receiving memoranda and receiving oral evidence up to 30th June, 1981. Further, a series of sittings were held at Ahmadabad, Hyderabad, Calcutta, and New Delhi and the Committee, in all examined 101 witnesses who appeared before the Committee for giving oral evidence. The Bill was considered clause by clause and the report of the Committee was adopted on 18th November, 1981. The recommendations of the, Committee in respect of the following clauses in the Bill are : Clause 4 : The period of 12 months was substituted for the period of six months in the proviso to the said clause since the Committee felt that the period of 6 months was not sufficient for registering the chit from the date of sanction. Under Clause 6(i)(c) the words 'interest or penalty' were included for any default in the payment of installments. Likewise, in Clause 6(i)(d) amendment was proposed to specify the probable date of commencement of the chit agreement. Clause 7(3) : The words 'within a period of three months' were incorporated with a view to ensure that the foreman did not lake unduly. long time to start the chit and did not misappropriate the subscribers' money. Clause 8 : Instead of the figure 20 per cent, 10 per cent was suggested as the amount to he transferred to the Reserve Fund. Clause 11(2) : A period of one year was incorporated for complying with the requirements

of Clause 11(1) to avoid any hardship being caused to such persons carrying or business on the commencement of the proposed legislation. Clause 13 : The Committee considered the aggregate amount of chit to be conducted by an individual foreman, partnership foreman and foreman-Company. The Committee felt that in order to ensure that the foreman has sufficient stake in the chit business conducted by him, recommended an increase of the amount from Rs. 10,000/- to Rs. 25,000/- in the case of individual foreman, from Rs. 40,000/- to Rs. 1 lac in case of partnership foreman. As regards the foreman-Company, the Committee recommended for the words 'net assets' the words 'net owned funds' to be substituted and that should be made applicable also to co-operative Societies. This recommendation was because of the fact that the concept of net owned funds will be in tune with the Reserve Bank of India-directions to financial companies which would mean the aggregate of the paid-up capital and free reserves reduced by the amount of accumulated balance of loss, deferred revenue expenditure and other intangible assets, if any, as per the latest audited balance sheet of the company. Clause 14 : The representation for extension of the period of 2 years was rejected as the Committee felt that the period of three years was sufficient for securing the money invested by the person carrying on chit business in any other business. The Committee was also of the view that the State Government's power to extend the period of two years should be limited to one year only and proviso to sub-Clause (2) was accordingly amended. Clause 15 : By substitution of a new clause it was provided that chit agreement shall not be altered, added to or cancelled except with the consent in writing of the foreman and all the subscribers in the chit. The Committee felt that since the foreman was a party to the agreement, his consent must be obtained before altering the agreement. Clause 16 was suitably amended by the Committee in order to ensure that there was no mischief in conducting the chits by making it obligatory for the Chairman to issue notices to all the subscribers and the draw should be held in the presence of at least two subscribers. Clause 18 : 21 days' time was granted to the foreman to file the returns instead of 14 days. Clause 19 : A new sub-Clause (3) was added to enable the subscribers to know the State where the new business is opened by approaching the Registrar of that State instead of the Registrar of the State where the main office is situated for making any complaints with regard to the conduct of chit business at the new place of business. Clause 20 : Sub-clause (1) was amended as the Committee was of the view that in order to ensure that the foreman does not utilize the subscriptions so collected for the purpose of depositing the security and also to ensure further that the financial position of the foreman is sound to conduct the chit, he should be required to furnish security before he applies for previous sanction of the State Government under Clause (4) of the Bill.

Clause 21: The provisions of sub-Clause (1)(a) was amended since the Committee was of the view that where a foreman has subscribed to more than one ticket, he should be allowed to get more than one chit amount in a chit without discount. Clause 22 : Sub-clause (2) was amended since the Committee felt that the existing clause would cause hardship to the foreman and therefore, he may be required to make deposit of the Prize money in respect of the draw only if it remains unpaid before the date of the next succeeding installment in a separate account in an approved Bank. A new proviso to sub-clause (2) was added to avoid any hardship to the foreman by such contingencies by allowing the foreman to hold another draw in respect of the installment

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

12. We have made a reference to these recommendations made by the Select Committee and to the reports of the expert bodies with a view to satisfy ourselves that when Parliament enacted the impugned Act, it had given its careful consideration to the various aspects of chit fund business, to the various suggestions made by the State Government, by the financial institutions, by the Companies, by the Co-operative Societies and by individuals, to the interests of the subscribers, to the risks of the foreman and the difficulties in complying with certain regulatory measures, as found in the Bill and passed the impugned Act. Almost all the recommendations of the Select Committee were incorporated in the impugned Act as passed by the Parliament. Most of the petitioners had the opportunity of presenting their views before the Select Committee as could be seen from the report of the Select Committee to which we have made a brief reference. Therefore, we have to examine whether the onus cast on the State to sustain the Constitutional validity of the various provision of the Act is discharged by it.

12-A. The next point for consideration is whether the impugned provisions of the Act are violative of Article 19(1)(g) of the Constitution. This appears to be the main contention of the petitioners in all these petitions. According to some of the petitioners, their companies are registered under the Companies Act and that Act provides elaborate regulatory measures over the business of the petitioners by prescribing provisions for running the day-to-day business through a Board of Directors who are responsible to the shareholders, maintenance of various statutory returns which have to be submitted to the Registrar of Companies from time to time thus ensuring the Registrar of Companies to have an effective control over the business of the

petitioners and annual statutory audit preceded by internal audits. Therefore, it is submitted that an additional control over the business of the petitioners by the Registrar of Societies under the impugned Act makes a serious inroad into their rights to carry on their business and it would therefore be violative of Article 19(1)(g) of the Constitution. They have complained that the provisions of Section 3 of the impugned Act will have an overriding effect notwithstanding anything to the contrary contained in the memorandum or articles of association or bye-laws or in any agreement or resolution whether the same be registered, executed or passed dealing with the chit fund business of these petitioners and they having carried on their business without any complaint from any source either from the subscribers or from any third party. Section 3 imposes unreasonable restrictions on the existing rights of the petitioners to carry on chit business in accordance with the Memorandum or Articles of Association. They have been carrying on their business over a number of years in accordance with the Memorandum and Articles of Association of the respective companies and bye-laws; but, now they have to regulate their business in conformity with the provisions of the impugned Act. Mr. Balachandran, appearing for some of the petitioners, submitted that the provisions of Sections 8, 13 and 20 overlap one another and the restrictions imposed by these provisions are unreasonable and they do not subserve the object and purpose of the Act. The preamble also does not define what the social content and objects of the Act are and, therefore, it cannot be said that Sections 8, 13 and 20 of the Act impose reasonable restrictions on the petitioners to carry on the Chit Fund business. According to him, in the light of the decision of the Supreme Court in Srinivasa Enterprises case AIR 1981 Supreme Court 504 the business of conventional chits is a legitimate business and that is the reason it was not banned by the Prize Chits and Money Circulating Schemes (Banning) Act. His further argument is that chit business is a business which rests on the co-operative efforts of the foreman and the subscribers and is not a business in the strict sense of the term and the Companies Act provides for sufficient control over the business conducted by the companies registered under the Act and, therefore, the provisions of sub-sections (1) and (4) of Section 8, sub-section(2) of Section 12 of the Act are violative of Article 19(1)(g) of the Constitution. Since the restrictions imposed by these provisions do not serve any public purpose, there is no warrant for dual control over this business under the Companies Act and under the impugned Act. He pressed into service the provisions of the Money Lenders Act and submitted that no sanction was necessary under that Act for every money lending transaction and, therefore, Sections 4 and 6 impose unreasonable restrictions on the right of the petitioners to carry on chit business. Further Section 14 according to him is unworkable and offends Article 19(1)(g) of the Constitution as the provisions of Section 14 will completely eliminate the profit motive of running Chit Funds companies. He submitted that the right to carry on chit business includes the right to sufficient incentive for that business and viewed in that light the regulatory measures are hit by the provisions of Article 14 and Article 19(1)(g) of the Constitution.

13. Mr. Narayana Rao, learned counsel for the petitioner in W.P. No. 15062 of 1985 has challenged the vires of Sections 3, 4(3), 6(3), 7, 8, 12, 16(2), 17(1), 19, 20, 21, 70, 76, 77 and 84 of the Act. In his case, the petitioner is a Private Limited Company registered under the Indian

Companies Act, 1956, having an authorized capital of Rs. 1 lac and the paid up capital to the tune of Rs. 50,000/-. Steps are also being taken to call for the remaining capital and that there has been a good response to the same. The petitioner company was registered under the Companies Act in the year 1967 and is carrying on only chit business. It is averred that the petitioner has been functioning within the frame-work of the Companies Act and is subjected to inspection by the Reserve Bank authorities and also the Registrar of Companies with whom the statutory provisions under the Companies Act have to be complied with. The accounts of the petitioner-Company are being audited regularly by a Chartered Accountant and a balance sheet with profit and loss account and the report of the auditors and the resolution of the Board of Directors are being sent to all the shareholders of the Company and placed in the Annual General Meeting. The Board of Directors also are being elected in accordance with the provisions of the Companies Act. So far there has been no complaints from any quarters and regularly income-tax is also being paid. The Memorandum of Association of the petitioner/Company specifically provides to conduct periodical chits such as monthly, fortnightly, weekly and daily, to collect subscriptions from the members of the chit fund and to render other financial assistance to the members like advances, furnishing guarantee and indemnity etc. The petitioner-Company has a reserve fund of Rs. 28,000/- and has invested in a Fixed Deposit in Nationalized Banks to the tune of Rs. 1 lac and that the financial position of the Company is very sound and no loss to the company has occurred so far. The challenge to the various provisions of the impugned Act are on the following grounds :

(a) Section 3 of the Act has the effect of overriding the rules, bye-laws, resolutions, articles of association or agreements, concerning the chit fund business as a result of which the said resolutions, agreements, bye- laws etc., in existence earlier have become void to the extent that they are contrary to the provisions of the Act:

(b) Section 4(1) of the Act prohibits the conduct of the chit fund business without the previous sanction of the State Government unless each chit is registered in accordance with the provisions of the Act; that in a chit business, daily there will be numerous deeds, and transactions pertaining to various persons involving certain financial implications. "The mandate of the law as provided under Section 4(1) of the Act is that in respect of every chit viz., every transaction, before it is commenced or conducted, the previous sanction of the State Government is absolutely necessary. This is highly draconian in character and violative of Articles 14 and 19(1)(g) and 300-A of the Constitution of India. It is not only arbitrary but has no rational relation to the object that is sought to be achieved. In the guise of regulating the functioning of the chit funds, an arbitrary provision has been incorporated which has absolutely no basis for a rational classification inasmuch as it directs a company to obtain the previous sanction in respect of every chit. Section 3(j) defines 'foreman' and means the person who, under the chit agreement, is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under Section 39 of the impugned Act. In the instant case, the petitioner comes within the ambit of the word 'foreman' as defined under the said provision and that

the petitioner is liable to obtain the permission to conduct the business in respect of each transaction/chit from the appropriate authority. The imposition of the said restriction on the petitioner is violative of Articles 14 and 19(1)(g) of the Constitution of India;

(c) Likewise Section 4(2) provides for an application to be made for obtaining the sanction and sub-section (3) of Section 4 empowers the authorities to refuse the previous sanction for the reasons enumerated therein. Sub-section 3(b) of Section 4 states that the previous sanction could be refused if the foreman has defaulted in the payment of fees or the filing of any statement or record required to be paid or filed under the Act or has violated any of the provisions of the Act. This provision also is draconian in nature because it equates default in payment of fees or filing of any statement or record required to be filed under the Act with serious disqualification of a foreman such as conviction for any offence relating to the chit fund business or conviction for any offence involving moral turpitude. The said provision is therefore arbitrary and violative of Articles 14 and 19(1)(g) and 300-A of the Constitution;

(d) Section 6(3) restricts the amount of discount referred to in Clause (f) of sub-section(1) to 30% of the chit amount. It is submitted that the ceiling on discount will not bring about the ceiling on dividend and any ceiling on dividend will definitely discourage the subscribers from joining long term chits. For instance, in a monthly chit which is a long term chit, if ceiling on discount is imposed, the long term investor will get the return of only 12% and obviously it would not be attractive to the subscriber and that it would only be advantageous to the borrower under the early stages of the chit as he will borrow at a lower rate of 9% interest. Further the subscribers can be expected to take care of the discount when they bid at the time of the chit auction. In view of this situation, Section 6(3) of the Act is highly arbitrary and imposes unreasonable restrictions on the business of the petitioner. There is absolutely no element or reasonableness having due regard to the object of the Act;

(e) Section 7 deals with the filing of chit fund agreements. The attack on this section is with reference to Clause (c) of sub-section(2). The wordings of Section 7(2)(c) are identical to those in Clause (b) of sub-section(3) of Section 4. As stated above, the said provision, viz., Section 7(2)(c) of the Act has equated the default in the payment of fees or filing of any statement or record required to be filed under the Act with a serious disqualification of a foreman. This is also arbitrary in nature and liable to be struck down as violative of Articles 14 and 19(1)(g) of the Constitution;

(f) Section 12 of the Act contains two subsections. Sub-section (1) lays down that except with a general or special permission of the State Government, no company carrying on chit business can conduct any other business. Sub-section (2) lays down that if an existing company is already carrying on any business in addition to the chit fund business, it shall wind up the other business within the period stipulated in the sub-section or the extended period of time that may be availed under the proviso. On the face of it, it is seen that sub-section(2) appears to be in conflict with sub-section(1) because under sub-section(1) the Government can grant permission for a company to carry on chit fund business as well as

any other business but in sub-section(2) there is a mandate to close down the other business. The said provisions viz., Section 12(1) and (2) are unintelligible, vague and they are contradictory in nature, as such it is contended, are liable to be struck down as violative of Article 14 of the Constitution of India;

(g) Section 13 imposes a ceiling limit of chits that can be started by a foreman, a firm or other association of individuals or a company or a co-operative society. Section 20(1) of the Act provides that for the proper conduct of the chit, every foreman shall before applying for a previous sanction under Section 4 shall deposit in an approved bank an amount equal to the chit amount in the name of the Registrar or transfer Government securities of the face value or market value of not less than 11/2 times the chit amount in favour of the Registrar or transfer in favour of the Registrar such other security as may be prescribed by the State Government from time to time. Hence, it is clear that as per Section 20(1) every foreman has to offer security by way of cash deposit or Government Security for each chit. In view of this restriction, placing a ceiling limit on the chit fund started by different classes of foremen as provided under Section 13 of the Act is redundant and violative of Articles 14 and 19(1)(g) of the Constitution of India;

(h) Section 16 of the Act provides for dhu conduct of the chit business regarding the day, time and place, Sub-section (2) of Section 16 insists upon the presence of not less than two subscribers before a draw is conducted. Sub-section (3) envisages a procedure which should be followed when a draw could not be conducted on the ground that two subscribers required to be present at a draw under Sub-section(2) are not present or on any, other ground. In many cases, it may not be possible to have the presence of a minimum of two subscribers, especially in the later stages of the draws. Further there is absolutely no reason as to why there should be the presence of two subscribers at the day, time and place of conducting the chit when sufficient safeguards have been given in the provisions of the Act. This tantamounts to placing unreasonable restrictions on the business of the petitioner and hence violative of Articles 14 and 19(1)(g) of the Constitution of India. Further one is not able to comprehend as to how Section 16 of the Act could be implemented and given effect to. Further the powers given to the Registrar under this provision and taking away the powers given to the subscribers as also the foreman in certain contingency will affect the actual running of the chit business. Consequently Section 17 which provides for minutes of the proceedings also is bad;

(i) Section 20 of the Act provides for giving security. Giving of security in cash is as burdensome as giving security in the form of Government Securities; that the said provision for depositing an amount equal to the chit amount in the name of the Registrar or transfer of Government securities of the face value or market value of not less than 11/2 times the chit amount in favour of the Registrar is draconian in character, arbitrary and confiscatory in nature. The petitioner invariably conducts business in chit fund to the tune of Rs. 1 lac. As per Section 20 of the Act, he is bound to deposit the same amount in the name of the Registrar earlier to the conducting of his business. This is nothing but confiscatory in nature. There is no rational basis behind this scheme. This is an

unreasonable restriction on the business of the petitioner and hence violative of Articles 14 and 19(1)(g) of the Constitution of India. There is no reasonable nexus to the object that is sought to be achieved. This would obviously affect the financial stability of the petitioner, inasmuch as it is practically impossible to deposit the amount in the name of the Registrar every time whenever a chit transaction takes place. Further no provision is made regarding the refund of the same or retransfer of the same and also regarding the interest that accrues in the case of deposits. Whenever the petitioner deposits this huge amount of Rs. 1 lac, it should carry interest and there is no provision in the Act or in the Rules for payment of any interest that accrues on the said sum which amounts to deprivation of the property and such a provision is liable to be struck down as violative of Articles 14, 19(1)(g) and 300-A of the Constitution of India;

(j) Section 21 of the Act deals with the rights of the foreman. The maximum limit of 5% of the chit amount provided under Section 21(1)(b) is provided by way of commission, remuneration or meeting the expenses of running the chit. This figure of 5% is unreasonably low having due regard to the risk that the company has to take and the huge investment it has already made. In other words, there is no reasonable return on the capital invested and that it becomes practically impossible to run the chit business. This also amounts to unreasonable restriction on the business of the petitioner and there is no reasonable nexus with the object that is sought to be achieved;

(k) Section 22 of the Act deals with the duties of the foreman and on default on the part of the prized subscriber, certain procedure to be followed as mentioned therein. But it makes no provision for the loss if any that may be occasioned by the subscriber's default. On the face of it, the said provision is highly arbitrary and violative of Articles 14 and 19 of the Constitution of India; and

(I) Likewise, Section 24 of the Act also has put a fetter which is highly unreasonable on the duties of the foreman and that an unreasonable obligation is cast on him. Likewise, Section 76 of the Act deals with the penalty and provides for penal consequences that are sweeping in character and draconian in nature. The provisions made in Section 84 of the Act regarding the powers to delegate in all matters except the matters excepted under the said section are again violative of Articles 14 and 19 of the Constitution besides being hit by excessive delegation of powers without any guidelines in the matter in respect of which power could be delegated. These provisions also are arbitrary and discriminatory in nature. He also submitted that Section 12 of the Act imposes an unreasonable restriction on companies, that the Select Committee is also silent on these provisions and no reasons are forthcoming for excluding partnership business from the restrictions imposed under Section 12 of the Act and thus Section 12 is also violative of Article 14 of the Constitution.

14. Sri K.B. Sachidananda Murthy and Sri Subash B. Adi and the other learned counsel appearing for other petitioners have adopted the arguments of Sri Balachandran and Sri Narayana Rao and have laid more stress on the working difficulties of their clients under the various

regulatory measures in the impugned Act.

15. In the writ petitions filed by the Pawn Brokers' Association, Piece Goods Merchants' Association and Shroff Vartakara Sangh, they have challenged the validity of the impugned Act on the ground that it is not applicable to them since their business cannot be construed as chit fund business. Their learned counsel has contended that the bye-laws of these Associations limit their business only to their members for their mutual benefit. According to them, Section 4 of the Act would not apply to them since they are not carrying on any chit fund business. Even if it applies, they contend that Section 4 is void since no right of appeal is provided against the order of the Government and that attracts the vice protected under Article 14 of the Constitution. According to Mr. Jeshtmal, learned counsel for these petitioners, Section 4 of the Act is not attracted since no business of chit is carried on by these Associations and the provisions of Section 5 indicate that it is not applicable to these Associations. Under Section 5 a prohibition is imposed for inviting public to subscribe for tickets in any chit unless a notice inviting the public contains a declaration that the previous sanction of the Government is obtained under Section 4 of the Act. He also relied on Section 8 and Section 11 of the Act which use the words 'chit business' in contradistinction to the word 'chit'. He also relied on Section 14 of the Act and submitted that the impugned Act is not applicable to all the transactions but transactions in the nature of chit business and that is clear from Sections 8, 11 and 14 of the Act. He maintained that the State has not discharged its burden to prove that the restrictions imposed are reasonable and therefore, the provisions of Section 4 of the Act are liable to be struck down.

16. In our view, the mere fact that the chit transactions are confined to members of the Association for their mutual benefit will not take them out of the purview of Section 3 of the Act. Section 3 is a clear answer to the contentions of the learned counsel for the Associations. If the transaction in question is a chit within the meaning of Clause (b) of Section 2 of the Act (and the Associations do not say anything to the contrary), then chit business refers to a transaction within the meaning of the word 'chit' under Clause (b) of Section 2 of the Act and it would be a chit business as defined under Clause (e) of Section 2 of the Act and that chit business is sought to be regulated tinder Section 4 of the Act. Though Section 4 of the Act does not use the words 'chit business', the opening words at Section 4, namely, 'No chit shall be commenced' only refer to chit business since it is obvious, Conducting more than one chit becomes chit business and it is not the case of the Associations that they conduct only one chit during the entire period of the existence of the Associations. Therefore, these Associations also come within the sweep of Section 4 of the Act. A right of appeal is provided to a high authority like the State Government and therefore, it cannot be said that right of appeal is illusory attracting the vice protected under Article 14 of the Constitution.

17. The preamble to the impugned Act makes it clear that it is enacted for the regulation of chit funds and for matters connected therewith. Even so, the regulatory measures must satisfy that test of reasonableness under Article 19(1)(g) of the Constitution if they are not to be held as

unconstitutional. The test of reasonableness is not an abstract test and is not to be judged by a priori standards unrelated to the facts and circumstances of the case. As observed by the Supreme Court in *State of Madras v. V.G. Row*[2]*,*

> "It is important in this context to bear in mind that the test of reasonableness, wherever prescribed, should be applied to each individual statute impugned, and no abstract standard, or general pattern of reasonableness can be laid down as applicable to all cases. The nature of the right alleged to have been infringed, the underlying purpose of the restrictions imposed, the extent and urgency of the evil sought to be remedied thereby, the disproportion of the imposition, the prevailing conditions at the time, should all enter into the judicial verdict." These tests have undergone a little modification in the case of economic statutes. The petitioners have not urged that the provisions of the impugned Act impair their existing contractual rights with the subscribers of the chit fund. Such a contention is also nor available in the light of the decision of the Supreme Court in *M/s. Raghubar Dayal Jai Parkash v. The Union of India*[3]*,* where it was ruled that the guarantee against the impairment of obligations under the contract which was available under the U.S. Constitution was not applicable for testing the reasonableness of the restrictions on the rights conferred under Article 19(1)(g) of the Constitution on persons who had entered into forward contracts in gur. The preamble to the Act brings out the object of the Act, i.e., an Act to provide for the regulation of chit funds and for matters connected therewith. The regulatory measures do not extinguish the rights of persons to carry on chit fund business but regulate the conduct of such business so that the malpractices that are found to exist in that business are eliminated in the interest of public who also include a large segment of subscribers belonging to poorer and not so poorer sections of the society.

18. This takes us to the main question as to the circumstances under which the restriction imposed by the State can be said to contain the quality of reasonableness. In *M/s. Laxmi Khandsari etc. v. State of U.P*[4]*.,* the Supreme Court observed :

> "It is abundantly clear that fundamental rights enshrined in Part III of the Constitution are neither absolute nor unlimited but are subject to reasonable restrictions which may be imposed by the State in public interest under Clauses 1

[2] AIR 1952 SC 196 [4]1981 SC 873

[3] AIR 1962 SC 263

> to 6 of Article 19.
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> xx xx
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> Further, restrictions may be partial, complete, permanent or temporary but they must bear a close nexus with the object in the interest in which they are imposed.
>
> xx xx
>
> Another important consideration is that the restrictions must be in public interest and are imposed by striking a just balance between the deprivation of right and danger or evil

sought to be avoided.

xx xx

Another important test that has been laid down by this Court is that restrictions should not be excessive or arbitrary and the Court must examine the direct and immediate impact of the restrictions on the rights of the citizens and determine if the restrictions are in larger public interest while deciding the question that they contain the quality of reasonableness. In such cases a doctrinaire approach should not be made but care should be taken to see that the real purpose which is sought to be achieved by restricting the rights of the citizens is subserved.

xx xx

Finally, in determining the reasonableness of restrictions imposed by law in the field of industry, trade or commerce, the mere fact that some of the persons engaged in a particular trade mayninour loss due to the imposition of restrictions will not render them unreasonable because it is manifest that trade and industry pass through periods of prosperity and adversity on account of economic, social or political factors.

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19. Since the provisions of the impugned Act are challenged under Article 14 of the Constitution, the true scope and ambit of Article 14 should be noted. The Supreme Court in *R.K. Garg v. Union of India*[5], has ruled that classification may be made for the purpose of legislation but (1) the classification must not be arbitrary but must be rational, that is to say, it must not only be based on some qualities or characteristics which are to be found in all the persons grouped together and not in others who are left out but those qualities or characteristics must have a reasonable relation to the object of the legislation. In order to pass the test, two conditions must be fulfilled, namely, "(a) that the classification must be founded on an intelligible differentia which distinguishes those that are grouped together from others and (b) that differentia must have a rational relation to the object sought to be achieved by the Act and (2) the differentia which is the basis of the classification and the object of the Act are distinct things and what is necessary is that there must be a nexus between them. In short, while Article 14 forbids class discrimination by conferring privileges or imposing liabilities upon persons arbitrarily selected out of a large number of other persons similarly situated in relation to the privileges sought to be conferred or the liabilities proposed to be imposed, it does not forbid classification for the purpose of legislation, provided such classification is not arbitrary in the sense abovementioned." We have kept these well settled principles of law in our adjudication of the validity of the various impugned provisions of the Act.

20. Provisions of Section 4 of the Act are challenged on the ground that every time a chit is floated, previous sanction of the State Government should be obtained and further the chit should be registered in the State in accordance with the provisions of the Act. Section 4 permits floating more than one chit subject to the aggregate amounts fixed under Section 13 of the Act. If that be so, it is contended by the learned counsel for the petitioners that applying for, the previous

sanction for every chit and obtaining the same will necessarily involve time and the resultant delay in obtaining previous sanction from the State Government would tantamount to unreasonable restriction on the petitioners' right to carry on their business. We must confess that these provisions of this section had rabed some doubts as to the real intention of the legislature in imposing a prohibition of this nature. If the meaning of the word 'chit' under sub-section(1) of Section 4 is understood as 'chit business', then there is no difficulty at all in understanding the object of this section since the previous sanction of the State Government would be a *sine qua non* for commencing and conducting the chit business in the State. But the word used in Section 4 is 'chit' and not 'chit business' and 'chit' is defined under Clause (b) of Section 2 of the Act and it has a distinct meaning in contradistinction to 'chit business' which is defined under Clause (e) of Section 2 of the Act. If Section 4 is read with Rule 3 and Form No. I framed under Rule 3 it is clear beyond all doubt that what the legislature meant in Section 4 by the word 'chit' is 'chit transaction' and not 'chit business'. So, under sub-section(1) of Section 4 every time a chit transaction is entered into by entering into an agreement with the specified number of persons as defined under Clause (b) of Section 2 of the Act, previous sanction of the State Government is necessary and also registration of chit in the State where it is sought to be commenced or conducted is necessary. So, if a person floats 4 chits at any time not exceeding Rs. 25,000/- in the aggregate he has to obtain previous sanction of the State Government 4 times for the 4 chits to be commenced or conducted. Such a provision is not there in the Andhra Pradesh Act or in the Tamil Nadu Act. However, in the Kerala Act Section 3 imposes a requirement as posited under Section 4 of the impugned Act. The object of this requirement is apparent, inasmuch as it enables the State Government or the Officer empowered by the State Government to keep a close check on the functioning of the promoters of the chit. Form I prescribed under Rule 3 is an indication as to how the State Government or the Officer appointed by it could keep a watch on the functioning and credibility of the prompters of the chit fund. It is argued that Section 20 of the Act which provides for security for the proper conduct of the chit would be adequate protection of the interest of the subscribers and also of the public and the control sought to be imposed on the conduct of the chit by insisting on the previous sanction of the State Government every time the chit transaction is sought to be entered into imposes an unreasonable restriction. In our view, it appears at first sight that Section 4 imposes an unreasonable restriction when Section 20 of the Act protects the interests of the subscribers by taking security from the foremen in the manner provided under that section. Section 4 is an additional control over the functioning of the promoters of chit funds. The report of the Study Group which we have excerpted is an answer to this contention of the learned counsel for the petitioners on this point. We have noticed in Para 6.17 of the Report, of the Study Group on Non-Banking Financial Intermediaries that there are cases where the foreman and his associates disappear from the scene and are untraceable and the number of many such cases are on record. During 1962-66, as many as 255 chitties collapsed in several districts of Kerala on account of such malpractices. In Para 6.54 of the Report, the Study Group had recommended regulation of the conduct of chit funds by requiring the foreman to obtain permission of competent authorities before a chit fund could be started, stipulating security to be provided by the foreman to the Registrar, detailing his rights and obligations and

providing for punishment for infringement of law. These recommendations have been incorporated in Sections 4 and 20. That is the reason in the Kerala Act a provision similar to Section 4 of the impugned Act is found. The wisdom of the Kerala State Legislature in enacting Section 3 of the Kerala Act was kept in view by the Parliament in the light of the report of the study Group to which we have made a reference. Therefore, the need for a prohibition on the commencement or conduct of a chit transaction without obtaining previous sanction of the State Government cannot be said to be unreasonable restriction notwithstanding the provisions of Section 20 of the Act. It may be that Section 4 imposes a certain amount of administrative burden on the promoters of the chit fund in that they have to approach the State Government every time they float a chit for prior sanction but that by itself would not amount to unreasonable restriction which would come in their way of carrying ontheir legitimate business. Another attack that is made on Section 4 is that under sub-section(3) of Section 4 of the Act conviction for any offence under the Act or under any other Act relating to chit business and imprisonment following such conviction is a ground for refusing previous sanction. So also default in the payment of fees or the filing of any statement or record required to be paid or filed under the Act or violation of any of the provisions of the Act the rules made thereunder. It is submitted that default in the payment of fees or the filing of any statement or record under the Act or violation of any of the provision of the Act or rules made thereunder is treated on par with conviction for any offence under this Act or under any other Act and on that ground it is stated that the provisions of Section 4(3)(b) are arbitrary and impose an unreasonable restriction on the right to carry on business. Sub-section (3) of Section 4 is not mandatory but only directory. The previous sanction referred to in sub-section (1) of Section 4 'may be refused' and not 'shall be refused'. Therefore, a discretion is given to the sanctioning authority to accord sanction or refuse to accord sanction depending on the circumstances of each case. Therefore, the validity of Section 4(1) as also Section 4(3) of the Act on the grounds available under Articles 19(1)(g) and 14 of the Constitution must fail. Accordingly, it is held that sub-sections (1) and (3) of Section 4 of the Act are not violative of Articles 14 and 19(1)(g) of the Constitution.

21. There is no serious challenge to Sections 5, 6 and 7 of the Act. As regards Section 8, the stipulation as to the minimum paid up capital in the case of companies is said to be bad in law. Para 6.19 of the Raj Committee Report provides for these stipulations. Regard being had to the nature of the chit business a smaller paid up capital will add to the risk of the business and that is the reason the Raj Committee Report recommended a minimum paid up capital of Rs. 1 lakh, whether it is a private company or a public limited company. So, it cannot be said that the provisions of Article 14 or 19(1)(g) of the Constitution are attracted for impeaching the validity of Section 8.

22. There is no serious challenge to Section 11 of the Act. Section 11 is similar to the provisions of Section 3A of the Unit Trust of India Act, 1963, or the provisions of Section 7 of the Banking Regulation Act, 1949.

23. Vires of Section 12 is challenged on the ground that it imposes an unreasonable restriction on the right of the foreman to carry on other business with the proceeds of the chit fund business. The Raj Committee recommendation in para. 6.19 is as follows :

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

Section 8 of the Banking Regulation Act also is a pointer to this restriction. The views of te Study Group are found are at Annexure to the Appendix to the Raj Committee Report. The Study Group has observed as follows :

> "Whether institutions conducting chit funds should be prohibited from doing any, other type of business? If so, the period that, may be allowed to such companies to divest, themselves of non-chit business.Companies as also unincorporated bodies such as individuals/sole proprietorship/ partnership firms conducting chits may be prohibited from doing any other type of business except chit business or granting of loans to subscribers against their paid up subscriptions. If they are currently conducting non-chit business, they may be allowed time not exceeding three years or such extended period not exceeding three years as may be allowed by the State Government for divesting themselves of non-chit business. During such period, they may be allowed to carry on nonchit business for the beneficial winding up of such business as proposed in clause 5 of the Bill. Further, if the institution conducting chits is an incorporated body, it shall use as part of its name any of the words 'chit,' 'chit fund' or 'kuri' and no company shall carry on the business of chit funds unless it uses as part of its name at least one of such words."

24. Section 13 is challenged on the ground that the aggregate amount fixed for conducting chit business at any time is unrealistic, unremunerative and in effect virtually amounts to liquidation of the chit fund business. Under Section 13, individual foreman is permitted up to Rs. 25,000/- in the aggregate at any point of time, foreman of a firm or other association of individuals is permitted up to Rs. 1 lakh if the number of partners of the firm or individuals constituting the same is less than 4 and in any other cases, Rs. 25,000/- with respect to each partner or individual and in the case of companies or Co-operative Societies, the aggregate chit amount is fixed at 10 times the net owned funds of the company or co-operative society as the case may be. This was also considered by the Raj Committee in para 6.19. The recommendations of the Study Group on this point is as follows :

> "Ceiling in respect of the aggregate amount of chits that may be conducted at any point of time. The aggregate amount of chits conducted by a chit fund company at any point of, time may not exceed 50 per cent of the net worth of the company i.e. the paid-up capital plus free reserves less balance of accumulated loss, and other intangible assets such as deferred revenue expenditure, goodwill, etc., if any (vide Clause 8(6) . In the case of

commercial banks conducting chit funds, no ceiling on the aggregate amount of chits that may be conducted at any point of time need be prescribed, since chits conducted by commercial banks are subject to the close scrutiny of the Reserve Bank.

As regards the chit funds conducted by unincorporated bodies such as individuals, sole proprietorships and partnerships, the aggregate amount of chits should not at any point of time exceed Rs. 10,000. They are prohibited from opening branches (vide item 3 above)."

The Parliament has taken note of these recommendations and it has in our view liberalized the provisions for fixing a ceiling in respect of the aggregate amounts of chit that may be conucted at any point of time. Therefore, we do not find any infirmity in these provisions either under Article 14 or Article 19(1)(g) of the Constitution.

25. Section 14 of the Act does not find a place in the State enactments of Andhra Pradesh Tamil Nadu, Maharashtra or Kerala. But this provision is introduced in the light of the recommendations of the Raj Committee Report and the Report of the Study Group on Non-Banking Financial Intermediaries. In para. 6.19(ii) of the Raj Committee Report, it is observed as follows :

" Utilization of funds. Institutions conducting chits may be permitted to utilise their funds only in the manner contemplated in Clause 6 of the Bill. Those holding investments of the type other than those mentioned in the said clause may be required to regularize them within a period of three years from the date of coming into operation of the Act or such extended period not exceeding three years as the State Government may allow."

26. There is no serious challenge to Section 15 of the Act nor to Sections 16, 17 and 18 of the Act.

27. Section 19 of the Act does not prohibit, but only imposes some restrictions on, opening of a new place of business, which are regulatory in nature. This does not find a place in other State enactments. Parliament obviously had in view the report of the Study Group in para. 6.57 and in para. 6.19 of the Raj Committee Report. It reads as :

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

Section 23 of the Banking Regulation Act, 1949, is also a pointer to these provisions. These are purely regulatory treasures intended to curb the malpractices of Chit Fund promoters by extending the area of operation to the States where the State enactment is not in force prior to the promulgation of this Act. The Study Group has observed as follows in para 6.57 of the Report :

"We also recommend that pending enactment of an All India Chit Funds Act, chit funds carried on in the States where no legislation exists may also be regulated. It is the situs of the agreement that now determines the application of the chit fund legislation to a particular chit. If the foreman of a chit fund company registered in Tamil Nadu runs a chit series in Maharashtra (where there is no such chit fund regulation), then if the chit agreement relating to that series is entered into Maharashtra, the Tamil Nadu legislation does not extend to such business. Since a large number of chit funds operating in States having no chit fund legislation, are branches of the chit funds registered in States having such legislation (e.g. Kerala and Tamil Nadu), it will be useful if the provisions of chit fund legislation in the latter States are applied to branches functioning in the former States. Thus, e.g., a chit fund registered in Tamil Nadu will be governed by the Tamil Nadu Chit Funds Act not only in respect of its chit fund business in that State but also of its branches operating in States having no chit fund legislation."

The provisions of Section 23 of the Banking Regulation Act may be noticed in this connection. They read as : -

"23. Restrictions on opening of new, and transfer of existing, places of business.(1) - Without obtaining the prior permission of the Reserve Bank

(a) no banking company shall open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India; and

(b) no banking company incorporated in India shall open a new place of business outside India or change, otherwise than within the same city, town or village in any country or area outside India, the location of an existing place of business situated in that country or area :

"Provided that nothing in this sub-section shall apply to the opening for a period not exceeding one month of a temporary place of business within a city, town or village or the environs there of within which the banking company already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any other like occasion.

(2) Before granting any permission under this section, the Reserve Bank may require to be satisfied by an inspection under Section 35 or otherwise as to the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects and that public interest will be served by the opening or, as the case may be, change of location, of the place of business.

(3) The Reserve Bank may grant permission under sub-section ill subject to such conditions as it may think fit to impose either generally or with reference to any particular case.

(4) Where, in the opinion of the Reserve Bank, a Banking company has, at any time,

failed to comply with any of the conditions imposed on it under this section, the Reserve Bank may, by order in writing and after affording reasonable opportunity to the banking company for showing cause against the action proposed to be taken against it, revoke any permission granted under this section.

(5) For the purposes of this section 'place of business' includes any suboffice, pay office, sub-pay-office and any place of business at which deposits are received, cheques cashed or moneys lent."

28. Section 19 being a regulatory measure, the same cannot be said to impose any unreasonable restriction on the right to carry on chit business in a new place.

29. Section 20 is enacted in the light of the recommendation of the Study Group at para. 6.54. We have already excerpted the recommendations while dealing with Section 4 of the Act. Para. 25 in the report of the Select Committee is also a pointer to this section. It reads as :

"The Committee note that under the provisions proposed in sub-clause (1) of this clause, the foreman is required to give security for the proper conduct of the chit only before filing a declaration for the grant of a certificate of commencement of the chit. The Committee also note that before filing a declaration, the foreman has to complete other formalities like obtaining previous sanction of the State Government, inviting the public to subscribe for tickets in the chit and getting the registration of the chit agreement.

The Committee feel that in order to ensure that the foreman does not utilise the subscriptions so collected for the purpose of depositing the security and also to ensure further that the financial position of the foreman is sound to conduct the chit, he should be required to furnish security before he applies for previous sanction of the State Government under clause 4 of the Bill."

Though in the Kerala Act, immoveable properties could also be furnished as security (Section 15A) to the satisfaction of the Registrar for the realization of twice the chitty amount, such a provision is not present in Section 20 of the impugned Act. But a proviso is made under sub-section (3) of Section 20 for permitting the substitution of the security furnished under sub-section (1) of Section 20 of the Act. Sub-section (3) of Section 20 reads as under :

" The Registrar may, at any time during the currency of the chit, permit the substitution of the security :

Provided that the face value or market value (whichever is less) of the substituted security shall not be less than the value of the security given by the foreman under subsection (1)."

This shows that the rigour of Section 20(1) by insisting on security in cash or Government securities' is toned down by the provision for substitution of security under sub-section (3) of Section 20. A Division Bench of the Madras High Court in *Chockanathan Chit Fund and Finance (P) Ltd. Pondicherry v. Union Territory of Pondicherry*[5], dealing with the constitutional

validity of Pondicherry Chit Funds Act observed thus :

> "We can find nothing objectionable in those provisions which call upon the foreman to register the by-laws of the chit, furnish security as required by Section 12 and obtain a certificate of commencement from the Registrar. Strong objection was taken to Section 12 of the Act requiring the foreman to furnish security. This provision is absolutely necessary to ensure fulfillment of the obligations of the foreman. The foreman receives at each installment of the chit transaction a large amount of money which he has under the rules to disburse to the prize winner less certain deductions. If the foreman fails to carry out his obligation in this regard, the numerous subscribers to the chit fund will be left without any remedy except by way of preferring suits, which in some cases will be fruitless. It is true that this provision calls upon the foreman to provide security even in advance of his commencement of the chit business. The foreman is at liberty to realise the whole amount of the security by taking to himself the prize at the first installment. This provision requiring security to be furnished, in our opinion, is in the interests of

[5] AIR 1972 Mad 99

> the large body of subscribers. The other provisions sought to be attacked cannot be said to be unreasonable."

30. The other sections, viz., Sections 21 to 26 deal with the rights and duties of the foreman. These are also regulatory measures and they are enacted in the light of the 'recommendations of the Study Group in para. 6.54 of the Report which had pointed out the legal and illegal ways of the foremen who derive income by carrying on chit business which were highlighted by the Study Group in paras. 6.15 and 6.16 of the Report, which we have excerpted above. The role of the foreman and his legal relationship with the subscribers is exhaustively brought out by the Full Bench of the Kerala High Court in *Janardhana Mallan v. Gangadharan*[6], The Kerala High Court observed :

> "There were differing views on the relationship between the subscribers and the foreman. At one time it was assumed that there was a sort of partnership arrangement between the subscribers. Yet another view was that the foreman was a Trustee in regard to the subscriptions due to him from prized subscribers and as a Trustee he was to see that this was utilized for discharging the dues of non-prized subscribers. Yet another view was that the fund arising by reason of the subscriptions was a common or mutual fund from out of which loans were being advanced to prized subscribers. None of these concepts arose from the terms of the contract between the foreman and the subscribers nor did they arise on the terms of any statute. Chitty being a peculiar institution and the solvency of the foreman being a matter of concern for the subscribers to the chitty and further the due conduct of the chitty being necessary to protect the interest of the subscribers who join the chitty the courts envisaged certain concepts in order to secure the rights of those to whom money was due from the foreman in respect of the chitty. Therefore even while resoling

later from the theory if partnership and trusteeship, though not expressly, courts recognized some sort of right in the nonprized subscriber in the future subscriptions due from prize subscribers to the foreman so as to limit the power of alienation by the foreman of the right to collect future subscriptions. Thus the approach of courts to the question from time to time was not strictly based on any legal obligation that could be read from contract, statute or custom but on what was required by the exigencies of the situation. The early cases of the Travencore High Court may, in this context, be referred to as they illustrate the point.

One of the earliest cases to which reference may be made in this context is the decision of a Bench of 5 Judges of Travancore High Court in *Mariandran Thommannathan v. aswaran Marathandan*[7], It will be profitable to extract here a passage from that judgment which describes the relationship of parties in a chitty. At page 40 of the report the court said :

"The relation which exists between the foreman of a Chitty and the subscribers and of the subscribers among themselves is somewhat complex and incapable of easy definition. The chitty is generally started for the benefit of the foreman. He induces his friends and acquaintances to subscribe to the chitty, promising to pay

[6] AIR 1983 Ker 178

[7](1887) 5 Trav Co LR 38

his own subscription punctually, to collect subscriptions periodically from the subscribers, and to pay the collections (save those made at the first installment which he takes for himself) to such of the subscribers as may be determined by lot to be publicly drawn, and to carry on the scheme notwithstanding the default of any of the subscribers. The advantages of being a foreman are that he is entitled to receive the first installment of the collections, interest due from the subscribers who may make a default in payment of their subscriptions on due dates, and a small fee on all the collections. He is required to take security from those subscribers to whom the collections are paid, for the due discharge of their obligation as to future installments although, in practice, the payment without security to a subscriber whose solvency is above suspicion is not uncommon. It being his (foreman's) duty to collect subscriptions and carry on the scheme be, in his sole name and at his own expense, sues the defaulting subscribers and recovers from them the sums due with interest and costs. For the amounts due to them, the subscribers sue the foreman alone as under his contract with them, the latter is responsible for the collection and distribution of contributions.

From this the court deduces that the foreman is a to credit is given by the subscribers, and that he is personally liable to the subscribers for the proper conduct of the chitty and the performance of the obligations arising out it and that the success of the scheme depends entirely upon his personal care, judgment and integrity. The court observes in the background thus:

> This circumstance and the manifold advantages he exclusively enjoys point to the conclusion that the relationship between him and the subscribers is somewhat different from that of ordinary partners. His position towards the unprizeed subscribers is analogous to that of a debtor, and towards the prized subscribers, who have received the collections, to that of a creditor."
>
> "The examination of this question was with a view to ascertain whether a chitty foreman had a power of alienation and the court was of the view that he did not have absolute power of alienation over the chitty funds, funds on which according to the court, unprised subscribers held a lien. While observing that prized subscribers from whom money was due to the foreman were in the position of ordinary debtors, non-prized subscribers were found to have a lien upon the amount due from prized subscribers on account of future installments to the extent of their claim against the foreman. Thus while the theory of partnership was not promoted the court read a lien though not based on any terms of the contract between the parties. Ormsby J. who concurred with the judgment of the Chief Justice and the two other Judges made a further observation thus :
>
> "In the absence of legislation. I can only we that parties to chitty transactions (which are, I believe, most numerous) will themselves see that the variola itself contains an explicit statement of what they desire to be rights and obligations of the parties.
>
> Kunhiraman Nair, J. who also concurred with the other Judges, in his concurring judgment was evidently not willing to go the whole way with the Chief Justice and the other judges. This is evident from the following statement in the concurring judgment :
>
> 'The proper view to be taken of the rights and liabilities of the foreman of a chitty is that he is both the proprietor and manager of the chitty scheme and that the chitty installment bond is his property though subject perhaps to the claims of unprized subscribers.'

(Emphasis supplied)

From these observations, we could infer that, the need for legislation for regulating the rights and duties of the foreman was imperative and these sections fulfil that longfelt need.

31. Section 20 read with Section 4 of the Act makes it incumbent upon the foreman to deposit in an approved bank an amount equal to chit amount in the name of the Registrar before applying for previous sanction under Section 4 of the Act. The object of providing such a security, as already noticed, is to ensure that the foreman is solvent and the interest of subscribers to the chit is safe in his hands. If such is the object, we do not see any justification for the security deposit made in cash not carrying any interest and such interest not being made payable to the foreman. It is contended on behalf of the petitioners that lakhs of rupees are required to be deposited depending upon the value of the chits and if such amounts are not to carry interest, it would amount to acquiring the property of a citizen without compensation inasmuch as the foreman is deprived of the use of the amount without any interest and the amount deposited in any bank carries interest; that the Central Government in the guise of ensuring solvency of foreman and insisting upon depositing of the amount by way of security cannot enrich itself in as much as the

amount so deposited would be available to the Central Government for its use without interest. We see no reason why the amount deposited by way of security as per Section 20 read with Section 4 of the Act in the name of the Registrar should not carry interest. It is in this context, the learned Standing counsel appearing for the Central Government has filed a memo dated 11-11-1987 which reads thus :

> "The undersigned submits that interest earned on the deposit in cash, deposited by the Foreman under Section 20(1)(a) of the Chit Funds Act, 1982, in the name of the Registrar, will enure to the benefit of the Foreman and will be permitted to withdraw only when he substitutes the security as per law or as otherwise is he entitled to, in accordance with law."

We place the memo on record. Whatever loss that may be caused to the foreman by not providing for interest on security deposit would now be made good in terms of the memo filed on behalf of the Central Government by paying interest. The memo is made part of this order. In the light of the aforesaid memo, which is rightly filed by the learned Standing counsel appearing for the Central Government, it hardly requires to be observed that the Central Government shall take immediate steps to amend Section 20 of the Act providing for payment of interest on the security deposit made by the foreman at the scheduled bank rate of interest and to enable the foreman to draw the interest accrued on such security deposit either on the termination of the chit, of annually or on substitution of the security as per Section 20 of the Act whichever is earlier. We accordingly direct that till the necessary amendment is effected to Section 20 of the Act, the amount deposited by the foreman as security under Section 20 read with Section 4 of the Act shall carry interest at the scheduled bank rate of interest and shall be payable to the foreman either at the termination of the chit or annually or on substitution of the security as per Section 20 of the Act whichever is earlier.

32. It should further be noted that the Central Government also had the benefit of the various other State enactments, namely, Andhra Pradesh Chit Funds Act, 1971, Kerala Chitties Act, 1975, Maharashtra Chits Fund Act, 1974, and Tamil Nadu Chit Funds Act, 1961. The validity of these State enactments had been upheld earlier by the High Courts where these Acts had been enacted by the respective legislatures. The impugned Act is an improvement on these Acts, in that, there is no such provision like Section 6(2) of the Act in the Andhra Pradesh, Kerala and Tamil Nadu Acts. Likewise, there is no such provision as Section 9 of the Act in the other State Acts. Section 9(3) of the Act does not find a place in the Kerala Act. Sections 11 and 12 of the Act do not find a place in the other State enactments. Section 13 of the Act does not find a place in the Andhra Pradesh and Tamil Nadu Acts. Section 14 of the Act does not find a place in the other State enactments. Section 16(3) also does not find a place in the other State enactments. Section 19 does not find a place in the other State enactments. From these features it could be made out that the impugned Act is an improvement on the other State enactments and it comprehensively incorporates the expert opinion of the various bodies constituted by the Reserve

Bank. The Bill which preceded the impugned Act, in turn, was referred to a Select Committee and the Select Committee, after hearing all the parties concerned, including the representatives of the petitioners, had offered its considered views and they were also taken into consideration by the Parliament when they enacted the Act. After all this exercise, the challenge to the Constitutional validity of the Act on the various grounds based on the provisions of Articles 14 and 19(1)(g) of the Constitution is indeed a formidable task. We have noticed the tests of reasonableness to be applied while interpreting the provisions of Article 19(1)(g) of the Constitution. In our view, this piece of legislation was passed by the Parliament after a careful examination of the views of the persons and authorities who were concerned with, involved in and affected by chit business. Mere administrative inconvenience from which the petitioners enjoyed respite in this State because this State did nor have an Act regulating the business of chit funds and on account of which most of the petitioners transferred their business from Kerala and Tamil Nadu enjoying virtually laissez-faire conditions under which they conducted their business in this State would not be a ground to invoke the provisions of Article 19(1)(g) and Article 14 of the Constitution. It should also be seen from the report of the expert Committees that they were not in favour of continuance of the chit fund business in any form. But, they found that this was an alternative form of obtaining cheap finance since the, Banking facilities in this country have not been able to cope up with the demands of a class of persons who require credit in a small way without furnishing adequate security and, therefore, these expert bodies did not want to put an end to this business but they had recommended the complete abolition of prize chits. On their advice the Parliament had earlier enacted the Prize Chits and Money Circulation Scheme (Banning) Act, 1978. As regards this conventional chit business, the expert bodies permitted this business to be continued by formen subject to certain regulatory measures. But, there is nothing in their report to indicate that this type of business should continue for ever. Therefore, if these regulatory measures which are contained in the various provisions of the Act offer lesser incentive to persons who carry on chit fund business, they could not be treated as unreasonable restrictions on the right to carry on the said business. If these provisions offer a lesser incentive, that is because the collective wisdom of Parliament wanted this business to come to an end in due course but desired that it should continue till such time as the Bankers in this country extend credit facilities to every section of the Society which is in need of short term and easy, credit. Till that need is met by the Banks and other financial institutions, the conventional chit business will continue under the regulatory measures as contained in the impugned Act. If at all the promoters of the business want to carry on this business, they should do it under these regulatory measures. Therefore, the Court must be slow to invalidate the provisions of the impugned Act, because there is more paper work for the petitioners, mare procedure to be followed, more security to be furnished more rights have been conferred on the subscribers and more duties imposed on the foremen. The very object of the Act is to secure the interest of the poor subscribers. From the experience of hundreds of chit Companies whose business had busted in this country from time to time causing untold misery to thousands of subscribers with practically no chance of recovering the amounts subscribed by them, these provisions have been designed to protect the interests of the subscribers and they do not in any way affect the fundamental rights of the

petitioners. The very nature of chit fund business, the evils of which have been highlighted by the Expert Committees in their reports and which have been quoted extensively in the earlier part of our judgment, calls for very stringent control of this business if at all the business is allowed to continue. The provisions of the impugned Act offer the necessary safeguards to the subscribers and at the same time allow the petitioners to carry on their business without violating their fundamental rights and they strike a proper balance between the needs of the subscriber for greater protection and the right of the petitioners to carry on chit business. Incidentally, it protect the fiscal economy of the State.

33. It was further contended by the learned counsel for the petitioners that the statement of objections filed by the Central and the State Governments are absolutely bald and apart from merely asserting that the provisions of the Act are valid they do not afford any grounds for negativing the reliefs sought for by the petitioners. They also submitted that the reports of the Expert Committee are not relevant for judging the validity of the Act and the alleged malpractices in chit fund business as found in the reports do not afford a good ground to validate the Act. It was further contended that the reports of the Expert Committees do not answer the contentions of the writ petitioners since these reports do not touch upon the fundamental rights of the petitioners protected under Articles 14 and 19 of the Constitution. They relied on a decision of the Supreme Court in *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd*[8]*.,* in which, despite a hue and cry of the general public who are alleged to have been swindled by this Company and despite the alleged propaganda done by both the Government and other institutions against the Company concerned therein the Supreme Court did not find any substance in the allegations made against the Company and upheld its contentions that it is not a prize-chit business which is banned under the Prize Chits and Money Circulations schemes (Banning) Act, 1978. This argument is an argument of despair since we are not dealing with a case of prize-chit fund, but a case of conventional chit fund. Though, the Expert Committees did not and could not consider the scope of Articles 14 and 19 of the Constitution in their reports, the Court could take into consideration these reports when it is proved that the very legislation for regulation of chit fund business was enacted in the light of the recommendations of these expert bodies. The very purpose of interpreting the

[8] AIR 1987 SC 1023

provisions of the Act is to ascertain the intention of the Parliament which passed the Act and, therefore, the source material for the Act would afford a useful guidance to the Court to gather the intention of the Parliament. The restrictions imposed on persons carrying on chit business are not restrictions imposed on the basis of abstract propositions but restrictions based on the experience of the thousands of subscribers and the information gathered by the expert bodies by their personal interviews, discussions and through various mettings held by them in various centres in India and the proceedings of the Select Committee. By placing all those materials before the Court, the respondents have discharged the onus cast on them to prove the reasonableness of the restrictions complained of by the petitioners. But the petitioners have not placed any material either to rebut the presumption as to the constitutional validity of the

impugned Act or to justify their stand that the restrictions imposed by the impugned Act are either unreasonable or arbitrary.

34. To quote the Supreme Court again in *Srinivasa Enterprises v. Union of India*[9],

> "We have already indicated that the Raj Report does recommend a total ban on prize chits. In matters of economics, sociology and other specialised subjects, courts should not embark upon views of halflit infallibility and reject what economists or social scientists have, after detailed studies, commend as the correct course of action. True, the final word is with the court in constitutional matters but judges hesitate to 'rush in' where even specialists 'fear to tread' ".

For these reasons, these petitions fail and they are dismissed subject to the directions contained in para 31 of this order. We declare that the Act is within the legislative competence of the Parliament. We further declare that Sections 4(3), 6(3), 7, 8, 12, 16(2), 17(1), 19, 20, 21, 70, 76, 77 and 84 of the Act challenged in these petitions are constitutionally valid and are not violative of Articles 14 and 19(1)(g) of the Constitution.

Though we have concluded that the petitioners have failed in their challenge to the constitutionality of the impugned provisions of the Act, the implementation of the Act and the Rules may trrow up some problems specially in regard to the regulatory measures under Sections 4, 13 and 20 of the Act and, therefore, if real difficulties are experienced by the promoters foremen in complying with the regulatory measures under those provisions or any other provisions of the Act, we have no doubt that the Parliament will be responsible to those difficulties and make the necessary changes in law to redress their grievances. It should be noticed that this business of chit is prevalent in this country for over 100 years and was not subject to any regulation by, the Central enactment. The impugned Act repeals the State enactments in force in some of the States and is now applicable to whole of India. Therefore, it is all the more necessary that Parliament should be responsive to the genuine working difficulties of the petitioners if any in the matter of complying with the regulatory measures in the, impugned Act and redress their grievances by making appropriate amendments or rules wherever necessary in the interest of justice.

Parties to bear their costs in all these petitions.

Petitions dismissed.

[9] AIR 1981 SC 504