Tamil Nadu Protection of Interest of Depositors (In Financial Establishments) Act, 1997-Constitutional Validity

(Judgement dated September 8, 1999 of the Madras High Court in Writ Petition Nos. 4157, 4158, 5932, 7576, 7577, 7976, 7977, 8254, 86911, 16711, 20244 and 20748 of 1998, 4467, 4819, 4887 and 12375 of 1999)

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The constitutional validity of the Tamil Nadu Protection of Interest of Depositors (in Financial Establishments) Act, 1997 (Tamil Nadu Act XIV of 1997) has been upheld by the Madras High Court by its judgement dated September 8, 1999, in a group of writ petitions under Article 226 of the Constitution. The decision assumes significance as similar Acts are being enacted by various State Legislatures for protection of interest of depositors in financial establishments.

I. The Scheme of the Act

1. The object of the Act is to regulate the activities of financial establishments which are not covered under the Reserve Bank of India Act, 1934. The Objects and Reasons to the Bill states that there has been mushroom growth of such financial establishments in the State which have been formed with the sole object of grabbing the deposits of the public, received on the promise of extraordinary interest. The Act provides for stringent measures against such establishments.

2. The Act defines the term "deposit" to mean "the deposit of a sum of money made with a Financial Establishment for a fixed period, for interest or return of any kind". The term "Financial Establishment" is defined to mean "an individual, an association of individuals or a firm carrying on the business of receiving deposits under any scheme or arrangement or in any other manner but does not include a company registered under the Companies Act, 1956 or a corporation or a co-operative society owned or controlled by any State Government or the Central Government, or a banking company as defined under Section 5 (c) of the Banking Regulation Act, 1949 or a non-banking financial company as defined in clause (f) of Section 45-I of the Reserve Bank of India Act, 1934...".

3. The main objection was centered around Sections 3 and 5 of the impugned Act which read as follows :

> "3. **Attachment of properties on default of return of deposits**
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> Notwithstanding anything contained in any other law for the time being in force —
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> (i) where, upon complaints received from a number of depositors, that any Financial Establishment defaults the return of deposits after maturity, or
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> (ii) where the Government have reason to believe that any Financial Establishment is acting in a calculated manner with an intention to defraud the depositors,
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> and if the Government are satisfied that such Financial Establishment is not likely to return the deposit, the Government may, in order to protect the interest of the depositors of such Financial Establishment, pass an ad-interim order attaching the money or other property alleged to have been procured either in the name of the Financial Establishment or in the name of any other person from and out of the deposits collected

by the Financial Establishment, or if it transpires that such money or other property is not available for attachment or not sufficient for repayment of the deposit, such other property of the said Financial Establishment or the promoter, manager or member of the said Financial Establishment, as the Government may think fit and transfer the control over the said money or property to the Competent authority".

"5. **Default in repayment of deposit and interests honouring the commitment**

Notwithstanding anything contained in Chapter II, where any Financial Establishment defaults the return of the deposit or defaults the payment of interest on the deposit, every person responsible for the management of the affairs of the Financial Establishment shall be punished with imprisonment for a term which may extend to ten years and with fine which may extend to one lakh of rupees and such Financial Establishment is also liable for fine which may extend to one lakh of rupees".

4. The Act confers the power on the Government to attach the properties of Financial Establishment which are not likely to return the deposits. It also provides for the appointment[1] of competent authority by the Government with power to exercise control over the properties attached under Section 3 and for the establishment of special Courts[2] in the cadre of a District Judge with exclusive jurisdiction in respect of any matter of which the provisions of the Act apply. Cases pending in any court are to be transferred to the special court. On the application of the Competent Authority, the Special court has the power to pass necessary orders and directions for the equitable distribution, among the depositors, of the money realised from out of the property attached[3]. The Special Court has the power to make an order of attachment absolute or to vary it. Persons who have any interest in the property attached can file objection before the Special Court on a notice being issued by it or otherwise[4]. Appeal against the Orders of the Special Court lie before the High Court and a person aggrieved by an order of the Special Court, including the Competent Authority, can appeal within thirty days from the date of the Order[5].

II. Brief Facts

All the writ petitions arose from identical facts. The petitioners were doing the business of accepting deposits from the public and investing the same in the real estate market etc. Because of the adverse trend in financial market, the depositors started demanding the deposits which prevented the petitioners, who had no intention to cheat anybody, from utilising the funds for developing the property as originally planned. A few persons from the depositors threatened to take action under the impugned legislation.

III. Argument of the Petitioners

The challenge on the constitutionality of the Act is mainly on the ground of legislative incompetence of the State under Article 246 of the Constitution. It was contended that the businesses done by them comes under "banking" within Entry 45 in the Union List of the Seventh Schedule to the Constitution and hence the State was not competent to enact the impugned enactment. The petitioner sought to rely on the judgement of the Hon'ble Supreme Court in *T. Velayudhan Achari vs. Union of India*[6] in which the Hon'ble Supreme court had upheld the judgement of the High Court of Delhi in *Kanta Mehta vs. Union of India*[7] wherein it was held that the "business of acceptance of deposits from the public falls within Entry 45 or in any case under Entry 97 of List I of the Seventh Schedule". It was further contended that in view of the Reserve Bank of India Act, 1934

as amended by the Reserve Bank of India (Amendment) Act, 1997, the impugned Act is not at all necessary and that the same is repugnant to the provisions of the RBI Act. It was also contended that the Act makes a distinction between individual and firms on the one hand and Companies and Corporations on the other hand. Another contention was that after attachment of the properties of a person under Section 3, Section 5 may also be invoked, in which case, it will be absolutely impossible for such a person to make any payment towards deposits or interest. Section 5 of the Act provided for punishment of 10 years for a civil liability and even for a non-payment of Rs. 1/-, imprisonment of 10 years may be given. Hence it was alleged that unguided power has been conferred on the Government under the Act. In short, the validity of the said sections were challenged on the ground that the same violates Articles 14, 19(1) (g) and 21 of the constitution.

IV. Arguments of the State

The State of Tamil Nadu contended in its counter that there had been a mushroom growth of Financial Establishments in the State with the sole object of grabbing money received as deposit from the public, particularly from the middle class and poor without any obligation to refund the same on maturity. It was submitted that the Reserve Bank of India Act is only to regulate monetary stability in India and deals with various monetary systems for the Indian monetary system and the banking business have to be carried out in accordance with the RBI Act and that the impugned Act is intended to safeguard the interest of depositors by providing stringment measures against those who deprive the depositors of their dues. It was contended for the State that the impugned legislation comes under Entry 32 in List 2 which deals with "un-incorporated trading".

V. The Findings

The Court held that even though there is a prohibition/restriction in the Reserve Bank of India Act, against acceptance of deposits by unincorporated entities, since there no provision for recovery of matured debts and no effective remedy against persons committing default, the State Act was passed in order to see that crores of deposits deposited with such establishments are recovered and distributed to the general public. Accordingly, Court rejected the allegations that the impugned Act violated Article 14, 19 (1) (g) and 21 of the Constitution. The Court was of the view that in view of the elaborate procedure laid down in the Act to attach or release the property or to cancel the order of attachment or to go on appeal to the High Court, the provisions were not arbitrary or unguided. It was held that the impugned legislation came under Entry 32 in List II of the VII Schedule and was within the competence of the State Legislature and that though it trenches into certain other enactments upon which the State Legislature is not competent. Taking note of the object of the Act and the fact that the assent of the President was obtained, the Court held that the State Legislature was competent to pass the impugned Act and the same is valid in all respect. However, the Court said, "if there is any hurdle or difficulty in the proper implementation of the Act, I believe and trust that undoubtedly the Legislature would make suitable amendments then and there".

VI. Conclusion

Sub-section (1) of Section 15 of the Act, enables the Government to make rules to carryout the provisions of the Act. The State Government has made "Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Rules, 1997" under the Act. Rule 7 so framed by the Government lays down that when an ad-interim order

attaching the money or other property of a Financial Establishment is made by the Government under section 3 of the Act, such money or property referred to in the order shall not be transferred to any other person by any mode whatsoever and if any such transfer is made, it shall be void. The question whether the rule making power conferred by the statue will empower the Government to make such a provision, which the Legislature has in its wisdom not provided for, is debatable. Though the said Rule is referred to in the judgement, it appears that no challenge against the same was advanced by the bar in that respect. In any view of the matter, the challenges against similar Acts passed by the various State Legislatures are bound to result in interesting case law in the times to come.

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1. S. 4.
2. Section 6.
3. Sec. 6 (4).
4. S. 7.
5. S. 11.
6. (1993)2 SCC 582.
7. (1987) (62) Comp. Cas. 769.