From The Editorial Desk

Two decades ago when a borrower pleaded before the Supreme Court of India for reddressal of his grievance for denial of release of loan sanctioned by a State Financial Corporation ["the Corporation"] established under the State Financial Corporations Act, 1951, the Apex Court came down very heavily on the Corporation for unreasonable conduct and arbitrariness of action. According to the Apex Court when on the solemn promise of the lender, the borrower has acted upon and incurred huge expenditure, the borrower cannot be made to suffer and the lender can be compelled to release loan sanctioned. The lender's action can be struck down as contrary to solemn contract in discharge and performance of a statutory duty. The writ could be issued on the well-known administrative law principle of promissory estoppel.

The true principle of promissory estoppel, according to the Apex Court, seems to be: where one party has by his words or conduct made to the other a clear and unequivocal promise which is intended to create legal relations or affect a legal relationship to arise in the future, knowing or intending that it would be acted upon by the other party to whom the promise is made and it is in fact so acted upon by the other party, the promise would be binding on the party making it and he would not be entitled to go back upon it, if it would be inequitable to allow him to do so having regard to the dealings which have taken place between the parties, and this would be so irrespective of whether there is any pre-existing relationship between the parties or not.

Two decades later, once again a borrower looked to the Honorable Supreme Court to come to its rescue on the ground that the lender and the borrower have fiduciary relationship. As partners in business, the lender is in the position of a trustee and the lender is not expected to act like any other individual moneylender. The Apex Court did not oblige the borrower. It noticed that the relationship of the Corporation and the borrower is that of a creditor and debtor. That basic feature cannot be lost sight of. A Corporation is not supposed to give loan and then to write off as bad debt and ultimately go out of business! Fairness cannot be a one-way street!! And the fairness required of the Corporation cannot be carried to the extent of disabling the lender from recovering what is due to them!!! Readers would be interested in these cases which are a good study in contrast [Gujarat State Financial Corporation v. Lotus Hotels 1983 (3) SCC 379 & Haryana Financial Corporation v. Jagdamba Oil Mills 2002 (3) SCC 496]

We begin this issue with an article on bankruptcy of banks under the Indian laws. Another article deals with the legal challenges before the urban co-operative banks. In the Guest Column, we have the pleasure of presenting the views of Hon'ble Justice Shri A.B. Palkar on judicial review with the specific reference to administrative action or executive fiat.

In the Judgments Section, we have included a variety of judgments of different High Courts and the Supreme Court on topics of interest to bankers. The legislation section covers some of the recent enactments like Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, the Legal Services Authorities (Amendment) Act, 2002 and the Consumer Protection (Amendment) Act, 2002. In the Book Review and Bibliography Section, we have reviewed a book on Credit Derivatives and Synthetic Securitisation by Shri Vinod Kothari. The Bibliography Section as usual covers recent articles on law of interest to bankers. In FAQ, we have clarified some of the queries on electronic cheques and truncated cheques. Apart from the

above, we have all our usual features like LD News and Mail Bag.

M.A. Batki

Legal Adviser

Journal Section

Bank Bankruptcy - Under the Indian Laws*

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Banks operating in India fall in the following categories :

1. Private banks incorporated under the Companies Act;
2. Public sector banks which are governed by the statutes of their incorporation;
3. Foreign banks
4. Cooperative banks

Depending on the category to which a bank belongs, different rules apply when it goes bankrupt.

Bank bankruptcy – what it means?

2.1 In common parlance, bankruptcy is understood as a person's status declared in law as unable to pay his debts. As a matter of law, Bankruptcy Acts define fully and precisely **what acts or defaults by a debtor,** will render him liable to be made a bankrupt, that is, to have his property taken into possession by the Court, and equitably distributed *pro rata* among his just creditors. They are not only confined to acts or defaults which are *indicia* of insolvency; but also embrace acts and defaults which evince an intention on the part of the debtor to deprive his creditors of their remedy against his person or his estate. Corporate Bankruptcy may similarly mean a corporate's **inability to pay its debts.**

2.2 In the case of a bank, there may be **no overt act or** default which may be an invariable indicia of bankruptcy; nor there may be such an act or default evincing an intention on its part to deprive its creditors, that is, its depositors. It **may be a situation reached during the course of its business.** The question therefore would be: when a bank can be said to be unable to pay its debts? In India, a **legal fiction** for the purpose is incorporated in Section 38 (4) of the Banking Regulation Act, 1949 (the BR Act). It provides that a banking company shall be deemed to be unable to pay its debts if it has refused to meet any lawful demand made at any of its offices or branches within two working days, if such demand is made at a place where there is an office, branch or agency of the Reserve Bank, or within five working days, if such demand is made elsewhere, and if the Reserve Bank certifies in writing that the banking company is unable to pay its debts. Therefore, mere refusal to meet the demand within specified period does not *per se*

amount to inability to pay, unless it is **further certified** by the Reserve Bank as prescribed. There does not appear any instance at least in the recent past–where a bank is proceeded against on the basis of the certificate issued by the Reserve Bank. On the other hand, there could be a situation warranting action on the ground of inability to pay, though there is no refusal as contemplated by the statutory provision *ibid.* It is not merely a problem of liquidity, but a situation where the bank's liabilities outstrip its assets.

2.3 Then, what could be the **considerations to conclude** that a banking company is unable to pay its debts? **Erosion of capital, which has the potential to lead to erosion of deposits,** may be construed as a relevant consideration for the purpose. It is pertinent to note that the capital requirement for a banking company is stipulated with reference to the aggregate value of its paid up capital and reserves. "Value" for the purpose has been defined to mean the real or exchangeable value, and not the nominal value which may be shown in the books of the banking company concerned. Accordingly, erosion in the real value of the paid up capital of a banking company may validly be reckoned as a relevant factor while considering if the banking company should be treated as unable to pay its debts.

2.4 Needless to state that erosion in the real value of the paid up capital of a banking company is prejudicial to the interest of depositors. Interestingly, BR Act permits action against a banking company whose continuance is prejudicial to the interest of depositors. Therefore, when the real value of the paid-up capital of a banking company is eroded and hence it is unable to pay its debts, it may be proceeded against on the ground that on these considerations, **its continuance has become prejudicial to the interest of depositors.**

Consequences of inability to pay

3. Inability to pay the debts may lead to the following actions –

a) Liquidation or winding up of the banking company;

b) Amalgamation/Reconstruction

Liquidation/Winding up

4.1 In the case of private sector banks (referred to as banking companies), the law is contained in the BR Act and the Companies Act, 1956. The latter Act enshrines the general Corporate Law in India. The Act contains elaborate provisions relevant for a company bankruptcy. The provisions prescribe the modes of winding up; circumstances in which a company may be wound up; appointment of official liquidator and his powers; provisions applicable to compulsory and voluntary winding up; proof and ranking of claims; preferential payments; etc.

4.2 Provisions contained in the Companies Act are modified by the BR Act in their application to the companies conducting banking business with a proper authorisation. **BR Act is a special legislation** and its provisions prevail over the provisions of the general law, namely the Companies Act. Special provisions in the BR Act relate to the circumstances in which a banking company may be wound up; appointment of official liquidator; proof of claims. Part IIIA of the

Act further contains special provisions for speedy disposal of winding up proceedings which *inter alia* include power of the High Court to decide all claims in respect of banking companies; settlement of list of debtors; special provisions to make calls on contributories; documents of banking company to be evidence; public examination of directors and auditors; assessment of damages against delinquent directors; etc.

Main features of these provisions may be noted as under :

4.3 Section 38 of the Banking Regulation Act provides for winding up by High Court. In terms thereof, the High Court shall order the winding up of a banking company –

(a) if the banking company is unable to pay its debts; or

(b) if an application for its winding up has been made by the Reserve Bank under Section 37 or Section 38.

4.4 Sub-section (3) of Section 38 lays down the circumstances in which Reserve Bank may make an application for the winding up of a banking company. One of the circumstances is that the continuance of the banking company is prejudicial to the interest of its depositors.

4.5 Judicial interpretation of Section 38 by the Supreme Court of India is that when an application is made by the Reserve Bank for winding up of a banking company, the **High Court has no discretion** in the matter and it is bound to make winding up order.

4.6 Another significant feature of the legislative scheme is that on an application made by the Reserve Bank in this behalf, the Reserve Bank, the State Bank of India or any other notified bank or any individual shall be appointed as **the official liquidator** of the banking company.

4.7 After the application is made and after preliminary hearing the application is admitted and a liquidator/provisional liquidator is appointed, the conduct of proceedings thereafter **does not require involvement of the Reserve Bank,** unless specifically required by the High Court. The provisions dealing with liquidation do not cast any further obligation on the Reserve Bank in the matter of liquidation, and the only part that the Reserve Bank has to play is provided in Sections 45P and 45Q of the Act. Section 45P makes it lawful for the Reserve Bank to tender advice to the liquidator when he is directed by the High Court to obtain such advice. Section 45Q requires the Reserve Bank, on being directed so to do by the Central Government or by the High Court, to cause an inspection to be made of a banking company which is being wound up.

Re : Public sector Banks

5. Public Sector Banks are the nationalised banks whose capital is held by the Central Government; State Bank of India (SBI) whose majority shareholding is in the hands of the Reserve Bank; and the SBI Subsidiary/Associate banks whose capital is held by SBI. These banks are constituted by or under special legislation and are governed by the provisions of the statue of their constitution. These statutes do not contain detailed provisions as regards liquidation of these banks. In any case, the provisions of the Corporate Law governing the

banking companies do not apply to the public sector banks **governed by their own statute of incorporation.** There has been no instance of a public sector bank having been taken into liquidation.

Re : Foreign banks

6.1 For the purpose of BR Act, a banking company includes a foreign bank, that is, a company incorporated outside India and having established a place of business (branch) within India. The BR Act does not maintain any distinction between an Indian bank and a branch of a foreign bank in the matter of applicability of the winding up provisions. Therefore, it is within the ambit of the legislative scheme of the BR Act to take a foreign bank into liquidation on the grounds on which, and in the circumstances in which, a banking company can be taken into liquidation.

6.2 As regards liquidation of a 'foreign bank' operating in India, the important question relates **to discharge of its liabilities in India.** Where its liabilities in India exceed its assets in India, the overseas parent company is obliged to bring funds for meeting the liabilities in India. It is when the overseas parent company fails, leading to the failure of the branch in India, the question arises as regards merging Indian assets and liabilities of the branch in India with the global assets and liabilities of the overseas parent company. The legal position in India in this area is not much developed, as there has been no judgement in which these issues have been considered by an Indian Court. The legal proposition laid down by the Supreme Court that the Indian law does not discriminate between foreign and Indian creditors was in the context of liquidation of a non-banking company. In the solitary instance of BCCI, this issue among several other issues, was canvassed before the High Court but had not been considered in view of transfer of assets and liabilities of the BCCI's Indian branch to a subsidiary formed by State Bank of India.

Re : Co-operative Banks

7. In the field of co-operative banking sector, the problem is peculiar due to the system of dual control over the functioning and affairs of these banks. While regulation of their banking business falls within the exclusive jurisdiction of Reserve Bank, the non-banking areas relating to incorporation and registration of co-operative societies, their management and control thereon are the matters falling within the jurisdiction of authorities under the State Laws. There has been a statutory mechanism developed whereunder Reserve Bank is able to exercise some control over these banks in the matters of amalgamation, reconstruction, supersession of board of management, albeit indirectly through the authorities under the State Laws. Accordingly, the Reserve Bank may require the state authority to take a co-operative bank into liquidation and it is obligatory on the part of state authority to do so. Where a co-operative bank is found to have become unable to pay its debts, Reserve Bank may require its liquidation by the state authorities.

Amalgamation

8.1 Amalgamation may be compulsory or voluntary. The BR Act empowers the Reserve Bank, on being satisfied that there are good grounds so do, to apply to the Central Government for imposition of moratorium on a banking company and during the period of moratorium, prepare a scheme of its amalgamation or reconstruction. In terms of these provisions, a banking company

can be amalgamated with only another banking company or a public sector bank. Amalgamation is always with a financially strong bank, and all deposit liabilities being transferred to the transferee bank, interests of the depositors are fully protected in such a scheme.

8.2 Voluntary amalgamation between two banking companies needs to be sanctioned by the Reserve Bank which however cannot sanction the same unless approved by the requisite majority shareholders of each of the banks.

8.3 While the law permits voluntary amalgamation of a banking company with a non-banking company, there is no role assigned by any statute to the Reserve Bank in such a case, unless the Court involves the Bank in the amalgamation proceedings.

8.4 A private sector bank can be amalgamated with a public sector bank being a nationalised bank, or *vice versa*. There has been a single instance of amalgamation of two nationalised banks in 1986.

8.5 In the co-operative banking sector, a cooperative bank can be amalgamated with only another co-operative bank. This is because that amalgamation is effected under the provisions of the State Co-operative laws. The amalgamation however requires prior approval of the Reserve Bank when one of the co-operative banks is an insured bank.

Role of the Reserve Bank

9. Reserve Bank being a **'State'** for the purpose of enforcement of fundamental rights guaranteed under the Constitution of India, its actions are **amenable to the writ jurisdiction** of the High Courts of the States and the Supreme Court of India. Reserve Bank's actions in taking a bank in liquidation, or placing it under moratorium are challenged mostly on the grounds of denial of opportunity of hearing amounting to infringement of principles of natural justice. Though there is a significant number of Court decisions on the subject, those are mostly based on the facts of those cases, and no conclusive principle can be deduced thereform to the effect that the Reserve Bank is bound in law to provide an opportunity of hearing. The Reserve Bank's legal stand has been that the statute conferring these powers on the Reserve Bank does not expressly provide for opportunity of hearing before the action is taken, and that no requirement for affording such opportunity can be inferred from the statutory provisions. There are a few Court judgements endorsing this stand of the Reserve Bank. It may also be mentioned that the Reserve Bank's recourse to amalgamation or liquidation is only in exceptional circumstances which warrant the action, and is supported by the material which is germane, sufficient and relevant to sustain its validity on the touchstone of legal principles.

Every one wants to live at the expense of the state. They forget that the state lives at the expense of everyone.

-Frederic Bastia

Urban Co-Operative Banks Tottering to Survive - Legal Challenges Ahead*

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1. INTRODUCTION

"Madhavpura Bank scam: coop banks under cloud"[1]

"Seven banks lost Rs 262 crore in gilts scam"[2]

"Disturbing trend"[3]

"Charminar Co-operative Urban Bank Chairman attempts suicide"[4]

"Burgeoning problems of co-operative banks"[5]

"AP urban co-op banks in a mess, says expert panel"[6]

"Maharashtra probing all co-operative banks"[7]

"Regulator Imperative For Urban Co-Op Banks: RBI"[8]

A cursory glance of the above news clippings leaves the impression that the crisis in the cooperative banking sector has become serious in the last couple of years and the Reserve Bank of India being a regulator is responsible for the evaporation of poor man's, funds from the Urban Co-operative Banks (UCBs). At the end of March 2002, the number of UCBs stood at 2,090 (inclusive of 89 salary earners' banks and 130 banks under liquidation). Of these, 52 banks were scheduled UCBs spread across the States of Andhra Pradesh, Goa, Gujarat, Karnataka, Maharashtra and Uttar Pradesh.[9]

During 2001-02, the RBI had placed 13 cooperative banks under liquidation in the State of Gujarat,[10] as per the recommendations of the High Powered Committee to place sick companies under moratorium/liquidation as also their automatic winding up. As at March-end 2002, there were 285 identified weak UCBs compared to 249 the previous year-end. During 2001-02, 119 weak banks could not comply with the minimum capital requirement as laid down by Section 11(1) of Banking Regulation Act (1949).[11]

These statistics further establishes the fact that the urban co-operative bank sector has been badly affected recently.[12] The common modus operandi adopted by the management of the majority of the banks is investment in gilt transactions and access to brokers. On top of the series of scams involving cooperative banks starting with the Madhavapura Cooperative Bank in Ahmedabad, the Krushi Cooperative Bank in Hyderabad and more recently the Nagpur District Central Cooperative Bank, the involvement of some urban cooperative banks in Maharashtra in the Home Trade scam involving fraudulent dealing in gilt through brokers has been revealed. A few days back, the Board of Directors of the Amravati People's Cooperative Bank in Vidarbha, which lost Rs 9.5 crore in the raging gilt scam, has been dissolved by the State cooperative department. It is the fifth cooperative bank in the State to face the axe following involvement in the gilt scam.[13]

At present, Co-operative Societies are under the dual control of Reserve Bank of Inida and the Registrar of Co-operative Societies. Under this system, the Reserve Bank of India only has jurisdiction over the banking operations of the cooperative society while the registrar looks after the managerial and administrative functions. State Governments being not liked by the Reserve Bank of India control have recently adopted a trend to enact legislations creating para banking institutions. To quote for instance, Andhra Pradesh Mutually Aided Co-operative Societies Act, 1995 and Karnataka Souharda Sahakara Act, 1997. These legislations allow the societies to accept deposits from non-members with cheque facility.

Banking business involves financial intermediation and it plays a key role in the mobilization and distribution of country's savings. A failure of a bank may cause financial crisis with the cascading effect on many other banks, financial institutions, other societies and members of public at large. Collapse of a bank may ruin the life savings of a vast multitude of depositors. It is for these reasons that a critical study has been undertaken in the current paper to analyze the constitutional, legal and extra-legal factors influencing the sickness of the urban banks in the recent past and measures taken by the Reserve Bank of India to create the confidence of the depositors and public at large.

2. CONSTITUTIONAL AND LEGAL PROVISIONS

2.1 CONSTITUTIONAL PROVISIONS

In terms of Article 246 of the Constitution, the field of exercise of legislative powers is divided into three areas, (i) exclusively reserved for the Union of India and referred to as the "Union List", (ii) exclusively reserved for the States and referred to as the "State List" and (iii) those left for both and referred to as the "Concurrent List".

These areas of Legislation are indicated by Entries in List I, II and III respectively, of the VII Schedule to the Constitution. The Cooperative Credit Societies doing banking business fall, to a certain extent in the area exclusively reserved for the Union and to a certain extent, in the area exclusively reserved for the States. This results in the duality of jurisdiction over cooperative banks both by the Reserve Bank of India, in terms of the Banking Regulation Act, 1949 and the Registrar of Cooperative Societies, in terms of the Cooperative Societies Act, of the State concerned. Entries 43[14] and 45 in the Union List and the Entry 32[15] of the State List are the relevant Entries in this regard.

2.2 LEGAL PROVISIONS

2.2.1 BANKING REGULATION ACT, 1949 (AACS)

Reserve Bank has been empowered under the Banking Regulation Act, 1949 (AACS) to regulate the affairs of the cooperative banks. Section 5 (CCV) read with Section 22 of the Act, provides that in case a primary credit society's share capital and reserves reaches the level of Rs.1 lakh, it gets automatically converted into an urban cooperative bank. Section 49A of the Act permit a primary credit society to function as a primary cooperative bank even if it is not licensed. In

view of this, primary cooperative societies are allowed to carry on banking business and the used words Bank, Banker and Banking. Section 7 of the Act prohibits Cooperative Society other than a cooperative bank from using any of the words Bank, Banker or Banking unless it uses as part of its name at least one of such words. Section 22 of the Act empowers the Reserve Bank to grant licence subject to the condition mentioned therein. Section 23 deals with the restrictions on opening of new and transfer existing places of business. Section 35 empowers the Reserve Bank to conduct inspection of the cooperative banks. Under Section 35A Reserve Bank may issue direction in the interest of the public to prevent the affairs of any cooperative bank and Section 46 and 47 deals with imposing penalty and conducting prosecution against the bank for contravention of provisions of B.R. Act.

2.2.2 DEPOSIT INSURANCE CREDIT GUARANTEE CORPORATION ACT, 1961

The relevant provisions of the DICGC Act, 1961 are mentioned hereunder.

Section 2(gg) defines the meaning of "eligible cooperative bank". Section 13 D of the Act lays down the circumstances in which Reserve Bank may require winding up of cooperative banks. Section 16 of the Act deals with liability of Corporation in respect of insured deposits.

2.2.3 MAHARASHTRA COOPERATIVE SOCIETIES ACT, 1960

Section 110A of the Maharashtra Co-operative Societies Act, 1960[16] provides that if so required by the Reserve Bank in the public interest or for preventing the affairs of the bank being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of the bank, an order shall be made by the Registrar for the winding up , reconstruction, supersession of the committee etc.

3. REASONS FOR INCREASING SICKNESS AMONG UCBS

3.1 DUAL CONTROL

Two swords cannot be fitted into one scabbard. The two independent bodies viz., one Central Bank (non-political body) and another State Government cannot control the working of the UCBs. The frequent interference by the State Government in the working of the Registrar widen the gap between the Reserve Bank and State functionaries in administration of UCBs. In most of the cases it was observed that the State Governments even issue directions to defuse the control of the Reserve Bank. The High Power Committee formed under the Chairmanship of Shri. Madhava Rao has pointed out series of instances of the State Government's non-cooperation in administration of the UCBs. The Committee observed that "it is the absence of a clear-cut demarcation between the functions of RBI and that of the State Governments that adversely affects the smooth functioning of the Urban Cooperative Bank".[17]

3.2 OVERLAPPING OF FUNCTIONS

The instances mentioned above are only illustrative. As most of the State Governments may not agree to transfer cooperatives to the Union List there is a need to address the issue of duality of

control by carrying out necessary statutory amendments. Earlier Committees like Madhava Das Committee, Marathe Committee, Narsimham Committee and quite recently Madhava Rao Committee have all suggested for bringing out necessary statutory amendments to address the issue of dual control. However, till date nothing substantial has been done. Therefore, it is suggested that till the statutory amendments take place the State Governments and the Reserve Bank shall enter into a Memorandum of Understanding demarcating the Bank related function and cooperative function to have an affective functioning of UCBs. The Madhava Rao Committee has made an attempt to list the bank related functions and cooperative functgions to avoid conflict of exercise of power over the UCBs by State Government and Reserve Bank. According to the Committee, Bank related function which should be under the Reserve Bank of India are 1. Issues relating to interest rates, loan policies, investments, prudential exposure norms, forms of financial statements, reserve requirements, appropriation of profits etc. 2. Branch licensing, area of operation laws. 3. Acquisition of assets incidental to carrying on banking functions. 4. Policy regarding remission of debts. 5. Audit 6. Change of Management and appointment of CEO. 7. Appointment of administrator. And 8. Any other Banking related function to be notified by Reserve Bank from time to time. Similarly Cooperative function which should be under the domain of Registrar of Cooperative Societies are listed as under: 1. Registration of co-op. societies.2. Approval and amendment to by- laws 3. Elections to Managing Committees. 4. Protection of members' rights. And 5. Supersession of Managing Committee for violation of items 1 to 4 above.

3.3 TREND OF STATE GOVERNMENTS ACTION SHOWING THE WIDENING GAP

Urban cooperative banking has witnessed severe bitter experiences in the past half a dozen years. The collapse of UCBs in few States provocated protagonists of the Cooperative movement to ponder upon the reasons.

The prominent reason is non-cooperation by the State Governments to minimize the downfall. Rather it is seen that the State Governments are on their foot to keep the regulator's supervision over the UCBs and allow the banks run unregulated and uncontrolled at the cost of the public and depositors interest. The following legislations are one of such tools the States of Andhra Pradesh, Karnataka, Chhttisgarh and Kerala have used under the pressure of the political lobby against the public interest.

3.3.1 A.P. Mutually Aided Cooperative Societies Act, 1995 (APMACS ACT, 1995)

The Govt. of Andhra Pradesh passed A. P. Mutually Aided Cooperative Societies Act, 1995 in order to promote self reliant and autonomous cooperative societies and make cooperative movement vibrant in the State. The Act allows the Mutually Aided Co-operative Societies (MACS) to function under autonomy without being dependent on Governmental resources.[18] Though the objectives of the Act are appreciated, several provisions of the Act are not in consonance with its objectives.[19] The Mutually Aided Cooperative Societies have been permitted to accept the deposits from public. The Act enacted with an objective to make societies self reliant without being dependant on Government resources allowed MACS to receive deposits from public other than its members.[20] The Act permits the MACS to invest the funds outside the business without any restrictions and unguided by any supervision or

regulation. It is also important to mention that the State Government whilst passing the enactment has not taken steps to protect the interest of the depositors as the MACS is left free to function without the supervision of the regulator. Section 45S of the Reserve Bank of India Act, 1934, prohibits an individual or a firm or unincorporated association of individuals from accepting the deposits from public. Under Chapter IIIB of the RBI Act, 1934, companies registered under the Companies Act, 1956, are alone will be considered for grant of certificate of registration to accept the deposits from public. The APMACS Act, 1995 permits the societies to accept the deposits from public contrary to the provisions of the central Act, i.e. Section 45S of the RBI Act, 1934. Section 12 of the APMACS Act, 1995 empowered the societies to promote one or more subsidiary organisations for furtherance of its objectives. Societies having multiple objectives under their byelaws may establish subsidiary organisations and may divert pubic deposits to their subsidiaries.

CASE STUDY 1 - CHERUKURI MUTUAL AIDED COOPERATIVE SOCIETY

The following case study highlights the fallacy of the system under APMACS Act, 1995 that how an Multi-State Cooperative Society can manage to conduct business of banking within the provisions of State Law without being caught by the regulator under the guise of "subsidiary".

The promoters of the Cherukuri Mutual Aided Cooperative Society initially started Cherukuri Finance Registration to carry on non-banking financial business and to accept the deposits from public.

The Reserve Bank of India conducted an inspection of the book of accounts of the Cherukri Finance India Ltd., and found that it is conducting its business in violation of various provisions of Chapter III B of the RBI Act and the directions issued there under. The Reserve Bank of India kept the application of the Cherukuri Finance India Ltd., in abeyance and advised it to comply with the violations, so as to consider its application for grant of Certificate of Registration. The promoters of the Cherukuri Finance India Ltd., without pursuing their Application with the Reserve Bank of India, registered the Cherukuri Mutually Aided Co-operative Society under the A.P. Mutually Aided Co-operative Societies Act, 1995, with the Registrar of Co-operative Societies of A.P. All the deposits accepted by the Cherukuri Finance India Ltd., were transferred to the Cherukuri Mutually Aided Co-operative Society. The Mutually Aided Co-operative Society started Cherukuri Banking Services by accepting the deposits from public. Seciton 7(2) of the Banking Regulation Act, 1949, states that no firm, individual or group of individuals shall, for the purpose of carrying any business, use as part of its or his name any of the words "bank" "banking" or banking company." Section 8 of the A.P. Mutually Aided Co-operative Societies Act, 1995, states that every Society shall display its full name registration number and the address of its registered office in legible characters in a conspicuous position at every office or place at which it carries on business. The Cherukuri Mutually Aided Co-operative Society, is not displaying its name and is displaying the name "Cherukuri Banking Services" out side its office. It has been observed that the Cherukuri Mutually Aided Co-operative Society started several groups and subsidiary organizations (Cherukuri Real Estates and Constructions, Cherukuri Swarnanjali, Cherukuri Advertising, Cherukuri Diagnostics, Cherukuri Old Age Homes). The deposits accepted by the Mutually Aided Co-operative Society have been diverted to the subsidiaries for the development of their business. The recovery of funds so diverted

depends upon the earning of profits by its subsidiaries. If the funds diverted are not recovered, the society may not be able to repay to its depositors. The diversion of funds by the management to subsidiaries would be detrimental to the interests of own members and depositors. As such the very purpose of enactment of the Act is defeated (encourage them to pursue the legitimate interests of their members in an effective, self reliant, responsible, accountable and democratic manner).

CASE STUDY 2 - Ganga Godawari Mutually Aided Co-operative Society

It is interesting to throw light on a case study where an individual who has collected the huge quantity of deposits from public has saved his skin from public and police and escaped from the clutches of law under the umbrella of APMACS Act, 1995. Shri S. Srinivas promoted Ganga Godawari Farmers' Development Corporation Ltd., He started accepting the deposits from public with impracticable promises (Repayment of Rs 2000/ - for every Rs 1000/- deposit within 15 days). Accordingly he collected Rs 9.60 crores. On complaints from public, police registered cases against him. It was observed that there are no proper accounts for the deposits collected by him and investments made by him. To overcome the hurdles from the police and regulatory authorities Shri S. Srinivas registered the Ganga Godawari Mutually Aided Co-operative Society.

Therefore, the regulator/State must have legal mechanism to restrain such societies registered under the Act and also to prevent the existing societies from accepting deposits from public and the invest funds outside its business.

Section 13 of the Act provides for creation of a new organization for collaboration with any organization or organizations. The new organisation may be registered as a company or a public society. No norms are prescribed regarding the functioning of new organisation under the Act. There is every possibility of diverting the funds through this new organisation to other organizations and siphoning off the deposits of public. Section 14 of the Act grants unlimited power to the societies registered under the Act to raise any amount of public deposits from any source. Section 15 of the Act grants power to invest the funds in any non-speculative manner outside its business. Since there are restrictions under other statutes on the acceptance of public deposits and investment of funds, certain persons started registering under the A.P. Mutually Aided Co-operative Societies Act, 1995.

There is no provision for inspection of the book of accounts of the mutually aided co-operative societies. The Registrar of Co-operative Societies has no power to inspect the book of accounts of the societies registered under the Act. The Registrar can inquire into only a specific complaint made against Societies. There is no provision for inspection of books of accounts, conduct of elections of Directors by the Registrar. Even the Registrar has no role to play in case the Board decides *suo motto* to liquidate the Society.[21]

The State of Andhra Pradesh is the first State to enact such a legislation giving absolute autonomy to the societies at the cost of public and depositors interest without ensuring safety and security to the pubic money in the hands of the unregulated and uncontrolled bodies. In case the State is not going to repeal the legislation immediately then there will be a mushroom growth of

societies like cases discussed above. The State Government is bound to answer to public in such episodes and they cannot usurp their responsibility by merely filing police complaint against the wrongdoer. The State Government should be made party to the proceedings before the Court for enacting such legislations which create unregulated bodies especially dealing with pubic money.

3.3.2 KARNATAKA SOUHARDA SAHAKARI ACT, 1997 (KSS ACT, 1997)

Learning from the experience of the State of A.P., the Karnataka Government has brought into force the Karnataka Souharda Sahakari Act, 1997 on the lines of Andhra Pradesh Mutually Aided Cooperative Societies Act, 1995.

The State of Karnataka enacted the Karnataka Souharda Sahakari Act, 1997 (KSS Act, 1997) to recognize and encourage the formation of societies based on self help and mutual aid so as to make it a self reliant economic enterprise guided by cooperative principles. The KSS Act, 1997 grants more autonomy than presently available to the societies registered under the Karnataka Cooperative Societies Act, 1959 and enables them to conduct their operations themselves. Under 1959 Act, the Registrar enjoys substantive control over the affairs of a co-operative bank. Hence, wherever necessary the Reserve Bank acts through the Registrar to control or supervise the activities of the bank. Under the KSS Act, 1997 this position has changed. Section 4 of the KSS Act, 1997 provides that societies existing and newly formed societies or already registered under the Karnataka Co-operative Societies Act, 1959 and are desirous of converting themselves into a society under the new Act, may be registered. Since, the co-operative societies carrying on banking business require licence from Reserve Bank. It is necessary to obtain prior approval of the Reserve Bank for registration under this Section. Section 10 of the Act, 1997 requires a co-operative society to function in accordance with the provisions of the Act and the bye-laws framed by it. However, the Act is not clear of observance of directions/guidelines issued by the Reserve Bank from time to time by the cooperative bank. Individual banks cannot be allowed to ignore certain restrictions put by Reserve Bank on the conduct of their business. This is more important for the reason that in case of a cooperative bank, its business has to be carried on, in conformity with the banking and credit policy laid down by the Reserve Bank of India. Section 12 of the Act, 1997 allows the co-operative society by resolution passed in the general body to transfer its assets and liabilities, divide itself into two or more co-operatives etc. In order to ensure that such changes do not adversely affect the interest of depositors or are not detrimental to the public interest or contrary to banking policy, it is necessary that the Reserve Bank is given a definite say in all such matters. Section 14 permits a co-operative to form a partnership. It may at time be in the interest of the depositors of one or the other co-operative bank that such an agreement is entered into. However, Reserve Bank would like to be satisfied that formation of such partnership is not detrimental to the interest of depositors or is not against banking policy. However, such approval from the Reserve Bank is ignored under the provision. Section 16 permits a co-operative to enter into collaboration with any other organization approved by the Government and to carry on one or more business provided in the bye-laws of such co-operative. It is difficult to foresee how a co-operative bank would need to collaborate with any other non-banking organization. It is, therefore, necessary to provide for a prior permission of Reserve Bank for seeking collaboration with any other non-banking organization in the interests of the depositors. In terms of Section 47 a decision to wind-up a cooperative is to be taken by the society in general meeting. Since co-operative banks accept deposits from non-members also, it

is necessary to protect the interest of the non-member depositors that a decision, in this regard, is taken with the prior concerned in writing of Reserve Bank of India. Section 72A & B of 1959 Act has not been retained in the 1997 Act, 1997. Reserve Bank being the regulator and supervisor of the banking institutions, must have absolute say in matters pertaining to merger, amalgamation, liquidation of a co-operative bank. Under DICGC Act, in terms of Section 17 where an order of winding-up or liquidation of an insured bank is made, the corporation which is subsidiary of Reserve Bank, shall pay to every depositor of the bank under winding-up or liquidation, an amount equal to the amount due to him in respect of his deposit in that bank at the time when such order was made, subject to a sealing of Rs.1 lac per depositor. Later when the Act was extended to co-operative banks it required that co-operative bank should comply with the provisions of Section 2 (gg) and 13(D) of DICGC Act, 1961. While Sub-Section (6) of Section 38 of Act 1997, partly fulfills the requirement of Section 2(gg)(iii) of DICGC Act, 1961, other requirements of Section 2(gg) and of Section 13(D) are not fulfilled by Act 1997. Section 13(D) of DICGC Act enumerates the circumstances in which the Reserve Bank can require the winding-up of an insured co-operative bank. Therefore, it is necessary that the KSS Act, 1997 should be modified to comply with the provisions of DICGC Act.

Under 1959 Act, Reserve Bank in terms of Section 72A is vested with certain powers which it can enforce through the Registrar of co-operative societies. The Act 1997 grants autonomy to cooperatives in various matters including their own winding up. Consequently, the role of the Registrar in these matters are substantially reduced. The Federal Co-operative, which is assigned to play the role of supervisor in certain are as is also not vested with powers to direct merger or amalgamation etc. It is, therefore, necessary that the provisions on the lines of Section 72A of 1959 Act may be inserted with such modification as are necessary.

3.3.3 CHHATTISGARH COOPERATIVE SOCIETIES (AMENDMENT) ACT, 2001

The State of Chhattisgarh is the third State in a row acting against the public interest. The State has been separated from the State of Madhya Pradesh in the year 2000. On its formation all the laws as they are applicable to the State of M.P were made applied to the State of Chhattisgarh including M.P. Cooperative Societies Act, 1960. However, in the year 2001, the State of Chhattisgarh has brought an amendment to the Chhattisgarh Cooperative Societies Act, 2000 and inserted Section 16C to the existing provisions of the Chhattisgarh Cooperative Societies Act. The effect of the amendment is that in matters of reorganization, amalgamation and bifurcation of the cooperative societies the Registrar can approve the scheme without obtaining prior approval from the Reserve Bank of India. This trend of the State of Chhattisgarh has further widened the gap between the regulator and State Government.

The Madhya Pradesh Co-operative Societies Act, 1960 as adopted by Government of Chhattisgarh, in proviso to Sub-section 2 of Section 16 provided for prior consultation with Reserve Bank of India in case of preparation of scheme of amalgamation/ reconstruction of a co-operative bank. The provision of prior consultation with Reserve Bank has been impliedly done away with in the new Section 16(C) of Chhattisgarh Co-operative Societies (Amendment) Act, 2001. After coming into force of Section 16(C) of Chhattisgarh Cooperative Societies (Amendment) Act, 2001 all co-operative banks in the State of Chhattisgarh would ceased to be eligible co-operative banks for insurance under Section 2(gg) of Deposit Insurance and Credit

Guarantee Corporation Act, 1961 and the same will be the matter of concerned of the Reserve Bank as regulator of the banks. This position has put the co-operative banks in the State of Chhattisgarh in doldrums. Further, in view of the amendment no new co-operative bank commencing banking business in the State of Chhattisgarh will be an eligible co-operative bank to be registered as insured bank under DICGC Act, 1961. The matter has been referred to the State Government for modifying the Section 16(C) to provide for prior consultation with the Reserve Bank of India at the time of preparation of any scheme for amalgamation/reconstruction of any co-operative bank in the State of Chhattisgarh. The state legislation should be inconsonance with the central legislation, DICGC Act, 1961. It is statutory requirement under DICGC Act that any co-operative bank to be eligible for a deposit insurance cover, the law for the time being governing the co-operative bank should provide that in order for winding-up, or an order sanctioned a scheme of compromise or arrangement or of amalgamation for reconstruction of the bank may be made only with the previous sanction in writing of the Reserve Bank. Therefore, the state legislation providing for the scheme of re-organisation should contain a provision for obtaining prior approval from the Reserve Bank without which the scheme or re-organisation would be invalid and deposits would not be eligible for insurance cover of DICGC. However, it is learnt that after prolonged consultations and persuasion by the Reserve Bank of India, the State of Chhattisgarh has restored the earlier position.

3.4.4 STATE OF KERALA - UNLICENCED COOPERATIVE BANKS

The position in the State of Kerala is very critical.

The Government went a step ahead of Andhra Pradesh and Karnataka and introduced a concept unknown to the cooperative movement that registering a society as "unlicensed cooperative bank". The State of Kerala conferred power upon the Registrar under the Kerala Cooperative Societies Act, 1969 read with Keral Cooperative Societies Rules, to register "unlicensed Cooperative bank" as an entity without the prior approval from the Reserve Bank of India in writing and the entity is allowed to conduct banking business including collecting the deposits from non-members with cheque fecility. There are nearly 50-70 entities registered since the date of introduction of the Rule 15 (1) (A) (3) (b) to the Kerala Cooperative Society Rules in the State. Encouraging the lawlessness in the banking sector throwing the depositors interest to wind and unregulated, Registrar has classified the societies in the State into deferent groups adding a new nomenclature "unlicensed cooperative bank".

Rule 15 (1) (A) (3) of the Kerala Co-operative Societies Rules deals with Primary Credit Societies giving Short Term/Medium Term loans. Among the Primary Credit Societies a further distinction is made and a new category of Unlicensed Urban Co-operative Banks is introduced in Sub-Clause (b) of Clause 1(A) (3) of Rule 15 of the Rules introduced with effect from 2.5.2000. The entities registered under Rule 15 as "unlicensed cooperative banks' are conducting banking business including acceptance of deposits from non-members and cheque facility in violation of section 49A of B R Act, 1949.[22] The entities have *prima facie* contravened provisions of section 7, 22 and 49A of the Banking Regulation Act 1949 (AACS) and are liable penal action.

Having come to know of the fact, Reserve Bank sung into action and directed all the unlicensed cooperative banks to stop conducting banking business. In spite of the Court directions most of

the unlicensed cooperative banks have taken a stand that they are functioning under the registration granted by the Joint Registrar of Cooperative Societies of the District which is the competent authority for registration of unlicensed Urban Cooperative Bank as per the relevant provisions of Kerala Co-op. Societies Act and Rules. Further the existing entities have taken the stand that the Joint Registrar of the District and the Registrar has not issued any direction against the functioning of their unit/s or restricted any activities as per registered bye-laws and approved sub-rules. Therefore, they are entitled to conduct banking business within the framework of the bye laws.

3.4 DILUTION OF RESERVE BANK'S POWER - MULTI STATE CO-OP. SOCIETIES ACT, 2002

The recent amendment to the Multi-State Cooperative Societies Act, 2002[23] is another episode to show how Government's are serious about keeping away the Multi-State co-operative banks from the purview of supervision of the Reserve Bank of India. In the preceding parts it has been analysed how State Governments have kept the depositors at risk by taking away the supervision of the Registrar/Reserve Bank of India. Now it is the Central Government that has become one in the bandwagon of States acting against the interest of depositors granting wider autonomy to the Multi-State Cooperative Societies.

A Multi-State Cooperative Societies Act 2002 came into force on 19.8.2002.[24] The preamble of the MSCS Act 2002, reveals the basic objectives behind enacting this Act. The MSCS Act 2002 has been enacted to consolidate and amend the law relating to Cooperative Societies, with the objects not confined to one State and serving the interest of members in more than one State. Another objective, mentioned is to facilitate the voluntary formation and democratic functioning of Cooperatives as people's institutions. One of the most important object to provide functional autonomy and in this respect provisions have been introduced.

The provisions of the new Act empower the Central Government to give directions to the Multi-State Co-operative Societies in the public interest or to supersede their board only with respect to those Multi-State Co-operative Societies in which not less than 51% of the paid up share capital or of the total shares is held by the Central Government. Under the new Act, the Central Registrar does not have any power or authority to supersede the Board the whether of his own or at the instance of the Reserve Bank. The new Act will need to be amended to avoid regulatory vacuum and also to ensure that the multi-state cooperative societies retain their character as the "insured banks".

The MSCS Act, 2002 prominently keeps the regulator away in the areas of voluntary amalgamation/reconstruction of MSCBs, promotion of subsidiary institutions; and control over the management. Further, it restricts the Central Government's power to issue directions and to remove the Board of only the specified multi-state cooperative society in which that Government holds not less than 51% of the paid-up share capital . These omissions and changes directly impinge on the RBI's powers which were available under the repealed Act of 1984. The changes have created a vacuum in these areas relevant from regulatory and supervisory angle and need to be corrected to avoid unintended consequences.

Viewed from the deposit insurance angle, it has been rightly pointed out that the banks registered under the new Act would not be 'eligible cooperative banks' as defined in the DICGC Act. Resultantly, even the existing MSC Banks may cease to be eligible for insurance cover. In consequence of that, their banking licence may itself be liable to be cancelled. The corrective steps would require restoring the position as it prevailed under the repealed Act. This would involve amendments to the new Act. The alternative step could be to amend the B.R. Act in its application to the multi-state cooperative banks by amending the definition of the cooperative bank including the Multi-state Cooperative Societies Act.

4. MEASURES TO IMPROVE THE SYSTEM

Amid all the negative support from the State Governments, RBI is efficiently controlling the crisis. The Media has wrongly generalised that the urban Co-operative bank sector has been badly affected by the recent scam involving fraudulent trading in government securities by few co-operative banks. As per the Annual Report 2001-2002 of available information for 1854 UCBs for 2001-2002, 1569 UCBs posted profits while the remaining 285 UCBs incurred losses. Of the 52 scheduled UCBs, 10 banks reported losses during 2001-2002 as compared with 11 banks during 2000-2001. Reserve Bank of India has taken initiative to minimize the crises by tightening prudential norms and by introducing other measures. The following are the some of the measures recently the Reserve Bank has taken in this direction.

a) Reserve Bank has formed an external Committee consisting of persons with expertise in banking, finance and co-operation to advise the Reserve Bank to screen applications received under the new licensing norms for setting up new UCBs. The Reserve Bank decides on the proposals after considering the recommendations of the Committee.

b) Reserve Bank has directed all the existing UCBs to have Boards of Directors, all the times, at least consisting of two directors with suitable banking experience or with relevant professional qualifications, i.e, chartered accountants with banks accounting/auditing experience.

c) All UCBs are required to form Audit Committee of the Board to supervise the audit functions. Compliance in this regard is a prerequisite for opening new branches.

d) All the scheduled UCBs are required to put in place an effective ALM system by June 30,2002.

e) All the UCBs are to make additional provisions for NPAs staring from the year ended March 31, 2004.

f) UCBs were cautioned against indiscriminate financing against the security of real estate and were advised to strictly follow the Reserve Bank's policy guidelines issued in January 1994.

g) UCBs would be classified as "weak", commencing from March 31, 2002, if they fail to achieve 75 per cent of prescribed level of CRAR, or the level of their net NPAs exceeds

10 percent, or they incur losses for two of the previous three years. They will be classified as "sick" if they fail to achieve 50 per cent of prescribed level of CRAR and the level of their net NPAs exceeds 15 per cent or they have incurred losses continuously for the previous three years. The UCBs should formulate action plans for revival on their own or with the help of experts in bank management.

h) The system of constituting Bank Level Rehabilitation Review Committee for monitoring progress of rehabilitation has been discontinued.

i) The Reserve Bank proposed the establishment of a separate supervisory authority with representatives of the Centre, States and other interested entities. Such a body can be exclusively responsible for efficient functioning of the co-operative institutions and the safety of public deposits. A draft legislative bill proposing amendments to Banking Regulation Act, 1949 has been forwarded to the Government of India and recommendations of the High Power Committee on UCBs.

V. CONCLUSION

The cooperative banking sector caters to the varied needs of small investors and small businesses. Some 150 odd entities from Gujarat have tainted the image of UCBs in the country. Bad loans in the books of these banks have dramatically altered the percentage of NPAs of the entire sector. This is the case with State of Andhra Pradesh too. The recent gilt scam is illustrative of "unholy nexus" of some directors of at least half-a-dozen UCBs and three district central co-operative banks in Maharashtra with some brokers that had caused huge loss to the tune of nearly 200 crores to these banks. No purchase of government securities taken place. Transactions are not put through the Reserve Bank's public debt office for settlement. Brokers offer hefty commissions to the brass of UCBs. Bankers develop bogus bankers' receipts in collusion with the brokers. This resemble the same modus operandi adopted by brokers to divert funds to the stock markets from the now defunct Bank of Karad in the early 1990. Here it is necessary to know the difference between the audit and supervision. What Reserve Bank performs inspection of the book of accounts of the banks is different from the audit of book of accounts done by the RCS. During the inspection, the inspection team confines to the books of records to take stock of the financial position of the bank. Therefore, often such transactions will be unfolded during the inspection. After the Ahmedabad-based Madhavpura Mercantile Cooperative Bank went under in March 2001, the RBI asked urban co-operative banks to unwind their deposits, which were deemed SLR investments, with bigger co-operative banks. These banks were asked to gradually increase their minimum SLR holding in two stages by September 30, 2002. However, district banks have no compulsion to buy government securities because they are not subject to any SLR stipulation. It is indeed necessary for co-operative banks to devote adequate attention to maximizing their returns on every unit of resources through an effective funds management strategy and mechanism. With elements of good corporate governance, sound investment policy, appropriate internal control systems, better credit risk management, focus on newly-emerging business areas like micro finance, commitment to better customer service, adequate mechanisation and proactive policies on house-keeping issues, cooperative banks will definitely be able to grapple with these challenges and convert them into opportunities.[25]

The preceding discussion brings out clearly the increasing trend of the State Governments to enact laws to conduct para banking unregulated by any authority by allowing entities to receive deposits from non-members also with cheque facility. In this regard it is more relevant to remember the observations of Shri. K.Madhava Rao, Chairman of the High Power Committee constituted by the Reserve Bank in 1999. He said "it was absolutely necessary that the RBI should be the sole regulator of the banking business carried on by the Urban Cooperative Banks." The committee also added that it was "convinced that the dual control must end, and end soon." However, the greatest challenge would be in cleansing the system of the state governments and the domestic industries, both of which enjoy a tremendous amount of influence on the cooperative banks.

The deepest sin against the human mind is to believe things without evidence.

— Thomas H. Huxley

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* Paper presented at the Seminar on "Comparative Banking and Financial Law", organised by bank of France at Marne-La-Vallee, Paris (20-24 January, 2003).

* Paper published in Economists' Conference 2002 Volume. The Economists' Conference 2002 was hosted by the Corporation Bank in association with the Indian Banks' Association at Bangalore (27-29 December 2002).

** The views expressed in this article are purely of the author and do not necessarily pertain to the Reserve Bank of India.

1 Tribune News Service-New Delhi, April 14, 2001.

2 Deccan Herald Thursday, May 16, 2002.

3 Deccan Herald, 14-5-2002.

4 Andranews.com.dated 25-2-2002.

5 The Hindu 11-5-2002.

6 Business Line 28-9-2002

7 Business Line dated 7-5-2002.

8 Business Line, April 30, 2002.

9 Business Line, 16-11-2002.

10. Currently, there are 149 UCBs in the State of Andhra Pradesh, with a total deposit base of Rs. 3600 crore and advances of Rs. 2,400/- crore. Out of these banks, 21 are under liquidation, 37 are classified as weak (by the RBI as on August 2002), which, in other words, mean that 34 per cent of the banks "are getting into problems". Business Line, 28-9-2002.

11 Financial Express, Dated 16-11-2002.

13 Deccan Herald, 14-5-2002

14. Entry 43 of List I, "Incorporation regulation and winding up of trading corporation, including banking insurance or any financial corporations but not including co-operative societies".

15 Entry 32, "Incorporation, regulation and winding up of Corporations, other than those specified in list I, and universities, unincorporated trading, literary, scientific, religious and other societies and associations; cooperative societies".

16 Similar provisions are incorporated in the respective State Legislations dealing with winding up, reorganisation, supersession of the Board etc.,

17 Report of the High power Committee on Urban Cooperative Banks, Reserve Bank of India, Mumbai 1999, at page 94. The Committee has also pointed out the following instances where the State Government has issued instructions in clear conflict with those issued by reserve Bank.

(a) In terms of Section 23 of B.R. Act 1949 (AACS) the Reserve Bank has authority to issue a branch licence to an urban co-operative bank and under the existing policy, RBI issues branch licence after convincing itself about the financial strength of the UCB. Strangely, in some states, the UCBs are required to obtain "No Objection Certificate" (NOC) from RCS of the concerned State even after the licence has been granted by the RBI. The Committee fails to understand the necessity of a NOC from the Registrar of Co-operative Societies.

The Committee feels that grant of licence is purely a banking related function and should be left to the Reserve Bank.

(b) Another area of concern arising out of dual control is investment of surplus funds by UCBs. The "investment" is also a banking function within the meaning of Section 5 of Banking Regulation Act, 1949. Hence UCBs should, subject to the guidelines issued by the Reserve bank, have the freedom to choose the products in which they may invest. Yet, some Registrar of Co-operative Societies insist on their permission being taken for every investment decision. Due to limited avenues of profitable investments in the co-operative sector, the RBI has allowed UCBs to invest upto 10% of their surplus funds in the equity of All India Financial Institutions, units of UTI, and PSU bonds. However, in some of the States, this freedom is frustrated by the Registrars of Co-operative Societies. The Committee is unable to understand why, the RCS or any other Government Official should sit in judgement over the commercial decision of the board or a professional treasury manager of a bank.

There are instances when the Registrars of Cooperative Societies have issued instructions in clear conflict with those issued by Reserve Bank. For example, in terms of Section 21 of the Banking Regulation Act 1949, the Reserve Bank is empowered to give direction to a co-operative bank regarding "the rate of interest and other terms and conditions on which advances or other financial accommodations may be made or guarantees may be issued". Section 21 (3) further lays down that every bank shall be "bound to comply with any direction given by Reserve Bank". Notwithstanding these provisions, there are instances where a RCS issued a direction that UCBs should charge interest on deposits in accordance with his instructions. After having learnt about it, the RBI took up the matter with the RCS and with the Co-operation Department of the State but has not succeeded in getting the directive withdrawn.

[18] Section 2 (d) of the Act defines the term "Co-operative Society" a mutually aided co-operative society registered under Section 4 whose bye laws prohibit it from raising share capital from the Government, a Co-operative Society registered under Section 7 of the Andhra Pradesh Co-operative Societies Act 1964, it it amends its byelaws where necessary to reconstitute its capital base and in respect of other relevant aspects to be in accordance with this Act, and returns to the Government its share capital, if any and either enters into a Memorandum of Understanding with the Government for any outstanding loans due to, or guarantees given by the Government or Returns to the Government of such assistance and further gets itself registered under Section 4 as a Co-operative Society under this Act.

[19] The salient features of the A.P. Mutually Aided Cooperative Societies Act, 1995 are; (a) To enable the Societies to change the form or that extent of their liability to transfer their assets and liabilities, to divide or amalgamate in furtherance of their stated objectives (b) To enable the Societies registered under the A.P. Cooperative Societies Act, 1964 to become Co-operative societies registered under this Act by making a suitable provision. (c) To enable the Co-operative Societies to mobilise their own funds, (d) To empower the Cooperative Societies to provide for the qualifications and disqualifications for the membership and to make the cooperative societies responsible to hold the elections and to regulate the process thereof.

[20] Section 14 (1) (a) Co-operative Society may mobilise funds in the shape of share capital, deposits, debentures, loans and other contributions from its members to such extent and under such conditions as may be permissible under the bye-laws of the Co-operative Society.

Provided that, at the time of dissolution of a Co-operative Society the amounts due to the members shall be settled only after the settlement of dues to others.

(2) A Co-operative Society may also mobilise funds in the shape of deposits, debentures, loans and other contributions from other individuals and institutions, to such extent and under such conditions may be permissible under the bye-laws.

Provided that a Co-operative Society shall not accept share capital from the government but may accept other funds or guarantee from the Government on such terms and conditions as are mutually agreed upon through a Memorandum of Understanding.

[21] Section 39, 40, 41, 42 and 43 of the said Act deals with the dissolution of the Co-operative Societies by members, dissolution by Tribunal, appointment of Liquidator and duties and powers of Liquidator respectively. It is important to note that a Co-operative Societies registered under this Act may be dissolved by the members of the Society. The powers of the Registrar to control and supervise the Co-operative Society have been diluted under the present Act.

[22] Under Section 49A of the Banking Regulation Act 1949 (AACS), no person other than the co-operative bank, the Reserve Bank, the State Bank of India or any other banking institution, firm or other person notified by the central Government in this behalf on the recommendation of the Reserve Bank of India, shall accept from the public, deposits of money withdrawable by cheque.

[23] A need arose to regulate Co-operative Societies whose objections extend to more than one State in view of the fast development of co-operative movement and with growth of trade between the several States in the Country. Hence, the Indian Legislature enacted the Multi-State Co-operative Societies Act 1984, to provide for incorporation, regulation and winding up of Cooperative Societies with the object not confined to one State. Multi-Unit Co-operative Societies Act 1942 is repealed by Act No. 51 of 1984.

[24.] This Act has repealed the Multi-State Co-operative Societies Act 1984.

[25] Vepa Kamesam, "Co-operative Banks in India : Strengthening Through Corporate Governance", Inaugural Address delivered on July 5, 2002, at the National Convention of "Urban Co-operative Banks : Strengthening through Corporate Governance" at Mumbai, organised by Academy of Corporate Governance, Hyderabad supported by Administrative Staff College of India, Hyderabad.

Guest Column

Judicial Review with the Specific Reference to Administrative Action or Executive Fiat*

Hon'ble Shri Justice A.B. Palkar
Judge, High Court, Mumbai

Born on 14th June, 1941. Enrolled as an Advocate on 13th September, 1967 and practised for a period of four and half years in Civil and Criminal Courts including District Court at Akola as also before Revenue Courts and Rent Control Authorities.

Joined Judicial Service as Civil Judge, Junior Division, on 24th February 1972, and worked in various capacities.

Promoted as District Judge on 11th September 1989. Worked as Judge, Family Court and thereafter as Principal Secretary to the Government of Maharashtra, Law and Judiciary Department, Mantralaya, Mumbai.

Appointed as an Additional Judge of the Bombay High Court on 9th June 1997. Confirmed as a permanent Judge of the Bombay High Court on 7th June 1999.

Basic features of fundamental rights

Some of the basic features of our Constitution are, guarantee of fundamental rights which envisages equality before the law, equal protection of laws, freedom of different types including freedom of religion and prevention of discrimination on the grounds of caste, religion, sex, dissent, etc.

Remedy – Writ Jurisdiction of High Court under Article 226 & Supreme Court under Article 32 of Constitution

1. In order to secure these inalienable rights of the citizen, the Constitution has also empowered the Courts i.e. the High Courts and the Supreme Court to issue different prerogative writs in case the rights are violated by the State by passing any legislation or by making certain rules in exercise of the powers of subordinate legislation or by the action of any administrative authority including Administrative tribunals.

2. The Courts are, therefore, guardians of the fundamental rights of the citizens and the guardian has to protect his ward from any violent action of any body. It is for this purpose, that the Courts are empowered to issue different types of writs which I need not detail herein.

3. Today, I have decided to restrict the subject to the part of Administrative action or executive fiats of the State and its judicial review.

Nature of administrative job – necessity to take Action

4. The growth of administrative process is a Worldwide phenomenon in the present day society. No Government can function unless it has executive powers and in exercise of all these powers it has to pass necessary orders.

Free, fair and transparent judicial review

If the administration is to be free and fair and is to be kept confined to the rule of law, the actions of the administrative authorities are required to be transparent and as such open to judicial review and it is only an independent judiciary which can fearlessly decide upon the legality or otherwise of the action and can also examine whether the order suffers from malafides.

5. It is true that the task of administration and the job of judicial dispensation are different. It does not, however, mean that an administrator should not have a fair approach to the problem faced by him in discharge of his functions although his approach need not be judicial. After all, administration involves the process of decision making and in a democratic polity, the decision has to be confined to the provisions of Constitution, various statues and rules and has to be impartial and that is the only guarantee of protection of rights of the citizens. There is tremendous inflow of legislations since India became republic and as a necessary concomitant different pieces of legislation were introduced for bringing into reality a welfare state. The Legislature is required to delegate some of its functions to the executive while making rules which we call as subordinate legislation.

6. **Difference in Legislation and Subordinate Legislation**

One must always remember the distinction between law passed by the Legislature of the State and the subordinate legislation passed by some other authority or body corporate under the powers delegated to it under any statute passed by the Legislature.

7. There has been tremendous increase in workload in different High Courts and Supreme Court as a result of various administrative actions of the Government which sometimes may suffer from vice of favouritism or discrimination or may be even politically motivated. However, while sitting on judgement over the administrative action, the Judges must remember that the action should not be viewed with a prejudiced mind. (Fairness) The presumption, of any, should be of legality and fairness on the part of the administrator and the contrary must be established by the person challenging the action. (limitation of administrator). It should also be present to the judicial mind that there are certain limitations on the action of the administrator and he is not

posted with all the information which ultimately comes before the Court of law, when his action is challenged. (Inadequate information necessity to take quick decisions). The administrator has to take immediate action and in doing so, there is a possibility of his falling into error. There is also necessity of taking quick decisions. No Judge should allow a capital to be made of this.

8. **First duty of Court**

i. Whether the authority had jurisdiction or power.

ii. If it has, then erroneous order is no ground.

While reviewing any administrative orders, the Courts have to first determine, whether the authority had jurisdiction or power to decide the issue or to pass the said order. If there is lack of jurisdiction in any sense of the term, then the order has to be reviewed. However, if there is jurisdiction but its exercise is not proper or that the order is erroneous, that cannot be a ground to review the said order. It is a well established principle that the authority who has power to decide has a power to decide rightly or wrongly.

Appeal, Revision Review-difference

9. In Court of law, in the appellate jurisdiction, we correct an erroneous order or a wrong order and substitute the order which the appellate court feels should have been passed. If there is a right of appeal which is always created by a statute, then the appellate court has normally the same powers which the Court below had. Unless at certain stage of appeal a restriction is imposed, for example in case of Second Appeal, it can be entertained only on a substantive question of law under our present system. You are aware of this and, the distinction between the appeal and the revision while exercising revisional jurisdiction, the revisional court has no powers to re-appreciate the evidence and substitute its own findings on facts for that of the authority or Court below. Similarly, in case of review of its own order, the criteria is not whether the order is right or wrong, the criteria is whether there is an error apparent on the record or whether some material which has been brought at the time of review was not available and could not be placed before the authority when the earlier order was passed. These restrictions have been placed in order that there should be consistency in judicial findings and there should be finality to the judicial findings at some stage.

10. Almost all legal systems recognise that some subjects are inappropriate for judicial determination and, therefore, under various constitutions there are issues which are justiciable and which are not justiciable. (Issues not proper for judicial determination). For example, Political questions, foreign affairs, relations with the foreign nations, matters of Policy are and cannot be subject to judicial review. The Courts have a limited role to play and in our system, Courts cannot decide upon the wisdom of the executive authority or legislature. The legislative functions of the State is a sovereign function unless the Court has a strong reason to hold and record a finding that the Legislature had no power to pass the said legislation. If the legislature has power to pass the legislation, its wisdom is not to be decided upon by the Courts. It has also power to pass it with retrospective effect, of course, subject to the limitations imposed by the Constitutional mandate.

Nanavati case – passing reference – clemency

11. In the well known case of Naval officer Mr. Nanavati, the Governor had used his prerogative rights to give clemency. There was a hue and cry and some authors and Press went to the extent of saying that it would amount to contempt of Court. (Powers of Clemency by Governor or President) Those who said this, were not aware that the powers of the Governor and President in Mercy petitions arise only after the conviction and the sentence if finally confirmed and this power cannot be controlled by the Courts.

No Contempt of Court

The Supreme Court cannot exercise jurisdiction over the powers of Governor and President and they are final authorities. The person may remain a convict, but by mercy petition, his sentence can be wiped out altogether or reduced.

Origin in powers of King Emperor

This is the authority which was always in the Emperor of any State and even in the history, the people approached the King as a last resort for seeking mercy. The powers of the President and the Governor are of that type. They are, however, exercised in accordance with the Constitution.

Deviation

12. This may appear to be slight deviation, but, since it is a matter relevant to the subject with which we are dealing with today, I have made a passing reference to this.

COMING PRECISELY TO TODAY'S TOPIC –

Motive – unless malafide are proved against

13. While reviewing the administrative order, normally no argument pertaining to the motive of the administrator should be entertained unless the exercise of power is in flagrant disregard of law or mandate of the Constitution and malafides are positively proved against a particular person who has an opportunity to defend himself (any particular person).

Preponderance – opportunity to put up case

No finding in that respect can be recorded as it would amount to condemning a person unheard as it violates the principles of natural justice. While considering this aspect, we have to remember as to what are the principles of natural justice. It is not possible to enlist all the principles. But, certain basic principles have been accepted all over the world in course of time and they are :

No person can be condemned unheard. This includes an opportunity of being heard and, therefore, the opportunity must be a reasonable opportunity. If after giving opportunity, the

person declines to avail of it, no fault can be found with the administrative authority as the duty of the administrative authority is to give reasonable opportunity.

Reasonableness or adequate opportunity –question of fact

Reasonableness or the adequacy of opportunity is again a question of fact, which has to be determined by the Court and normally an opportunity should be considered to be reasonable if a man of ordinary prudence in the given set of circumstances would feel that it was sufficient for the person to have noticed all the allegations or charges made against him and could have defended by him by exercise of due diligence.

Another principle is what is commonly known as AUDI ALTERAM PARTEM.

Equality

14. Apart from the Constitutional mandate, equal treatment is also a principle of natural justice.

Fairness

15. Natural justice also requires the person exercising powers of administration to act fairly and fairness of the administrative order and fairness in passing the administrative order can be subject matters for review. When law imposes a duty to act, it implies duty to act fairly. The rule of audi alteram partem is that no person should be deprived of his liberty, property or his valuable right without having a fair opportunity of being heard and of defending himself even if the statutes or rules do not make such express provisions the principles of audi alteram partem applies to the administrative actions. The Supreme Court has held in one case that the use of the word "may" in a rule requiring the authority to give show cause notice to a person before taking action cannot be interpreted as the authority having discretion to give or not to give notice to show cause and if such a notice is not given or the right of having such notice is taken away by framing a rule, then it would be violative of principles of natural justice. The Court will read the principle of audi alteram partem into a Statute even if it is not there.

A person cannot be a Judge in his own cause

16. Another principle of natural justice is that a person cannot be a Judge in his own cause. It means that the authority exercising the jurisdiction should not take any interest in the cause. Even if there is a likelihood of a feeling being entertained that the authority was likely to be influenced by some extraneous considerations, then the party may carry an impression that he has not been evenly dealt with.

Example of Judgement of Supreme Court

The Supreme Court has laid down in the case of S.L. Kapoor vs. Jagmohan reported in AIR 1981 SC 136 and in the case of Province of Bombay vs. Khushaldas S. Advani, reported in AIR 1950 SC 222, that the judicial element and the requirement of natural justice have to be looked for in statutory provisions by he Courts of law. Similarly, in the case of Anglo American Direct Tea

Trading Co. Ltd. vs. Their Workmen, reported in AIR 1963 SC 874, Justice Gajendragadkar has laid down that the question whether an act is judicial or quasi-judicial one or purely executive act depends on the terms of the particular rules and on the nature, scope and effect of the particular powers in the exercise of which the act may be done. Where an authority is required to act judicially either by express provisions of the statute under which he acts or by necessary implication of the said statute, the decisions of such an authority generally amounts to quasi-judicial decisions. Whereas, the administrative authorities are not required to act judicially and are competent to deal with issues referred to them administratively and their conclusions cannot be treated as of quasi-judicial authorities.

17. When there is a provision for appeal or revision in the statute, the deciding authority or body are deemed to act atleast in a quasi-judicial manner. A party must know the case against him and unless he has knowledge, it is difficult to exercise right of appeal and, therefore, the authorities are required to give reasonings in the orders. In absence of which, the right of appeal is likely to be frustrated. However, brief and short the reasons may be, that there are reasons given by the authority is a sufficient compliance with the principles of natural justice. Its correctness cannot be a matter of judicial review.

18. Powers of State like the power of eminent domain must be kept in mind and in exercise of these powers, what is required to be shown by the authority is to satisfy prima facie that the person is being deprived of his property for a public purpose. The propriety or otherwise of the public purpose is not a matter for judicial enquiry. The act of State under the power of eminent domain is a sovereign act and the Government is not required to justify the act and on the contrary, it is required to be proved that it was not in the exercise of sovereign power, but under colour of such exercise the act was performed. Sometimes the act may apparently appear to be discriminatory, but has to be upheld on the principle that unless such a power is conferred on the authority exercising the power, the authority cannot function. The best example for this can be of cutoff date which has been upheld by the Supreme Court in the case of D.S. Nakara vs. Union of India, reported in AIR 1983 S.C. 730. Certain persons were deprived of pensionary benefits on the ground that they retired before a particular date. Upholding the criteria, the Supreme Court stated that in the absence of such a provisions, it is not possible to effectively administer and exercise the administrative powers.

19. Sometimes question arises before the Court as to why a person who has sent in his application even one day after the final date prescribed for receipt of the application has been denied opportunity. If such arguments are entertained, it is not possible to function. Fault is with the person who has noticed the final date and no sympathy can be shown to him even if one feels that for a small mistake, he has to suffer severe consequences.

20. The proceedings of Court Marshall are also subject to judicial review, but Court Marshal is not a subject under the superintendence of the High Court under Article 227 of the Constitution of India. The proceedings of a properly constituted and convened Court Marshal, if conducted according to the rules, is beyond the scope of judicial review. Where reasonable opportunity to challenge the evidence was given, subject matter was within its jurisdiction and prescribed procedure was followed and the punishment awarded was with its power, the conviction and sentence passed by the Court Marshal is not to be interfered with by the Courts. A mere

inadequacy of pretrial investigation in the absence of prejudice cannot be said to be violative of mandatory provisions vitiating the proceedings of Court Marshal, 1998 (I) SC 537 Union of India vs. Major Hussain.

21. In a recent case of State Bank of Patiala vs. S.K. Sharma, reported in AIR 1996 S.C. 1669, the Supreme Court has laid down certain basic principles of judicial review of administrative actions keeping in view the conduct of enquiry and orders of punishment imposed by an employer. Instead of stating the same in my words, I would like to read out the said principles as narrated by the Supreme Court.

> "1. An order passed imposing a punishment on an employee consequent upon a disciplinary/departmental enquiry in violation of the rules/regulations/statutory provisions governing such enquiries should not be set aside automatically. The Court or the Tribunal should enquire whether (a) the provision violated is of a substantive nature, or (b) whether it is procedural in character.
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> 2. A substantive provision has normally to be complied with and the theory of substantial compliance or the test of prejudice would not be applicable in such a case.
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> 3. In the case of violation of a procedural provision, the position is this : procedural provisions are generally meant for affording a reasonable and adequate opportunity to the delinquent officer/employee. They are, generally speaking, conceived in his interest. Violation of any and every procedural provisions cannot be said to automatically vitiate the inquiry held or order passed. Except in cases falling under 'no notice', 'no opportunity and 'no hearing' categories, the complaint of violation of procedural provision should be examined from the point of view of prejudice, viz. whether such violation has prejudiced the delinquent officer/employee in defending himself properly and effectively. If it is found that he has been so prejudiced, appropriate orders have to be made to repair and remedy the prejudice including setting aside the enquiry and/or the order of punishment. If no prejudice is established to have resulted thereform, it is obvious no interference is called for. In this connection, it may be remembered that there may be certain procedural provisions which are of a fundamental character, whose violation is by itself proof of prejudice. The Court may not insist on proof of prejudice in such cases. Take a case where there is a provision expressly providing that after the evidence of the employer/Government is over, the employee shall be given an opportunity to lead evidence in his defence and in a given case, the enquiry officer does not give that opportunity in spite of the delinquent officer/employee asking for it. The prejudice is self-evident. No proof of prejudice as such need be called for in such a case. To repeat, the test is one of prejudice, i.e., whether the person has received a fair hearing considering all things. Now, this very aspect can also looked at from the point of view of directory and mandatory provisions, if one is so inclined. The principle stated under (4) herein below is only another way of looking at the same aspect as is dealt with herein and not a different or distinct principle.
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> 4. (a) In the case of a procedural provision which is not of a mandatory character the complaint of violation has to be examined from the standpoint of substantial compliance. Be that as it may, the order passed in violation of such a provision can be set aside only where

such violation has occasioned prejudice to the delinquent employee.

(b) In the case of violation of a procedural provision, which is of a mandatory character, it has to be ascertained whether the provision is conceived in the interest of the person proceeded against or in public interest. If it is to be found to the former, then it must be seen whether the delinquent officer has waived the said requirement, either expressly or by his conduct. It he is found to have waived it, then the order of punishment cannot be set aside on the ground of said violation. If, on the other hand, it is found that the delinquent officer/ employee has not waived it or that the provision could not be waived by him, then the Court or Tribunal should make appropriate directions (including the setting aside of the order of punishment). The ultimate test is always the same, viz., test of prejudice or the test of fair hearing, as it may be called.

5. Where the enquiry is not governed by any rules/regulations/ statutory provisions and the only obligation is to observe the principles of natural justice or, for that matter, wherever such principles are held to be implied by the very nature and impact of the order/action-the Court or the Tribunal should make a distinction between a total violation of natural justice (rule of audi alteram partem) and violation of a facet of the said rule. In other words, a distinction must be made between 'no opportunity' and no adequate opportunity, i.e., between 'no notice'/ 'no hearing' and 'no fair hearing'.

(a) In the case of former, the order passed would undoubtedly be invalid (one may call it 'void' or anality if one choses to). In such cases, normally liberty will be reserved for the Authority to take proceedings afresh according to law., i.e. in accordance with the said rule (audi alteram partem). (b) But in the latter case, the effect of violation (of a facet of the rule of audi alteram partem) has to be examined from the standpoint of prejudice; in other words, what the Court or Tribunal has to see is whether in the totality of the circumstances, the delinquent officer/employer did or did not have a fair hearing and the orders to be made shall depend upon the answer to the said query. (It is made clear that this principle (No. 5) does not apply in the case of rule against bias, the test in which behalf are laid down elsewhere).

6. While applying the rule of audi alterm partem (the primary principle of natural justice) the Court/Tribunal/Authority must always bear in mind the ultimate and overriding objective underlying the said rules, viz., to ensure a fair hearing and to ensure that there is no failure of justice. It is this objective which should guide them in applying the rule to varying situations that arise before them.

7. There may be situations where the interest of State or public interest may call for a curtailing of the rule of audi alterm partem. In such situations, the Court may have to balance public/State interest with the requirement of natural justice and arrive at an appropriate decision.

22. Recently, we had an occasion to decide upon such an inquiry held by the Disciplinary Authority, where instead of recording any evidence, the petitioner was provided with a questionnaire which gave him option which indicated that he could reply either in the affirmative

or in negative. But, as a matter of fact, apart from the answers given, the petitioner had given additional explanation, wherever felt it necessary as he was not satisfied with the answer 'Yes' or 'No' and these answers were taken in to consideration by the authority. The petitioner himself did not claim that he wanted to lead any evidence in his defence and it was proved on record that although holding a post of high responsibility and being highly qualified, he had refused to obey the transfer order and he approached the High Court and even after dismissal of his petition and had remained absent for days together continuously for and obvious reasons which affected the student community. In view of this, it was held that the opportunity given was adequate. The petitioner was allowed to file written statement. His written statement and his answers in detail given by him were taken in to consideration and, therefore, the order was not open to judicial review. Similarly, in case of punishment, the Court cannot decide on the adequacy thereof and the only exception to interfere with the punishment part would be that the punishment is such that it shocks the conscience of the Court that it is totally disproportionate to the charge. The administrative authority is in a better position to decide upon the adequacy of the Punishment and it is not a matter for Consideration by the Court. In the case of Union of India vs. B.C. Chaturvedi, Reported in AIR 1996 SC 484, the Supreme Court after taking review of the above legal position held that the disciplinary Authority and on appeals the appellate Authority being fact finding authorities have their exclusive powers to consider the evidence with a view to maintain discipline. They are vested with the discretion of appropriate punishment keeping in view the magnitude and misconduct. The High Court or the tribunal while exercising the power judicially, should not normally substitute on the penalty and impose some other penalty. If the punishment imposed by the disciplinary authority shocks the conscience of the High Court, then it would be appropriate to mould the relief and such occasions would arise in exceptional or rare cases.

23. In another landmark Judgement in the case of National Telecom Federation of Telecom Employees and others vs. Union of India and others, reported in (1996) 2SCC 405, the Supreme Court has laid down the law in very candid terms. The Government had taken a decision to privatise telecommunication which is Internationally recognised as Public Utility of strategic importance. The primary ground of challenge to the legality of the implementation of the policy was that Central Government which has the exclusive privilege under Section 4 of the Indian Telegraph Act, 1885 of establishing, maintaining and working telegraphis which shall include telephones, has no authority to part with the said privilege to non-government companies for the consideration to be paid by such companies on the basis of tenders submitted by them, it was contended that, it amounts to an out and out sale of the said privilege. The Supreme Court found that the Act was Enacted in 1885 and the Central Government Exercised the exclusive privilege of establishing, maintaining and working telegraphs for more than a century. But the framers of the Act since the very beginning conceived and contemplated that a situation may arise when the Central Government may have to grant a licence to Any person to establish, maintain or work such telegraph including telephone within any part of India and with that object in view, it was provided and prescribed that Licence may be granted to any person on Such conditions and in consideration of such payments as the Central Government may Think fit. It clearly shows that the power to grant licence was sufficient to indicate that such a privilege is vested in the Central Government and Central Government is the Final authority. When it has taken a Policy decision to grant such licence, the same is in conformity with the statutory provision and cannot be interfered with.

24. It was also contended that the words **as they "think fit" is vague.** The argument was rejected and it as held that the Central Government was also enjoined to act in fiduciary capacity and to act with the due restrain, to avoid misplaced philanthropy or ideology.

25. At the same time, it must be remembered that in these days of Fallen rectitude and honesty when the Bureaucracy fails to implement public Policy and constitutional philosophy of Achieving equality and protecting weaker sections, the judiciary would be astute in Declaration of law, judicial review or Dispensation of justice. (1997) 6 SCC 129 : State of Punjab and others vs. G.S. Gill and another)

26. In the case of M.S. Bindra vs. Union of India and others, the Supreme Court was required to consider the grounds of doubtful integrity. The Government Officer who enjoyed higher position Throughout his career was suddenly branded as person of unrealisable integrity and unfit to be entrusted with any position of responsibility in government service on the basis of a statement made by the Screening Committee. The statement was judicially Reviewed and it was held that the Conclusions drawn by the Screening Committee were not borne from available material. It should be based on preponderance of probabilities as judged from the standard of a reasonable man. Referring to the Mazim "Nemo firut repente Turpissimus" (no one becomes dishonest all of a sudden). It was also held that the grounds that there was no evidence or that the conclusions are reasonable apparent from the available material are almost equivalent and referred to the same infirmity in the administrative action and, therefore, the administrative authority's conclusions were not open to be judicially reviewed as they were not supported by the available material.

27. In an interesting and recent case reported in (1998) 3 SCC 72 in the case of High Court of Judicature of Rajasthan vs. Ramesh Chand Paliwal and another, a very interesting question had arisen. In that case the petitioner had challenged the promotion of Respondent No. 2 to the post of Deputy Registrar. The argument that was raised before the Division Bench of the Rajasthan High Court that, although all the posts in the establishment of high Court could be manned by the officers belonging to that establishment, certain posts of Deputy Registrar and all higher posts were being filled in by bringing officers of Rajasthan Judicial Service of Rajasthan Higher Judicial Service on deputation while many of the Subordinate Courts lay vacant causing not only frustration to the High Court staff but also difficulty to the Litigating public. The Division Bench although found that point not necessary for deciding the Writ Petition, proceeded to issue a direction to the Registrar to prepare a report in that respect and to put up the same before the Full Court through the Chief Justice for consideration and decision as to whether the officers belonging to the Judicial Services should be spared to man such posts in the High Court especially when many courts in various districts of the State remained vacant. On reviewing the law under various statutes including the Charter of 1777(10) and High Courts Act, 1861, Section 9. The Supreme Court allowed the appeal and held after referring to the Constitutional Scheme that Under the Constitution The Chief Justice is the Supreme authority alongwith other judges, so far as officers and servants of the High Court are concerned, have no role to play On the administrative side. Some Judges, Undoubtedly, will become Chief justices in their own turn one day, but it is Imperative under the Constitutional Discipline that, they work in tranquillity, Judges have been described as "hermits". They have to live and behave like "hermits" who have no desire or aspiration, having shed it through penance. Their mission is to supply light and not

heat. This is necessary so that their latent desire to run the High Court administration may not sprout before time, at least in some cases. The Supreme Court in very categorical terms pointed out that the direction of the Division Bench of the Rajasthan High Court was contrary to Article 229 of the Constitution and also contrary to Rule 2-A and beyond the power of other Judges of the High Court, as the power of appointment is vested absolutely in the Chief Justice. Even if in compliance with the directions, the Registrar reports that the said post could well be manned by High Court staff itself or that when the officers are brought from the District Courts to High Court for appointment on the aforesaid Posts render some of the subordinate courts vacant, the Full Court could not direct the Chief Justice to fill up these posts not by bringing judicial officers on deputation but by promotion from the High Court Staff. Administrative powers of the Chief Justice to run the High Court administration are wide and subject to judicial review of the judicial order, like the action of any other authority. However, the said direction involved the question which was not necessary for deciding the pending writ petition writ ought not have been issued. The status, power and authority of Chief Justice qua other Judges of the High Court under various statures from 1774 till date were reviewed and it was held that the power of the Chief Justice under Article 229 is akin to the power of Chief Justice of India under Article 147 and Government of India Act, 1935, Sections 241 and 242 (4). The academic question not necessary for deciding the writ petition even if raised, should not be adverted to by the Court.

28. Similarly, in the case of State of Punjab and ors. vs. Ram Lubhaya Bagga and ors. Reported in (1998) 4 SCC 117, the Supreme Court in categorical terms pointed out that the policy matter and the wisdom of policy cannot be judicially scrutinised though the Court can consider whether the policy is arbitrary or violative of Constitution and principle of equality.

29. Similarly, commercial transactions are also subject to a limited review and the Courts cannot sit upon the judgement over the wisdom of the executive authority in entering into a commercial transaction.

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*Speech delivered by the Hon'ble Mr. Justice A.B. Palkar at the workshop of Law Officers of Reserve Bank of India.

Judgement Section

Recent Judgements Relevant to Bankers

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I. Registration of Co-operative Banks

High Court of Kerala at Ernakulam — Original Petition No. 33751 of 2001 (R) — M.P. Unnikrishnan and another vs. Joint Registrar Co-operative Societies and others, along with OP Nos. 29908, 311471, 33751, 33904, 34640, 35024, 35059, 35284, 35753, 36426, 36915, 37305 & 37316 of 2001, 2029, 2289, 3106, 3250, 3461, 4376, 5014, 5045, 5140, 5379, 5654, 7767, 8929, 10529, 16180, 16718, 17031, 23099, 23454, 26434 and 27308 of 2002 — Decided on 29th November 2002 (Kurian Joseph J.)

1. Background facts

The chairman of Payangadi Urban Co-operative Bank Ltd. filed a writ petition against the Joint Registrar, Co-operative Societies, Kannur and the chief promoters of the proposed Pilathara Urban Co-operative Bank, Pappinisory Urban Cooperative Bank, and Madayi Urban Co-operative Bank impleading Reserve Bank as a party respondent to the writ petition. In the writ petition prayers were made (i) to declare that the registration of new proposed urban co-operative banks within the area of operation of the petitioner bank would be in violation of section 7(1)(c) of the Kerala Co-operative Societies Act, illegal and violative of Banking Regulation Act (ii) to issue writ of mandammus against the Joint Registrar, Co-operative Societies directing him not to grant registration to any unlicenced urban Co-operative Banks and (iii) to issue direction to Joint Registrar not to take up any proposal for registration of any new Urban Co-operative Bank without getting sanction from the Reserve Bank of India. Thirty three more writ petitions were filed by various parties more or less on similar lines in the High Court seeking issue of writ of prohibition and other reliefs. All 34 petitions were disposed of by the High Court by common judgement delivered on 29 November 2002.

2. Issues

(1) Whether an unlicenced urban co-operative bank can be registered under Rule 15 of Kerala Co-operative Societies Rules.

Observations of the Court – The Court held that it was significant to note that the question of classification into a type of society arises only after the registration of a society. It could not have been otherwise because an unlicensed urban cooperative bank is not a species in itself to be formed and registered. As can be seen from section 22(2) and section 36A(3) of the Banking Regulation Act an unlicensed urban bank comes into existence only in limited situations. None of the situations warrant the formation of a cooperative society from the stage of Rule 3(2), by not less than 25 persons forming a promoting committee. It follows that the Kerala Co-operative Societies Act and Rules do not permit registration of a co-operative society as an unlicensed urban bank.

(2) Whether Reserve Bank has any say in the matter of registration of co-operative societies for the purposes of transacting banking business under the Kerala Co-operative Societies Act.

Observations of the Court - The process of registration and licensing, as far as co-operative banks are concerned is complimentary to each other and unless there be close co-ordination between the registering authority on the one hand and Reserve Bank of India on the other, it might lead to a situation of defeating the purpose of both Acts in matters relating to banking by co-operative societies. Since the purpose of formation of a society and registration of the same as an urban co-operative bank is to transact banking business in urban areas as a co-operative bank, it is necessary in public interest that an assessment is made as to whether the proposed co-operative bank is capable of complying with the requirements of the various provisions of the Banking Regulation Act. True, the registering authority is the Registrar of Co-operative Societies, but the purpose of registration is transaction of banking business, which is regulated

under the provisions of the Banking Regulation Act. The Reserve Bank of India being the authority vested with supervisory powers over the banking institutions and the regulatory authority in banking business, it is for the Reserve Bank of India to prescribe norms.

The registering authority under the Kerala Cooperative Societies Act, 1969 is bound to comply with Ext. R5(a) to (f) circulars (dated 5-10-1974, 2-6-1979, 12-11-1982, 11-10-1983, 25-5-1993, 30-8-2000) and such other directions issued by Reserve Bank of India from time to time in the matter of registration of new urban co-operative banks.

Obviously all the norms prescribed by Reserve Bank of India in the matter of registration of the new nuban banks are only with a view to ensuring sound banking business by co-operative banks. Hence for that reason also Registrar is bound to comply with the directions issued by the Reserve Bank of India in the matter of registration of the new urban banks.

(3) Whether Reserve Bank can take action against unlicensed urban banks.

Observations of the Court — There was challenge against the steps taken by the Reserve Bank of India cautioning the gullible public regarding the unauthorised and illegal activities undertaken by certain unlicenced urban cooperative banks. It is the duty of the Reserve Bank of India under section 35A of the Banking Regulation Act to protect public interest and the interest of the banking policy. The Reserve Bank of India is also bound to prevent the affairs of the co-operative bank being conducted in a manner detrimental to the interest of the depositors or any manner prejudicial to the interest of the cooperative banks. It was also duty to secure the proper management of the banking business of a co-operative bank.

Therefore the steps taken by them including the press release cautioning the general public regarding the unlicenced and unauthorised actions of certain co-operative societies are perfectly in order and in exercise of their duties and powers under the Banking Regulation Act. The Reserve Bank of India can be faulted only if they do not take such steps in public interest being the statutory authority to act in such circumstances to protect public interest.

3. Directions issued by the Court

It was held by the High Court that it is for the Registrar of Co-operative Societies and the State Government under the Kerala Co-operative Societies Act, and the Reserve Bank of India under the Banking Regulation Act to take appropriate steps in the light of what is stated above. In cases where the Registrar, the Government or the Reserve Bank of India, as the case may be, has already been moved regarding the violation of statutory provisions, action in the light of the judgement shall be taken to set things in order, within two months and in other cases within two months from the date of receipt of appropriate representation. It is the duty and function of the Reserve Bank of India to take prompt steps provided under the Banking Regulation Act, 1949 in the event of violation of the provisions of the Act, for safeguarding public interest, for protecting banking policy, for preventing the disorderly functioning of the co-operative banks and for the proper management of banking business in co-operative banks and it is for the public to alert the Reserve Bank of India regarding their duties and functions, in the event of violation of the provisions of the Banking Regulation Act, 1949.

All the petitions were disposed of in the light of the above.

II. Direction under section 35A of Banking Regulation Act

Decision of Division Bench of Bombay High Court in Writ Petition No. 1400 of 2002 – T.A. Khan vs. Reserve Bank of India & another –Decided on 8 October 2002. (A.P. Shah and Smt. Ranjana Desai, JJ)

Facts

The Reserve Bank in exercise of the powers conferred under section 35 of the Banking Regulation Act, 1949 as applicable to co-operative societies conducted statutory inspection of the Bombay Mercantile Co-operative Bank Ltd., a cooperative bank registered under Multi-state Cooperative Societies Act, 1984 with reference to its financial position as on 30 September 1998. The inspection revealed several irregularities in the working of the co-operative bank in particular the credit department, which resulted in huge NPA in loans and advances granted by the bank. The Reserve Bank issued directive on 12-8-1999 under section 35A of the Banking Regulation Act to the co-operative bank requiring the bank to divest the petitioner of the charge of the Credit Department in the interest of the depositors. The co-operative bank in pursuance of the Reserve Bank's directive dated 12-8-1999 issued show cause notice to the petitioner asking him to explain the allegations about the financial irregularities allegedly committed by him. The petitioner was also facing crimina case relating to shoes scam which was exposed in 1992. A special audit of the bank was carried out in the year 2000-2001. The interim audit report revealed number of irregularities, malpractices and fraud during the year under report. The co-operative bank was directed to convene the meeting of the Board of Directors and prepare plan of action to rectify the situation in a time bound limit. The Reserve Bank conducted inspection again for the period ended 30 September 2001 which revealed that the financial position of the bank further deteriorated. In the meantime the Chairman of the co-operative bank forwarded a resolution passed by the Board of Directors of the Bombay Mercantile Co-operative Bank seeking approval of Reserve Bank to the appointment of the petitioner as a Managing director of the cooperative bank. The Reserve Bank vide letter dated 3rd May 2001 and 4th May 2002 in reply advised the co-operative bank to conduct the inquiry as per procedure in vogue in the bank and on its conclusion to take final decision on the basis of finding of the Enquiry Officer. The petitioner challenged in the writ petition propriety and legality of the directives dated 12-8-1999, 3-5-2001 and 4-5-2002 issued by the Reserve Bank.

Issue

Whether the Reserve Bank was empowered to issue direction to remove managerial and other officers of the co-operative bank or to direct the bank to hold an inquiry against the petitioner.

Decision

The High Court after considering the submissions made by the Counsels held that the action taken by the Reserve Bank of India was not for the removal of the petitioner. The Reserve Bank

of India merely directed to divest the petitioner of the charge of the Credit Department having discovered several irregularities in the working of the said Department. The petitioner continues in the service and his increment was not affected in any manner. It was admitted position that the criminal cases were pending against the petitioner. The inquiry initiated by the bank against the petitioner pursuant to the Reserve Bank directive was also pending. Under these circumstances, the Reserve Bank of India was fully justified in advising the bank to complete the inquiry against the petitioner and take final decision on the basis of the findings of the inquiries.

The Court further held that (a) in the present case, the Reserve Bank acted to safeguard the interest of the depositors, (b) it was impossible to accept the argument that the directives issued the Reserve Bank were without any authority of law, and (c) in view of the requisition issued by Reserve Bank, on the basis of interim audit, to Central Registrar to supersede the Board of Directors of the cooperative bank and to appoint an Administrator for preventing the affairs of the bank from being conducted in a manner detrimental to the interest of he depositors and for securing proper management of the bank and board having been superseded by Joint Secretary and Registrar of Co-operative Societies vide his order dt. 14-8-2002, the recommendation of the erstwhile Board of Directors has become redundant.

Conclusion

The writ petition was dismissed.

III. Supersession of the Board of Directors of Urban Co-operative Banks

High Court of Gujarat at Ahmedabad – Special Civil Application No. 5368 of 2002 with Special Civil Application No. 5396, 5397, 5398, 5399, 5400 and 5406 and 2002 – Surat Mahila Nagrik Sahakari Bank Ltd. vs. Reserve Bank of India – Order dt. 15-7-2002

Facts

Petitioners, urban co-operative banks entered into transactions with brokers for purchase and sale of Government securities in violation of directives issued by the Reserve Bank from time to time. Reserve Bank conducted scrutiny of investment portfolio in Government securities of these banks which revealed that the banks suffered judge loss in these transactions for the reasons that they did not follow the safeguards provided in directives issued by Reserve Bank from time to time. The amount paid by these banks to brokers resulted in clean advance to the brokers without any security and loss asset. In fact no securities were purchased, sold or delivered in physical form. Considering the enormity of the transactions, the amount involved and the conduct of the board of directors of these banks, the Reserve Bank was satisfied that the affairs of the co-operative banks were being conducted in the manner prejudicial to the interest of the depositors. In exercise of the powers conferred section 115A of the Gujarat Co-operative Societies Act, 1960, the Reserve Bank issued requisition to the Registrar Co-operative Societies Gujarat Ahmedabad requiring him to supersede the Board of Directors of these co-operative banks and appoint administrator. The requisition issued by the Reserve Bank was binding on the Registrar Co-operative Societies in view of the judgement of Gujarat High Court in Harisidh Co-operative Bank's case and Sardar Nagarik Sahakari Bank's case. The co-operative banks filed writ

petitions in the High Court challenging the requisition issued by the Reserve Bank. The Reserve Bank filed detailed counter affidavit to the writ petition justifying the action taken by the Reserve Bank in the matter. The Minister of State, Protocal and Co-operation, Government of Gujarat sent a letter dated 25th June 2002 to the Reserve Bank stating therein that the State Government shall take collective measures to improve the financial position of the banks concerned. In the light of representation made by the Union Minister of State for Textiles and the delegation from the South Gujarat Urban Co-operative Banks Association to the Union Minister of State for Finance during his visit to Mumbai on June 21, 2002 and also the assurance given by the Minister of State Protocol and Co-operation, Government of Gujarat, the Reserve Bank issued a letter that it agreed not to enforce the requisition made to the Registrar of Co-operative Societies for a period of one year. It was also made clear that if the collective measures were not properly implemented within a period of one year, the Reserve Bank will invoke the requisition.

Decision

After considering the Reserve Bank's letter dated 9-7-2002, the Court observed that the apprehension of the petitioners that the Committee/ Board of Directors will be superseded would not survive for the present and therefore all the writ petitions were disposed off as having become infractuous. The petitioners also submitted that the right may be reserved in case the Reserve Bank enforces its directive even after one year. The Court observed that no clarification is required because if the Reserve Bank of India enforces such directives, the petitioner will have remedy as available to them in accordance with law.

The petitions were disposed of having become infractuous.

IV. Execution of Foreign Decree Before DRT

Before the High Court of Bombay – Bank of India. vs. Harshadrai Odhavji – Chamber summons No. 38 of 2002 – AIR 2002 Bom. 449

Principle

Foreign decree may be executed in India in accordance with the law in India as if it has been passed by the District Court. Execution of a foreign decree is within the jurisdiction of DRT.

Facts

On 16th October 1996 Bank of India obtained a decree before the High Court of Justice, Queen's Bench Division at England for a sum of Rs. 2,47,82,743.40. The decree holder has started execution proceeding against the judgement debtor before the High Court of Bombay. DRT had not been constituted then. When the constitution of DRT was notified, the execution application was transferred to DRT. The judgement debtor has taken out the present chamber summons for a direction that the execution application filed by the decree holder be retained before the High Court and not be transferred to DRT under the provisions of Recovery of Dues due to Banks and Financial Institutions Act (RDB Act).

Observations of the Court

Section 44-A of the Code of Civil Procedure makes it clear that the foreign decree may be executed in India as if it has been passed by the District Court. Thus, the original character of foreign decree is not of any consequence and the amount "payable under the decree or order of any civil court" may be treated as debt payable within the meaning of Section 2(g) of RDB Act.

A domestic decree must necessarily be executed in accordance with the law in India. A foreign decree by virtue of Section 44A(i) must also be executed in accordance with the law in India. For the purpose of ascertaining whether a foreign decree is liable to be executed only under the provisions of RDB Act the difference between the two kinds of decree would be of no significance.

The Court has also relied upon the principle laid down by the Supreme Court in Allahabad Bank vs. Canara Bank (AIR 2000 SC 1535), wherein it was held that the execution of a decree whether domestic or foreign is in the nature of an application for recovery of a debt and must be entertained and decided by the DRT alone and its Recovery officer only under the Scheme of the RDB Act. Application for execution of a foreign decree when made to the Tribunal or upon transfer under Section 19 of RDB Act would be decided according to the powers of the Tribunal, which as held by the Supreme Court includes all powers of a Court as cont ained in Code of Civil Procedure. The procedure provided by the special law must prevail over the general law. Considering the scope of Section 17 and 22 of the RDB Act the execution of a foreign decree must be heard and tried by the tribunal since it is within the jurisdiction of the Tribunal to do so.

Decision

The Chamber Summons is disposed of accordingly.

V. Invocation of Personal Guarantee

Before the High Court fo Allahabad – Kailash Chand Jain vs. Uttar Pradesh Financial Corporation, Kanpur and Others – Civil (Mis) Writ Petition No. 16530 of 2000 – AIR 2002 All 302

Principle

It is the choice of the creditor as to which remedy it would pursue and the defaulting party cannot compel the creditor to take recourse to any particular remedy. Even though the creditor had taken the possession of the unit of the principal borrower by invoking Section 29 of the State Financial Corporation Act 1951, still it is open to the creditor to invoke personal guarantee. Such action of the creditor is not barred on the basis of doctrine of election. The liability of the guarantor is co-extensive with that of the principal borrower.

Facts

It is alleged by the petitioner that M/s. Deepak Rice Mills (P) Ltd. (the Company) was disbursed

of loan in eight instalments from 1992 to 1997 to the tune of Rs. 2,29,97,000/- out of which Rs. 60,49,800/- towards the principal amount and interest thereon had been repaid. Thus an amount Rs. 1,69,57,600/- has remained outstanding against the company. The petitioner and 3 others were the directors of the company. When due to financial crisis and non-availability of raw materials one of the instalments had fallen due and the creditor by its letter dated 30th March 1997 took over physical possession of the company in exercise of its power under Section 29 of the State Financial Corporation Act, 1951. The creditor had also published an advertisement in the news paper for sale of the unit of the company alongwith its sister concern. Thus started proceedings under Section 29 of the State Financial Corporation Act for sale of the unit of the Company. It is further alleged by the petitioner that the petitioner submitted his resignation from directorship by letter dated 1st October 1997 under Section 303 (2) of the Companies Act. Thus the Petitioner continued as director only during the period 7-2-92 to 1-10-97. Further, the Assistant Registrar (Companies) vide letter dated 18-2-2000, under Section 628 of the Companies Act indicated that the petitioner has ceased to be a director of the said Company on 19th January 1998.

Observations of the Court

The liability of the guarantor is co-extensive with that of the principal borrower under Section 138 of the Indian Contract Act. Though the creditor had taken possession of the unit of the Company, under Section 29 of the State Financial Corporation Act, 1951, it is legally permissible for the creditor to proceed against the guarantors on the basis of their guarantees. It is the choice of the creditor as to which of the remedies it would pursue and against which of the parties it would proceed. The proceedings initiated by the Creditor against the company and its directors cannot be termed to be unfair or unjust. The petitioner and other director/ guarantors of the Company did not take any efforts to ensure repayment of the loan taken by the Company. The liability for repayment of interest is depend on the terms and conditions of the agreement. The interest would continue to run in terms of the agreement as long as repayment of the loan is not made. The interest would not cease to run merely because the creditor has taken possession of the unit of the company or has failed to sell the unit of the Company.

Decision

The writ petition is allowed to the extent that the Tehsildar is directed to decide the question as to whether any personal property of the petitioner had been mortgaged with the creditor. If the Tehsildar comes to the conclusion that no personal property of the petitioner had been mortgaged there will be no bar in proceedings to make recovery against the personal properties of the petitioner which had not been mortgaged.

VI. Dishonour of Cheque

Before the Supreme Court – Criminal Appeal No. 950 of 2001 – Vinod Tanna and another vs. Zohar Siddiqui and others – (2002) 7 SCC 541

Principle

Dishonour of Cheque because of incomplete signature of drawer did not attract Section 138 of the Negotiable Instruments Act, 1881.

Facts

This appeal is against the judgement of the High Court of Bombay refusing the prayer of the accused to quash the criminal proceedings initiated under Section 138 and 142 of the Negotiable Instruments Act 1881 alleging that the cheque was not honoured by the Bank. The petitioners case before the High Court was that the cheque was dishonoured by the bank not because of insufficient funds at the credit of the account holder but the cheque was dishonoured because of the drawer's signature was incomplete.

Observations of the Court

A plan regarding of Section 138 of the Negotiable Instrument Act, 1882 makes it ample clear that unless he conditions precedent therein are satisfied the said penal provision cannot be attracted. The High Court has committed error in relying upon the judgement in Modi Cement Case (1998) 3 SCC 249.

Decision

Criminal Appeal was allowed.

VII. Irregularities in Bank Guarantee

Before the Supreme Court – Delhi Development Authority vs. Skipper Construction Co. (Pvt.) Ltd. – Special Leave Petition (Civil) – No. 21000 of 1993 – Jt. 2002(9) SC 225

Facts

M/s Skipper Constructions (P) Ltd. (the Company) undertake development and construction of commercial and residential complexes. The bid of Rs. 982 lacs in respect of a Plot of land offered by the company was accepted by the Delhi Development Authority (DDA). The company had deposited Rs. 245.75 lakh on the date of auction and the balance amount of Rs. 736.25 was required to be deposited within 90 days. The company raised Rs. 645.66 lakh from the flat owners to of which Rs. 583.25 lacs was paid to DDA towards land cost. DDA had agreed to recover the balance amount of Rs. 398.75 lacs together with interest @ 18% per annum in five equal instalments in 2½ years and delivered possession of the land against bank guarantee for the like amount. The application for issue of guarantee submitted by the company to, New Bank of India, was finally sanctioned by the board of New Bank of India for 8.7 crores. Irregularities in the matter of furnishing of bank guarantee resulted substantial loss to the bank. The Court directed the sitting judge of the Delhi High Court to inquire into the matter. The report of the one man commission indicates that there were several lacunnae in considering the request and the terms of supervision by intermediary authorities such as regional office and also wrong forms were used in the transaction. There was complete lack of prudence on the part of the officials. The officials of the bank did not act diligently or prudently in extending the facility to the

company. The commission however was not recorded or quantified the amount of misfeasance and malfeasance on the part of the bank officials. The matter was also examined by the two Deputy Governors of Reserve Bank of India. However, the court was not satisfied with the report submitted by the Deputy Governors of Reserve Bank of India.

Order

The matter in issue is to be considered by the Central vigilance Commission for the purpose of ascertaining the quantum of loss suffered by the bank by reason of malfeasance of the officials of the bank. The commission has to submit its report within eighteen months.

Nothing is more permanent than a temporary government programme.

— Milton Friedman

The illegal we do immediately. The unconstitutional takes a little longer.

— Henry Kissinger

Serious sport... is war minus the shooting

— George Orwell

Two Judgements from the Apex Court

P.S.N Prasad
Deputy Legal Adviser,

I. ON RECENT AMENDMENTS TO CIVIL PROCEDURE CODE

Salem Advocate Bar Association, Tamil Nadu vs. Union of India

JT 2002 (9) SC 175

Under Article 32 of the Constitution of India, writ petitions were filed in public interest seeking to challenge the amendments made to the Civil Procedure Code by the amendment Act 46 of 1999 and Amendment Act 22 of 2002. Section 27 (Summons to defendants), Section 89 – Settlement of disputes outside the Court, Section 100 – Appeal – Bar of intra court appeal, – New Section 100A providing that no appeal shall lie from the order or judgement passed by single judge of High Court in an appeal from an original or appellate decree or order, etc. were challenged before the Supreme Court as unconstitutional. The court after examining the contentions for and against these provisions concluded that the provisions are not in any way ultra virus the Constitution and that the amendments made do not attract any constitutional infirmity.

Amendment to Section 27 – summons. It has been clarified that the amendment fixes outer time

frame, by providing that steps must be taken within thirty days from the date of institution of the suit, to issue summons. In other words, if the suit is instituted, for example, on 1st January, 2002 then the correct addresses of the defendants and the process fee must be filed in the court within thirty days so that summons be issued by the court not beyond thirty days from the date of the institution of the suit. The object is to avoid long delay in issue of summons for want of steps by the plaintiff. It is quite evident that if all that is required to be done by a party, has been performed within the period of thirty days, then no fault can be attributed to the party. If for any reason, the court is not in a position or is unable to or does not issue summons within thirty days, there will be, compliance with the provisions of section 27 once within thirty days of the issue of the summons the party concerned has taken steps to file the process fee along with completing the other formalities which are required to enable the court to issue the summons.

Insertion of a new section 89. It is obvious that section 89 has been inserted to try and see that all the cases which are filed in court need not necessarily be decided by the court itself, keeping in mind the laws, delays and the limited number of judges which are available. It has now become imperative that resort should be made to Alternative Dispute Resolution (ADR) mechanism with a view to bring to an end litigation between the parties at an early date. Arbitration or conciliation or judicial settlement including settlement through Lok Adalat or mediation need to be encouraged. In certain countries of the world ADR has been successful to the extent that over 90 per cent of the cases are settled out of court. There is a requirement that the parties to the suit must indicate the form of ADR which they would like to resort to during the pendency of the trial of the suit. Even though arbitration or conciliation has been in place as a mode for settling the disputes, this has not really reduced the burden on the courts. The modalities have to be formulated for the manner in which section 89 and, for that matter, the other provisions which have been introduced by way of amendments, may have to be in operation.

All counsels agreed that it will be appropriate if a committee is constituted so as to ensure that the amendments made become effective and result in quicker dispensation of justice. With the constitution of such a committee, any creases which require to be ironed out can be identified and apprehensions which may exist in the minds of the litigating public or the lawyers clarified. As suggested, the committee will consist of a judge sitting or retired nominated by the Chief Justice of India and the other members of the committee will be Mr. Kapil Sibal, senior advocate, Mr. Arun Jaitley, senior advocate, Mr. S.S. Vaidyanathan, senior advocate and D.V. Subba Rao, Chairman, Bar Council of India. This committee will be at liberty to co-opt any other member and to take assistance of any member of the Bar Association. This committee may consider devising a model case management formula as well as rules and regulations which should be followed while taking resource to the ADR referred to in section 89. The model rules, with or without modification, which are formulated may be adopted by the High Court concerned for giving effect to section 89(2)(d).

Amendment to Section 100A – Appeal. The Supreme Court observed that Section 100A deals with two types of cases which are decided by a single judge. One is where the single judge hears an appeal from an appellate degree or order. The question of there being any further appeal in such a case cannot and should not be contemplated. Where, however, an appeal is filed before the High Court against the decree of a trial court, a question may arise whether any further appeal should be permitted or not. Even at present depending upon the value of the case, the

appeal from the original decree is either heard by a single judge or by a division bench of the High Court. Where the regular first appeal so filed is heard by a division bench, the question of there being an intra-court appeal does not arise. It is only in cases where the value is not substantial that the rules of the High Court may provide for the regular first appeal to be heard by a single judge. In such a case to give a further right of appeal where the amount involved is nominal to a division bench will really be increasing the workload unnecessarily. No prejudice would be caused to the litigants by not providing for intra court appeal, even where the value involved is large. In such a case, the High Court by rules, can provide that the division bench will hear the regular first appeal. No fault can, thus, be found with the amended provision of section 100A.

Clauses (e) & (f) added to order 7 rule 11. It was observed that the said clauses being procedural would not require the automatic rejection of the plaint at the first instance. If there is any defect as contemplated by rule 11(e) or non-compliance as referred to in rule 11(f), the court should ordinarily give an opportunity for rectifying the defects and in the event of the same not being done the court will have the liberty or the right to reject the plaint

Examination of witness – Order 18, rule 4. Sub rule (i) of rule 4 provides that in every case Chief Examination should be on affidavits and copy should be served on the other side. The Supreme Court has taken a view that Order 18, Rule 4 (1) will necessarily apply to a case contemplated by order 16, Rule 1(a) i.e. where a party to a suit, without applying for summoning under Rule 1 brings any witness to give evidence or produce any document. In such a case, Examination-in-Chief is not to be recorded by Court but shall be in the form of an Affidavit. When summons are issued the Court can give an option to the witness summoned either to file an affidavit by way of examination-in-chief or to be present in court for his examination. It is further said that in appropriate cases, the court can direct the summoned witness to file an affidavit by way of examination-in-chief. In other words, with regard to the summoned witnesses the principle incorporated in order 18 rule 4 can be waived. Whether a witness shall be directed to file affidavit or be required to be present in court for recording of his evidence is a matter to be decided by the court in its discration having regard to the facts of each case.

Recording evidence. Regarding the evidence recorded by the Commissioner, it has been clarified that the evidence can be recorded even by the help of media, audio – visual and in fact whenever the evidence is recorded by the commissioner it will be advisable that there should be simultaneously at least an audio recording of the statement of the witnesses so as to obviate any controversy at a later stage.

Additional evidence – rule 17A. By amendment in 1976, rule 17A had been inserted in Order 18 which gives an opportunity to a party to adduce additional evidence under the circumstances mentioned therein. The Amendment Act of 2002, deletes this sub-rule The Supreme Court has observed that the effect of the deletion of this provision in 2002 is merely to restore status quo ante, that is to say, the position which existed prior to the insertion of rule 17A in 1976. The remedy, if any, that was available to a litigant with regard to adducing additional evidence prior to 1976 would be available now and no more. It is quite evident that rule 17A has been deleted with a view that applications are not filed primarily with a view to prolonging the trial.

Memo of Appeal – order 41 rule 9. The Supreme Court has clarified that the appeal is to be filed under order 41 rule 1 in the court in which it is maintainable. All that order 41 rule 9 requires is that a copy of memorandum of appeal which has been filed in the appellate court should also be presented before the court against whose decree the appeal has been filed and endorsement thereof shall be made by the decreeing court in a book called the register of appeals. Perhaps, the intention of the legislature was that the court against whose decree an appeal has been filed should be made aware of the factum of the filing of the appeal which may or may not be relevant at a future date. Merely because a memorandum of appeal is not filed under order 41 rule 9 will not, to our mind, make the appeal filed in the appellate court as a defective one.

Removal of Difficulties. While concluding the judgement, it is stated that if any difficulties are felt, these can be placed before the committee constituted hereinabove for the purpose. The Committee would consider the said difficulties and make necessary suggestions in its report. It would be open to the Committee to seek directions. The Committee is requested to file its report within a period of four months.

Further Steps – Directions. To consider the report of the Committee, the petitions are posted after four months and copies of the judgement have been ordered to be sent to the Registrars of all the High Courts so that necessary action can be taken by the respective High Courts and any writ petition pending in those High Courts can be formally disposed of.

II. NATIONAL CONSUMER COMMISSION –POWER TO DIRECT TO GO TO CIVIL COURT

This is an appeal from the National Consumer Disputes Redressal Commission in Synco

Industries vs. State Bank of Bikaner & Jaipur, (2002 (3) CRR 105 (SC). The prayer of the appellant was for awarding damages of Rs. 15 crores and cost of Rs. 61 lakhs. The National Commission dismissed the case as it did not find it a fit case triable under summary procedure of Consumer Protection Act. However, liberty was given to move to the Civil Court. The Appellants challenged the above order before the Supreme Court, to determine whether National Commission was right?

Facts

The facts in brief indicate that appellants moved the National Consumer Disputes Redressal Commission alleging that the respondents had committed deficiency in service by frozening the sanctioned working facilities without prior intimation to the appellants. The appellants also prayed for a direction to the first respondent to prepare a funding package to restart the appellant's oil division and grant waiver of interest, damages in the sum of Rs. 15 crores and additional sum of Rs. 60 lakhs to cover the cost of travelling, man days lost and other expenses incurred by the appellant in pursuing the matter with the respondents. The National Consumer Disputes Redressal Commission dismissed the complaint. The National Commission had come to a conclusion that it is not a fit case to be tried under the Consumer Protection Act and hence dismissed the petition by granting liberty to go to the Civil Court or any other Forum.

Observations of the Court

The very important aspect of the judgement was that **where the complaint required detailed evidence to prove the claim and to prove the damages and expenses, it is not an appropriate case to be heard and disposed of in a summary fashion under Consumer Protection Act. The Apex Court observed that the National Commission rightly gave liberty to move the Civil Court. The appellant instead of moving Civil Court to save heavy court fees, appealed to Apex Court which is an abuse of the process of Consumer Forum.**

Decision

The appeal was dismissed with cost in favour of first respondent.

Legislation Section

The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 (Act No. 55 of 2002)

Statement of Objects and Reasons

The Negotiable Instruments Act, 1881 was amended by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988 wherein a new Chapter XVII was incorporated for penalties in case of dishonour of cheques due to insufficiency of funds in the account of the drawer of the cheque. These provisions were incorporated with a view to encouraging the culture of use of cheques and enhancing the credibility of the instrument. The existing provisions in the Negotiable Instruments Act, namely sections 138 to 142 in Chapter XVII have been found deficient in dealing with dishonour of cheques. Not only the punishment provided in the Act has proved to be inadequate, the procedure prescribed for the Courts to deal with such matters has been found to be cumbersome. The courts are unable to dispose of such cases expeditiously in a time bound manner in view of the procedure contained in the Act.

2. A large number of cases are reported to be pending under sections 138 to 142 of the Negotiable Instruments Act, 1881 in various courts in the country. Keeping in view the large number of complaints under the said Act pending in various courts, a Working Group was constituted to review section 138 of the Negotiable Instruments Act, 1881 and make recommendations as to what changes were needed to effectively achieve the purpose of that section.

3. The recommendations of the Working Group along with other representations from various institutions and organisations were examined by the Government in consultation with the Reserve Bank of India and other legal experts, it has been decided to bring out, inter alia, the following amendments in the Negotiable Instruments Act, 1881, namely:--

(i) increasing the punishment as prescribed under the Act from one year to two years;

(ii) increasing the period for issue of notice by the payee to the drawer from 15 days to 30 days;

(iii) to provide discretion to the court to waive the period of one month, which has been prescribed for taking cognizance of the case under the Act;

(iv) to prescribe procedure for dispensing with preliminary evidence of the complainant;

(v) to prescribe procedure for servicing of summons by the Court through speed post or empanelled private couriers;

(vi) to provide for summary trial of the cases under the Act with a view to speeding up disposal of cases; and

(vii) make the offences under the Act compundable.

4. The amendments in the Act are expected to result in early disposal of cases relating to dishonour of cheques by the Courts and are also aimed at enhancing punishment for offenders.

5. The Bill seeks to achieve the above objects.

*** * ***

An Act further to amend the Negotiable Instruments Act, 1881, the Bankers' Books Evidence Act, 1891 and the Information Technology Act, 2000.

Be it enacted by Parliament in the Fifty-third Year of the Republic of India as follows:--

CHAPTER I

Preliminary

1. Short title and commencement.--

(1) This Act may be called the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002.

(2) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act.

CHAPTER II

Amendments to the Negotiate Instruments Act, 1881

Substitution of new section for section 6.--

2. For section 6 of the Negotiable Instruments Act, 1881 (hereinafter referred to as the principal Act), the following section shall be substituted, namely:--

'6. "Cheque".-- A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Explanation 1.--For the purposes of this section, the expressions--

(a) "a cheque in the electronic form" means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;

(b) "a truncated cheque" means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Explanation II.--For the purposes of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India.'.

3. Amendment of section 64.--

Section 64 of the principal Act shall be renumbered as sub-section (1) thereof, and after sub-section (1) as sore-numbered, the following sub-section shall be inserted, namely:--

"(2) Notwithstanding anything contained in section 6, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification:

Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.",

4. Amendment of section 81.--

Section 81 of the principal Act shall be renumbered as sub-section (1) thereof, and after sub-section (1) as on re-numbered, the following sub-sections shall be inserted, namely:--

"(2) Where the cheque is an electronic image of a truncated cheque, even after the payment the banker who received the payment shall be entitled to retain the truncated cheque.

(3) A certificate issued on the foot of the printout of the electronic image of a truncated cheque by the banker who paid the instrument, shall be prima facie proof of such payment.".

5. Amendment of section 89.--

Section 89 of the principal Act shall be renumbered as sub-section (1) thereof, and after sub-section (1) as so re-numbered, the following sub-sections shall be inserted, namely:--

"(2) Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image.

(3) Any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same.".

6. Amendment of section 131.--

In section 131 of the principal Act, Explanation shall be re-numbered as Explanation 1 thereof, and after Explanation I as so re-numbered, the following Explanation shall be inserted, namely:--

"Explanation II.--It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.".

7. Amendment of section 138.--

In section 138 of the principal Act,--

(a) for the words "a term which may be extended to one year", the words "a term which may be extended to two years" shall be substituted;

(b) in the proviso, in clause (ft), for the words "within fifteen days", the words "within thirty days" shall be substituted.

8. Amendment of section 141.--

In section 141 of the principal Act, in sub-section (1), after the proviso, the following proviso shall be inserted, namely:--

"Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for-prosecution under this Chapter.".

9. Amendment of section 142.--

In section 142 of the principal Act, after clause (b), the following proviso shall be inserted, namely:-

"Provided that the cognizance of a complaint may be taken by the Court after the prescribed period, if the complainant satisfies the Court that he had sufficient cause for not making a complaint within such period.".

10. Insertion of new sections after section 142.--

After section 142 of the principal Act, the following sections shall be inserted, namely:--

"143. Power of Court to try cases summarily.--

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials:

Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees:

Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

(2) The trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

(3) Every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

144. Mode of service of summons.--

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), and for the purposes of this Chapter, a Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by 8 Court of Session.

(2) Where an acknowledgment purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorised by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the Court issuing the summons may declare that the summons has been duly sewed.

145. Evidence on affidavit.--

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any enquiry, trial or other proceeding under the said Code.

(2) The Court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein.

146. Bank's slip prima facie evidence for certain facts.--

The Court shall, in respect of every proceeding under this Chapter, on production of bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved.

147. Offences to be compoundable.--

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), every offence punishable under this Act shall be compoundable.".

CHAPTER III

AMENDMENTS TO THE BANKERS' BOOKS EVIDENCE ACT, 1891

11. Amendment of section 2.--

In section 2 of the Bankers' Books Evidence Act, 1891 (18 of 1891),--

(a) for clause (3), the following clause shall be substituted, namely:--

'(3) "bankers' books" include ledgers, day-books, cash-books, account-books and all other records used in the ordinary business of the bank, whether these records are kept in written form or stored in a micro film, magnetic tape or in any other form of mechanical or electronic data retrieval mechanism, either onsite or at any offsite location including a back-up or disaster recovery site of both;';

(b) in clause (5), after sub-clause (6), the following sub-clause shall be inserted, namely:--

"(c) a printout of any entry in the books of a bank stored in a micro film, magnetic tape or in any other form of mechanical or electronic data retrieval mechanism obtained by a mechanical or

other process which in itself ensures the accuracy of such printout as a copy of such entry and such printout contains the certificate in accordance with the provisions of section 2 A.".

CHAPTER IV

AMENDMENTS TO THE INFORMATION TECHNOLOGY ACT, 2000

12. Amendment of section 1.--

In the Information Technology Act, 2000 (21 of 2000) (hereinafter referred to as the principal Act), in section 1, in sub-section (4), for clause (a), the following clause shall be substituted, namely:--

"(a) a negotiable instrument (other than a cheque) as defined in section 13 of the Negotiable Instruments Act, 1881 (26 of 1881);".

13. Insertion of new section 81A.--

After section 81 of the principal Act, the following section shall be inserted, namely:---

'81 A. Application of the Act to electronic cheque and truncated cheque.--

(1) The provisions of this Act, for the time being in force, shall apply to, or in relation to, electronic cheques and the truncated cheques subject to such modifications and amendments as may be necessary for carrying out the purposes of the Negotiable Instruments Act, 1881 (26 of 1881) by the Central Government, in consultation with the Reserve Bank of India, by notification in the Official Gazette.

(2) Every notification made by the Central Government under sub-section (1) shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of me session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or both Houses agree that the notification should not be made, the notification shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification.

Explanation.--For the purposes of this Act, the expressions "electronic cheque" and "truncated cheque" shall have the same meaning as assigned to them in section 6 of the Negotiable Instruments Act, 1881.'.

The Legal Services Authorities (Amendment) Act, 2002

(ACT NO. 37 OF 2002*

An Act further to amend the Legal Services Authorities Act, 1987

Be it enacted by Parliament in the Fifty-third Year of the Republic of India as follows :

1. Short title. — This Act may be called the Legal Services Authorities (Amendment) Act, 2002.

2. Amendment of Section 11A.— In the Legal Services Authorities Act, 1987 (hereinafter referred to as the principal Act), in section 11A, in sub-sec. (2), clause (a), for the words "senior Civil Judge", the words "senior-most Judicial Officer" shall be substituted.

3. Amendment of section 22.— In section 22 of the principal Act, for the words "Lok Adalat", wherever they occur, the words "Lok Adalat or Permanent Lok Adalat" shall be substituted.

4. Insertion of new Chapter VIA.— After Chapter VI of the principal Act, the following Chapter shall be inserted, namely :

CHAPTER VIA

PRE-LITAGATION CONCILIATION AND SETTLEMENT

22A. Definitions.— In this Chapter and for the purposes of sections 22 and 23, unless the. context otherwise requires, —

(a) "Permanent Lok Adalat" means a Permanent lok Adalat established under sub-section (1) of section 22B;

(b) "public utility service" means any —

(i) transport service for the carriage of passengers or goods by air, road or water; or

(ii) postal, telegraph or telephone service; or

(iii) supply of power, light or water to the public by any establishment; or

(iv) system of public conservancy or sanitation; or

(v) service in hospital or dispensary; or

(vi) insurance service.

and includes any service which the Central Government or the State Government, as the case may be, may, in the public interest, by notification, declare to be a public utility service for the purposes of this Chapter.

22B. Establishment of Permanent Lok Adalats.—(1) Notwithstanding anything contained in

section 19, every State Authority shall, by notification, establish Permanent Lok Adalats at such places and for exercising such jurisdiction in respect of one or more public utility services and for such areas as may be specified in the notification.

(2) Every Permanent Lok Adalat established for an area notified under sub-section (1) shall consit of

(a) a person who is, or has been, a district Judge or additional district Judge or has held judicial office higher in rank than that of a district Judge, shall be the Chairman of the Permanent Lok Adalat; and

(b) two other persons having adequate experience in public utility service to be nominated by the Central Government or, as the case may be, the state Government on the recommendation of the Central Authority or, as the case may be, the State Authority; appointed by the Central Authority or, as the case may be, the State Authority, establishing such Permanent Lok Adalat and the other terms and conditions of the appointment of the Chairman and other persons referred to in clause (b) shall be such as may be prescribed by the Central Government.

22C. *Cognizance of cases by Permanent Lok Adalat*. — (1) Any party to a dispute may, before the dispute is brought before any Court, make an application to the Permanent Lok Adalat for the settlement of dispute :

Provided that the permanent Lok Adalat shall not have jurisdiction in respect of any matter relating to an offence not compoundable under any law :

Provided further that the permanent Lok Adalat shall also not have jurisdiction in the matter where the value of the property in dispute exceeds ten lakh rupees :

Provided also that the Central Government, may, by notification, increase the limit of ten lakh rupees specified in the second proviso in consultation with the Central Authority.

(2) After an application is made under subsection (1) to the Permanent Lok Adalat, no party to that application shall invoke jurisdiction of any court in the same dispute.

(3) Where an application is made to a Permanent Lok Adalat under sub-section (1), it—

(a) shall direct each party to the application to file before it a written statement, stating therein the facts and nature of dispute under the application, points or issues in such dispute and grounds relied in support of, or in opposition to, such points or issues, as the case may be, and such party may supplement such statements with any document and other evidence which such party deems appropriate in proof of such facts and grounds and shall send a copy of such statement together with a copy of such document and other evidence, if any, to each of the parties to the application;

(b) may require any party to the application to file additional statement before it at any stage of the conciliation proceedings;

(c) shall communicate any document or statement received by it from any party to the application to the other party, to enable such other party to present reply thereto.

(4) When statement, additional statement and reply, if any, have been filed under sub-section (3), to the satisfaction of the Permanent Lok Adalat, it shall conduct conciliation proceedings between the parties to the application to such manner as it thinks appropriate taking into account the circumstances of the dispute.

(5) The Permanent Lok Adalat shall, during conduct of conciliation proceedings under subsection (4), assist the parties in their attempt to reach an amicable settlement of the dispute in an independent and impartial manner.

(6) It shall be duty of every party to the application to cooperate in good faith with the Permanent Lok Adalat in conciliation of the dispute relating to the application and to comply with the direction of the Permanent Lok Adalat in conciliation of the dispute relating to the application and to comply with the direction of the Permanent Lok Adalat to produce evidence and other related documents before it.

(7) When a Permanent Lok Adalat, in the aforesaid conciliation proceedings, is of opinion that there exist elements of settlement in such proceedings which may be acceptable to the parties, it may formulate the terms of a possible settlement of the dispute and give to the parties concerned for their observations and in case the parties reach at an agreement on the settlement of the dispute, they shall sign the settlement agreement and the Permanent Lok Adalat shall pass an award in terms thereof and furnish a copy of the same to each of the parties concerned.

(8) Where the parties fail to reach at an agreement under sub-section (7), the Permanent Lok Adalat shall, if the dispute does not relate to any offence, decide the dispute.

22D. *Procedure of Permanent Lok Adalat*. — The Permanent Lok Adalat shall, while conducting conciliation proceedings or deciding a dispute on merit under this Act, be guided by the principles of natural justice, objectivity, fair play, equity and other principles of justice, and shall not be bound by the Code of Civil Procedure, 1908 and the Indian Evidence Act, 1872

22E. *Award of Permanent Lok Adalat to be final*.— (1) Every award of the permanent Lok Adalat under this Act made either on merit or in terms of a settlement agreement shall be final and blinding on all the parties thereto and on persons claiming under them.

(2) Every award of the Permanent Lok Adalat under this Act made either on merit or in terms of a settlement agreement shall be final and binding on all the parties thereto and on persons claiming under them.

(2) Every award of the Permanent Lok Adalat under this Act shall be deemed to be a decree of a civil Court.

(3) The award made by the Permanent lok Adalat under this Act shall be by a majority of the persons constituting the Permanent Lok Adalat.

(4) Every award made by the Permanent Lok Adalat under this Act shall be final and shall not be called in question any original suit, application or execution proceeding.

(5) The Permanent Lok Adalat may transmit any award made by it to a civil Court having local jurisdiction and such civil Court shall execute the order as if it were a decree made by that Court.

5. Amendment of Section 23.— In Section 23 of the principal Act, for the words “members of the Lok Adalats”, the words “members of the Lok Adalats or the persons constituting Permanent Lok Adalats” shall be substituted.

6. Amendment of Section 27.— In section 27 of the principal Act, in sub-section (2), after clause (1), the following clause shall be inserted, namely :—

“(1a) the other terms and conditions of appointment of the Chairman and other persons under sub-section (2) of section 22B”.

Consumer Protection (Amendment) Act, 2002
[62 of 2002]

PREAMBLE

An Act further to amend the Consumer Protection Act, 1986.

Be it enacted by Parliament in the Fifty-third Year of the Republic of India as follows:--

1. Short Title and Commencement.

(1) This Act may be called the Consumer Protection (Amendment) Act, 2002.

(2) It shall come into force on such dale as the Central Government may, by notification in the Official Gazette, appoint.*

2. Amendment of section 2.

In the Consumer Protection Act, 1986 (68 of 1986) (hereinafter referred to as the principal Act), in Section 2, in Sub-section (1),--

(a) in Clause (b), after Sub-clause (iv), the following sub-clause shall be inserted, namely:--

"(v) in case of death of a consumer, his legal heir or representative;";

(b) in Clause (c),--

(i) in Sub-clause (i) for the words "any trader", the words "any trader or service provider" shall be substituted;

(ii) for Sub-clauses (iv) and (v), the following sub-clauses shall be substituted, namely;--

"(iv) a trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price--

(a) fixed by or under any law for the time being in force;

(b) displayed on the goods or any package containing such goods;

(c) displayed on the price list exhibited by him by or under any law for the time being in force;

(d) agreed between the parties;

(v) goods which will be hazardous to life and safety when used are being offered for sale to the public,-

(A) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;

(B) if the trader could have known with due diligence that the goods so offered are unsafe to the public;

(vi) services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety;";

(c) in Clause (d),--

(i) in Sub-clause (ii), the following words shall be inserted at the end, namely:--

"but does not include a person who avails of such services for any commercial purpose";

(ii) for the Explanation, 'the following Explanation shall be substituted, namely:--

'Explanation.-- For the purposes of this clause, "commercial purpose" does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment;';

(d) for Clause (j), the following clause shall be substituted, namely:--

'(j) "manufacturer" means a person who--

(i) makes or manufactures any goods or part thereof; or

(ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others; or

(iii) puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer;';

(e) for Clause (nn), the following clauses shall be substituted, namely:--

'(nn) "regulation" means the regulations made by the National Commission under this Act;';

(nnn) "restrictive trade practice" means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include--

(a) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price;

(b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services;';

(f) in Clause (o), for the words "users and includes the provision of, the words "users and includes, but not limited to, the provision of " shall be substituted;

(g) after Clause (o), the following clause shall be inserted, namely:--

'(oo) "spurious goods and services" mean such goods and services which are claimed to be genuine but they are actually not so;';

(h) in Clause (r),--

(i) after Sub-clause (3), the following sub-clause shall be inserted, namely:--

"(3A) withholding from the participants of any scheme offering gifts, prizes or other items free of charge, on its closure the information about final results of the scheme.

Explanation.--For the purposes of this sub-clause, the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time published, prominently in the same newspapers in which the scheme was originally advertised;.";

(ii) after Sub-clause (5), the following sub-clause shall be inserted, namely:--

"(6) manufacture of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services.".

3. Amendment of section 4.

In section 4 of the principal Act, in Sub-section (1), for the words "The Central Government may", the words "The Central Government shall" shall be substituted.

4. Amendment of section 7.

In Section 7 of the principal Act, in Sub-section (1),--

(a) in the opening portion, for the words "The State Government may", the words "The State Government shall" shall be substituted;

(b) after Clause (b), the following clause shall be inserted, namely:--

"(c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government".

5. Insertion of new sections 8A and 8B.

After Section 8 of the principal Act, the following sections shall be inserted, namely:--

"8A. The District Consumer Protection Council.-
- (1) The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification.

(2) The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following numbers, namely:-

(a) The Collector of the district (by whatever name called), who shall be its Chairman; and

(b) such number of other official and non-official members representing such interests as may be prescribed by the State Government

(3) The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

(4) The District Council shall meet as such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

8B. Objects of the District Council.-- The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to (f) of section 6.".

6. Amendment of section 10.

In Section 10 of the principal Act,--

(a) in Sub-section (1), for Clause (b), the following clause shall be substituted, namely:--

"(b) two other members, one of whom shall be a woman, who shall have the following qualifications, namely:--

(i) be not less than thirty-five years of age,

(ii) possesss a bachelor's degree from a recognised universily,

(iii) be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that a persons shall be disqualifed for appointment as member if he--

(a) has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude; or

(b) is an undischarged insolvent; or

(c) is of unsound mind and stands so declared by a competent court; or

(d) has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or

(e) has, in the opinion of the State Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or

(f) has such other disqualifications as may be prescribed by the State Government;";

(b) in Sub-section (1A), the following proviso shall be inserted, namely:--

"**Provided** that where the President of the Stale Commission is, by reason of absence or otherwise, unable to act as Chairman of the Selection Committee, the Stale Government may refer the matter to the Chief Justice of the High Court for nominating a sitting Judge of that High Court to act as Chairman.";

(c) for Sub-section (2), the following sub-section shall be substituted, namely:--

"(2) Every member of the District Forum shall hold office for a term of five years or up to the age of sixty-five years, whichever is earlier:

Provided that a member shall be eligible for reappointment for another term of live years or up to the age of sixty-five years, whichever is earlier, subject to the condition that he fullils the qualifications and other conditions for appointment mentioned in Clause (b) of Sub-section (1) and such re-appointment is also made on the basis of the recommendation of the Selection

Committee;

Provided further that a member may resign his office in writing under his hand addressed to the State Government and on such resignation being accepted, his office shall become vacant and may be tilled by appointment of a person possessing any of the qualifications mentioned in Sub-section (i) in relation to the category of the member who is required to be appointed under the provisions of Sub-section (1A) in place of the person who has resigned:

Provided also that a person appointed as the President or as a member, before the commencement of the Consumer Protection (Amendment) Act. 2002, shall continue to hold such office as President or member, as the case may be, till the completion of his term.";

(d) in Sub-section (3) , the following proviso shall be inserted, namely:--

"Provided that the appointment of a member on whole-lime basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work load of the District Forum.".

7. Amendment of Section 11.

In Section 11 of the principal Act, in Sub-section (1), for the words "does not exceed rupees five lakhs", the words "does not exceed rupees twenty lakhs" shall be substituted.

8. Substitution of new Section for Section 12.

For Section 12 of the principal Act, the following section shall be substituted, namely:--

12. Manner in which complaint shall be made.--(1) A complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided may be filed with a District Forum by--

(a) the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided;

(b) any recognised consumer association whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided is a member of such association or not;

(c) one or more consumers, where there are numerous consumers having the same interest, with the permission of the District Forum, on behalf of or for the benefit of all consumers so interested; or

(d) the Central or the State Government, as the case may be, either in its individual capacity or as a representative of interests of consumers in general.

(2) Every complaint filed under Sub-section (1) shall be accompanied with such amount of fee

and payable in such manner as may be prescribed.

(3) On receipt of a complaint made under Subsection (1), the District Forum may, by order, allow the complaint to be proceeded with or rejected:

Provided that a complaint shall not be rejected under this sub-section unless an opportunity of being heard has been given to the complainant:

Provided further that the admissibility of the complaint shall ordinarily be decided within twenty-one days from the dale on which the complaint was received

(4) Where a complaint is allowed to be proceeded with under Sub-section (3), the District Forum may proceed with the complaint in the manner provided under this Act:

Provided that where a complaint has been admitted by the District Forum, it shall not be transferred to any other court or tribunal or any authority set up by or under any other law for the time being in force.

Explanation.-- For purposes of this section, "recognised consumer association" means any voluntary consumer association registered under the Companies Act, 1956 (1 of 1956) or any other law for the time being in force.'.

9. Amendment of section 13.

In Section 13 of the principal Act,--

(a) in the marginal heading, for the words "Procedure on receipt of complaint.", the words "Procedure on admission of complaint." shall be substituted;

(b) in Sub-section (1),--

(i) in the opening portion, for the words "on receipt of a complaint", the words "on admission of a complaint" shall be substituted;

(ii) for Clause (a), the following clause shall be substitued, namely:--

"(a) refer a copy of the admitted complaint, within twenty-one days from the date of its admission to the opposite party mentioned in the complaint directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the District Forum;";

(c) in Sub-section (2),--

(i) in the opening portion, for the words "complaint received", the words "complaints admitted" shall be substituted;

(ii) in Clause (b) , in Sub-clause (ii) , for the words "on the basis of evidence", the words "ex parte on the basis of evidence" shall be substituted;

(iii) after Clause (b), the following clause shall be inserted, namely:--

"(c) where the complainant fails to appear on the date of hearing before the District Forum, the District Forum may either dismiss the complaint for default or decide it on merits.";

(d) after Sub-section (3) the following sub-sections shall be inserted, namely:--

"(3A) Every complaint shall be heard as expeditiously as possible and endeavour shall be made to decide the complaint within a period of three months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities:

Provided that no adjournment shall be ordinarily granted by the District Forum unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the Forum:

Provided further that the District Forum shall make such orders as to the costs occasioned by the adjournment as may be provided in the regulations made under this Act.

Provided also that in the event of a complaint being disposed of after the period so specified, the District Forum shall record in writing, the reasons for the same at the time of disposing of the said complaint.

(3B) Where during the pendency of any proceeding before the District Forum, it appears to it necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.";

(e) after Sub-section (6), the following sub-section shall be inserted, namely:--

"(7) In the event of death of a complainant who is a consumer or of the opposite party against whom the complaint has been filed, the provisions of Order XXII of the First Scheduled to the Code of Civil Procedure, 1908 (5 of 1908) shall apply subject to the modification that every reference therein to the plaintiff and the defendant shall be construed as reference to a complainant or the opposite party, as the case may be.".

10. Amendment of section 14.

In Section 14 of the principal Act, --

(a) in Sub-section (1),--

(i) in Clause (d), the following proviso shall be inserted, namely:--

"Provided that the District Forum shall have the power to grant punitive damages in such circumstances as it deems fit;";

(ii) in Clause (e) for the words "remove the defects", the words "remove the defects in goods" shall be substituted;

(iii) after Clause (h), the following clauses shall be inserted, namely:--

"(ha) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;

(hb) to pay such sum as may be determined by il if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently:

Provided that the minimum amount of sum so payable shall not be less than five per cent, of the value of such defective goods sold or service provided, as the case may be, to such consumers:

Provided further that the amount so obtained shall be credited in favour of such person and utilized in such manner as may be prescribed;

(hc) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;";
(b) in Sub-section (2), for the proviso, the following proviso shall be substituted, namely:--

"Provided that where a member, for any reason, is unable to conduct a proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.".

11. Amendment of section 15.
In Section 15 of the principal Act, after the first proviso, the following proviso shall be inserted, namely:--

"Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited in the prescribed manner fifty per cent, of that amount or twenty-five thousand rupees, whichever is less:".

12. Amendment of section 16.

In Section 16 of the principal Act,--

(a) in Sub-section (1), for Clause (b) and the proviso thereunder, the following clause shall be substituted, namely:--

"(b) not less than two, and not more than such number of members, as may be prescribed, and one of who shall be a woman, who shall have the following qualifications, namely:--

(i) be not less than thirty-five years of age;

(ii) possess a bachelor's degree from a recognised university; and

(iii) be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that not more than fifty per cent of the members shall be from amongst persons having a judicial background.

Explanation.-- For the purposes of this clause, the expression "persons having judicial background" shall mean persons having knowledge and experience for at least a period of ten years as a presiding officer at the district level court or any tribunal at equivalent level:

Provided further that a person shall be disqualified for appointment as a member if he--

(a) has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude; or

(b) is an undischarged insolvent; or

(c) is of unsound mind and stands so declared by a competent court; or

(d) has been removed or dismissed from the service of the Government of a body corporate owned or controlled by the Government; or

(e) has, in the opinion of the State Government, such financial or other interest, as is likely to affect prejudicially the discharge by him of his functions as a member; or

(f) has such other disqualifications as may be prescribed by the State Government.";

(b) after Sub-section (1), the following sub-sections shall be inserted, namely:--

"(1A) Every appointment under Sub-section (7), shall he made by the State Government on the recommendation of a Selection Committee consisting of the following members, namely:--

(i) President of the State Commission..... Chairman;

(ii) Secretary of the Law Department of the State.....Member;

(iii) Secretary incharge of the Department dealing with Consumer Affairs in the State ..... Member:

Provided that where the President of the State Commission is, by reason of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting Judge of that High

Court to act as Chairman.

(1B) (i) The jurisdiction, powers and authority of the State Commission may he exercised by Benches thereof.

(ii) A Bench may he constituted by the President with one or more members as the President may deem fit.

(iii) If the members of a Bench differ in opinion on any point, the points shall he decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and make a reference to the President who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more or the other members and such point or points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it.";

(c) in Sub-section (2), the following proviso shall be inserted, namely:--

"**Provided** that the appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work load of the State Commission.";

(d) for Sub-sections (3) and (4), the following subsections shall be substituted, namely:--

"(3) Every member of the State Commission shall hold office for a term of five years or up to the age of sixty-seven years, whichever is earlier:

Provided that a member shall be eligible for reappointment for another term of five years or up to the age of sixty-seven years, whichever is earlier, subject to the condition that he fulfills the qualifications and other conditions for appointment mentioned in Clause (b) of Sub-section (1) and such reappointment is made on the basis of the recommendation of the Selection Committee:

Provided further that a person appointed as a President of the State Commission shall also be eligible for re-appointment in the manner provided in Clause (a) of Sub-section (1) of this section:

Provided also that a member may resign his office in writing under his hand addressed to the State Government and on such resignation being accepted, his office shall become vacant and may be filled by appointment of a person possessing any of the qualifications mentioned in Sub-section (1) in relation to the category of the member who is required to be appointed under the provisions of Sub-section (1A) in place of the person who has resigned.

(4) Notwithstanding anything contained in Subsection (3), a person appointed as the President or as a member, before the commencement of the Consumer Protection (Amendment) Act, 2002, shall continue to hold such office as President or member, as the case may be, till the completion

of his term.".

13. Amendment of section 17.

Section 17 of the principal Act shall be renumbered as Sub-section (1) and in Sub-section (1) as so renumbered,--

(a) in Clause (a), in Sub-clause (i), for the words "exceeds rupees five lakhs but does not exceed rupees twenty lakhs", the words "exceeds rupees twenty lakhs but does not exceed rupees one crore" shall be substituted;

(b) after Sub-section (1) as so renumbered, the following sub-section shall be inserted, namely:-

"(2) A complaint shall be instituted in a State Commission within the limits of whose jurisdiction,-

(a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain; or

(b) any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain, provided that in such case either the permission of the State Commission is given or the opposite parties who do not reside or carry on business or have a branch office or personally work for gain, as the case may be, acquiesce in such institution; or

(c) the cause of action, wholly or in part, arises.".

14. Insertion of new sections 17A and 17B.

After Section 17 of the principal Act, the following sections shall be inserted, namely:--

"17A. Transfer of cases.-- On the application of the complainant or of its own motion, the State Commission may, at any stage of the proceeding, transfer any complaint pending before the District Forum to another District Forum within the State in the interest of justice so requires.

17B. Circuit Benches.-- The State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette, from time to time.".

15. Omission of section 18A.

Section 18A of the principal Act, shall be omitted.

16. Amendment of section 19.

In Section 19 of the principal Act, after the first proviso, the following proviso shall be inserted, namely:--

"Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission unless the appellant has deposited in the prescribed manner fifty per cent, of the amount or rupees thirty-five thousand, whichever is less.".

17. Insertion of new section 19A.

After Section 19 of the principal Act, the following section shall be inserted, namely:--

"19A. Hearing of appeal.-- An appeal filed before the State Commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of ninety days from the date of its admission:

Provided that no adjournment shall be ordinarily granted by the State Commission or the National Commission, as the case may be, unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by such Commission:

Provided further that the State Commission or the National Commission, as the case may be, shall make such orders as to the costs occasioned by the adjournment as may be provided in the regulations made under this Act.".

Provided also that in the event of an appeal being disposed of after the period so specified, the State Commission or, the National Commission, as the case may be, shall record in writing the reasons for the same at the time of disposing of the said appeal."

18. Amendment of section 20.

In section 20 of the principal Act, -

(a) in Sub-section (1), for clause (b) and the proviso, the following clause shall be substituted, namely:--

'(b) not less than four, and not more than such number of members, as may be prescribed, and one of whom shall be a woman, who shall have the following qualifications, namely:--

(i) be not less than thirty-five years of age;

(ii) possess a bachelor's degree from a recognised university; and

(iii) be persons of ability, integrity and standing and have adequate knowledge and experience of at least ten years In dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that not more than fifty per cent of the members shall be from amongst the persons having a judicial background.

Explanation.--For the purposes of this clause, the expression "persons having judicial background" shall mean persons having knowledge and experience for at least a period of ten years as a presiding officer at the district level court or any tribunal at equivalent level:

Provided further that a person shall be disqualified for appointment if he-

(a) has been convicted and sentenced to imprisonment for an offence which, in the opinion of the Central Government, involves moral turpitude; or

(b) is an undischarged insolvent; or

(c) is of unsound mind and stands so declared by a competent court; or

(d) has been removed or dismissed front the service of the Government or a body corporate owned or controlled by the Government; or

(e) has in the opinion of the Central Government such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or

(f) has such other disqualifications as may be prescribed by the Central Government:

Provided also that every appointment under this clause shall be made by the Central Government on the recommendation of a selection committee consisting of the following, namely:--

(a) a person who is a Judge of the Supreme Court, to be nominated by the Chief Justice of India

– Chairman;

(b) the Secretary in the Department of Legal Affairs in the Government of India

– Member;

(c) Secretary of the Department dealing with consumer affairs in the Government of India

– Member;

(b) after Sub-section (i), the following sub-section shall be inserted, namely:--

"(1A) (i) The jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof.

(ii) A Bench may be constituted by the President with one or more members as the President

may deem fit.

(iii) If the Members of a Bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and make a reference to the President who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more or the other Members and such point or points shall be decided according to the opinion of the majority of the Members who have heard the case, including those who first heard it.";

(c) for Sub-sections (3) and (4), the following subsections shall be substituted, namely:--

"(3) Every member of the National Commission shall hold office for a term of five years or up to the age of seventy years, whichever is earlier:

Provided that a member shall be eligible for reappointment for another term of five years or up to the age of seventy years, whichever is earlier, subject to the condition that he fulfils the qualifications and other conditions for appointment mentioned in Clause (b) of Sub-section (1) and such re-appointment is made on the basis of the recommendation of the Selection Committee:

Provided further that a person appointed as a President of the National Commission shall also be eligible for re-appointment in the manner provided in Clause (a) of Sub-section (1):

Provided also that a member may resign his office in writing under his hand addressed to the Central Government and on such resignation being accepted, his office shall become vacant and may be filled by appointment of a person possessing any of the qualifications mentioned in Sub-section (1) in relation to the category of the member who is required to be appointed under the provisions of Sub-section (1A) in place of the person who has resigned.

(4) Notwithstanding anything contained in Subsection (3), a person appointed as a President or as a member before the commencement of the Consumer Protection (Amendment) Act, 2002 shall continue to hold such office as President or member, as the case may be, till the completion of his term.".

19. Amendment of section 21.

In Section 21 of the principal Act, in Clause (a), in Sub-clause (i), for the words "rupees twenty lakhs", the words "rupees one crore" shall be substituted.

20. Substitution of new sections for section 22.

For Section 22 of the principal Act, the following sections shall be substituted, namely:--

"22. Power and procedure applicable to the National Commission.-- (1) The provisions of sections 12, 13 and 14 and the rules made thereunder for the disposal of complaints by the

District Forum shall, with such modifications as may be considered necessary by the Commission, be applicable to the disposal of disputes by the National Commission.

(2) Without prejudice to the provisions contained in Sub-section (1), the National Commission shall have the power to review any order made by it, when there is an error apparent on the face of record.

22A. Power to set aside ex parte orders.-- Where an order is passed by the National Commission ex parte against the apposite party or a complainant, as the case may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice.

22B. Transfer of cases.-- On the application of the complainant or of its own motion, the National Commission may, at any stage of the proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one State to a District Forum of another State or before one State Commission to another State Commission.

22C. Circuit Benches.-- The National Commission shall ordinarily function at New Delhi and , perform its functions at such other place as the Central Government may, in consultation with the National Commission, notify in the Official Gazette, from time to time.

22D. Vacancy in the office of the President.--When the office of President of a District Forum, State Commission, or of the National Commission, as the case may be, is vacant or a person occupying such office is, by reason of absence or otherwise, unable to perform the duties of his office, these shall be performed by the senior-most member of the District Forum, the State Commission or of the National Commission, as the case may be:

Provided that where a retired Judge of a High Court is a Member of the National Commission, such member or where the number of such members is more than one, the senior-most person among such members, shall preside over the National Commission in the absence of President of that Commission.".

21. Amendment of Section 23.

In Section 23 of the principal Act, after the first proviso, the following proviso shall be inserted, namely:--

"**Provided further** that no appeal by a person who is required to pay any amount in terms of an order of the National Commission shall be entertained by the Supreme Court unless that person has deposited in the prescribed manner fifty per cent, of that amount or rupees fifty thousand, whichever is less :".

22. Substitution of new section for section 25.

For Section 25 of the principal Act, the following section shall be substituted, namely:--

"25. Enforcement of orders of the District Forum, the State Commission or the National

commission.-

(1) Where an interim order made under this Act, is not complied with the District Forum or the Stale Commission or the National Commission, as the case may be, may order the property of the person, not complying with such order to be attached.

(2) No attachment made under Sub-section (1) shall remain in force for more than three months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.

(3) Where any amount is due from any person under an order made by a District Forum, State Commission or the National Commission, as the case may be, the person entitled to the amount may make an application to the District Forum, the State Commission or the National Commission, as the case may be, and such District Forum or the State Commission or the National Commission may issue a certificate for the said amount to the Collector of the district (by whatever name called) and the Collector shall proceed to recover the amount in the same manner as arrears of land revenue.".

23. Amendment of section 27.

In Section 27 of the principal Act,--

(a) the proviso shall be omitted;

(b) after the proviso so omitted, the existing Section 27 shall be renumbered as Sub-section (7) and after Sub-section (7) as so renumbered, the following sub-sections shall be inserted, namely:-

"(2) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the District Forum or the State Commission or the National Commission, as the case may be, shall have the power of a Judicial Magistrate of the first class for the trial of offences under this Act, and on such conferment of powers, the District Forum or the State Commission or the National Commission, as the case may be, on whom the powers are so conferred, shall be deemed to be a Judicial Magistrate of the first class for die purpose of the Code of Criminal Procedure, 1973.

(3) All offences under this Act may be tried summarily by the District Forum or the State Commission or the National Commission, as the case may be.".

24. Insertion of section 27A.

After section 27 of the principal Act, the following section shall be inserted, namely :–

“27A. Appeal against order passed under section 27. – (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, an appeal under section 27, both on facts and on law,

shall lie from –

(a) the order made by the District Forum to the State Commission;

(b) the order made by the State Commission to the National Commission; and

(c) the order made by the National Commission to the Supreme Court.

(2) Except as aforesaid, no appeal shall lie to any court from any order of a District Forum or a State Commission or the National Commission.

(3) Every appeal under this section shall be preferred within a period of thirty days from the date of an order of a District Forum or a State Commission or, as the case may be, the National Commission :

Provided that the State Commission or the National Commission or the Supreme Court, as the case may be, may entertain an appeal after the expiry of the said period of thirty days, if, it is satisfied that the appellant had sufficient cause for not preferring the appeal within the period of thirty days.".

25. Insertion of new section 28A.

After Section 28 of the principal Act, the following section shall be inserted, namely:--

"28A. Service of notice, etc.-- (1) All notices required by this Act to be served shall be served in the manner hereinafter mentioned in Subsection (2).

(2) The service of notices may be made by delivering or transmitting a copy thereof by registered post acknowledgment due addressed to opposite party against whom complaint is made or to the complainant by speed post or by such courier service as are approved by the District Forum, the State Commission or the National Commission, as the case may be, or by any other means of transmission of documents (including FAX message).

(3) When an acknowledgment or any other receipt purporting to be signed by the opposite party or his agent or by the complainant is received by the District Forum, the Slate Commission or the National Commission, as the case may be, or postal article containing the notice is received back by such District Forum, State Commission or the National Commission, with an endorsement purporting to have been made by a postal employee or by any person authorised by the courier service to the effect that the opposite party or his agent or complainant had refused to take delivery of the postal article containing the notice or had refused to accept the notice by any other means specified in Sub-section (2) when tendered or transmitted to him, the District Forum or the State Commission or the National Commission, as the case may be, shall declare that the notice had been duly served on the opposite party or to the complainant:

Provided that where the notice was properly addressed, pre-paid and duly sent by registered post acknowledgment due, a declaration referred to in this sub-section shall be made notwithstanding

the fact that the acknowledgment has been lost or mislaid, or for any other reason, has not been received by the District Forum, the State Commission or the National Commission, as the case may be, within thirty days from the date of issue of notice.

(4) All notices required to be served on an opposite party or to complainant shall be deemed to be sufficiently served, if addressed in the case of the opposite party to the place where business or profession is carried and in case of complainant, the place where such person actually and voluntarily resides.".

26. Amendment of section 29.

In Section 29 of the principal Act, after Subsection (2), the following sub-sections shall be inserted, namely:--

"(3) If any difficulty arises in giving effect to the provisions of the Consumer Protection (Amendment) Act, 2002, the Central Government may, by order, do anything not inconsistent with such provisions for the purpose of removing the difficulty:

Provided that no such order shall be made after the expiry of a period of two years from the commencement of the Consumer Protection (Amendment) Act, 2002.

(4) Every order made under Sub-section (3) shall be laid before each House of Parliament.".

27. Substitution of new section for section 30.

For Section 30 of the principal Act, the following section shall be substituted, namely:--

"30. Power to make rules.-- (1) The Central Government may, by notification, make rules for carrying out the provisions contained in Clause (a) of Sub-section (1) of Section 2, Clause (b) of Sub-section (2) of section 4, Sub-section (2) of section 5, Sub-section (2) of Section 12, Clause (vi) of Sub-section (4) of Section 13, Clause (hb) of Sub-section (1) of Section 14, Section 19, Clause (b) of Sub-section (1) and Sub-section (2) of Section 20, Section 22 and Section 23 of this Act.

(2) The State Government may, by notification, make rules for carrying out the provisions contained in Clause (b) of Sub-section (2) and Sub-section (4) of Section 7, Clause (b) of Subsection (2) and Sub-section (4) of Section 8A, Clause (b) of Sub-section (1) and Sub-section (3) of Section 10, Clause (c) of Sub-section (1) of Section 13, Clause (hb) of Sub-section (1) and Sub-section (3) of Section 14, Section 15 and Clause (b) of Sub-section (7) and sub section (2) of Section 16 of this Act.".

28. Insertion of new section 30A.

After Section 30 of the principal Act, the following section shall be inserted, namely:--

"30A. Power of the National Commission to make regulations.-- (1) The National Commission

may, with the previous approval of the Central Government, by notification, make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

(2) In particular and without prejudice to the generality of the foregoing power, such regulations may make provisions for the cost of adjournment of any proceeding before the District Forum, the State Commission or the National Commission, as the case may be, which a party may be ordered to pay.".

29. Substitution of new section for section 31.

For Section 31 of the principal Act, the following section shall be substituted, namely:--

"31. Rules and regulation to be laid before each house of parliament.-- (1) Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

(2) Every rule made by a State Government under this Act shall be laid as soon as may be after it is made, before the State Legislature.".

*Received the assent of the President on 11-6-2002 and published in Gaz. of India : 12-6-2002, Part II -S.1, Ext.; P. 1 (No. 40)

*The amendment Act has been brought into force w.e.f. 15th March 2003-04-19

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V. Raghavendra Prasad
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N.R. Moorthy, "NPAs Recovery Ordinance Flawed, Needs Fine Tuning", (2002) 39 SCL 183 (Magazine) - critically analyses certain hassles in the Ordinance

N.Suresh, "Anomalies in the Amended CPC., 2002", AIR 2002 Journal 339- critically examines the anomalies in the Amended CPC, 2002.

P. Apser Hussen, "Judicial Intervention in Arbitration", (2002) 40 SCL 1 (Magazine) - elaborately examines the issues in relation to judicial intervention in Arbitration proceedings under the Arbitration and Conciliation Act, 1996 - opines that the said Act still contains some provisions which provide for supervision/ intervention of the Court under certain specified circumstances - proposes certain amendments in the Act with a view to speeding up the Arbitral process and further reducing the scope of judicial intervention therein.

Padmaja Chakravarty, "Stock Brokers, Market Makers and Jobbers: Competing Intermediaries in the Financial Market", (2002) 40 SCL 8 (Magazine) - explains the different roles of three types of intermediaries and brings out their importance in the functioning of the capital market as a place where securities are bought and sold.

Padmaja Chakravarty, "SEBI and Legal Controls on Stock Brokers - Need for Revision of Guidelines", (2002) 40 SCL 45 (Magazine) -points out the need for a strong legal framework to guide and control the activities of stock brokers.

Prashanth Srinivas, "Inspection, Investigation and other similar Provisions in the Companies Act, 1956", (2002) 39 SCL 174 (Magazine) - discusses provisions of the Companies Act, 1956 relating to inspection of records and books, etc. and investigation into the affairs of the Company by Governmental Authorities.

Rathindranath Bhattacharyya, "Financial Reporting of Companies - How Far These Can be Relied Upon ? ", (2002) 40 SCL 20 (Magazine) - discusses the issue of financial reporting of companies in the Indian context and stresses the need for ensuring fairness, veracity and trustworthiness of corporate financial reporting.

R.N. Bansal, "Making Company Boards more Effective", (2002) 40 SCL 13 (Magazine) - elucidates the role of the Board in the context of the urgent need for good Corporate Governance.

Rajesh Relan, "Derivatives Segment : The Rising Sun of the Stock Market", (2002) 38 SCL 49 (Magazine) - elaborately discusses the meaning, nature and significance of a derivative and difference between forward and future contract, trading in futures, options and concept of `In-the-Money', `At-the-Money' and `Out-of-the-Money' options.

Rajesh Relan, "Stop MNCs from Deserting Stock Market", (2002) 38 SCL 71(Magazine) - discusses and points out that the strategy being adopted by MNCs, resulting in their desertion of stock exchanges, is disadvantageous to Indian shareholders and is not good for economy of the country and that the SEBI should take urgent remedial measures.

Rumer Shah, "E-Commerce Insurance Policy -Issues and Coverage", (2002) 38 SCL 61(Magazine) - briefly analysis the concept of E-Commerce Risk Management and describes various types of risks associated with E-Commerce and their consequences and also gives an overview of the salient features of an E-Commerce Insurance Policy.

S. Venugopalan, "Model Regulations for Management of a Company in Table 'A' of Schedule I of Companies Act, 1956 - A Study", (2002) 39 SCL 149 (Magazine) - discusses the need for incorporation of new regulations in Table 'A' in the wake of certain amendments made in the Act.

S. Venugopalan, "Securitisation Ordinance - An Overview", (2002) 40 SCL 76 (Magazine) - gives a bird's eye view of the provisions of the Ordinance.

S. Venogoplan, "Managerial Appointment and Remuneration under Schedule XIII As Amended Recently", (2002) 38 SCL 23 (Magazine) - explains the term `managerial personnel' and sets out the circumstances under which it is compulsory for a company to appoint managerial personnel and the conditions required to be met for such appointment - also discusses details of the remuneration including perquisites payable to such personnel.

S. Venugopalan, "The Managing Director - His Status, Powers and Duties", (2002) 38 SCL 100 (Magazine) - sets out the status, powers and duties of the managing director of a company as per the provisions of the Companies Act, 1956 alongwith the case law and discusses limitations on powers of Managing Director.

S. Venkataraman, "Company Secretary and Directors' Report", (2002) 39 SCL 170 (Magazine) - examines the question whether Company Secretary has a role to play in respect of Directors' Report to be attached with the balance sheet.

Sai Krishna Bharathan, 'Securitisaiton and Reconstruction of Financail Assets and Enforcement of Security Interest (Second) Ordinance, 2002 - Material Issues", (2002) 40 SCL 58 (Magazine) - analyses the main provisions of the Ordinance as well as the Security Interest (Enforcement) Rules, 2002 framed thereunder.

Sanjiv Agarwal, "Segment Reporting - The Indian, US and International Framework", (2002) 38 SCL 174 (Magazine) - explains the concept of segment reporting and briefly outlines the framework of segment reporting as per the accounting standards and norms.

Sheela Rai, "Determination of Injury: A Study of Anti-dumping cases in India", (2002) 39 SCL 75 (Magazine) - gives a brief historical account of anti-dumping legislation at the international level and highlights the contradiction in the anti-dumping policies and free trade based on free and fair competition.

Siddheshwar Mishra, "Section 185 of Indian Contract Act, 1872 - A Redundant Section", AIR 2002 Journal 281 - examines in brief provisions of Section 185 of the Contract Act,1877 and its relevance to the present world.

Sushila Madan, "A Longitudnal Study of Expectations of Indian Companies in E-Commerce", (2002) 39 SCL 155 (Magazine) -focuses the results of a survey of 120 Indian Companies (covering different sectors and Industries) involved in E-Commerce.

T.K.A Padmanabhan, "Stop Payment of Cheque - Analysis of MEDCHL Judgment", (2002) 38 SCL 33 (Magazine) - examines the issue of `stop payment' under Section 138 of Negotiable Instruments Act, 1881 in the background of several judgments of Supreme Court and tries to bring out the complexities and finer nuances of the present legal position on this issue.

T.K.A. Padmanabhan, "Allotment of Subscription Shares- Can Filing of Return of Allotment be Dispensed with ?", (2002) 39 SCL 97 (Magazine) - examines the provisions of Section 75 of the Companies Act, 1956 which states that whenever a company having a share capital makes any allotment of its shares, it is required to file a return of such allotment with the Registrar of Companies within 30 days of the allotment.

T.N. Pandey, "Fine for Bounced Cheques cannot be less than the Minimum Prescribed", (2002) 39 SCL 54 (Magazine) - examines the issue in the light of provisions contained in Section 138 of the Negotiable Instruments Act 1881 and the judgement of the Karnataka High Court in the case of B. Harikrishna Vs. Macro Links (P) Ltd. (2002) 34 Comp. Cas. 551.

V.L. Iyer, "Significant Changes Likely to be Made in the Companies Act, 1956", (2002) 39 SCL 136 (Magazine) - discusses certain significant changes that are likely to be made in the Companies Act, 1956 under the provisions pertaining to vacation of office of director, rotation of statutory auditors and exemption for companies in small towns from appointment of qualified company secretaries.

V.L. Iyer, "Real Corporate governance", (2002) 40 SCL 52 (Magazine) - discusses certain basic factors which lie at the root of good corporate governance - suggests measures which can turn

the dream of good corporate governance into a living reality.

V.Vijay Laxmi, "Copyright or Author's Authority over his Intellectual Creations", AIR 2002 Journal 267 (Magazine) - elucidates and examines the scope of copyright and author's authority over his intellectual creations in the context of Copyright Act, 1957 which is amended from time to time, including the recent amendment in 1999

Vijay Kumar Gaba, "Objectives and Principles of Securities Regulation", (2002) 38 SCL 89 (Magazine) - examines and discusses the objectives and principles of securities regulation.

Vijay Kumar Gaba, "Role of the Securities Market Regulator", (2002) 38 SCL 109 (Magazine) - briefly explains the three chief models of regulation of the securities market viz. the US, the UK and the continental model, and then goes on to state and discuss the principles on which the role of the regulator should be based - further explains how far these principles apply to the regulatory model adopted by India which is largely based on US Model.

Vinod K. Shah, "E-Cheque is Here", (2002) 39 SCL 36 (Magazine) - explains the concept of an E-Cheque and some technical terms associated with it such as digital signatures, and cheque truncation.

Vinod K. Shah, "Copyright and Some Other Aspects of Software", (2002) 39 SCL 46 (Magazine) - focuses some commercial, legal and other important aspects of software, especially those relating to copyright protection for software developers, protection of consumers against damages suffered by using a particular type of software, protection of a computer against attack by viruses and worms and hackers, etc.

Vinod K Shah, "COPRA - Deficiency in Banking Services", (2002) 40 SCL 86 (Magazine) - exhaustively deals with the scope and provisions of the Banking Ombudsmen Scheme, 2002 framed by the Reserve Bank of India which provides another forum to the banking customers for resolving their grievances.

Vinod K. Shah, "Internet Banking in India", (2002) 39 SCL 60 (Magazine) - analyses scope of services provided under Internet Banking and its importance for the corporate sector and need for maintaining confidentiality and taking appropriate steps to safeguard the interests of customers.

Vinod K. Shah, "Legal Aspects of E-Commerce", (2002) 40 SCL 116 (Magazine) - highlights how E-Commerce works, its various aspects, the laws governing E-Commerce and its limitations.

Vinod K. Shah, "All about Plastic Cards", (2002) 38 SCL 85 (Magazine) - elucidates nature and function of various types of plactic cards such as credit card, debit card, ATM Card, etc.

There is an old and somewhat foolish saying that "Hard cases make bad law," and therefore the law must be left as it is. It would be equally true to say, "Bad law makes hard cases", and therefore the law must be amended. The real truth lies somewhere between. Mere freaks of fortune should not be made an excuse for weakening a law which is sound. But a law which is

seen to multiply hard cases, not through any accident but by its necessary elements, is not worth preserving, for the law was made for man, not man for the law.

— HERBERT, A.P., Uncommon Law (Garden City, New York : Double-day, Doran & Company, Inc., 1936), p. 274

Book Review

CREDIT DERIVATIVES & SYNTHETIC SECURITISATION
By Vinod Kothari

D.V.Sekhar
Asstt. Legal Adviser

Credit derivatives, a device of structured trading in credit risks, emerged around 1993 and in a short span of 8 years has attained a global volume of USD 1.5 trillion. Credit derivatives are today used in global banking to transfer risks, clone debt securities, structure and leverage positions on credit assets, etc. Add to it the device of securitisation, and credit risk becomes a commodity for the capital markets. As risk gets more concentric, there is greater need to diffuse it - and that is where credit derivatives come handy. It would be difficult to establish that credit derivatives reduce the risk of the corporate system we live with, but certainly, as more risk is traded, it becomes better understood, better appreciated, and diversified.

CREDIT DERIVATIVES & SYNTHETIC SECURITISATION, edited by Shri Vinod Kothari, presents a detailed outline of credit derivatives and synthetic securitisation. The book under review has been published by Academy of Financial Services, B 42, Metropolitan Cooperative Housing Society, Kolkata. The author of the book has stated in the preface that the book is a complete treatise on the technique, issues, motivations and structures.

The contents of the book are divided into 13 chapters. Chapter 1 deals with credit derivatives structure, evolution, motivations and economics. Credit derivatives are derivative contracts that seek to transfer defined credit risks in a credit product to the counterparty to the derivative contract. The counterparty to the derivative contract could either be a market participant, or could be the capital market through the process of securitisation. As the risks, and the corresponding rewards, are transferred to the counterparty, the counterparty assumes the position of a virtual or sympathetic lender to the debtor. Credit derivatives can be defined as arrangements that allow one party (protection buyer or originator) to transfer, for a premium, the defined credit risk, or all the credit risk, computed with reference to a notional value, of a reference asset or assets, which it may or may not own, to one or more other parties (the protection sellers). The credit asset so created is referred to as synthetic or unfunded asset. The author has given tabulations, diagrams and examples for the purpose of easy understanding. The terminology used in Credit derivatives is also given in Appendix B to this Chapter.

In Chapter 2, the author has discussed 'Credit Default Swaps'. A Credit Default Swap is a bilateral financial contract between two parties with reference to a certain notional value of a reference credit, whereby one person pays a premium to the other, expressed in basic points per annum on the notional value. The credit events as per the definitions published by ISDA have

been discussed in this chapter. Basket trade has become quite popular in recent times. In a basket default swap, the reference asset is a basket or bundle of several equally-rated reference obligations, each having the same notional amount.

In Chapter 3, the author has discussed the topic, Total Rate of Return Swaps (TROR). In TROR swap, the protection buyer agrees to transfer, periodically and throughout the term of the contract, the actual returns from a reference asset, to the protection seller and the latter, in return, agrees to transfer returns calculated at a certain spread over a base rate.

Chapter 4 deals with Credit Linked Notes (CLN). A Credit linked note is a note or an obligation of an issuer, subscribed to by an investor, where the note carries an embedded credit derivative, whereby the principal, or coupon, or both of the note can be written down based on the protection payments required under the credit derivative. Credit derivatives being a commodity in the capital markets could not have been though of, in absence of credit linked notes. It is an investment product and is different from CDS or TROR swaps. The author has discussed substance of CLN, CLN issued by Special Purpose Vehicles etc., in this chapter.

Chapter 5 deals with Synthetic Securitisation. Synthetic Securitisation is responsible for much of the growth in the credit derivatives market. It is not a type of credit derivative but is a type of Securitisation different from cash structure securitisations. The modus operandi, advantages etc., of the Synthetic Securitisation are discussed in this chapter. Securitisation requires massive legal documentation for achieving the transfer of assets and the elaborate representations and warranties, transfer of collateral etc. Credit derivatives have a much simpler documentation. There is no transfer of receivables. Therefore, there are no stamp duties whatsoever. Similarly no upfront taxation and avoids double taxation of residual profits. The author has also discussed the various elements of synthetic securitisation, Special purpose vehicle and its role, arbitrage etc., in this chapter.

In Chapter 6, the author has discussed some of the important case studies pertaining to the securitisation. The author has stated that the objective of the case study is to illustrate the distinctive features of different transactions.

The legal aspects of credit derivatives are discussed in Chapter 7. Legally speaking a credit derivate is not very different from other derivatives and within the genre of derivatives, it is akin to any other OTC derivatives. The author has distinguished the credit derivatives from the other forms of contracts such as contingent contracts, actionable claims, contract of guarantee or surety, contract of indemnity, bank letters of credit, insurance contracts, gaming, gambling or wager contracts, investment contracts, transferable contracts etc. The author has also discussed the enforceability of credit derivative contracts, commodities futures law in USA, permissibility for banks etc.

In Chapter 8, the author has discussed the taxation of Credit derivatives. In most countries, credit derivatives have not reached a level where they can draw the attention of the taxmen. The author has discussed the key issues in taxation of credit derivatives, taxation of the protection buyer & protection seller, notional principle contract etc. Notional principle contract is a contract based on a notional amount, where periodic payments are exchanged based on an index. The US tax

regulations provide for detailed rules for taxation of notional principle contracts.

Chapter 9 deals with the accounting for Credit derivatives. Accounting for credit derivatives is a part of the larger issue of accounting for financial instruments. Accounting for financial instruments has been in a flux since the collapse of Barings Bank and other derivatives related failures in 1997-98. The author has discussed in detail the accounting standards applicable to the various credit derivative instruments by giving many examples. The author has also elaborately discussed the accounting rules for the various derivatives and accounting systems that are required to be followed in the books of the protection buyer and seller.

The Regulatory and Economic Capital impact of Capital Derivatives is analysed in Chapter 10. The author has also discussed the existing regulatory framework/ guidelines in USA, UK, proposals of the Bank for International Settlements (BIS) etc.

The pricing of Credit derivatives find place in Chapter 11. A credit derivative is essentially a credit risk product. What is being transferred through a credit risk? Risk and its mathematical measurement apparently sound aliens. If risk was measurable, it would not be a risk but a certainty. If there was a uniform method for measurement of risk, no two persons using the same measurement would ever trade in risk. Therefore, it is obvious that there cannot be a uniform way of measuring the credit risk inherent in credit derivatives. The author has highlighted the procedure of estimating default probabilities, estimating recovery rates etc.

In Chapter 12, the author has discussed the Recent advances in Credit Risk Management with a Comparison of five Models. The concepts and models of Fisher Black, Mayson Scholes, Robert Merton, Kamakura and Mckinsey are discussed with examples and diagrams.

The last Chapter deals with Pricing of Multi Name Credit Derivatives presented by Mr Roy Mashal. The author has discussed various forms of approaches for fixing the prices of credit derivatives and the difficulties therein. In the end, an extensive subject index has been provided, which would help the readers to have quick access to the required topic in the book.

On the whole, the book would be useful for the bankers, business community, practicing lawyers, risk managers and those who deal with credit derivatives and securities. The book is priced Rs 1250/-.

The attempt to silence a man is the greatest honour you can bestow on him. It means that you recognize his superiority to yourself.

— Joseh Sobran

One cannot subdue a man by holding back his hands. Lasting peace comes not from force.

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The cure for the evils of democracy is more democracy.

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I'd like to start a religion. That's where the money is.

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Book Review

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The contents of the book are divided into 13 chapters. Chapter 1 deals with credit derivatives structure, evolution, motivations and economics. Credit derivatives are derivative contracts that seek to transfer defined credit risks in a credit product to the counterparty to the derivative contract. The counterparty to the derivative contract could either be a market participant, or could be the capital market through the process of securitisation. As the risks, and the corresponding rewards, are transferred to the counterparty, the counterparty assumes the position of a virtual or sympathetic lender to the debtor. Credit derivatives can be defined as arrangements that allow one party (protection buyer or originator) to transfer, for a premium, the defined credit risk, or all the credit risk, computed with reference to a notional value, of a reference asset or assets, which it may or may not own, to one or more other parties (the protection sellers). The credit asset so created is referred to as synthetic or unfunded asset. The author has given tabulations, diagrams and examples for the purpose of easy understanding. The terminology used in Credit derivatives is also given in Appendix B to this Chapter.

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FAQ

Frequently Asked Questions on Electronic Cheques and Truncated Cheques

K.D.Zacharias
Legal Adviser

1. What is meant by an electronic cheque?

An electronic cheque is a cheque in electronic form (as against the usual paper instrument in writing). A cheque in electronic form is defined in Explanation 1 to Section 6 of the Negotiable Instruments Act as a cheque which contains the exact mirror image of a paper cheque and is generated, written and signed in a secured system ensuring the minimum safety standards with the use of digital signature (with or without biometric signature and asymmetric crypto system).

2. Are electronic cheques valid and binding in law like paper instruments?

The Negotiable Instruments Act, 1881 has been amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 to include a cheque in electronic form within the definition of cheque in Section 6 of the Negotiable Instruments Act. Hence, cheques in electronic form are valid and binding in law like the paper instruments (cheques in writing on paper).

3. Does the Information Technology Act apply to cheques? What about other negotiable instruments?

The Information Technology Act was not originally applicable to Negotiable Instruments in terms of Section 1(4) of that Act. The Information Technology Act was amended by the Negotiable Instruments (Amendments and Miscellaneous Provisions) Act, 2002 modifying Section 1(4) and inserting Section 81A making the Act applicable to electronic cheques. This is, however, subject to such modifications and amendments as may be necessary for carrying out the purposes of Negotiable Instruments Act by the Central Government, in consultation with the Reserve Bank of India by notification in the Official Gazette. The Act, however, does not apply to other negotiable instruments,namely promissory notes and bills of exchange.

4. What is meant by truncation of cheques?

In truncation of cheques, cheques will be scanned and the electronic image, instead of the physical cheque, will be transmitted in the clearing cycle. A truncated cheque is defined in Section 6 (Explanation 1) of the Negotiable Instruments Act as a cheque which is truncated during the course of a clearing cycle either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

5. Can the presentment of an electronic image of a truncated cheque to the paying bank be treated as a valid 'presentment' within the meaning of section 64 of the NI Act?

Under Section 64 of the Negotiable Instruments Act, a cheque must be presented for payment on behalf of the holder. The definition of 'cheque' under section 6 of the Negotiable Instruments Act as amended by the Negotiable Instruments (Amendments and Miscellaneous Provisions) Act, 2002 includes an electronic image of a truncated cheque. Hence, the presentment of an electronic image of a truncated cheque would amount to presentment of cheque for the purpose of section 64 .

6. What is the advantage of truncation of cheques?

Cheques are truncated for the purpose of avoiding the physical movement of the paper instruments and instead transmitting the electronic image of the truncated instruments thereby ensuring faster clearing of the instruments and reduction in the cost of processing. It is, however, open to the drawee bank to demand further information regarding a truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of the instrument. Only in the case of suspicion of any fraud, forgery, tampering or destruction of the instrument, the drawee/paying bank is entitled to demand the presentment of the truncated cheque itself for verification.

7. Who will have the custody of the truncated cheques?

The collecting bank who receives the payment shall be entitled to retain the truncated cheque. However, on suspicion of any fraud, forgery, tampering or destruction of the instrument , the drawee bank demands the presentment of the truncated cheque itself for verification and after verification makes payment, the truncated cheque so demanded and paid shall be retained by the drawee/paying bank.

8. In the case of a truncated cheque, will any difference in apparent tenor of the electronic image with the truncated cheque be a material alteration under Section 87 of the Negotiable Instruments Act ? Who is responsible to verify any difference in apparent tenor of the electronic image with the truncated cheque?

In the case of an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image with the truncated cheque shall be a material alteration. It shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of the electronic image of the truncated cheque while truncating and

transmitting the image. Any bank or the clearing house which receives a transmitted electronic image of truncated cheque has a duty to verify from the party who transmitted the image to it that the image so transmitted to it and received by it is exactly the same.

9. Who will verify the prima facie genuineness of the cheque to be truncated?

The banker who wants to receive payment based on an electronic image of a truncated cheque held with him (collecting bank) has the duty to verify the prima facie genuineness of the cheque to be truncated. Any fraud, forgery or tampering apparent on the face of the instrument which can be verified with due diligence and ordinary care has to be so verified.

LD News

The India Trade Promotion Organisation, Government of India invited the Principal Legal Adviser, Shri N.V. Deshpande, to the working group meetings at New Delhi between 16th and 18th December 2002 and in Chennai between 19th December and 20th December 2002. He was an expert speaker in the sessions on Policy, Legal and Regulatory Aspects at the E-Trade, Bridge SMEs-Kick of Meeting.

Shri S.R. Kolarkar, Legal Adviser has been appointed as a Member of the Working Group on ADB Assisted Housing Finance II (LN) 1761 IND on Mortgage Registration.

Shri K.D. Zacharias, Legal Adviser addressed the participants of the programme on Information System Audit at BTC, Mumbai on IT Act and Its Implications for Information Systems Security and Audit. He also attended a seminar on Straight through processing organised by TCS at Taj, Mumbai.

Good Bye

Shri S.R. Hegde, Legal Adviser, DNBS, Legal Division retired from the services of the Bank at the close of business on 31st July 2002.

Shri N.K. Puri, Joint Legal Adviser retired from the services of the Bank at the close of business on 31st December 2002.

Welcome

Shri S.M. Kunder, Record Clerk, reported to Legal Department from BTC on 18th October 2002.

Congrats

Shri C. Pushparaj, P.S. Gr. A, has been promoted to P.S. Gr. B with effect from 2nd September 2002 and retained in the Department.

Hindi Day

The Department celebrated Hindi day on 21st October 2002 with great enthusiasm. Deputy

Governor, Shri G.P. Muniappan inaugurated the Hindi Vidhi Graha Patrika.

Mail Bag

We have received letters from M/s. M. Chaturvedi, Mukeshchand, S.R. Subrahmanya, Bahadur Singh, Pradeep K. Madhaav, K. Mohan, Sarita Panda, Shamlal Gaur, Deepak Kumar Barik, R.S. Bakkannavar, S.S. Nigam, and C.N. Vazirani.

The names of the above readers have been included in the mailing list.

The nuts and bolts of lending money is getting it back. And that still depends upon human judgment.

— WRISTON, Walter, as quoted in Bennett, Robert A. "Inside Citicorp", The New York Times Magazine, May 29, 1983, p.46

Turn now to the oath of the Queen herself at Her coronation and you will find that there too law and justice are treated as inseparable. The Archbishop asks "Will you to your power cause Law and Justice, in Mercy, to be executed in all your judgments?". And the Queen answers " I will," Now the judgments of Her Majesty's judges are the judgments of the Queen herself. They are her delegates for the purpose. By this oath, they must in her name execute, not law alone but "law and justice"; and they must do so "in Mercy"; and how shall they be merciful unless they have in them something of that quality which "droppeth as the gentle rain from heaven upon the earth beneath"?

— DENNING, Alfred, The Road to Justice (London : Stevens & Sons Limited, 1955) p.5

If it be true that, both in the popular and in the professional view, a Contract was long regarded as an incomplete Conveyance, the truth has importance for many reasons. The speculations of the last century concerning mankind in a state of nature, are not unfairly summed up in the doctrine that "in the primitive society property was nothing, and obligation everything".

— MAINE, Hency Sumber, Ancient Law
(New york : Henry Holt and Company, 1888), p. 311

Your obligations are stronger than your personal desires.

— ADAMS, Abigail, to john Adams, Channel 46, February 24, 1976, The Adams Chronicles, at 9:40 p.m.