KERALA HIGH COURT

P.K. Achuthan

Vs

State Bank of Travancore

A.S. Nos. 236 and 237 of 1970

(P. Govindan Nair, C.J., V. Balakrishna Eradi and K. Bhaskaran, JJ.)

11.10.1974

JUDGMENT

Balakrishna Eradi, J.

1. From very early times chit fund transactions have been highly popular in all parts of Kerala as an indigenous system providing financing facilities in the shape of advances from the common fund repayable in easy installments and serving also as a scheme for investment and savings. The question that we are called upon to decide in these two appeals is one of vital importance for the conduct of such chit fund transactions since it concerns the legal validity and enforceability of a provision commonly found in most kuri varis and hypothecation bonds executed by prized subscribers in favor of the foreman which empowers the latter to demand immediate payment of the whole of the amounts due in respect of the future installments in a lump sum with interest at 12% per annum if default is committed by a prized subscriber in due payment of two consecutive installments. In *Raghavan v. Subbrama Sastrigal*[1], a Division Bench of this court had occasion to consider the enforceability of such a stipulation contained in a kuri variola. It was held in that case that the said provision when considered against the background of the several other clauses contained in the concerned kuri variola was "undoubtedly penal and unconscionable". These two appeals have been referred to a Full Bench since the Division Bench before which these cases came up for hearing was of opinion that the decision in 1971 Ker LT 231 which was strongly relied on by the appellant herein requires reconsideration, particularly in the light of the observations contained in the judgment of another Division Bench of this court reported in *Mathai v. Varkey*[2],

2. Before we proceed to consider the question of law that has occasioned the reference to the Full Bench it is necessary to set out a few relevant facts. The Perintalmanna branch of the Chaldean Syrian Bank Ltd. had started an annual kuri from 1-10-1949 consisting of 96 tickets of Rs. 1,000 each, the term of the kuri being 16 years. The 1st defendant had subscribed for two tickets as per pass-books Nos. 108 and 131. The 1st defendant's ticket covered by pass-book No. 108 became prized at the fifth draw and thereby he became entitled to be paid Rs. 12,500 after deducting

[1]1971 Ker LT 231
[2]1973 Ker LJ 694

the amount of Rs. 8,500 being the permanent deduction allowed to the foreman.
Defendants 1 and 2 jointly executed in favor of the Chaldean Syrian Bank Ltd. a hypothecation bond as per Ext. A-3 dated 29-6-1954 mortgaging 15 items of immovable properties by way of security for the due payment by the 1st defendant of the remaining eleven installments. On the strength of such security the prize amount was disbursed to the 1st defendant by the foreman. Similarly, in respect of the second ticket covered by the pass-book No. 131 also the 1st defendant bid the kuri at the fifth installment and prized the same at a discount of Rupees 4,725 and thereby he became entitled to receive the balance amount of Rs. 11,275. The very same 15 items of immovable properties were offered by defendants 1 and 2 as security for the said amount also and they executed in favor of the foreman Bank another mortgage deed as per Ext. A-5 dated 29-6-1954 and drew the amount. The 1st defendant paid the installments due in respect of the two tickets up to and inclusive of the eighth installment payable on 1-10-1956 but thereafter he committed default in payment of the subsequent installments. Under the terms of the two mortgage deeds, if default is committed by the prized subscriber in the matter of payment of any of the installments on the due date the amount of the installment in default together with interest at 12% per annum is to be remitted on the date on which the next installment falls due and if default is committed in payment of such amount with interest on that date also the entire balance amount due under the kuri security bond is recoverable in lump by the foreman with interest at 12% from the date of the original default. The defendants did not pay the ninth installment which fell due on 1-10-1957 in respect of both the tickets. They did not also remit the amounts in default together with interest as stipulated in the mortgage bond on 1-10-1958 when the next installment fell due. As a matter of fact, the defendants did not remit any of the installments that accrued due subsequent to 1-10-1956. While matter stood thus, all the rights, assets of the Chaldean Syrian Bank Ltd. became vested in the State Bank of Travancore as per the notification Ext. A-11 issued by the Government of India in exercise of the powers conferred by sub-sections (2) and (3) of Section 38 of the State Bank of India (Subsidiary Banks) Act, 1959. The present suit has been instituted by the State Bank of Travancore for recovery from the defendants of the entire balance amounts due under the aforementioned two mortgage bonds with interest at 12%.

3. The execution of the mortgage bonds was admitted by the defendants. They, however, contended that the plaintiff Bank had not validly acquired the rights of the Chaldean Syrian Bank Ltd. to recover the amounts due under the two mortgage bonds since only the banking assets of the Chaldean Syrian Bank Ltd. had become vested in the plaintiff under Ext. A-11. According to the defendants the conduct of kuri was not part of the banking business of the Chaldean Syrian Bank Ltd. and hence the amounts due under the kuri mortgage deeds did not fall within the category of "banking assets". Other grounds of defence put forward by the defendants were that they had paid some more installments of the kuri besides the amounts for which credit had been given to them in the plaint and that in any event the claim for interest at the rate of 12% on the consolidated amount is not sustainable in law. The 1st defendant also raised a plea that he is an agriculturist entitled to the benefit of Act 31 of 1958 and that hence he is liable to pay interest only at 5% per annum and that too for the amount of the defaulted installments only and not for the consolidated amount claimed in lump in the plaint.

4. The trial Court as per its judgment dated 31st March, 1969 overruled all the contentions put forward by the defendants and granted the plaintiff a preliminary mortgage decree for the amount claimed in the plaint with future interest at 6% and costs. By the said decree the defendants were

allowed one month's time to pay the decree amount. Since the decree amount remained unpaid even after the expiry of the said period the plaintiff applied to the lower court under Order 34, Rule 5 of the Civil Procedure Code as per I. A. No. 1676 of 1969 for passing a final decree. That application was allowed by the lower court as per its order dated 23rd December, 1969 and a final decree for sale of the properties was passed as prayed for by the plaintiff. The defendants have filed A. S. No. 236 of 1970 challenging the preliminary judgment and decree passed in the suit. A. S. No. 237 of 1970 is against the final decree dated 23rd December, 1969.

5. In the court below the defendants had not urged the contention that the provision contained in the kuri hypothecation bonds that on default being committed by the prized subscriber in payment of any of the installments at least on the date of the subsequent draw the foreman is entitled to recover from the defaulting prized subscriber the whole of the balance amount due inclusive of the amount of the future installments in a lump sum charging interest at 12% is a stipulation in the nature of a penalty and is therefore legally unenforceable; nor is the said point covered by any of the grounds raised in the appeal memoranda. The plea was taken for the first time only in this court when these appeals were argued before the Division Bench and the observations in 1971 Ker LT 231 were strongly relied on as supporting the said contention. The Division Bench was inclined to permit the appellants to raise the new plea since it involved only a pure question of law and these appeals were referred to a Full Bench since it was felt that the decision in 1971 Ker LT 231 requires reconsideration.

6. The question whether a particular stipulation in a contractual agreement is in the nature of a penalty has to be determined by the court against the background of various relevant factors, such as the character of the transaction and its special nature, if any, the relative situation of the parties, the rights and obligations accruing from such a transaction under the general law and the intention of the parties in incorporating in the contract the particular stipulation which is contended to be penal in nature. If on such a comprehensive consideration, the court finds that the real purpose for which the stipulation was incorporated in the contract was that by reason of its burdensome or oppressive character it may operate in terrorem over the promiser so as to drive him to fulfill the contract, then the provision will be held to be one by way of penalty.

7. Where a contract provides for payment of money in installments and contains also a stipulation that on default being committed in paying any of the installments the whole sum shall become payable at once, the true test for determining whether the said condition is in the nature of a penalty is to find out whether the amounts referred to in the agreement were debits in praesenti although solvenda in future or whether they were to become due to the promisee only on the respective dates when the installments were payable. If on a proper construction of a contract it is found that the real agreement between the parties was to the effect that the whole amount was on the date of the bond a debt due but the creditor for the convenience of the debtor allowed it to be paid by installments intimating that if default should be made in the payment of any installment he would withdraw the concession, then the stipulation as to the whole amount of the balance becoming payable would not be penal; if, on the other hand, on a proper consideration of the terms of the contract the court comes to the conclusion that the debt itself arises or becomes due and payable by the debtor only on the respective dates fixed for the installments the sitpulation that on default being made in the payment of any installment the whole of the balance should become due and payable would be in the nature of a penalty.

8. In *John Wallingford v. The Directors and Co. of the Mutual Society, and the Official Liquidator thereof*[3], which is the leading English case on the subject the House of Lords had to consider the question whether a provision contained in a mortgage bond executed to secure the due payment, by installments, of a sum due, making the whole amount recoverable in the event of default in payment of any installment was a stipulation by way of penalty. Rejecting the contention of the appellant that the provision was penal in nature Lord Selborne, L. C. observed thus at page 696:-

> "The real matter seems to stand thus. These mortgage bonds were given to secure the # 6000, which sum was treated as advanced, although money did not pass, and also the premiums, which would become due by installments according to the rules of the society; and the payment of which under those rules was liable to be accelerated, if any of the installments were not punctually paid. I cannot think that such an acceleration of payments has anything in common with a penalty. It was a contract for certain payments which were debits in praesenti although solvenda in future; and, being such, it is consistent both with principle and with authority to hold, that if the party who ought to have paid them, or any of them, at the proper time failed to do so, the default was his own, and the time might lawfully be accelerated for the other payments which were originally deferred. I think, therefore, that it would not be right for your Lordships in your order to give effect to that contention on the part of the Appellant....."

Based on the above dictum laid down by the House of Lords and also subsequent pronouncements by the English courts reiterating the same principle the law on the point has been succinctly summarised in Halsbury's Laws of England (third edition), Volume 3, paragraph 655 in the following terms :-

> "Where a bond is conditioned for the payment of a sum of money by stated installments and it is provided that in default of payment of any one installment the whole sum remaining unpaid shall become payable, the acceleration of the payment of the remaining installments is not a penalty, and on default in respect of any installment the entire sum may be claimed."

[3](1880) 5 AC 685

The same principle has been embodied in illustration (f) to Section 74 of the Indian Contract Act, 1872 which reads :-

> "A undertakes to repay B a loan of Rs. 1,000 by five equal monthly installments, with a stipulation that in default of payment of any installment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms".

9. Such being the legal position let us now turn to the crucial question as to what is the true nature and extent of the liability which a prized subscriber who has drawn the chit amount owes to the foreman of the kuri, for securing which the mortgage bond is executed; was the whole amount covered by the bond a debt due by the subscriber to the foreman on the date of the bond

the facility of installment payment being only a concession allowed to the debtor, or did the debt itself arise only piecemeal on the respective dates fixed for the payment of the several installments?

10. The nature and incidents of a kuri or chitty transaction have been succinctly explained in an early Full Bench decision of the Travancore High Court reported in *Bhagavathi Ammal Lekshmi Ammal v. M. Vencatasubba Iyer*[4], The Full Bench said :

> "For all practical purposes, a Chitty may be described shortly as a transaction by which a certain number of persons agree that each shall subscribe a certain sum of money or quantity of paddy by certain periodical installments and that each, in his turn, as determined by lot, should take the whole of the subscribed amount in each drawing. There is a Kuri or Chitty known as Lela Kuri or auction Chitty; in this the prize-winner is not determined by casting lots, but the total collection is put up to auction and is paid to the bidder among the subscribers who offers the largest interest in the shape of discount. Taking the first mentioned class of Chitties which appears to be the more general one in vogue (and the transaction in this suit is one of that kind), it seems that, under the arrangement above mentioned, all the subscribers get a return of the amount of their contributions so that the concern is really of mutual benefit fund and the prize-winner simply gets in his turn a loan of the common money over and above his own contribution, and neither the right of the subscribers to the return of their contributions nor to a loan of the fund is made a matter of risk or speculation. No loss appears to be necessarily hazarded, nor any gain made a matter of chance, though some of the subscribers may gain their prizes earlier than others".

Again in *Guru Narasimha Aiyer v. Muthuswamy Chidambaram*[5], the same High Court observed a follows :-

> "An ordinary Chitty however is essentially a loan transaction in which each subscriber gets a loan from a common fund, only the order of taking the loan is settled by lots and to that extent the getting of interest alone as distinguished from the principal is made to depend on chance. Further the benefit of the loan

[4]15 Trav LR 133

[5]18 Trav LR 56

> is given to all alike". Observations to the same effect have been made by the Madras High Court in *Kamakshi Achari v. Appavu Pillai*[6], and *Vasudevan Namabudri v. Mammod*[7],

11. Recently in The Commr. of *Income-tax, Kerala v. The Kottayam Coop. Bank Ltd. Kottayam*[8], a Division Bench of this court while dealing with the question that arose under Section 80-P (2) (a) (i) of the Income-tax Act, 1961 had occasion to consider whether in conducting a chit fund a co-operative society could be said to be providing credit facilities to its members. The observations contained in the aforementioned rulings of the Travancore and Madras High Courts

regarding the nature and incidents of a Kuri transaction were relied on by the Division Bench and it was held that in running the chit fund the co-operative society was providing credit facilities to its members. The following observations made by the Division Bench are relevant for our present purpose:-

> "The dominant motive which prompts most people to join chit fund schemes is to avail themselves of the facility of bidding the kuris when they are in urgent need of finance so that they may receive the chit amount in lump as a loan with the facility of repaying it in monthly installments. A chit fund does, no doubt, incidentally partake of the nature of saving scheme also. But, unless amounts are advanced to the prizing subscribes through a scheme of competive bidding or by drawing lots there will be no income derived either by way of interest or by way of amounts foregone by the bidders at the auction. Thus the chit fund is primarily intended to operate as a scheme for advancing loans from the common fund to the subscribers, their turn for getting such loans being determined either by auction or by drawing lots".

We are in respectful agreement with the dicta laid down by the Travancore and Madras High Courts in the decisions aforecited and we also fully concur with the observations made by the Division Bench in ILR (1974) 1 Ker 602 in the passage which we have extracted above.

12. From what has been said above it is manifest that what actually transpires when a prized subscriber is allowed to draw the kuri amount is the grant of a loan to him from the common fund in the hands of the foreman with the concessional facility of effecting the repayment in installments subject to a stipulation that the said concession is liable to be withdrawn in the event of default being committed in payment of any of the installments. Thus, it is really a debt in praesenti but permitted to be paid by installments the benefit of the said facility being available to the debtor only so long as the installments are regularly paid. Such being the true nature of the transaction it is evident that on a correct application of the test laid down by House of Lords in John Wallingford's case (1880) 5 AC 685, the stipulation contained in the Kuri security bond entitling the foreman to recover from the prized subscriber the whole of the balance amount due from him in a lump sum on his committing default in payment of any of the installments cannot be regarded as a penalty clause. In this context it is necessary to remember that in case of a stake-holder (foreman) of a chit

[6](1863) 1 Mad HCR 448 [8] ILR (1974) 1 Ker 602 : (1975 Tax LR 175)
[7](1899) ILR 22 Mad 21

his relation to the subscribers is of such a special nature that special necessity exists justifying stringent provisions being incorporated in the agreement for the protection of his interest. Without punctual payments by the individual subscribers the foreman will not be in a position to discharge his obligations to those who prize the kuri from time to time and hence it is necessary that he should reserve to himself powers to enforce such payments. It is in furtherance of this objective of ensuring prompt payments that the stipulation is incorporated in the bond empowering the foreman to recover in a lump sum the entirety of the balance amount due in respect of the future installments on default being committed by a prized subscriber in prompt payment of any of the installments. We are clearly of opinion that in the context of the special features and incidents of the chit fund transactions such a stipulation in a kuri vari or chitty

hypothecation bond cannot be regarded as unconscionable or penal.

13. The High Court of Travancore had consistently upheld the validity and enforceability of similar provisions contained in chitty blonds providing for the recovery of all the future installments in a lump sum in the case of default by a prized subscriber in payment of any installment. We may usefully extract the following passage from the decision reported in *Subrahmonia Iyer Venkitasubrahmoni Iyer v. Kanakku Padmanabhan Velayudhan*[9] wherein the learned Judges have referred to the earlier unreported rulings of the same High Court:-

> "The foreman of a Chitty has responsibilities and duties which he cannot discharge properly, if the prized subscribers are not punctual in the payment of their subscriptions as they fall due, and the relation between the foreman and a prized subscriber is in effect, that of lender and borrower. The lender may impose any terms upon the borrower in regard to the mode of repayment of the money borrowed and installment bonds which contain a stipulation for payment of the whole sum due in case of failure to pay any one installment are often enforced by the courts. No valid distinction in principle exists between a stipulation of the above nature in an ordinary installment bond and that in chitty transaction, but the point need not be discussed at any great length as the question is concluded by authority. A Full Bench of this Court has held in A. S. No. 158 of 1069 that a stipulation of the kind in a Chitty bond is not penal and this decision has been followed in other cases in this Court (A. S. No. 60 of 1070)."

The above decision was subsequently followed in *Krishnen Ramen v. Ramen Aiyappen*[10]*,*

14. The Madras High Court has also expressed the same view in a long series of decided cases wherein the said question had directly arisen for consideration before that court. In *Vaithinatha Iyer v. Govindaswami Odayar*[11]*,* Old field and Ramesam, JJ. referred to the special nature of the relationship that exists between the stake-holder and the subscribers of a chit fund and upheld the validity of a provision contained in the kuri agreement that prized subscribers who failed to pay their

[9] 15 Trav LR 182 [11] AIR 1922 Mad 67
[10] 21 Trav LR 52

subscriptions were liable to pay the whole amount on demand with interest at
1=% per mensem. The contention that the said stipulation was in the nature of a penalty was rejected by the learned Judges following the view taken in an earlier unreported decision of the same court in S. A. No. 23 of 1902. The same principle was subsequently reiterated by Venkatasubba Rao, J. in *P. Sankuni Menon v. Empire of India Life Assurance Co., Ltd., Bombay*[12] and by Anantakrishna Ayyar, J. in a very illuminating judgment in *M. Kunju Nair v. Narayanan Nair*[13]*,* Even though a dissenting note was struck by Srinivasa Aiyangar, J. in two cases decided by the learned Judge sitting singly - *Ramalinga Adayiar v. Meenakshi-sundaram Pillal*[14] and *Subbiah Pillai v. Shanmugam Pillai*[15]*,* - the latter decision was reversed on Letters Patent Appeal by a Division Bench consisting of Beasley, C., J. and Bardswell, J. in *Subbiah Pillai v. Muthiah Pillai*[16]*,* The Division Bench approved the dictum laid down in AIR 1922 Madras 67, and held that the provision entitling the foreman to recover from a defaulting prized subscriber the amount of the future installments in a lump sum is not a penal one. The said decision AIR 1933 Madras

657 was subsequently followed in *Ayyakannu Pillai v. Doraiswami Pillai*[17] *P. N. Raghavan Patter v. S. Arumugham*[18], and *Perivatan Katanhipalli Kannan Nambiar v. Ullannur Madathil Subramania Pattar*[19],

15. The Chief Court of Cochin had also taken the view that such a provision in a kuri bond does not amount to a penalty. In *Madhava Menon v. Chuppan Chettiar*[20], it was observed thus:-

> "When regard is had to the nature of a kuri, it is impossible to regard such a provision as a penalty".

16. It is thus seen that in holding that the impugned provision is not a penalty clause we are not cutting any new ground but only restating a principle that had been laid down several decades ago by eminent Judges of the Madras and Travancore High Courts and of the Chief Court of Cochin.

17. Any question as to the unconscionableness of a stipulation contained in an agreement would properly arise for consideration only if it is shown that the relationship between the contracting parties was such that one of them was in a position to dominate the will of the other and that he had made use of such position to obtain an unfair advantage over the other. It is only in cases where both the conditions mentioned above are clearly established by the person who seeks to avoid the transaction and the court further finds that the bargain is in itself unconscionable that the impugned provision will be held to be unenforceable on the ground of unconscionableness. See *Poosathurai v. Kannappa Chettiar*[21], *Ladli Parshad Jaiswal v. The Kernal Distillery Co., Ltd. Karnal*[22], and *Subhas Chandra Das Mushib v. Ganga Presad Das Mushib*[23], If people with their eyes open choose wilfully and knowingly to enter into a contractual transaction the court will not step in to relieve them of their obligations under such contract on the ground that the terms thereof are unconscionable.

[12] AIR 1932 Mad 241
[13] AIR 1933 Mad 252
[14] AIR 1925 Mad 177
[15] AIR 1928 Mad 245
[16] AIR 1933 Mad 657
[17] AIR 1933 Mad 725
[18] AIR 1935 Mad 385
[19] AIR 1941 Mad 231
[20] 7 Coch. LR 437
[21] ILR 43 Mad 546
[22] AIR 1963 SC 1279
[23] AIR 1967 SC 878

18. We are unable to see how the foreman conducting a chit fund transaction can be said to be occupying any position of vantage which would enable him to dominate the will of a subscriber. Persons join as subscribers in a chit fund of their own free will. After having knowingly and voluntarily agreed to abide by the rules and conditions of the kuri they cannot be heard to contend that they should be relieved of their obligations under the chit fund transaction on the ground of alleged unconscionableness of the bargain.

19. All that we have said while dealing with the stipulation for recovery of all the future installments due by a defaulting prized subscriber in a lump sum are equally applicable in respect of the provision contained in the bond making the prized subscriber liable for interest at 12%. As already pointed out, the relationship between the foreman and the subscribers in a chit fund transaction is of such a nature that there is special necessity and justification for making stringent provisions for the protection of the interests of the foreman. Viewed against such background, the provision for interest at 12% cannot be regarded as unconscionable. In AIR 1922 Madras 67, a

similar stipulation for payment of interest at 1= per cent per mensem was upheld by the court. An even more stringent provision requiring the defaulting prized subscriber to pay the whole amount in a lump sum with interest at 2 per cent per mensem was upheld in AIR 1933 Madras 252. If a prized subscriber defaults in prompt payment of his subscriptions the foreman will be obliged to find an equivalent amount from other sources for the purpose of meeting his obligations for payment of the kuri amount to the other members who prize the kuri at the subsequent auctions or draws. For raising such amount the foreman may have to pay high rates of interest and this is a relevant aspect to be taken into account in deciding about the reasonableness of the stipulation that the defaulting subscriber shall be liable to pay interest at 12 per cent. We are unable to see any legal principle on the basis of which we will be justified in holding that such a stipulation is penal and unenforceable.

20. It appears to us on a close reading of the judgment of the Division Bench in 1971 Ker LT 231, that the observations found therein that the provisions of the kuri vari empowering the stake-holder to collect from the defaulting prized subscriber the entire future installments in lump with 12 per cent interest amounted to unconscionable stipulations in the nature of a penalty were made by the learned Judges only in the context of the peculiar facts and special circumstances of that case. We do not think that the Division Bench intended to lay it down as a principle of general application that such stipulations occurring in kuri varis or chitty security bonds have to be regarded as penal in nature. The correct legal position governing the matter has already been explained by us in detail in the preceding paragraphs. We need only say, with respect that to the extent to which any of the observations in 1971 Ker. L. T. 231 are inconsistent with the principles enunciated in this judgment those observations cannot be regarded as laying down correct law.

21. In the light of the preceding discussion it must be held that there is no merit in the contention raised on behalf of the appellants that the provision contained in the bonds Exts. A3 and A5 entitling the foreman Bank to recover from the appellants in a lump sum the whole of the balance amount due under the kuris inclusive of the amounts of the future installments with interest at 12 per cent amounts to a penalty and is not legally enforceable. We hold that the said provision is perfectly valid and enforceable in law. The other objections which had been put forward by the appellants (defendants) before the courts below were not pressed before us.

22. In the result, the judgment and decrees passed by the court below will stand confirmed and these appeals are dismissed with costs.
Appeals dismissed.