



LL.B. V Term

LB-5036 – Business Regulations

Cases Selected and Edited by

Ruchita Chakraborty

Arti Aneja

Parikshet Sirohi

**FACULTY OF LAW
UNIVERSITY OF DELHI, DELHI- 110 007
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Business is essentially an economic activity. However, business needs to be conducted within certain set norms and follow specific criteria in order to ensure that other aspects of the society and the stakeholders are not compromised. The legal framework is the set of laws and rules that govern and regulate the functioning of business. They aim to set standards and evolve systems which will ensure that the business activities are compliant with the best practices and more essentially are not detrimental to the health of the economy. Business regulations are also essential to promote, support and enhance the business environment of a nation. The ease of doing business, the flexibility in growth of a company, and the conduciveness of an economy in starting and operation of firms are certain important aspects that promote the economic growth. Business regulations are instrumental in controlling and managing these aspects for the best outcomes.

Freedom to carry on trade and business is a Fundamental Right guaranteed under the Indian Constitution. Additionally, there are a number of statutes that manage the legal and regulatory framework in Indian business. Moreover, with the liberalization of our economy, it has now become all the more essential to synthesize our domestic laws to meet the international standards and pave a path for both domestic and foreign players to operate smoothly in the economy. In the context of the rapid evolution of business and its forms, a robust regulatory framework is crucial to promote the effectiveness and efficiency of business. Further, with the evolution in business, the legislature and the judiciary is also pacing in evolving a strong, rigorous and well-built, legal framework. Hence, it is essential that the students of law are exposed to these areas to corporate and business laws.

This course aims to introduce the students to the recent developments that are taking place in the business scenario and the legal framework that exist to ensure that business can operate smoothly to fetch the best possible outcome

Prescribed Laws

1. Constitution of India, 1950
2. Essential Commodities Act, 1955
3. The Securities & Exchange Board of India Act, 1992
4. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002
5. The Takeover Code - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
6. Prevention of Money Laundering Act, 2002
7. Telecom Regulatory Authority Act, 1997
8. Real Estate (Regulation and Development) Act, 2016
9. The Insurance Regulatory and Development Authority Act, 1999

Prescribed Books:

1. Durga Das Basu, Constitution of India, Prentice Hall of India
2. Rajiv Jain, Guide to New Industrial Policy, with Procedure; India Investment Publications

3. Richard Parlour, International Guide to Money Laundering Law and Practice
4. N R Madhava Menon and Narasimhaswamy G. Mysore, Government Control over Private Enterprise
5. P.L. Malik, Industrial Law; Eastern Book Company
6. S. Suryanarayanan & V. Varadarajan: SEBI – Law, Practice & Procedure; Commercial Law Publishers (India) Pvt. Ltd.
7. V.L. Iyer, SEBI Practice Manual; Taxman Allied Service (Pvt) Ltd.
8. M.L. Tanna, revised by C.R. Datta & S.K. Kataria: Banking Law and Practice, Wadhwa & Company
9. Manual on The Telecom Regulatory Authority of India Act, Commercial Law House

Topic 1: Right to Trade and Business under the Indian Constitution

(A) Concept of Trade and Business [Art. 19(1)(g) and Art. 301]

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|----|---|----|
| 1. | Khoday Distilleries Ltd. v. State of Karnataka (1995) 1 SCC 574 | 1 |
| 2. | B. R. Enterprises v. State of UP and Others (1999) 9 SCC 700 | 11 |

(B) Reasonable Restrictions in Public Interest [Art. 19(6)]

- | | | |
|----|---|----|
| 3. | Chintaman Rao v. State of M.P., AIR 1951 SC 118:1950 SCR 759 | 17 |
| 4. | Narendra Kumar v. Union of India, AIR 1960 SC 430: (1960) 2 SCR 375 | 20 |

(C) Power to Carry on Trade by State and Government Contracts [Art 298-299]

- | | | |
|----|---|----|
| 5. | Raunaq International Ltd v. I.V.R. Construction Ltd., 1998 Supp (3) SCR 421 | 27 |
|----|---|----|

Topic 2: The Securities & Exchange Board of India Act, 1992

- (i) Need for protection of rights of investors
- (ii) Definitions
 - Board
 - Collective Investment Scheme
 - Securities as in 2(h) Securities Contracts (Regulation) Act, 1956
- (iii) Establishment of Securities and Exchange Board of India (Ss. 3-9)
- (iv) Powers and Functions of the Board (Ss. 11- 11D)
- (v) SEBI (Prohibition of Insider Trading) Regulations, 2015
 - Definitions- connected person, generally available information, immediate relative, insider, unpublished price sensitive information
 - Communication or procurement of unpublished price sensitive information.
 - Trading when in possession of unpublished price sensitive information
 - Trading Plan

- (vi) Collective Investment Scheme and Mutual Funds – Meaning and importance
- (vii) Regulation of Stock Exchanges - SEBI's powers over stock exchanges

6. <i>Sahara India Real Estate Corporation Limited & Ors. v. Securities and Exchange Board of India & Anr.</i> , (2012) 10 SCC 603	33
7. <i>The Chairman, SEBI v. Shriram Mutual Fund & Anr.</i> , (2006) 5 SCC 361	45

Topic 3: The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)

- (i) Background and Objective of the Act
- (ii) Definitions
 - Asset Reconstruction
 - Asset Reconstruction Company
 - Central Registry
 - Default
 - Non-performing Asset
 - Qualified Institutional Buyer
- (iii) Enforcement of Security Interest (Sec. 13)
- (iv) Application against measures to recover secured debts (Sec. 17)
- (v) Central Registry (Ss. 20, 20A, 20B, 21)
- (vi) Civil Court not to have jurisdiction (Sec. 34)

8. <i>Mardia Chemicals Ltd. v. U.O.I. & Ors.</i> , (2004) 4 SCC 311	52
9. <i>Pandurang Ganapati Chaugule v. Vishwasrao Patil Murgud Sahakari Bank Limited</i> , Supreme Court Judgment dated: 20 May 2020	65
10. <i>The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016</i>	

Topic 4 :The Takeover Code - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011)

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 as amended in 2017

- Definitions- acquirer , acquisition, control, immediate relative, listing agreement, offer period, persons acting in concert, target company
- Substantial acquisition of shares or voting rights,
- Indirect acquisition of shares or control,
- Voluntary Offer

- | | |
|--|----|
| 11. <i>SEBI v. Akshya Infrastructure Pvt. Ltd.</i> , (2014) 11 SCC 112 | 78 |
| 12. <i>Kosha Investments Ltd v. Securities & Exchange Board of India</i> ,
2015 (9) SCALE 820 | 88 |

Topic 5: The Prevention of Money Laundering Act (PMLA), 2002

Need for combating Money-Laundering
Magnitude of Money-Laundering, its steps and various methods

The Prevention of Money-Laundering Act, 2002:

- (i) Definition of 'Money Laundering', Ss. 3 & 2(1)(p)
- (ii) Punishment for Money Laundering (Sec. 4)
- (iii) Enforcement: Attachment (Sec. 5)
- (iv) Survey, Search, & Seizure (Ss. 16, 17 & 18)
- (v) Power to arrest (Sec. 19)
- (vi) Adjudication under the Act: Adjudication by Adjudicating Authorities (Sec. 8)
- (vii) Special courts (Ss. 43 to 47)
- (viii) Vesting of Property in Central Government (Sec. 9)
- (ix) Preventive Mechanisms under the Act: Obligation of banking companies, financial institutions and Intermediaries (Ss. 12 & 12A)
- (x) Reciprocal Arrangements with other countries (Overview of Chapter IX i.e. Ss. 55 to 61)

- | | |
|---|----|
| 13. <i>Rose Valley Real Estate v. Union of India</i> , (2015) 2 Cal LT 617 | 92 |
| 14. <i>P. Chidambaram v. Directorate of Enforcement</i> , Supreme Court
<i>Judgment dated: 5 September, 2019</i> | |
| 15. <i>Amendment in the Prevention of Money Laundering Act, 2002</i>
<i>brought by The Finance Act, 2019</i> | |

Topic 6: The Essential Commodities Act, 1955

- (i) Sec. 2 - Definitions
- (ii) Sec. 2A - Essential commodities declaration, etc
- (iii) Sec. 3 - Powers to control production, supply, distribution, etc., of essential commodities
- (iv) The Schedule – Essential Commodities
- (v) The importance of the Act in the wake of the Covid19 pandemic
 - *The Essential Commodities (Amendment) Ordinance, 2020*

Sectoral Regulators

Topic 7: Telecom Regulatory Authority of India Act, 1997

- Constitution, Jurisdiction, Role and Functions of TRAI
 - Telecom Disputes Settlement and Appellate Tribunal (TDSAT)
16. *Cellular Operators Association of India And Others v. Telecom Regulatory Authority of India and Others*, Supreme Court Judgment dated: 11 May, 2016 102

Topic 8: Real Estate (Regulation and Development) Act, 2016

- Registration of Real Estate Project & Registration of Real Estate Agents (Sec. 3)
 - Real Estate Regulatory Authority (RERA) (Sec. 20)
 - Offences, Penalties and Adjudication (Sec. 59)
17. *Neelkamal Realtors Suburban Pvt. Ltd. v. Union of India*, Bombay High Court Judgment dated: 6 December, 2017

Topic 9: Insurance Regulatory and Development Authority Act, 1999

- Establishment and Incorporation of the Authority (Sec. 3)
- Duties, Powers and Functions of the Authority (Sec. 14)

CONCEPT OF TRADE AND BUSINESS IS SALE OF LIQUOR TRADE / BUSINESS?

Khoday Distilleries Ltd. v. State of Karnataka
(1995) 1 SCC 574

PART IV: Directive Principles of the State Policy

47. Duty of the State to raise the level of nutrition and the standard of living and to improve public health.— The State shall regard the raising of the level of nutrition and the standard of living of its people and the improvement of public health as among its primary duties and, in particular, the State shall endeavour to bring about prohibition of the consumption except for medicinal purposes of intoxicating drinks and of drugs which are injurious to health.

Article 298 of the Constitution of India

298. Power to carry on trade, etc.— The executive power of the Union and of each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose:

Provided that—

(a) the said executive power of the Union shall, insofar as such trade or business or such purpose is not one with respect to which Parliament may make laws, be subject in each State to legislation by the State; and

(b) the said executive power of each State shall, insofar as such trade or business or such purpose is not one with respect to which the State Legislature may make laws, be subject to legislation by Parliament.

Article 300A of the Constitution of India

300A. Persons not to be deprived of property save by authority of law.— No person shall be deprived of his property save by authority of law.

Article 301 of the Constitution of India

301. Freedom of trade, commerce and intercourse.—Subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free.

[The right given by this article to freely carry on trade, commerce and intercourse throughout the territory of India is subject to certain restrictions as the right under Article 19(1)(g)].

P.B. SAWANT, J. -This is a bunch of appeals, special leave petitions and writ petitions. The first group consists of CA Nos. 4708-12 of 1989, 4718-27 of 1989, WP (C) Nos. 666, 667, 693, 694, 774, and 910 of 1990 wherein constitutional validity of the (i) Karnataka Excise (Distillery and Warehouse) (Amendment) Rules, 1989, (ii) Karnataka Excise (Manufacture of Wine from Grapes) (Amendment) Rules, 1989, (iii) Karnataka Excise (Brewery) (Amendment) Rules, 1989, (iv) Karnataka Excise (Sale of Indian and Foreign Liquors) (Amendment) Rules, 1989 and (v) Karnataka Excise (Bottling of Liquor) (Amendment) Rules, 1989 was unsuccessfully challenged by various parties before the Karnataka High Court, inter alia on the ground that the Rules in question affected adversely the fundamental right of the parties to carry on trade or business in liquor and that the said Rules were violative of Articles 14, 19(1)(g), 47, 300-A, 301, and 304 of the Constitution of India. A Bench of three learned Judges of this Court which heard this group of matters has referred them to the Constitution Bench.

8. Two incidental questions which, therefore, arise are (i) whether a monopoly for the manufacture, trade or business in liquor can be created in favour of the State and (ii) whether reasonable restrictions under Article 19(6) of the Constitution can be placed only by Act of Legislature or by a subordinate legislation as well.

9. It is contended that the State cannot carry on trade in liquor under Article 47 of the Constitution. If the law on the subject is considered to be law under Article 19(6), it has to be on the basis that a citizen had got a fundamental right to trade in liquor. If the law is that a citizen has no fundamental right, then Article 19(6) cannot be applied because the said article applies only to those rights which a citizen possesses. What a citizen cannot do under Article 19(1), the State cannot do under Article 19(6). Secondly, it is submitted that assuming that the State has got the power to carry on trade in liquor dehors Article 19(6) and under Article 298 of the Constitution, the power under Article 298 cannot extend to trade in liquor. This is so because the Union Government has no executive power to trade in a commodity which under Article 47 it is enjoined to prohibit.

10. In support of the contention that the appellants/petitioners have a fundamental right to trade in liquor, it is argued firstly, that Entry 51 of List II specifically accepts the fact that the manufacture of alcohol can be for human consumption. The said entry, among others, provides as follows: "Duty of Excise on intoxicating liquor for human consumption." Entry 8 of List II specifically provides for production, manufacture, purchase and sale of intoxicating liquor. The implication of this entry is that till prohibition is introduced by applying Article 47, there is no prohibition on consumption of liquor, and hence there is no prohibition for manufacture and sale of liquor. Secondly, it is submitted that there are other substances like tobacco which are more harmful to health than alcohol and they are being sold freely. A majority of the States did not introduce prohibition and some States which purported to do it, failed and reverted to the earlier pre-prohibition condition. On the other hand, the revenue from the auction of excise, vend fees, liquor and other levies forms a major source of the revenue of the State. Hence the trade in liquor cannot be looked upon as an obnoxious trade. Thirdly, the Union Government itself has recognised under its Industrial Policy Resolution as early as in 1956 that the production of potable alcohol as an industry has to be recognised though regulated and the licences have to be freely granted for the manufacture of potable liquor. During the last several years, a large number of distillery, brewery and winery licences have been granted all over the country. For all these reasons, it is submitted that there is no warrant for excluding liquor from the ambit of the words "any occupation, trade or business" under Article 19(1)(g) of the Constitution.

11. We will first refer to the relevant provisions of the Constitution which have a bearing on the subject. [Article 19(1)(g) and (6) was re-produced by the court]. Thus Article 19(1)(g) read with Article 19(6) spells out a fundamental right of the citizens to practise any profession or to carry on any occupation, trade or business so long as it is not prohibited or is within the framework of the regulation, if any, if such prohibition or regulation has been imposed by the State by enacting a law in the interests of the general public. It cannot be disputed that certain professions, occupations, trades or businesses which are not in the interests of the general public may be completely prohibited while others may be permitted with reasonable restrictions on them. For the same purpose, viz., to subserve the interests of general public, the reasonable restrictions on the carrying on of any profession, occupation, trade, etc., may provide that such trade, business etc., may be carried on exclusively by the State or by a Corporation owned or controlled by it. The right conferred upon the citizens under Article 19(1)(g) is thus subject to the complete or partial prohibition or to regulation, by the State. However, under the provisions of Article 19(6) the prohibition, partial or complete, or the regulation, has to be in the interests of the general public.

17. Apart from the restrictions placed on the right under Article 301, by the provisions of Articles 19(6), 47, 302 and 303, the provisions of Article 304 also place such restrictions on the said right. So do the provisions of Article 305, so far as they protect existing laws and laws creating State monopolies. The provisions of the aforesaid articles, so far as they are relevant for our purpose, read together, therefore, make the position clear that the right conferred by Article 19(1)(g) is not absolute. It is subject to restrictions imposed by the other provisions of the Constitution. Those provisions are contained in Articles 19(6), 47, 302, 303, 304 and 305.

18. We may now refer to the relevant entries of List II of the Seventh Schedule to the Constitution which give power to the State Governments to make the laws in question. Entry 8 reads as follows:

"8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors."

Entry 51 reads as follows:

“51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(a) alcoholic liquors for human consumption;

(b) opium, Indian hemp and other narcotic drugs and narcotics;

but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.”

Thus, a State has legislative competence to make laws in respect of the above subjects.

19. The relevant entry in List I which has a bearing on the subject is Entry 52 which reads as follows:

“52. Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest.”

Under this entry, Parliament has enacted the Industries (Development and Regulation) Act, 1951 (‘IDR Act’) and Item 26 of Schedule I of that Act reads as “Fermentation Industries - (1) Alcohol, (2) Other products of Fermentation and Distillery”. Read with Section 2 of the IDR Act, the said entry would mean that the alcohol industry dealing in potable or non-potable alcohol is a controlled industry within the meaning of the said Act. We are not in this reference concerned with the question as to whether there is any conflict between the relevant Acts of the respective State Legislatures and the Rules, Regulations, Notifications and Orders issued under the said Acts and the provisions of the IDR Act. It cannot further be denied that the pith and substance of the IDR Act is to provide the Central Government with the means of implementing their industrial policy which was announced in their resolution of 6-4-1948 and approved by the Central Legislature. That brings under Central control the development and regulation of a number of important industries, the activities of which affect the country as a whole and the development of which must be governed by economic factors of all-India import. The development of the industries on sound and balanced lines is sought to be secured by the licensing of all new undertakings. Hence the IDR Act confers on the Central Government power to make rules for the registration of existing undertakings and for regulating the production and development of the industries mentioned in the Schedule and also for consultation with the Provincial (now State) Governments in these matters. The Act does not in any way denude the power of the State Governments to make laws regulating and prohibiting the production, manufacture, possession, transport, purchase and sale of intoxicating liquors meant for human consumption (but not for medicinal or toilet preparations) and levying excise on them under Entries 8 and 51 of List II. If there is any incidental encroachment by the relevant State Acts on the area occupied by the IDR Act, that will not invalidate the State Acts. The impugned judgments of the High Courts also mention that the State Acts have received the assent of the President.

26. In *Narendra Kumar v. Union of India* [AIR 1960 SC 430] which is a decision of the Constitution Bench of five learned Judges, the question whether restriction on fundamental rights includes their prohibition, fell for consideration squarely. On different dates prior to 3-4-1958, the petitioners in that case had entered into contracts of purchase of copper with importers at Bombay and Calcutta, but before they could take delivery from the importers, the Government of India in exercise of its powers under Section 3 of the Essential Commodities Act, 1955, issued on 2-4-1958 Non-ferrous Metal Control Order, 1958. Clause (3) of the Order provided that no person shall sell or purchase any non-ferrous metal at a price which exceeded the amount represented by an addition of 3.5 per cent to its landed cost, while clause (4) prohibited any person from acquiring any non-ferrous metal except under and in accordance with the permit issued in that behalf by the Controller in accordance with such principles as the Central Government may from time to time specify. No such principles were, however, published in the Gazette nor laid before the Houses of Parliament. The Court held that the word ‘restriction’ in Article 19(5) and (6) of the Constitution includes cases of prohibition also. Where the restriction reaches the stage of total restraint of rights, special care has to be taken by the courts to see that the test of reasonableness is satisfied by considering the question in the background of the facts and circumstances under which the Order was made, taking into account the nature of the evil that was sought to be remedied by such law, the ratio of the harm caused to individual citizens by the proposed remedy, the beneficial effect reasonably expected to result to the

general public, and whether the restraint caused by the law was more than what was necessary in the interests of the general public. The prohibition, according to the Court, has to be treated as only a kind of restriction.

47. We may now deal with the decisions relating to trade or business in industrial alcohol. In **Indian Mica Micanite Industries v. State of Bihar** [(1971) 2 SCC 236], a Constitution Bench of five learned Judges was concerned only with the question whether the fee levied under Rule 111 of the Bihar and Orissa Excise Rules on denatured spirit used and possessed by the appellant had sufficient *quid pro quo* for that levy. The question whether the citizen had a fundamental right to carry on trade or business in industrial alcohol was neither raised nor answered. Dealing with the question raised before it, the Court held, among other things, that before a levy can be upheld as a fee, it must be shown that the levy has a reasonable co-relationship with the services rendered by the Government. The co-relationship is essentially a question of fact. On the facts of that case, the Court found that the only service rendered by the Government to the appellant and to other similar licensees was that the Excise Department had to maintain an elaborate staff not only for the purposes of ensuring that denaturing is done properly by the manufacturer but also to see that the subsequent possession of denatured spirit in the hands either of a wholesale dealer or retail seller or any other licensee or permit-holder was not misused by converting the denatured spirit into alcohol fit for human consumption. Since the State in that case, had not chosen to place before the Court the material in its possession from which the co-relationship between the levy and the services rendered could be established at least in a general way, the Court held that the levy under the impugned rule could not be justified.

49. In **State of U.P. v. Synthetics and Chemicals Ltd.** [(1980) 2 SCC 441] which is a decision of two learned Judges of this Court, the facts were that the State Legislature had enacted the U.P. Excise (Amendment, Act 1972 (30 of 1972). Under notification dated 3-11-1972, the Government was authorised to sell by auction the right of retail or wholesale vend of foreign liquor. The new rules were accordingly framed, the effect of which was that a vend-fee of Rs 1.10 per bulk litre was imposed. The Allahabad High Court, however, held the notification to be ultra vires. However, after the decision of this Court in **Nashirwar** case and **Har Shankar** case where the State's power to auction the right to vend, by retail or wholesale, foreign liquor was upheld, the State Legislature enacted the U.P. Excise (Amendment) Act, 1972 by U.P. Excise (Amendment) (Re-enactment and Validation) Act, 1976 (5 of 1976). Thereafter the High Court upheld the validity of the re-enacted Act and against that appeals were preferred here. The vend fee was made payable in advance on denatured spirit issued for industrial purposes. In that case, the Court held that the expression "intoxicating liquor" in Entry 8 of List II of Seventh Schedule of the Constitution is not confined to potable liquor alone but would include all kinds of liquor which contain alcohol. Hence the expression covered alcohol manufactured for the purpose of industries such as industrial alcohol. The Court also held that the words "foreign liquor" in Section 24-A of the State Act included the denatured spirit and the said words could not be given a restricted meaning for the word 'consumption' cannot be confined to consumption of beverages alone. When the liquor is put to any use such as manufacture of any articles, liquor is all the same consumed. Further, Section 4(2) of the Act provides that the State may declare what shall be deemed to be country liquor or foreign liquor and the State had under the rules issued the notification defining "foreign liquor" as meaning all rectified, perfumed, medicated and denatured spirit wherever made. The Court further held that "specially denatured spirit" for industrial purposes is not different from denatured spirit. The denatured spirit mentioned in the rules in question was treated as including "specially denatured spirit" for industrial purposes. The denatured spirit has ethyl alcohol as one of its constituents. The specially denatured spirit for industrial purposes is different from denatured spirit only because of the difference in the quality and quantity of the denaturants. Specially denatured spirit and ordinary denatured spirits are classified according to the use and the denaturants used. Hence the definition of 'alcohol' in the rules in question included both ordinary as well as specially denatured spirit.

50. The Court further held that although it was true that the stand taken by the State Government in the earlier proceedings in the High Court was that the levy was in the nature of excise duty or a fee and the present stand was that it was neither a duty nor a fee but only a levy for the conferment of the exclusive privilege, that would not make any difference so long as the Government has the right to

impose the levy. The levy was imposed for permission granted in favour of the licensees and allotment orders of denatured spirits issued to them from the various distilleries. The parties having paid the fee, had taken possession of denatured spirit from the distilleries and the re-enacted legislation, viz., Act 5 of 1976 had only restored the status quo enabling the State to collect the levy validly made under the earlier Act 30 of 1972 which was found to be illegal by the High Court.

51. Since the State had exclusive right of manufacturing and selling of intoxicating liquors, the imposition of vend fee on denatured spirit and the grant of licences to wholesale vend of denatured spirit was within the legislative competence of the State under Entry 8 of List II. The Court further held that the Ethyl Alcohol (Price Control) Order issued by the Central Government in exercise of power conferred under Section 18-G of the IDR Act did not explicitly or impliedly take away the power of the State Government to regulate the distribution of intoxicating liquor by collecting a levy for parting away with its exclusive rights. The power of the State under Entry 24 of List II is subject to the provisions of Entry 52 of List I. Therefore, the power of Parliament and the State Legislature were confined to Entry 52 of List I and Entry 24 of List II respectively. Parliament would have had exclusive power to legislate in respect of industry notified by Parliament but the provisions of Entry 26 of List II and Entry 33 of List III would also have to be taken into account for determining the scope of legislative power of Parliament and the State. Entry 33 of List III enables a law to be made regarding the production, supply and distribution of products of a notified industry. Thus, a fair scrutiny of the relevant entries made it clear that the power to regulate notified industries is not exclusively within the jurisdiction of Parliament. Hence, it cannot be contended that after passing of the Industries (Development and Regulation) Act, 1951, the claim by the State to monopoly with regard to the production and manufacture and the sale of the denatured spirit or the industrial alcohol was unsustainable.

52. In *Synthetics and Chemicals Ltd. v. State of U.P.* [(1990) 1 SCC 109] which is a decision of Constitution Bench of seven learned Judges, the question was with regard to the validity of levy on industrial alcohol. The Court held that it must accept the decision that the States have the power to regulate the use of alcohol and that power must include power to make provisions to prevent and/or check industrial alcohol being used as intoxicating or drinkable alcohol. The question, according to the Court, was whether in the garb of regulations, the legislation which is in pith and substance fee or levy which has no connection with the cost or expenses administering the regulations can be imposed purely as a regulatory measure. Judged by the pith and substance of the impugned legislation, the Court held that the levies in question could not be treated as part of regulatory measures. The Court further held that the State had power to regulate though not as emanation of police power but as an expression of the sovereign power of the State. But that power has its limitations. The Court then observed that only in two cases the question of industrial alcohol had come up for consideration before this Court. One in *Synthetics and Chemicals Ltd. case* and the other in *Indian Mica and Micanite Industries*. The latter cases starting with *F.N. Balsara* case are of potable liquor. The Court then referred to *K.K. Narula* case and observed as follows:

(T)here was no right to do business even in potable liquor. It is not necessary to say whether it is a good law or not. But this must be held that the reasoning therein would apply with greater force to industrial alcohol.

The Court then observed in paragraphs 77, and 80 to 85 as under:

77. Article 47 of the Constitution imposes upon the State the duty to endeavour to bring about prohibition of the consumption except for medicinal purpose of intoxicating drinks and products which are injurious to health. If the meaning of the expression 'intoxicating liquor' is taken in the wide sense adopted in Balsara case, it would lead to an anomalous result. Does Article 47 oblige the State to prohibit even such industries as are licensed under the IDR Act but which manufacture industrial alcohol? This was never intended by the above judgments or the Constitution. It appears to us that the decision in the Synthetics and Chemicals Ltd. case was not correct on this aspect. * * *

80. It was submitted that the activity in potable liquor which was regarded safe and exclusive right of the State in the earlier judgments dealing with the potable liquor were sought to be justifiable under the police power of the State, that is, the power to preserve public health, morals, etc. This reasoning can never apply to industrial alcohol manufactured

by industries which are to be developed in the public interest and which are being encouraged by the State. In a situation of this nature, it is essential to strike a balance and in striking the balance, it is difficult to find any justification for any theory of any exclusive right of a State to deal with industrial alcohol. Restriction valid under one circumstance may become invalid in changing circumstances. ...

81. It is not necessary for us here to say anything on the imposts on potable alcohol as commonly understood. These are justified by the lists of our legislature practised in this country.

82. In that view of the matter, it appears to us that the relevant provisions of the U.P. Act, A.P. Act, Tamil Nadu Act, Bombay Prohibition Act, as mentioned hereinbefore, are unconstitutional insofar as these purport to levy a tax or charge imposts upon industrial alcohol, namely alcohol used and usable for industrial purposes.

83. Having regard to the principles of interpretation and the constitutional provisions, in the light of the language used and having considered the impost and the composition of industrial alcohol, and the legislative practice of this country, we are of the opinion that the impost in question cannot be justified as State imposts as these have been done. We have examined the different provisions. These are not merely regulatory. These are much more than that. These seek to levy imposition in their pith and substance not as incidental or as merely disincentives but as attempts to raise revenue for States' purposes. There is no taxing provision permitting these in the lists in the field of industrial alcohol for the State to legislate.

84. Furthermore, in view of the occupation of the field by the IDR Act, it was not possible to levy this impost.

85. After the 1956 amendment to the IDR Act bringing alcohol industries (under fermentation industries) as Item 26 of the First Schedule to IDR Act the control of this industry has vested exclusively in the Union. Thereafter, licences to manufacture both potable and non-potable alcohol is vested in the Central Government. Distilleries are manufacturing alcohol under the central licences under IDR Act. No privilege for manufacture even if one existed, has been transferred to the distilleries by the State. The State cannot itself manufacture industrial alcohol without the permission of the Central Government. The States cannot claim to pass a right which they do not possess. Nor can the State claim exclusive right to produce and manufacture industrial alcohol which are manufactured under the grant of licence from the Central Government. Industrial alcohol cannot upon coming into existence under such grant be amenable to States' claim of exclusive possession of privilege.

53. The aforesaid decisions pertaining to the trade or business in denatured spirit or industrial alcohol, not only do not take the view that the citizen has a fundamental right to carry on trade or business in potable alcohol but on the contrary, hold that he has no such right. This is reiterated in the two *Synthetics & Chemicals* cases.

54. It will thus be obvious that all the decisions except the decision in *K.K. Narula* case have unanimously held as shown above that there is no fundamental right to carry on trade or business in potable liquor sold as a beverage. As pointed out above, the proposition of law which is put in a different language in *K.K. Narula* case has been explained by the subsequent decisions of this Court including those of the Constitution Benches. The proposition of law laid down there has to be read in conformity with the proposition laid down in that respect by the other decisions of this Court not only to bring comity in the judicial decisions but also to bring the law in conformity with the provisions of the Constitution. The fundamental rights conferred by our Constitution are not absolute. Article 19 has to be read as a whole. The fundamental rights enumerated under Article 19(1) are subject to the restrictions mentioned in clauses (2) to (6) of the said article. Hence, the correct way to describe the fundamental rights under Article 19(1) is to call them qualified fundamental rights. To explain this position in law, we may take the same illustration as is given in *K.K. Narula* case. The citizen has undoubtedly a fundamental right to carry on business in ghee. But he has no fundamental right to do business in adulterated ghee. To expound the theme further, a citizen has no right to trafficking in women or in slaves or in counterfeit coins or to carry on business of exhibiting and publishing pornographic or obscene films and literature. The illustrations can be multiplied. This is so because there are certain activities which are inherently vicious and pernicious and are condemned by all

civilised communities. So also, there are goods, articles and services which are obnoxious and injurious to the health, morals, safety and welfare of the general public. To contend that merely because some activities and trafficking in some goods can be organised as a trade or business, right to carry on trade or business in the same should be considered a fundamental right is to beg the question. The correct interpretation to be placed on the expression “the right to practise any profession, or to carry on any occupation, trade or business” is to interpret it to mean the right to practise any profession or to carry on any occupation, trade or business which can be legitimately pursued in a civilised society being not abhorrent to the generally accepted standards of its morality. Human perversity knows no limits and it is not possible to enumerate all professions, occupations, trades and businesses which may be obnoxious to decency, morals, health, safety and welfare of the society. This is apart from the fact that under our Constitution the implied restrictions on the right to practise any profession or to carry on any occupation, trade or business are made explicit in clauses (2) to (6) of Article 19 of the Constitution and the State is permitted to make law for imposing the said restrictions. In the present case, it will be clause (6) of Article 19 which places restrictions on the fundamental right to do business under Article 19(1)(g). These restrictions and limitations on fundamental right are implicit and inherent even in the fundamental rights spelt out in the American Constitution, although they are not explicitly stated as in our Constitution by clauses (2) to (6) of Article 19. That is how the American Supreme Court has read and interpreted the rights in the American Constitution as pointed out above by the excerpts from the relevant decisions. It will have, therefore, to be held that even under the American Constitution, there is no absolute fundamental right to do business or trade in any commodity or service. The correct way, therefore, to read the fundamental rights enumerated under Article 19(1) of our Constitution is to hold that the citizens do not possess the said rights absolutely. They have the said rights as qualified by the respective clauses (2) to (6) of Article 19. That is apart from the fact that Article 47 of the Constitution enjoins upon the State to prohibit consumption of intoxicating drink like liquor, which falls for consideration in the present case and, therefore, the right to trade or business in potable liquor is subject also to the provisions of the said article. Whether one states as in *K.K. Narula* case that the citizen has a fundamental right to do business but subject to the State’s powers to impose valid restrictions under clause (6) of Article 19 or one takes the view that a citizen has no fundamental right to do business but he has only a qualified fundamental right to do business, the practical consequence is the same so long as the former view does not deny the State the power to completely prohibit, trade or business in articles and products like liquor as a beverage, or such trafficking as in women and slaves. This Court in *K.K. Narula* case has not taken such view.

55. The contention that if a citizen has no fundamental right to carry on trade or business in potable liquor, the State is also enjoined from carrying on such trade, particularly in view of the provisions of Article 47, though apparently attractive, is fallacious. The State’s power to regulate and to restrict the business in potable liquor impliedly includes the power to carry on such trade to the exclusion of others. Prohibition is not the only way to restrict and regulate the consumption of intoxicating liquor. The abuse of drinking intoxicants can be prevented also by limiting and controlling its production, supply and consumption. The State can do so also by creating in itself the monopoly of the production and supply of the liquor. When the State does so, it does not carry on business in illegal products. It carries on business in products which are not declared illegal by completely prohibiting their production but in products the manufacture, possession and supply of which is regulated in the interests of the health, morals and welfare of the people. It does so also in the interests of the general public under Article 19(6) of the Constitution.

56. The contention further that till prohibition is introduced, a citizen has a fundamental right to carry on trade or business in potable liquor has also no merit. All that the citizen can claim in such a situation is an equal right to carry on trade or business in potable liquor as against the other citizens. He cannot claim equal right to carry on the business against the State when the State reserves to itself the exclusive right to carry on such trade or business. When the State neither prohibits nor monopolises the said business, the citizens cannot be discriminated against while granting licences to carry on such business. But the said equal right cannot be elevated to the status of a fundamental right.

57. It is no answer against complete or partial prohibition of the production, possession, sale and consumption etc. of potable liquor to contend that the prohibition where it was introduced earlier and where it is in operation at present, has failed. The failure of measures permitted by law does not

detract from the power of the State to introduce such measures and implement them as best as they can.

58. We also do not see any merit in the argument that there are more harmful substances like tobacco, the consumption of which is not prohibited and hence there is no justification for prohibiting the business in potable alcohol. What articles and goods should be allowed to be produced, possessed, sold and consumed is to be left to the judgment of the legislative and the executive wisdom. Things which are not considered harmful today, may be considered so tomorrow in the light of the fresh medical evidence. It requires research and education to convince the society of the harmful effects of the products before a consensus is reached to ban its consumption. Alcohol has since long been known all over the world to have had harmful effects on the health of the individual and the welfare of the society. Even long before the Constitution was framed, it was one of the major items on the agenda of the society to ban or at least to regulate, its consumption. That is why it found place in Article 47 of the Constitution. It is only in recent years that medical research has brought to the fore the fatal link between smoking and consumption of tobacco and cancer, cardiac diseases and deterioration and tuberculosis. There is a sizeable movement all over the world including in this country to educate people about the dangerous effect of tobacco on individual's health. The society may, in course of time, think of prohibiting its production and consumption as in the case of alcohol. There may be more such dangerous products, the harmful effects of which are today unknown. But merely because their production and consumption are not today banned, does not mean that products like alcohol which are proved harmful, should not be banned.

59. The 1956 Resolution of Industrial Policy adopted by the Central Government also does not help the petitioners/appellants in their contention that the production of industrial alcohol as an industry has to be recognised and all that can be done is to regulate the said production but not to prohibit it. Apart from the fact that the said resolution has no legal efficacy, and cannot have the effect of limiting the powers of the State to prohibit or restrict the production of potable alcohol, the resolution itself nowhere speaks against such prohibition or limitation. The licences granted to the distilleries, breweries and wineries of potable liquor are valid only so long as their production, possession, transport, sale, consumption etc. are not completely prohibited in the States concerned.

60. We may now summarise the law on the subject as culled from the aforesaid decisions.

(a) The rights protected by Article 19(1) are not absolute but qualified. The qualifications are stated in clauses (2) to (6) of Article 19. The fundamental rights guaranteed in Article 19(1)(a) to (g) are, therefore, to be read along with the said qualifications. Even the rights guaranteed under the Constitutions of the other civilized countries are not absolute but are read subject to the implied limitations on them. Those implied limitations are made explicit by clauses (2) to (6) of Article 19 of our Constitution.

(b) The right to practise any profession or to carry on any occupation, trade or business does not extend to practising a profession or carrying on an occupation, trade or business which is inherently vicious and pernicious, and is condemned by all civilised societies. It does not entitle citizens to carry on trade or business in activities which are immoral and criminal and in articles or goods which are obnoxious and injurious to health, safety and welfare of the general public, i.e., *res extra commercium*, (outside commerce). There cannot be business in crime.

(c) Potable liquor as a beverage is an intoxicating and depressant drink which is dangerous and injurious to health and is, therefore, an article which is *res extra commercium* being inherently harmful. A citizen has, therefore, no fundamental right to do trade or business in liquor. Hence the trade or business in liquor can be completely prohibited.

(d) Article 47 of the Constitution considers intoxicating drinks and drugs as injurious to health and impeding the raising of level of nutrition and the standard of living of the people and improvement of the public health. It, therefore, ordains the State to bring about prohibition of the consumption of intoxicating drinks which obviously include liquor, except for medicinal purposes. Article 47 is one of the directive principles which is fundamental in the governance of the country. The State has, therefore, the power to completely prohibit the manufacture, sale, possession, distribution and consumption of potable liquor as a beverage, both because it is inherently a

dangerous article of consumption and also because of the directive principle contained in Article 47, except when it is used and consumed for medicinal purposes.

(e) For the same reason, the State can create a monopoly either in itself or in the agency created by it for the manufacture, possession, sale and distribution of the liquor as a beverage and also sell the licences to the citizens for the said purpose by charging fees. This can be done under Article 19(6) or even otherwise.

(f) For the same reason, again, the State can impose limitations and restrictions on the trade or business in potable liquor as a beverage which restrictions are in nature different from those imposed on the trade or business in legitimate activities and goods and articles which are *res commercium*. The restrictions and limitations on the trade or business in potable liquor can again be both under Article 19(6) or otherwise. The restrictions and limitations can extend to the State carrying on the trade or business itself to the exclusion of and elimination of others and/or to preserving to itself the right to sell licences to do trade or business in the same, to others.

(g) When the State permits trade or business in the potable liquor with or without limitation, the citizen has the right to carry on trade or business subject to the limitations, if any, and the State cannot make discrimination between the citizens who are qualified to carry on the trade or business.

(h) The State can adopt any mode of selling the licences for trade or business with a view to maximise its revenue so long as the method adopted is not discriminatory.

(i) The State can carry on trade or business in potable liquor notwithstanding that it is an intoxicating drink and Article 47 enjoins it to prohibit its consumption. When the State carries on such business, it does so to restrict and regulate production, supply and consumption of liquor which is also an aspect of reasonable restriction in the interest of general public. The State cannot on that account be said to be carrying on an illegitimate business.

(j) The mere fact that the State levies taxes or fees on the production, sale and income derived from potable liquor whether the production, sale or income is legitimate or illegitimate, does not make the State a party to the said activities. The power of the State to raise revenue by levying taxes and fees should not be confused with the power of the State to prohibit or regulate the trade or business in question. The State exercises its two different powers on such occasions. Hence the mere fact that the State levies taxes and fees on trade or business in liquor or income derived from it, does not make the right to carry on trade or business in liquor a fundamental right, or even a legal right when such trade or business is completely prohibited.

(k) The State cannot prohibit trade or business in medicinal and toilet preparations containing liquor or alcohol. The State can, however, under Article 19(6) place reasonable restrictions on the right to trade or business in the same in the interests of general public.

(l) Likewise, the State cannot prohibit trade or business in industrial alcohol which is not used as a beverage but used legitimately for industrial purposes. The State, however, can place reasonable restrictions on the said trade or business in the interests of the general public under Article 19(6) of the Constitution.

(m) The restrictions placed on the trade or business in industrial alcohol or in medicinal and toilet preparations containing liquor or alcohol may also be for the purposes of preventing their abuse or diversion for use as or in beverage.

61. This Court neither in *K.K. Narula* case nor in the second *Synthetics and Chemicals Ltd.* case has held that the State cannot prohibit trade or business in potable liquor. The observations made in *K.K. Narula* case that a citizen has a fundamental right to trade or business in liquor are to be understood, as explained above, to mean only that when the State does not prohibit the trade or business in liquor, a citizen has the right to do business in it subject to the restrictions and limitations placed upon it. Those observations cannot be read to mean that a citizen has an unqualified and an absolute right to trade or business in potable liquor. This position in law is explained by this Court also in *Har Shankar* case. The decision in the second *Synthetics and Chemicals Ltd.* case also cannot be read to mean that the Court in that case has taken the view that a citizen has a right to trade or business in potable liquor. That decision is confined to trade or business in industrial alcohol which is

legitimately used for industrial purpose and not for consumption as an intoxicating drink. The Court has also there not taken any exception to the right of the State to place reasonable restrictions on the trade or business even of industrial alcohol to prevent its diversion for the use in or as intoxicating beverage.

62. We, therefore, hold that a citizen has no fundamental right to trade or business in liquor as beverage. The State can prohibit completely the trade or business in potable liquor since liquor as beverage is *res extra commercium*. The State may also create a monopoly in itself for trade or business in such liquor. The State can further place restrictions and limitations on such trade or business which may be in nature different from those on trade or business in articles *res commercium*. The view taken by this Court in *K.K. Narula* case as well as in the second *Synthetics and Chemicals Ltd.* case is not contrary to the aforesaid view which has been consistently taken by this Court so far.

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B.R. Enterprises v. State of U.P.

(1999) 9 SCC 700

[Legality of certain provisions of the Lotteries (Regulation) Act, 1998-whether lotteries organized by the state is gambling in nature- whether it is trade and business within the meaning of Articles 301-303 of the Constitution of India]

In this background, now we proceed to consider first, what is the nature and character of the lotteries? What changes, if any, is brought in when lottery becomes State lottery? So far as lotteries are concerned, it can neither be denied nor has been denied that lotteries are form of gambling. The question next is, whether a lottery, which is not a State lottery, if it is gambling, does it loose its character as such when it becomes a State lottery? The lotteries as such are pernicious in nature cannot be denied. However, the submission is, when it cloaks itself with the linen of State authority and is presented as State organised lottery, it loses its pernicious character and what could be said before he puts on the cloak to be *res extra commercium* becomes *commercium*. Hence, for this we have to understand what is trade and business, and what is lottery? Unless their true nature and character is understood, submissions could not be properly appreciated. We are also conscious, the resultant conclusion of it would not be proper if based on views of one or two individual judges but has to be based on what was and is understood at the common law. For this, we have to turn our pages to the ancient history to gather wholesome view as to what was understood then and what is understood now, which is revealed through the ancient texts and various decisions of our courts and courts of other countries.

In this context, we may first refer-to the Constitution Bench decision of this court in *RMDC (supra)*, which is a leading case, which has truly dwelled on this subject at some length. It holds that gambling activities are in its very nature and essence *extra commercium*. They were considered to be a sinful and pernicious vice by the ancient seers and law givers of India. It also records that it has been deprecated even by the laws of England, Scotland, United States of America and Australia, In support, it quoted what seers and law givers of India in (he ancient time looked upon gambling. A reference was made of Hymn XXXIV of the Rigveda which proclaims the demerits of gambling and quoted verses 7, 10 and 13. It referred to Mahabharata which deprecates gambling by depicting the woeful conditions of the Pandavas who had gambled away their kingdom. Manu in verse 221 advises the king to exclude from his realm gambling and betting, since these two vices cause the destruction of the kingdom of princes. Verse 226 describes a gambler as secret thieves who constantly harass the good subjects by their forbidden practices. Verse 227 referred to the gambling as a vice causing great enmity and advises wise men not to practice it even for amusement. As is the present case, even in the ancient time, inspite of condemnation of gambling, Yajnavalkya permitted it is under State control. Vrihaspati on this subject records that gambling had been totally prohibited by Manu because it destroys truth, honesty and wealth while some other law givers permitted it when conducted under the control of the State so as to allow the king a share of every stake. However, the Supreme Court of America as far back as in 1850 considered this issue as recorded in *Phalen v. Virginia*, (1850) 49 U.S. 163; 12L Ed. 1030, 1033, for useful appreciating its adjudication is quoted hereunder:-

"Experience has shown that the common forms of gambling are comparatively innocuous when placed in contrast with widespread pestilence of lotteries, the former are confined to a few persons and places, but the latter infests the whole community; it enters every dwelling it reaches every class; it preys upon the hard earnings of the poor; it plunders the ignorant and the simple."

The observations were quoted, with approval in *Douglas v. Kentucky*. After quoting the passage from Phalen case (*supra*) judgment proceeded:

"Is the state forbidden by the supreme law of the land from protecting its people at all times from practices which it conceives to be attended by such ruinous results. Can the Legislature of a State contract away its power to establish such regulations as are reasonably necessary from time to time to protect the public morals against the evils of lotteries?"

In die said decisions, a reference was made to the decision of Australian High court in *The King v. Connare*, [1939] 51 CLR 596 Evatt, J. did not think that lottery tickets can be regarded as goods or

commodities entitled for protection of Section 21 of the common wealth of Australian Constitution Act. He held at page 628:

"If they are goods or commodities they belong to a very special category, so special in the interests of its citizens the state may legitimately exile them from the realm of trade, commerce of business. The indiscriminate sale of such tickets may be regarded as causing business disturbance and loss which, on general grounds of policy, the State is entitled to prevent or at least minimize."

In the same decision, McTiernan J. held :

"Some trades are more adventurous or speculative than others, but trade or commerce as a branch of human activity belongs to an order entirely different from gaming or gambling. Whether a particular activity falls within the one or the other order is a matter of social opinion rather than jurisprudence..... It is gambling to buy a ticket or share in a lottery. Such a transaction does not belong to the commercial business of the country. The purchaser stakes money in a scheme for distributing prizes by chance. He is a gamester." Mc Tiernan J. reiterated his view in another case in *King v. Connare* (1938) 61 CLR 59:

"It is important to observe the distinction that gambling is not trade, commerce and intercourse within the meaning of S. 92 otherwise the control of gambling in Australia would be attended with constitutional difficulties."

In the same decision the view of Taylor J. is also quoted hereunder:

"No simple legislative expedient purporting to transmute trade and commerce: into something else will remove it from the ambit of S. 92. But whilst asserting the width of the field in which S.92 may operate it is necessary to observe that not every transaction which employs the forms of trade and commerce will, as trade and commerce, invoke its protection."

With reference to the history of lotteries in England, the learned judge quoted:

"The foregoing observations give some indication of the attitude of the law for over two and a half centuries towards the carrying on of lotteries. But they show also that, in this country, lotteries were, from the moment of its first settlement, common and public nuisances and that, in general, it was impossible to conduct them except in violation of the law. Indeed, it was impracticable for any person to conduct a lottery without achieving the status of a rogue and a vagabond."

It is significant that American congress faced with the difficulty to include gambling activity within the commerce clause of Article 1, Section 8 sub-section 3 of the Constitution of the United States in the interests of controlling its activity including ban or penalising a person, interpreted the commerce clause to include gambling activity. The relevant portion as recorded in *RMDC* case is quoted hereunder :

"Congress having made law regulating gambling activities which extended across the State borders, the question arose whether the making of the law was within the legislative competence of the Congress, that is to say whether it could be brought within the commerce clause. The question depended for its answer on the further question whether the gambling activities could be said to be commerce amongst the States. If it could, then it was open to congress to make the law in exercise of its Legislative powers under the commerce clause. More often than not gambling activities extend from State to State and in view of the commerce clause, no State Legislature can make a law for regulating inter-state activities in the nature of trade. If betting and gambling does not fall within the ambit of the commerce clause, then neither the Congress nor the State Legislature can in any way control the same. In such circumstances, the Supreme Court of America thought it right to give a wide meaning to the word 'commerce' so as to include gambling within the commerce clause and thereby enable the Congress to regulate and control the same. Thus in *Champion v. Ames*, (1903) 188 US 321;47 L. Ed. 492 the carriage of lottery tickets from one State to another by an express company was held to be inter-State commerce and the court upheld the law made by Congress which made such carriage an offence."

We have summarised the relevant portions of the various decisions given by the Australian, American and English Courts to show how they have received the lotteries in their countries, its nature, impact on public at large, their concern about its regulation and control. There can be no doubt, on the perusal of the said decisions that these courts considered lottery as gambling and even where such lotteries

were permitted under the regulating power of the state but were not given the status of "trade and commerce" as understood at common parlance. It is significant, within the fertile arid exclusive zone of interpretation, when situation arose, to interpret the word "commerce" which normally would not have included "gambling" within it, in the wider public interest as to bring jurisdiction to the legislature to control or restrict "betting and gambling" interpreted this also to come within commerce clause. This wider definition to the commerce clause was given by the American Court with an objective to control such lotteries rather giving absolute freedom to trade in it. Thus, the law in *Champion (supra)* penalising even carriage of lottery tickets from one State to another was upheld. In cases *United States v. Kahrigier* (1953) 345 U.S.22; 97 L. Ed. 754 and *Lewis v. United States*, (1955) 348 U.S.419; 99 L. Ed. 475, the Supreme Court Of United states held that there is no constitutional right to gambling.

From the references from Dharmashastra, opinions of distinguished authors, references in the Encyclopaedia of Britannica and Boston Law Review and others, we find that each concludes, as we have observed, lottery remains in the realm of gambling. Even where it is state sponsored still it was looked down as an evil. Right from ancient time till the day all expressed concern to eliminate this, even where it was legalised for raising revenue either by the king or in me modern times by the State. Even this legitimisation was for the sole purpose of raising revenue, was also for a limited period, since this received condemnation even for this limited purpose. All this gives clear picture of the nature arid character of lottery as perceived through the consciences of the people, as revealed through ancient scriptures, also by various courts of the countries. It is in this background now we proceed to examine, if lotteries are goods, could a contract for sale of such goods be conferred the status of trade and commerce as used in Chapter XIII of our Constitution.

Thus, now we proceed to examine what are lottery tickets? What are the ingredients of a contract of sale of lottery tickets? Whether its ingredients constitute it to be trade and to be such trade as to receive protection under our Constitution? In other words, could such trade qualify to be fundamental right or a right conferred by a Statute? If it is a right out of creature of a Statute could it not be regulated, curtailed or banned by the same Statute? Whether a right spoken of "free trade" under Article 301 speaks about fundamental right or does it include trade of the nature we are concerned? Whether mere legalisation of a transaction by itself becomes "commercium" of the nature as to qualify to be a trade as understood under Article 301.

Learned counsel for the States challenging the validity of the Act submits, since there is marked difference between our Constitution and the Australian Constitution and Constitution of the United States of America, hence we should not apply the principles of the decision of those Courts. It was pointed out, there is nothing in the American Constitution corresponding to Article 19(1)(g) or Article 301 as in our Constitution.

Similarly, in the Australian Constitution there is no provision as we have in our Articles 19(6) or Articles 302, 304 in contrast Section 92 of the Australian Constitution is free without any such limitations. This submission was taken note by our Court in the case of *KMDC (supra)*. The reference Of these judgments of these foreign Courts were only to take the stock of the view as to with what vision they judged and what they meant and understood while dealing with the sale of lottery tickets. Nevertheless, this apart, if reasoning of these decisions is to be tested, qua, our constitutional provisions, they should of course, be tested with circumspection. As said, we have referred to these decisions, not for interpreting the provisions of our Constitution but only to know the nature and character of lotteries as understood in those countries to which we find there is no difference than what is understood in our country. It is in this background, this Court in *RMPC (supra)*, after recording the activities of lotteries which is condemned in this country from the ancient times and also taking note of views of the courts of other countries, found that they equally condemned, discouraged and looked it down with disfavour, viz., in England, Scotland, the Unites of America and in Australia So this decision concludes that our constitutional makers could never have intended, with reference to the transaction of lottery tickets, to raise it to the Status of trade, commerce or intercourse. The purpose of Articles 19(1)(g) and 301 could not possibly have been to guarantee freedom of gambling. To dissolve principle laid down in *RMDC (supra)*, on behalf of such States challenging the validity of the Act, it is submitted that the *RMDC* case was concerned with the lotteries covered by Entry 34,

List II and not the lotteries organised by the State which is covered by Entry 40, List I, hence it would have no application. In addition, they referred to the case of *Gherulal Parekh (supra)* to submit that what is recorded in *RMDC (supra)* was narrowly interpreted in this case. The question in *Gherulal* case was, whether an agreement of partnership with the object of entering into wagering transactions was illegal within the meaning of Section 23 of the Indian Contract Act? It was held that although a wagering contract was void and unenforceable under Section 30 of the Contract Act, it was not forbidden by law and an agreement collateral to such a contract was not unlawful within the meaning of Section 23 of the Contract Act. What is narrowed down, if at all, was with reference to morality aspect based on ancient scriptures. It holds after referring the *RMDC* case:

"The moral prohibitions in Hindu Law texts against gambling were not legally enforced but were allowed to fall into desuetude and it was not possible to hold that there was any definite head or principle of public policy evolved by courts or laid down by precedents directly applicable to wagering contracts."

This decision has not diluted the law laid down with respect to the finding that gambling would not fall within the meaning of word 'trade' under Article 301 of the Constitution or to have diluted that such transaction would not get protection under Article 19(1)(g). What is said is that moral prohibitions in Hindu Law text against gambling were not legally enforced. It is true, within the moral format, in a strict sense, if it was to be legally enforced there could not have been any legalised gambling. But it cannot be doubted and it is recognised by all the countries that gambling by its very nature promises to make poor man a rich man, to quench the thirst of a man in dire economic distress or to a man with bursting desire to become wealthy overnight draws them into the magnetic field of lotteries with crippling effect. More often than not, such hopes with very remote chance encourages the spirit of reckless prosperity in him, ruining him and his family. This encouraging hope with the magnitude of prize money never dwindles. Losses and failures in lotteries instead of discouragement increases the craze with intoxicating hope, not only to erase the losses but to fill his imaginative coffer. When this chance mixes with this Utopian hope, he is repeatedly drawn back into the circle of lottery like drug addicts. Inevitably, the happiness of his family is lost. He goes into a chronic state of indebtedness. In this context, it is said that how the Constitution makers could ever have conceived to give protection to gambling under Article 19(1)(g) or Article 301 of our Constitution.

Before considering the submission, the difference between the lottery organised by the State and other lotteries, on which basis the applicability of the principle of *RMDC* case (*supra*) is sought to be distinguished, we would like to refer to another realm of State activity, the transaction which is in the nature of trade, viz., the manufacture and sale of potable liquor, but still this Court held it to be *res extra commercium*. In the *Krishan Kumar Narula v. State of Jammu & Kashmir & Ors.*, [1967] 3 SCR 50 at p. 54, the submission was that potable liquor is noxious and dangerous to the community and subversive of its morals. With reference to potable liquor a challenge was made, the Court held;

"...that dealing in noxious and dangerous goods like liquor was dangerous to the community and subversive of its morals.. Such an approach leads to incoherence in thought and expressions: Standards of morality can offer guidance to impose restrictions, but cannot limit the scope of the right."

The Court held that right to trade in liquor was business. However, in *Khoday Distilleries (supra)* it reversed the decision of *Krishan Kumar* case (*supra*) by holding that right to trade in liquor was not constitutionally protected. However, the Court in this case clearly made three exceptions,

- (a) trade in alcohol is not per se prohibited for medicinal and industrial uses;
- (b) even though trade in potable alcohol was *res extra commercium* the State itself may sell potable alcohol, set up a monopoly business for that purpose and maximise its revenue by any mode of sale; and
- (c) the state may on a non-discriminatory bases permit sale of alcohol through private parties. In *Khoday Distilleries (supra)* this Court held:

"The right to practice any profession or to carry on any occupation, trade or business does not extend to practising a profession or carrying on an occupation, trade or business which is inherently vicious and pernicious, and is condemned by all civilised societies. It does not entitle citizens to carry on trade or business in activities which are immoral and criminal and in articles or

goods which are obnoxious and injurious to health, safety and welfare of the general public, i.e., *res extra commercium*, (outside commerce). There cannot be business in crime.

Potable liquor as a beverage is an intoxicating and depressant drink which is dangerous and injurious to health and is, therefore, an article which is *res extra commercium* being inherently harmful. A citizen has, therefore, no fundamental right to do trade or business in liquor. Hence the trade or business in liquor can be completely prohibited. For the same reason, again, the State can impose limitations and restrictions on the trade or business in potable liquor as a beverage which restrictions are in nature different from those imposed on the trade or business in legitimate activities and goods and articles which are *res commercium*. The restrictions and limitations on the trade and business in potable liquor can again be both under Article 19(6) or otherwise. The restrictions and limitations can extend to the State carrying on the trade or business itself to the exclusion of and elimination of others and/or to preserving to -itself the right to sell licences to do trade or business in the same, to others.

The State can carry on trade or business in potable liquor notwithstanding that it is an intoxicating drink and Article 47 enjoins it to prohibit its consumption. When the State carries on such business, it does so to restrict and regulate production, supply and consumption of liquor which is also an aspect of reasonable restriction in the interest of general public. The State cannot on that account be said to be carrying on an illegitimate business. It carries on business in products which are not declared illegal by law which is regulated in the interests of the health, morals and welfare of the people. It does so also in the interests of the general public under Article 19(6).

The mere fact that the State levies taxes or fees on the production, sale and income derived from potable liquor whether the production, sale or income is legitimate or illegitimate, does not make the State a party to the said activities. The power of the State to raise revenue by levying taxes and fees should not be confused with the power of the State to prohibit or regulate the trade or business in question. The State exercises its two different powers on such occasions. Hence the mere fact that the State levies taxes and fees on trade or business in liquor or derives income from it, does not make the right to carry on trade or business in liquor a fundamental right, or even a legal right when such trade or business is completely prohibited." This decision clearly lays down and demonstrates that manufacture, sale, purchase of potable liquor, which State carries on at common parlance is trade and is a good still held to be an article different from goods and article which are *res commercium*. This holds further that transactions in potable liquor by sale and in spite of levy of taxes, fees on this trade or business, it is held to be *res extra commercium*. Such transactions are also not prohibited, rather authorised by law. Hence merely there is sanction in law for a transaction or is legalised not prohibited, it would not by itself make it to be *commercium*. Entry 62 of List II of the Seventh Schedule refers to taxes on betting and gambling which inherently permits gambling. Thus, it could be said that gambling is recognised and authorized by law, may be through regulations, licences etc. Thus, imposition of tax on gambling conceives of gambling, of course has to be legal to impose tax on it. In this background, we proceed to examine State lotteries (gambling), whether could it still qualify to be 'trade of commerce' within the meaning of Chapter XIII of our Constitution or could 'trade' or such transactions seek protection under the protective umbrella of constitutional provisions as it to be free 'trade'?

For this, we revert to scrutinize as to what trade lotteries gambling and how State lotteries cleanse this character. As we have already recorded, the difference between gambling and the trade that a gambling inherently contains a chance with no skill, while trade contains skill with no chance. What makes lottery a pernicious is its gambling nature. Can it be said that in the State organised lotteries this element of gambling is excluded? There could possibly be no two opinions that even in the State lotteries the same element of chance remains with no skill. It remains within the boundaries of gambling. The stringent measures and the conditions imposed under the State lotteries are only to inculcate faith to the participant of such lottery, that it is being conducted fairly with no possibility of fraud, misappropriation or deceit and assure the hopeful recipients of high prizes that all is fair and safe. That assurance is from stage one to the last with full transparency; No doubt holding of the State lotteries for public revenue has been authorised, legalised and once this having been done it is expected from the State to take such measure to see that people at large, faithfully and hopefully participate in larger number for the greater yield of its revenue with no fear in their mind. The Act

further ensure by virtue of Section 4(d) that the proceeds of the sale of such lottery tickets is credited to the public accounts of the State. This is to give clear message to the participants that the proceeds are not in the hands of individual group or association but is ensured to be credited in the State accounts. But, as we have said, this by itself would not take it outside the realm of gambling. It remains within the same realm. In this regard there is no difference between lotteries under Entry 34, List II and a lottery organised by the State under Entry 4.0, List I. When character of both the State organised lotteries and other lotteries remains the same by merely placing the apparel of the State with authority of law, would not make any difference, it remains gambling as element of chance persist with no element of skill. Even other lotteries under Entry 34, List II could only be run under the authority of the State or the law of the State. Only difference is in one case, authority is that of State and in other, the Parliament. That is why, what is excluded from the penal consequences under Section 294A, IPC is the lotteries authorised by the State not merely lotteries organised by the State. So, on the reasoning as put forward even lotteries under Entry 34, List II cannot be said to be pernicious. The lotteries authorised by the State is also has a sanction in law. As we have said, a gambling may be taxed and may be authorised for a specified purpose, but it would not attain the status of trade like other trades or become res commercium. No gambling could be commercium hence in our considered opinion the principle of RMDC case (supra) would equally be applicable even to the State organised lottery. In no uncertain terms the said decision recorded that the constitutional makers could never have conceived to give protection to gambling either under Article 19(1)(g) or it as a trade Article 301 of the Constitution.

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REASONABLE RESTRICTIONS IN PUBLIC INTEREST

Chintaman Rao v. State of Madhya Pradesh

1950 SCR 759

MAHAJAN J. - These two applications for enforcement of the fundamental right guaranteed under Article 19(1)(g) of the Constitution of India have been made by a proprietor and an employee respectively of a bidi manufacturing concern of District Sagar (State of Madhya Pradesh). It is contended that the law in force in the State authorizing it to prohibit the manufacture of bidis in certain villages including the one wherein the applicants reside is inconsistent with the provisions of Part III of the Constitution and is consequently void.

2. The Central Provinces and Berar Regulation of Manufacture of Bidis (Agricultural Purposes) Act, 44 of 1948, was passed on 19th October, 1948 and was the law in force in the State at the commencement of the Constitution. Sections 3 and 4 of the Act are in these terms:

“3. The Deputy Commissioner may by notification fix a period to be an agricultural season with respect to such villages as may be specified therein.

4. (1) The Deputy Commissioner may, by general order which shall extend to such villages as he may specify, prohibit the manufacture of bidis during the agricultural season.

(2) No person residing in a village specified in such order shall during the agricultural season engage himself in the manufacture of bidis, and no manufacturer shall during the said season employ any person for the manufacture of bidis.”

3. On 13th June, 1950 an order was issued by the Deputy Commissioner of Sagar under the provisions of the Act forbidding all persons residing in certain villages from engaging in the manufacture of bidis. On 19th June, 1950 these two petitions were presented to this Court under Article 32 of the Constitution challenging the validity of the order as it prejudicially affected the petitioners' right of freedom of occupation and business. During the pendency of the petitions the season mentioned in the order of 13th June ran out. A fresh order for the ensuing agricultural season - 8th October to 18th November, 1950 - was issued on 29th September, 1950 in the same terms. This order was also challenged in a supplementary petition.

4. The point for consideration in these applications is whether the Central Provinces and Berar Act 44 of 1948 comes within the ambit of this saving clause or is in excess of its provisions. The learned counsel for the petitioners contends that the impugned Act does not impose reasonable restrictions on the exercise of the fundamental right in the interests of the general public but totally negatives it. In order to judge the validity of this contention it is necessary to examine the impugned Act and some of its provisions. In the preamble to the Act, it is stated that it has been enacted to provide measures for the supply of adequate labour for agricultural purposes in bidi manufacturing areas. Sections 3 and 4 cited above empower the Deputy Commissioner to prohibit the manufacture of bidis during the agricultural season. The contravention of any of these provisions is made punishable by Section 7 of the Act, the penalty being imprisonment for a term which may extend to six months or with fine or with both. It was enacted to help in the grow more food campaign and for the purpose of bringing under the plough considerable areas of fallow land.

5. The question for decision is whether the statute under the guise of protecting public interests arbitrarily interferes with private business and imposes unreasonable and unnecessarily restrictive regulations upon lawful occupation; in other words, whether the total prohibition of carrying on the business of manufacture of bidis within the agricultural season amounts to a reasonable restriction on the fundamental rights mentioned in Article 19(1)(g) of the Constitution. Unless it is shown that there is a reasonable relation of the provisions of the Act to the purpose in view, the right of freedom of occupation and business cannot be curtailed by it.

6. The phrase “reasonable restriction” connotes that the limitation imposed on a person in enjoyment of the right should not be arbitrary or of an excessive nature, beyond what is required in

the interests of the public. The word “reasonable” implies intelligent care and deliberation, that is, the choice of a course which reason dictates. Legislation which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness and unless it strikes a proper balance between the freedom guaranteed in Article 19(1)(g) and the social control permitted by clause (6) of Article 19, it must be held to be wanting in that quality.

7. Clause (6) in the concluding paragraph particularizes certain instances of the nature of the restrictions that were in the mind of the constitution-makers and which have the quality of reasonableness. They afford a guide to the interpretation of the clause and illustrate the extent and nature of the restrictions which according to the statute could be imposed on the freedom guaranteed in clause (g). The statute in substance and effect suspends altogether the right mentioned in Article 19(1)(g) during the agricultural seasons and such suspension may lead to such dislocation of the industry as to prove its ultimate ruin. The object of the statute is to provide measures for the supply of adequate labour for agricultural purposes in bidi manufacturing areas of the Province and it could well be achieved by legislation restraining the employment of agricultural labour in the manufacture of bidis during the agricultural season. Even in point of time a restriction may well have been reasonable if it amounted to a regulation of the hours of work in the business. Such legislation though it would limit the field for recruiting persons for the manufacture of bidis and regulate the hours of the working of the industry, would not have amounted to a complete stoppage of the business of manufacture and might well have been within the ambit of clause (6). The effect of the provisions of the Act, however, has no reasonable relation to the object in view but is so drastic in scope that it goes much in excess of that object. Not only are the provisions of the statute in excess of the requirements of the case but the language employed prohibits a manufacturer of bidis from employing any person in his business, no matter wherever that person may be residing. In other words, a manufacturer of bidis residing in this area cannot import labour from neighbouring places in the district or province or from outside the province. Such a prohibition on the face of it is of an arbitrary nature inasmuch as it has no relation whatsoever to the object which the legislation seeks to achieve and as such cannot be said to be a reasonable restriction on the exercise of the right. Further the statute seeks to prohibit all persons residing in the notified villages during the agricultural season from engaging themselves in the manufacture of bidis. It cannot be denied that there would be a number of infirm and disabled persons, a number of children, old women and petty shopkeepers residing in these villages who are incapable of being used for agricultural labour. All such persons are prohibited by law from engaging themselves in the manufacture of bidis; and are thus being deprived of earning their livelihood. It is a matter of common knowledge that there are certain classes of persons residing in every village who do not engage in agricultural operations. They and their womenfolk and children in their leisure hours supplement their income by engaging themselves in bidi business. There seems no reason for prohibiting them from carrying on this occupation. The statute as it stands, not only compels those who can be engaged in agricultural work from not taking to other avocations, but it also prohibits persons who have no connection or relation to agricultural operations from engaging in the business of bidi making and thus earning their livelihood. These provisions of the statute, in our opinion, cannot be said to amount to reasonable restrictions on the right of the applicants and that being so, the statute is not in conformity with the provisions of Part III of the Constitution. The law even to the extent that it could be said to authorize the imposition of restrictions in regard to agricultural labour cannot be held valid because the language employed is wide enough to cover restrictions both within and without the limits of constitutionally permissible legislative action affecting the right. So long as the possibility of its being applied for purposes not sanctioned by the Constitution cannot be ruled out, it must be held to be wholly void.

8. The determination by the legislature of what constitutes a reasonable restriction is not final or conclusive; it is subject to the supervision by this Court. In the matter of fundamental rights, the Supreme Court watches and guards the rights guaranteed by the Constitution and in exercising its functions it has the power to set aside an Act of the legislature if it is in violation of the freedoms guaranteed by the Constitution. We are therefore of opinion that the impugned statute does not stand the test of reasonableness and is therefore void. The result therefore is that the orders issued by the

Deputy Commissioner on 13th June, 1950 and 26th September, 1950 are void, inoperative and ineffective.

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Narendra Kumar v. Union of India

AIR 1960 SC 430 : (1960) 2 SCR 375

K. Dasgupta, J. - The three persons who have filed this petition under Art. 32 of the Constitution for enforcement of their fundamental rights conferred by Art. 14, Art. 19(1)(f) and Art. 19(1)(g) thereof are dealers in imported copper and carry on their business at Jagadhri in the State of Punjab. On different dates prior to April 3, 1958, they entered into contracts of purchase of copper with importers at Bombay and Calcutta. Before, however, they could take delivery from the importers the Government of India issued on April 2, 1958, an order called the " Non-ferrous Metal Control Order, 1958 " hereafter referred to as " the order " in exercise of its powers under s. 3 of the Essential Commodities Act (Act X of 1955)-referred to hereafter as " the Act ". In this order " non-ferrous metal " was defined to mean " imported copper, lead, tin and zinc in any of the forms specified in the Schedule of the order." The Order was from the very beginning made applicable to imported copper. The price was controlled by cl. 3 of the Order which provides in its first sub-clause that " no person shall sell or offer to sell any non-ferrous metal at a price which exceeds the amount represented by an addition of 3 1/2% to its landed cost," and in its second sub-clause that " no person shall purchase or offer to purchase from any person non-ferrous metal at a price higher than at which it is permissible for that other person to sell to him under sub-cl. (i)." Clause 4 is designed to regulate the acquisition of non-ferrous metal by permit only and provides that " no person shall acquire or agree to -acquire any non-ferrous metal except under and in accordance with a permit issued in this behalf by the Controller in accordance with such principles as the Central Government may from time to time specify ". Clauses 5 and 6 of the Order made it obligatory on the importers to notify quantities of non-ferrous metal imported and to maintain certain books of account, while the last clause, i.e. cl. 7 confers powers on the Controller to enter and search any premises in order to inspect any book or document and to seize any non-ferrous metal in certain circumstances. This Order was published in the Gazette of India on April 2, 1958. No principles specified by the Central Government in accordance with cl. 4 of the Order were however published either on this date or any other date. Certain principles were however specified by the Central Government in a communication addressed by the Deputy Secretary to the Government of India dated April 18, 1958, to the Chief Industrial Adviser to the Government of India, New Delhi. The relevant portion of this communication is in these words:

" The following principles shall govern the issue of permits by the Controller :-

(1) In respect of the scheduled industries under the Control of the Development Wing, the Controller will determine the 6 monthly requirements of actual users based on their production in the year 1956;

(2) In the case of small-scale industries, the Chief Controller of Imports and Exports on the certificate of the State Directors of Industries will inform the Controller of the quantities that the units would be entitled to and thereupon the Controller will make such quantities available to these units from time to time;

(3) The Controller shall normally release one month's requirements at a time to the consuming units and the permit shall be valid for a period of two months; but if heavy imports are reported the Controller shall have the discretion to issue stocks in larger quantities." The position immediately on the issue of the Order on April 2, 1958, thus was that no person could buy or sell imported copper at a price above the landed Cost plus 3 1/2% thereof and that no person could acquire or agree to acquire such copper except under a permit issued by the Controller. In issuing such permits the Controller was to be governed by such principles as the Central Government would specify. After the principles were specified in the letter of the 18th of April, the Controller could no longer issue any permit to a dealer and could issue permits only to certain manufacturers as indicated in paras. 1 and 2 of the letter. In view of the requirement of cl. 4 of the Order the petitioners applied on April 14, 1958, for permits to enable them to take delivery of the copper in respect of which they had entered into contracts with different parties. Though no formal order appears to have been passed on these applications, it is not

disputed that the applications for permits were refused and no permits were issued to these petitioners. The main contention of the petitioners is two- fold. First, it is said that cl. 4 of the Order read with the principles specified in the letter of the 18th April violates the right conferred on them as citizens of India by Art. 19(1)(f) of the Constitution of India to acquire property and also the right conferred by Article 19(1)(g) to carry on trade, that these violations are not within the saving provisions of Art. 19(5) and 19(6) of the Constitution and therefore are void. Secondly, it is said that the fixation of the price at the landed cost plus 31 % as the maximum also abridge the rights conferred on them by Arts. 19(1)(f) and 19(1)(g) of the Constitution and that this also is not saved by the provisions in Arts. 19(5) and 19(6) and so are void. A further contention is that the principles specified being discriminatory in nature as between the manufacturers and dealers in copper have resulted in violating the right to equal protection of laws to the petitioners and thus infringe the right guaranteed by Art. 14 of the Constitution. As regards the principles specified in the letter of the 18th April it was further contended that as they form an integral part of the "Order" by which alone the Central Government can regulate the distribution and supply of essential commodities under s. 3 of the Act it was necessary for them to be notified in the Official Gazette as required by its 5th sub-section and to be laid before both Houses of Parliament as required by its 6th sub- section and as these requirements were not fulfilled, the principles have no legal force. Alternatively, it was contended that if the principles are considered not to form part of the order made by the Central Government the regulation in so far as it was by these principles, was outside the Act as s. 3 empowers the Central, Government to provide for regulating or prohibiting the production and supply of essential commodities and trade and commerce in essential commodities by an order only and not otherwise. The petitioners pray for an appropriate writ or order or direction (1) restraining the respondents, the Union of India, the Chief Industrial Adviser to the Government of India and the Development Officer, Ministry of Industry from enforcing clauses 3 and 4 of the order; (2) to quashing the order of the Development Officer rejecting the petitioners' application for grant of permit by a direction to the 2nd and 3rd respondents to grant the applications for permits and (3) restraining them from granting permits to others than the petitioners in respect of copper covered by their contracts with importers.

The application was opposed by the respondents, their main contention being that cls. 3 and 4 of the Order and the " principles " specified are laws -which impose reasonable restrictions on the exercise of rights conferred by Arts. 19(1)(f) and 19(1)(g) in the interest of the general public. While this was the main contention on behalf of the respondents, it was also contended that as the petitioners have not challenged the validity of the Essential Commodities Act and have admitted the power of the Central Government to make an order in exercise of the powers conferred by s. 3 of the Act it is not open to the Court to consider whether the law made by the Government in making the nonferrous metal control order and in specifying the principles under cl. 4 of the order violates any of the fundamental rights under the Constitution. It is urged that once it is found that the Government has power under a valid law to provide for regulating or prohibiting the production, supply and distribution of an essential commodity and trade and commerce therein as soon as it is of opinion that it is necessary or expedient so to do for maintaining or increasing supplies of the essential commodity or for securing its equitable distribution and availability at fair prices, the order made by them can be attacked only if it is outside the power granted by the section or if it is mala fide. Malafides have not been suggested and we are proceeding on the assumption that the Central Government was honestly of opinion that it was necessary and expedient to make an order providing for regulation and prohibition of the supply and distribution of imported copper and trade and commerce therein. So long as the Order does not go beyond such provisions, the Order, it is urged, must be held to be good and the consideration of any question of infringement of fundamental rights under the Constitution is wholly beside the point. Such an extravagant argument has merely to be mentioned to deserve rejection. If there was any reason to think that S. 3 of the Act confers on the Central Government power to do anything which is in conflict with the Constitution, anything which violates any of the fundamental rights conferred by the Constitution, that fact alone would be sufficient and unassailable ground for holding that the section itself is void being ultra vires the Constitution. When, as in this case, no challenge is made that S. 3 of the Act is ultra vires the Constitution, it is on the assumption that the powers granted thereby do not violate the Constitution and do not empower the Central Government to do anything which the Constitution prohibits. It is fair and proper to presume that in

passing this Act the Parliament could not possibly have intended the words used by it, viz., " may by order provide for regulating or prohibiting the production, supply and distribution thereof, and trade and commerce in," to include a power to make such provisions even though they may be in contravention of the Constitution. The fact that the words " in accordance with the provisions of the articles of the Constitution" are not used in the section is of no consequence. Such words have to be read by necessary implication in every provision and every law made by the Parliament on any day after the Constitution came into force. It is clear therefore that when s. 3 confers power to provide for regulation or prohibition of the production, supply and distribution of any essential commodity it gives such power to make any regulation or prohibition in so far as such regulation and prohibition do not violate any fundamental rights granted by the Constitution of India. It is therefore necessary for us to consider, even though mala fides on the part of the Government are not alleged, whether the law made by the Central Government by way of subordinate legislation, is a law, which though abridging or taking away the rights conferred by Art. 19(1)(f) and (g), is within the saving provisions of 19(5) and 19(6). On the face of it cl. 4 of the Order read with the principles specified in the letter of the 18th April has the effect of completely eliminating the dealers from the trade in imported copper. It is also reasonably clear that independently of Cl. 4 read with the principles, the fixation of the price at which the copper can be bought and sold at 3 1/2% above the landed cost has the effect of driving the dealer out of business in imported copper. The statement made on behalf of the Union of India in paragraph 11 of the counter affidavit that an addition of 3 1/2% of the landed cost was made in fixing the price in para. 3 of the Order in order to enable the importers to earn a margin of profit justifies the conclusion that this will be the minimum price at which the importers will sell. Any dealer would have thus to pay at the rate of landed cost plus 3 1/2% thereof in getting any supply of copper from the importers. Such dealer is however prevented from charging from his customer anything more than the landed cost plus 3 1/2% thereof. The position therefore clearly is that henceforth any actual consumer of the commodity would have to get it direct from the importer and the channel of distribution through the dealer would disappear.

In deciding whether this total elimination of dealer from trade' in imported copper is within the saving provisions of Art. 19(5) and Art. 19(6) we have first to consider the question whether such total elimination is a mere restriction on the rights under Arts. 19(1)(f) and 19(1)(g) or goes beyond " restriction."

On behalf of the petitioners it has been urged that the prohibition of the exercise of a right must be distinguished from restriction on the exercise of a right, and when the Constitution speaks of laws imposing reasonable restrictions on the exercise of rights it does not save laws which prohibit the exercise of any such right. It is urged that the total elimination of the dealer amounting as it will to prohibition of any exercise of the right to carry on trade or to acquire property would therefore be in any case outside the saving provisions of cls. 5 and 6 of Art. 19. Certain observations made by Kania, C. J., and S. R. Das, J. (as he then was) in Gopalan's Case (1) appear at first sight to lend support to this argument. At p. 106 of the Report, Kania, C. J., after pointing out that the 'deprivation of personal liberty has not the same meaning as restriction of free movement in the territory of India observed:-" Therefore, Art. 19(5) cannot apply to a substantive law depriving a citizen of personal liberty. I am unable to accept the contention that the word " deprivation " includes within its scope " restriction " when interpreting article 21".

Das, J., at p. 301 of the Report, says :-

" Clause (5) of Art. 19, qualifies sub-clause (d) of clause (1) which should, therefore, be read in the light of cl. (5). The last-mentioned clause permits the State to impose reasonable restrictions on the [1950] S.C.R. 88. exercise of the right of free movement throughout the territory of India as explained above. Imposition of reasonable restrictions clearly implies that the right of free movement is not entirely destroyed but that parts of the right remain."

It has to be noticed, however, that these observations were made in the context of an argument of conflict between Art. 19(5) and Art. 21 of the Constitution and could not have been intended for general application. *Chintaman Rao v. The State of Madhya Pradesh (supra)*, the constitutionality of the Central Provinces and Berar Regulation of Manufacture of Bidis (Agricultural Purposes) Act, came up for consideration, Mahajan, J., delivering the judgment of the Court, after pointing out that the question was whether the total prohibition of carrying on the business of manufacture of bidis within the agricultural season amounted to a reasonable restriction of the fundamental rights mentioned in Art. 19(1)(g) of the Constitution, based his decision that the impugned law did not come within the saving provisions of Art. 19(6) of the Constitution on the view that the test of reasonableness was not satisfied and not on a view that " prohibition " went beyond " restriction ". At p. 764 of the Report the learned Judge says: " The effect of the provisions of the Act, however, has no reasonable relation to the object in view but is so drastic in scope that it goes much in excess of that object. Not only are the provisions of the statute in excess of the requirements of the case but the language employed prohibits a manufacturer of bidis from employing any person in his business, no matter wherever that person may be residing. In other words, a manufacturer of bidis residing in this area cannot import labour from neighbouring places in the district or province or from outside the province. Such a prohibition on the face of it is of an arbitrary nature inasmuch as it has no relation whatsoever to the object which the legislation seeks (1) [1950] S.C.R. 759. to achieve and as such cannot be said to be a reasonable restriction on the exercise of the right." The law was struck down because the restriction in this case amounting to prohibition was not reasonable and not because it was a prohibition.

In *Saghir Ahamad v. State of UP & Ors.*, [1955] 1 SCR 707 and in *State of Bombay v. R.M.D. Chamarbaugwala*, [1957] SCR 874, the question whether prohibition of the exercise of a right was within the meaning of restrictions on the exercise of a right used in cl. 6 was raised but the Court decided to express no final opinion in the matter and left the question open. In *Cooverjee B. Bharucha v. The Excise Commissioner and The Chief Commissioner, Ajmer*, [1954] SCR 873, 879, the Court extended the provisions of Clause 6 of Art. 19 to a law which had the effect of prohibiting the exercise of a right to carry on trade to many citizens. Mahajan, J., delivering the judgment of the Court observed:

" In order to determine the reasonableness of the restriction regard must be had to the nature of the business and the conditions prevailing in that trade. It is obvious that these factors must differ from trade to trade and no hard and fast rules concerning all trades can be laid down. It can also not be denied that the State has the power to prohibit trades which are illegal or immoral or injurious to the health and welfare of the public. Laws prohibiting trades in noxious or dangerous goods or trafficking in women cannot be held to be illegal as enacting a prohibition and not a mere regulation. The nature of the business, is, therefore, an important factor in deciding the reasonableness of the restrictions."

In *Madhya Bharat Cotton Association Ltd. v. Union of India & Anr.*, AIR 1954 SC 634, the Court had to consider the constitutionality of an order which in effect prohibited a large section of traders, from carrying on their normal trade in forward contracts. In holding the order to be valid, Bose, J., delivering the judgment of the Court said " Cotton being a commodity essential to the life of the community, it is reasonable to have restrictions which may, in certain circumstances, extend to total prohibition for a time, of all normal trading in the commodity."

It is clear that in these three cases, viz., *Chintaman Rao v. State of Madhya Pradesh*, 1950 SCR 759, *Cooverjee* and *Madhya Bharat Cotton Association Ltd.*, the Court considered the real question to be whether the interference with the fundamental right, was " reasonable " or not in the interests of the general public and that if the answer to the question was in the affirmative, the law would be valid and it would be invalid if the test of reasonableness was not passed. Prohibition was in all these cases treated as only a kind of " restriction ". Any other view would, in our opinion, defeat the intention of the Constitution. After Art. 19(1) has conferred on the citizen the several rights set out in its seven sub-clauses, action is at once taken by the Constitution in clauses 2 to 6 to keep the way of social

control free from unreasonable impediment. The *raison d'être* of a State being the welfare of the members of the State by suitable legislation and appropriate administration, the whole purpose of the creation of the State would be frustrated if the conferment of these seven rights would result in cessation of legislation in the extensive fields where these seven rights operate. But without the saving provisions that would be the exact result of Art. 13 of the Constitution. It was to guard against this position that the Constitution provided in its clauses 2 to 6 that even in the fields of these rights new laws might be made and old laws would operate where this was necessary for general welfare. Laws imposing reasonable restriction on the exercise of the rights are saved by cl. 2 in respect of rights under sub-cl. (a) where the restrictions are " in the interests of the security of the State; " and of other matters mentioned therein; by clause 3 in respect of the rights conferred by sub-cl. (b) where the restrictions are " in the interests of the public order; by cls. 4, 5 and 6 in respect of the rights conferred by sub-cl. (c), (d), (e), (f) & (g) the restrictions are " in the interest of the general public "-in cl. 5 which is in respect of rights conferred by sub-cls. (d).

Clause (e) & (f) also are applicable where the restrictions are 'for the protection of the interests of any scheduled tribe ". But for these saving provisions such laws would have been void because of Art. 13, which is in these words " All laws in force in the territory of India immediately before the commencement of this Constitution, in so far as they are inconsistent with the provisions of this Part, shall, to the extent, of such inconsistency be void; (2) The State shall not make any law which takes away or abridges the rights conferred by this Part and any law made in contravention of this clause shall, to the extent of the contravention, be void . . . "

As it was to remedy the harm that would otherwise be caused by the provisions of Art. 13, that these saving provisions were made, it is proper to remember the words of Art. 13 in interpreting the words " reasonable restrictions " on the exercise of the right as used in cl. (2). It is reasonable to think that the makers of the Constitution considered the word restriction " to be sufficiently wide to save laws inconsistent " with Art. 19(1), or " taking away the rights " conferred by the Article, provided this inconsistency or taking away was reasonable in the interests of the different matters mentioned in the clause. There can be no doubt therefore that they intended the word " restriction " to include cases of " prohibition " also. The contention that a law prohibiting the exercise of a fundamental right is in no case saved, cannot therefore be accepted. It is undoubtedly correct, however, that when, as in the present case, the restriction reaches the stage of prohibition special care has to be taken by the Court to see that the test of reasonableness is satisfied. The greater the restriction, the more the need for strict scrutiny by the Court.

In applying the test of reasonableness, the Court has to consider the question in the background of the facts and circumstances under which the order was made, taking into account the nature of the evil that was sought to be remedied by such law, the ratio of the harm caused to individual citizens by the proposed remedy, to the beneficial effect reasonably expected to result to the general public. It will also be necessary to consider in that connection whether the restraint caused by the law is more than was necessary in the interests of the general public.

The position of the copper trade at the end of March, 1958, within two days of which the impugned order was made is fairly clear. Copper is so largely required by the industries in India for producing various consumer's goods and also sheets and other articles which are needed as raw material in other industries that the position that it is an essential commodity cannot be and has not been disputed. The quantity of copper produced in India is so small as compared with the normal needs of the Industry that for many years the Industry had to depend on imports from abroad. It was apparently because of the importance of this metal for the industries in India that copper was kept for a long time in the Open General List and free import was permitted. When however, the foreign exchange position of the country deteriorated and it was felt necessary in the larger interests of the country to conserve foreign exchange as much as possible copper was excluded from the Open General List from July 1, 1957, and it became necessary to obtain a licence before copper could be imported. During the period July to September 1957 licences were granted to both Established importers of coppers as also to

actual users not being established importers. During the period October 1957 to March 1958, licences were granted to established importers only. Whatever the motive of such exclusion of actual users might have been, the result was disastrous. Having a practical monopoly of this imported commodity a handful of importers was in a position to dictate terms to consumers and by March 1958 the price of copper in India per ton was ₹ 3,477 as against the international price of ₹ 2,221. It is not disputed that result of the abuse by the importers of the practical monopoly given to them of the copper market seriously affected the interests of the general public in India. Nor is it disputed that it was in an honest effort to protect these interests of the public that the impugned legislation in the form of Non-ferrous Metal Control Order and the subsequent specification of principles was made.

The first evil sought to be remedied by the law being thus the rise in price-which was bound to be reflected in the higher price of the consumers' goods in the production of which copper formed a major ingredient -an order controlling the price would of course be the first obvious step for fighting this evil. Experience has shown however that if nothing else is done it is practically impossible to make the control of price effective. The essential subsidiary step therefore was to introduce a system of permits so that the persons acquiring copper could be known. A system of permits would also be of great help in ensuring that the raw material would go to those industries where it was needed most and distributed in such quantities to several industries in different parts of the country as would procure the greatest benefit to the general public. Clause 3 of the Order fixes a price while cl. 4 introduces a system of permits for the acquisition of the material., Some fixation of price, being essential to keep prices within reasonable limits, must therefore be held to be a reasonable restriction in the interests of the general public. Was it necessary, however, that the prices should be fixed in such a manner as to eliminate the dealer completely, as has been done in the instant case ? The introduction of a system of permits was also clearly necessary in the interests of the general public. Was it necessary however to specify the principles that would drive the dealer out of business? These questions require careful consideration, for the injury inflicted on the dealer by such elimination is very great and in spite of the presumption of Constitutionality that attaches to every law the Court ought to examine with special care laws which result, as in the present case, in total restraint of rights conferred by the Constitution. That middleman's profits increase the price of goods which the consumer has to pay is axiomatic. It is entirely wrong to think that the middleman gets his profits for nothing and one has to remember that the middleman by forming the distribution channel between the producers and consumers relieves the procedures of the burden of storing goods for a length of time and the risk attendant thereto and relieves the consumers of the trouble and expense of going to the producer who may be and often is a long distance away. It is however in the very nature of things that the middleman has to charge not only as regards the interest on the capital invested by him, and a reasonable remuneration for management but also in respect of the risks undertaken by him-what the economists call the " entrepreneur's risk." These charges often add to a considerable sum. It has therefore been the endeavour at least in modern times for those responsible for social control to keep middlemen's activities to the minimum and to replace them largely by co-operative sale societies of producers and co-operative purchase societies of the consumers. While it is clear that the middleman does perform important services, it is equally clear that the interests of the public would be best secured if these services could be obtained at a price lower than what the middleman would ordinarily charge. If the middleman ceases to function because of the fixation of price at landed cost plus 3 1/2%, the manufacturers who require copper as their raw material will have to establish contacts with importers. This will mean some trouble and inconvenience to them but it is reasonable to think that the saving in the cost of obtaining the raw material would more than compensate them for this. The lower cost of the raw material is also likely to be reflected-in a competitive market-in the lower price of the consumer's goods, of which copper is a raw material, and thus redound to the benefit of the general public. It must therefore be held that cl. 3 of the Order even though it results in the elimination of the dealer from the trade is a reasonable restriction in the interests of the general public. Clause 4 read with the principles specified must also be held for the same reason to be a reasonable restriction.

It was next urged that these principles are discriminatory as between manufacturers and dealers and so violate Art. 14 of the Constitution. Quite clearly the dealers and manufacturers are by these

principles placed in different classes and while some manufacturers are eligible for permits dealers are not. It is equally clear however from what has already been said about that the differentia which distinguish dealers as a class from manufacturers placed in the other class have a reasonable connection with the object of the legislation. There is therefore no substance in the contention that the specification of the principles violates Art. 14 of the Constitution. While however cl. 3 of the Order is clearly within the Act, the question whether cl. 4 read with the principles is within the Act or not is not free from difficulty. If the principles had been specified in the Order itself and/or had been notified in the Official Gazette and laid before both the Houses of Parliament in the manner indicated in sub-ss. (5) and (6) of s. 3 of the Act, the regulation by cl. 4 would have been within the Act. These principles were not however mentioned in the Order nor were they notified or laid before both Houses of Parliament in the manner laid down in sub-ss. (5) and (6) of s. 3. The regulation in so far as it is by these principles is therefore not a regulation by an order under s. 3 of the Act but wholly outside it and so would not come within the protection of the saving provisions of cls. 5 and 6 of Art. 19 of the Constitution.

But without the principles, cl. 4 of the Order is not effective. The system of permits which this clause is designed to introduce can come into existence only if the permits can be issued; but permits can be issued only in accordance with the principles laid down by the Central Government. It is not possible to build on the use of the words " may specify " in cl. 4 an argument that so long as no principles are specified the Controller would have authority to issue permits by exercise -of his own judgment and discretion. The words used in cl . 4 do not permit such a construction and compel the conclusion that so long as the principles are not specified by the Central Government no permit can be issued by the Controller. Enforcement of the provision that no person shall acquire or agree to acquire except under a permit, would thus, so long as the principles are not specified in a legal manner as required by sub-ss. (5) and (6) of s. 3 of the Essential Commodities Act, would mean a total stoppage of the Copper trade-not only of the transactions of dealers but of any transaction whatever in imported copper. On the face of it this could not be a reasonable restriction in the interests of the general public. There is no escape therefore from the conclusion that so long as principles are not specified by the Central Government by an Order notified in accordance with sub-s. (5) and laid before both Houses of Parliament in accordance with sub-s. 6 of s. 3 the regulation by cl. 4 as it is now ,Worded is not within the - saying provisions of Arts. 19(5) and 19(6) of the Constitution, and is void as taking away the rights conferred by Arts. 19(1)(f) and 19(1)(g). All that is necessary to make cl. 4 effective is that some principles should be specified, and these notified in the Gazette and laid before the Houses of Parliament. It may be necessary from time to time to specify new principles in view of the changed circumstances; these have again to be notified in the Gazette and laid before the Houses of Parliament, in order to be effective. So long as new principles do not come into operation, by being specified by Government, and thereafter notified in the Gazette and laid before Houses of Parliament, the previous principles last specified, notified in the Gazette and laid before Houses of Parliament, will remain effective. As, however, the principles specified in the letter of the 18th April have not been notified in the Gazette, nor laid before Houses of Parliament, and no principles appear to have been specified before or after that date, cl. 4 of the order, as it now stands, must be struck down as void.

The petitioners are therefore entitled to relief only in respect of cl. 4 of the order. We direct that an order be issued restraining the respondents from enforcing cl. 4 of the Non-ferrous Metal Control Order, so long as principles in accordance with law, are not published in the Official Gazette and laid before the Houses of Parliament in accordance with sub-s. (5) and sub- s. (6) of s. 3 of the Essential Commodities Act. As the petition has succeeded in part and failed in part, we order that the parties will bear their own costs. Petition partly allowed.

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POWER TO CARRY ON TRADE BY STATE AND GOVERNMENT CONTRACTS

*Raunaq International Ltd v. I.V R. Construction Ltd.,
1998 Supp(3) SCR 421*

SUJATA V. MANOHAR, J. - 1. The Maharashtra State Electricity Board, the appellant in Civil Appeal No. 4893 of 1998 floated a tender dated 20.12.1997 for design, engineering, manufacture, supply, erection and commissioning of large diameter pipes and steel tanks with all accessories and auxiliaries as prescribed in the bid documents for units 3 and 4 of Khaperkheda Thermal Power Station, Maharashtra, each unit being of 210 MW. The qualifying requirements of bidders as specified in the tender were, that the bidder should have designed Fabricated/manufactured, supplied, erected and successfully commissioned large diameter piping system comprising the supply of M.S. pipes not less than 2000 mm diameter and laid/buried for a minimum total length of 3 kms. in a thermal power station and the same should be in successful operation for the past two years as reckoned on the date set for opening of the bid. Further, the bidder should have minimum turnover of ₹ 7.5 crores per annum for the last 3 consecutive years.

2. Under clause 1.4 of the qualifying criteria, it was provided :

'Notwithstanding anything stated above the Owner reserves the right to assess the Bidders' capability and capacity to perform, should the circumstances warrant such an assessment in the overall interest of the owner.' Pursuant to the invitation, the appellant-Maharashtra State Electricity Board received tenders from eleven bidders including M/s. IVR Construction Ltd. and M/s Raunaq International Ltd., who are the two contestants before us. After screening of the bids, a note was submitted by the Technical Director of the Maharashtra State Electricity Board for the consideration of the Board of Directors. The note stated that out of the offers received, four offers were from tenderers who qualified as per the qualifying criteria. M/s IVR Construction Ltd., Hyderabad was stated to be one of the four such offerors. The note also mentioned that two offerors which included M/s Raunaq International Ltd., though not meeting the qualifying requirements, had done CW piping for 210 MW units. M/S IVR Construction Ltd. were recommended by the Technical Director for the placement of the order. The said company, however, fell, short of the requisite experience by one year. The note also stated that the offer of M/s Raunaq International Ltd. was the most competitive, being Rs, 43,28,316 less than the price quoted by M/s IVR Construction Ltd, In this connection, it is pointed out by the Maharashtra State Electricity Board that M/s Raunaq International Ltd. have designed, fabricated and commissioned M.S. pipes of 2000 mm diameter buried underground but for a distance less than 3 kms. They also have the requisite experience of doing such work for thermal power units of 210 MWs. They have more than 2 years' experience in this work.

3. The Board of Directors of the Maharashtra State Electricity Board, at its meeting held on 29.6.1998, after considering the note submitted by the Technical Director, decided to accept the offer of M/s Raunaq International Ltd. in view of the price advantage to the Board and adequate experience of M/s Raunaq International Ltd. of having completed similar type of work for 210 MW units. The offer of M/s Raunaq International Ltd. was accordingly accepted and the tender was awarded to it. M/s IVR Construction Ltd. challenged the decision of the Board in a writ petition filed in the High Court of Bombay, The High Court has passed the impugned interim order under which the High Court stayed the operation of the Letter of Intent dated 20th Of July, 1998 issued to M/s Raunaq international Ltd. Hence the present appeal.

4. In these proceedings the Maharashtra State Electricity Board has filed an affidavit of its Technical Director. It is stated in this affidavit that the offer of M/s Raunaq International Ltd. was accepted on account of the price advantage to the Board, its offer being the lowest; and also, in view of the adequate experience which M/s Raunaq International Ltd. possessed, having completed similar work

in other 210 MW thermal power stations. This was done by relaxing the qualifying criterion which the Board said, it had the right to do, in view of clause 1.4 set out above. The Maharashtra State Electricity Board has also pointed out that M/s IVR Construction Ltd. also do not satisfy all the qualifying criteria because they do not have two years' experience of such work which is prescribed under the qualifying criteria. Their total experience; is of less than a year.

5. Therefore, looking to the fact that relaxation of criteria would have been required in respect of M/s IVR Construction Ltd. also and in view of the fact that the offer of M/s Raunaq International Ltd. is the lowest, if the Board has accepted the offer of M/s Raunaq International Ltd. after weighing their requirements against the qualifications of the two competing bidders, we fail to see how the High Court could have intervened and stayed the operation of the award of contract to M/s Raunaq International Ltd.

6. This is not a case where any mala fides have been alleged against any member of the Board. Nor is there any allegation of any collateral motive for awarding the contract to M/s Raunaq International Ltd. The only ground of challenge in the writ petition filed by M/s IVR Construction Ltd. is that M/s. Raunaq International did not fulfil the qualifying criterion of having laid such pipeline for a distance of 3 kms. But the challenger- M/s IVR Construction Ltd. also does not fulfil the qualifying criterion. In these circumstances, we fail to see any basis for passing the impugned order.

7. The award of a contract, whether it is by a private party or by a public body or the State, is essentially a commercial transaction. In arriving at a commercial decision considerations which are of paramount importance are commercial considerations. These would be : (1) The price at which the other side is willing to do the work; (2) Whether the goods or services offered are of the requisite specifications; (3) Whether the person tendering has the ability to deliver the goods or services as per specifications. When large works contracts involving engagement of substantial manpower or requiring specific skills are to be offered, the financial ability of the tenderer to fulfil the requirements of the job is also important; (4) the ability of the tenderer to deliver goods or services or to do the work of the requisite standard and quality; (5) past experience of the tenderer, and whether he has successfully completed similar work earlier; (6) time which will be taken to deliver the goods or services; and often (7) the ability of the tenderer to take follow up action, rectify defects or to give post contract services. Even when the State or a public body enters into a commercial transaction, considerations which would prevail in its decision to award the contract to a given party would be the same. However, because the State or a public body or an agency of the State enters into such a contract, there could be, in a given case, an element of public law or public interest involved even in such a commercial transaction.

8. What are these elements of public interest ? (1) Public money would be expended for the purposes of the contract; (2) The goods or services which are being commissioned could be for a public purpose, such as, construction of roads, public buildings, power plants or other public utilities. (3) The public would be directly interested in the timely fulfilment of the contract so that the services become available to the public expeditiously. (4) The public would also be interested in the quality of the work undertaken or goods supplied by the tenderer. Poor quality of work or goods can lead to tremendous public hardship and substantial financial outlay either in correcting mistakes or in rectifying defects or even at times in re-doing the entire work - thus involving larger outlays or public money and delaying the availability of services, facilities or goods. e.g. A delay in commissioning a power project, as in the present case, could lead to power shortages, retardation of industrial development, hardship to the general public and substantial cost escalation.

9. When a writ petition is filed in the High court challenging the award of a contract by a public authority or the State, the court must be satisfied that there is some element of public interest involved in entertaining such a petition. If, for example, the dispute is purely between two tenderers, the court must be very careful to see if there is any element of public interest involved in the litigation. A mere difference in the prices offered by the two tenderers may or may not be decisive in deciding whether

any public interest is involved in intervening in such a commercial transaction. It is important to bear in mind that by court intervention, the proposed project may be considerably delayed thus escalating the cost far more than any saving which the court would ultimately effect in public money by deciding the dispute in favour of one tenderer or the other tenderer. Therefore, unless the court is satisfied that there is a substantial amount of public interest, or the transaction is entered into mala fide, the court should not intervene under Article 226 in disputes between two rival tenderers.

10. When a petition is filed as a public interest litigation challenging the award of a contract by the State or any public body to a particular tenderer, the court must satisfy itself that party which has brought the litigation is litigating bona fide for public good. The public interest litigation should not be merely a cloak for attaining private ends of a third party or of the party bringing the petition. The court can examine the previous record of public service rendered by the organisation bringing public interest litigation. Even when a public interest litigation is entertained the court must be careful to weigh conflicting public interests before intervening. Intervention by the court may ultimately result in delay in the execution of the project. The obvious consequence of such delay is price escalation. If any re-tendering is prescribed, cost of the project can escalate substantially. What is more important, ultimately the public would have to pay a much higher price in the form of delay in the commissioning of the project and the consequent delay in the contemplated public service becoming available to the public. If it is a power project which is thus delayed, the public may lose substantially because of shortage in electric supply and the consequent obstruction in industrial development. If the project is for the construction of a road, or an irrigation canal, the delay in transportation facility becoming available or the delay in water supply for agriculture being available, can be a substantial set back to the country's economic development. Where the decision has been taken bona fide and a choice has been exercised on legitimate considerations and not arbitrarily, there is no reason why the court should entertain a petition under Article 226.

11. Hence before entertaining a writ petition and passing any interim orders in such petitions, the court must carefully weigh conflicting public interests. Only when it comes to a conclusion that there is an overwhelming public interest in entertaining the petition, the court should intervene.

Where there is an allegation of mala fides or an allegation that the contract has been entered into for collateral purposes, and the court is satisfied on the material before it, that the allegation needs further examination, the court would be entitled to entertain the petition. But even here, the court must weigh the consequences in balance before granting interim orders.

12. Where the decision-making process has been structured and the tender conditions set out the requirements, the court is entitled to examine whether these requirements have been considered. However, if any relaxation is granted for bona fide reasons, the tender conditions permit such relaxation and the decision is arrived at for legitimate reasons after a fair consideration of all offers, the court should hesitate to intervene.

13. It is also necessary to remember that price may not always be the sole criterion for awarding a contract. Often when an evaluation committee of experts is appointed to evaluate offers, the expert committee's special knowledge plays a decisive role in deciding which is the best offer. Price offered is only one of the criteria. The past record of the tenderers, the quality of the goods or services which are offered, assessing such quality on the basis of the past performance of the tenderer, its market reputation and so on, all play an important role in deciding to whom the contract should be awarded. At times, a higher price for a much better quality of work, can be legitimately paid in order to secure proper performance of the contract and good quality of work-which is as much in public interest as a low price. The court should not substitute its own decision for the decision of an expert evaluation committee.

14. Normally before such a project is undertaken, a detailed consideration of the need, viability, financing and cost, effectiveness of the proposed project and offers received takes place at various

levels in the Government. If there is a good reason why the project should not be undertaken, then the time to object is at the time when the same is under consideration and before a final decision is taken to undertake the project. If breach of law in the execution of the project is apprehended, then it is at the stage when the viability of the project is being considered that the objection before the appropriate authorities including the Court must be raised. We would expect that if such objection or material is placed before the Government the same would be considered before a final decision is taken. It is common experience that considerable time is spent by the authorities concerned before a final decision is taken regarding the execution of a public project. This is the appropriate time when all aspects and all objections should be considered. It is only when valid objections are not taken into account or ignored that the court may intervene. Even so, the Court should be moved at the earliest possible opportunity. Belated petitions should not be entertained.

15. The same considerations must weigh with the court when interim orders are passed in such petitions. The party at whose instance interim orders are obtained has to be made accountable for the consequences of the interim order. The interim order could delay the project, jettison finely worked financial arrangements and escalate costs. Hence the petitioner asking for interim orders, in appropriate cases should be asked to provide security for any increase in cost as a result of such delay, or any damages suffered by the opposite party in consequence of an interim order. Otherwise public detriment may outweigh public benefit in granting such interim orders. Stay order or injunction order, if issued, must be moulded to provide for restitution;

16. A somewhat different approach may be required in the cases of award of a contract by the Government for the purchase of times for its use. Judicial review would be permissible only on the established grounds for such review including mala fides, arbitrariness or unreasonableness of the Wednesbury variety. Balance of convenience would play a major role in moulded interim relief.

17. There is a third variety of transactions entered into by the Government which come up for consideration before the courts, This is where the Government grants licences or permissions for a fee or consideration to private parties, enabling them to commercially exploit such a licence or permission. The principles of judicial review are no different in such a case. However, grant of stay or injunction in such cases may or may not result in prejudice to the public revenue, depending on the facts of the case. At times granting of a licence or permission may cause public harm e.g. in the case of damage to the ecology. Interim orders will have to be moulded in such cases on a consideration of all relevant factors, providing for restitution where required in public interest.

18. It is unfortunate that despite repeated observations of this court in a number of cases, such petitions are being readily entertained by the High Courts without weighing the consequences. In the case of *Fertiliser Corporation Kamgar Union (Regd.), Sindri & Ors. v. Union of India and Ors.*, [1981] 1 SCC 568, this court observed that if the Government acts fairly, though falters in wisdom, the court should not interfere. "A pragmatic approach to social justice compels us to interpret constitutional provisions, including those like Articles 32 and 226, with a view to see that effective policing of the corridors of power is carried out by the court until other ombudsman arrangement..... emerges..... The court cannot usurp or abdicate, and the parameters of judicial review must be clearly defined and never exceeded. If the Directorate of a Government company has acted fairly, even if it has faltered in its wisdom, the court cannot, as a super auditor, take the Board of Directors to task. This function is limited to testing whether the administrative action has been fair and free from the taint of unreasonableness and has substantially complied with norms of procedure set for it by rules of public administration." *In Tata Cellular v. Union of India*, [1994] 6 SCC 651, this Court again examined the scope of judicial review in the case of a tender awarded by a public authority for carrying out certain work. This Court acknowledged that the principles of judicial review can apply to the exercise of contractual powers by Government bodies in order to prevent arbitrariness or favouritism. However, there are inherent limitations in the exercise of that power of judicial review. The Court also observed that the right to choose cannot be considered as an arbitrary power. Of course, if this power is exercised for any collateral purpose, the exercise of

that power will be struck down. "Judicial quest in administrative matters has been to find the right balance between the administrative discretion to decide matters and the need to remedy any unfairness. Such an unfairness is set right by judicial review." After examining a number of authorities, the Court concluded (at page 687) as follows :-

- (1) The modern trend points to judicial restraint in administrative action.
- (2) The court does not sit as a court of appeal but merely reviews the manner in which the decision was made.
- (3) The court does not have the expertise to correct the administrative decision. If a review of the administrative decision is permitted it will be substituting its own decision, without the necessary expertise, which itself may be fallible.
- (4) The terms of the invitation to tender cannot be open to judicial scrutiny because the invitation to tender is in the realm of contract.
- (5) The Government must have freedom of contract. In other words, a fair play in the joints is a necessary concomitant for an administrative body functioning in an administrative or quasi-administrative sphere. However, the decision can be tested by the application of the "Wednesbury principle" of reasonableness and the decision should be free from arbitrariness, not affected by bias or actuated by mala fides.
- (6) Quashing decisions may impose heavy administrative burden on the administration and lead to increased arid unbudgeted expenditure.

19. The same view has been reiterated in *Asia Foundation & Construction Ltd v. Trafalgar House Construction (I) Ltd & Ors.*, [1997] 1 SCC 738, the court observing that judicial review of contractual transactions by Government bodies is permissible to prevent arbitrariness, favouritism or use of power for collateral purposes. This Court added a further dimension to the undesirability of intervention by pointing out that where the project is a high cost project for which loans from the World Bank or other international bodies have been obtained after following the specifications and procedure of such a body, it would be detrimental to public interest to interfere. The same principles have been also reaffirmed in *New Horizons Limited and Anr. v. Union of India & Ors.*, [1995] 1 SCC 478 with this Court again emphasising the need to allow for certain flexibility in administrative decision-making, observing that the decision can be challenged only On the Wednesbury principle of unreasonableness i.e. unless the decision is so unreasonable that no sensible person would have arrived at such a decision, it should not be upset. In *Delhi Science Forum & Ors. v. Union of India and Anr.*, [1996] 2 SCC 405, this Court once again observed that if a reasonable procedure has been followed, the decision should not be challenged except on the Wednesbury principle of unreasonableness.

20. Dealing with interim orders, this Court observed in *Assistant Collector of Central Excise, Chandan Nagar, West Bengal v. Dunlop India Ltd. & Ors.*, [1985] 2 SCR 190 at page 196 that an interim order should not be granted without considering balance of convenience, the public interest involved and the financial impact of an interim order. Similarly, in *Ramnihal N. Bhutto & Anr: v. State of Maharashtra & Ors.*, [1997] 1 SCC 134, the Court said that while granting a Stay the court should arrive at a proper balancing of competing interests and grant a Stay only when there is an overwhelming public interest in granting it, as against the public detriment which may be caused by granting a Stay. Therefore, in granting an Injunction or Stay order against the award of a contract by the Government or a Government agency, the court has to satisfy itself that the public interest in holding up the project far out-weighs the public interest in carrying it out within a reasonable time. The court must also take into account the cost involved in staying the project and whether the public would stand to benefit by incurring such cost.

21. Therefore, when such a Stay order is obtained at the instance of a private party or even at the instance of a body litigating in public interest, any interim order which stops the project from proceeding further, must provide for the reimbursement of costs to the public in case ultimately the litigation started by such an individual or body fails. The public must be compensated both for the delay in implementation of the project and the cost escalation resulting from such delay. Unless an adequate provision is made for this in the interim order, the interim order may prove counter-productive, In the present case it was submitted that the terms and conditions of the tender specified the requisite qualifying criteria before a person could offer a tender. The criteria which were so laid down could not have been relaxed because such a relaxation results in a denial of opportunity to others. In support, the respondents relied upon *Ramana Dayaram Shetty v. International Airport Authority of India & Ors.*, [1997] 3 SCC 489. In that case the Court had held judicial review as a check on the exercise of arbitrary powers by the State and as a check on its power to grant largess. the Court also observed that When the exercise of discretion is structured in terms of the tenders which have been invited the discretion must be exercised in accordance with the norms so laid down. The same view has been taken by this Court in *Premium Granites and Anr. V. State of T.N. & Ors.*, [1994] 2 SCC 691, where this Court observed that where rational non- discriminatory norms have been laid down for granting of tenders, a departure from such norms can only be made on valid principles, These principles enunciated by this Court: are unexceptional.

22. In the present case, however, the relaxation was permissible under the terms of the tender. The relaxation which the Board has granted to M/s Raunaq International Ltd. is on valid principles looking to the expertise of the tenderer and his past experience although it does not exactly tally with the prescribed criteria. What is more relevant, M/s IVR Construction Ltd. who have challenged this award of tender themselves do not fulfil the requisite criteria. They do not possess the prescribed experience qualification. Therefore, any judicial relief at the instance of a party which does not fulfil the requisite criteria, seems to be misplaced. Even if criteria can be relaxed both for-M/s Raunaq International Ltd. and M/s IVR Construction Ltd., it is clear that the offer of M/s Raunaq International Ltd. is lower and it is on this ground that the Board has accepted the offer of M/s Raunaq International Ltd. We fail-to see how the award of tender can be stayed at the instance of a party which does not fulfil the requisite criteria itself and whose offer is higher than the offer which has been accepted, It is also obvious that by stopping the performance of the contract so awarded, there is a major detriment to the public because the construction of two thermal power units, each of 210 MWs., is held up on account of this dispute. Shortages of power have become notorious. They also seriously affect industrial development and the resulting job opportunities for a large number of people. In the present case there is no overwhelming public interest in stopping the project. There is no allegation whatsoever of any mala fides or collateral reasons for granting the contract to M/s. Raunaq International Ltd.

23. In our view the High Court has seriously erred in granting the interim order. The appeals are, therefore, allowed and the impugned order is set aside. M/s IVR Construction Ltd. shall pay to the appellants herein the costs of the appeals.

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The Securities & Exchange Board of India Act, 1992

Sahara India Real Estate Corporation Limited & Ors. v. Securities and Exchange Board of India & Anr.

(2012) 10 SCC 603

Bench: K. S. RADHAKRISHNAN & JAGDISH SINGH KHEHAR, J.J.

1. We are, in these appeals, primarily concerned with the powers of the Securities and Exchange Board of India (for short 'SEBI') under Section 55A(b) of the Companies Act, 1956 to administer various provisions relating to issue and transfer of securities to the public by listed companies or companies which intend to get their securities listed on any recognized stock exchange in India and also the question whether Optionally Fully Convertible Debentures (for short 'OFCDs') offered by the appellants should have been listed on any recognized stock exchange in India, being Public Issue under Section 73 read with Section 60B and allied provisions of the Companies Act and whether they had violated the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 [for short 'DIP Guidelines'] and various regulations of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 [for short 'ICDR 2009'], and also whether OFCDs issued are securities under the Securities Contracts (Regulation) Act, 1956 [for short 'SCR Act'].

2. Sahara India Real Estate Corporation Limited (for short 'SIRECL') and Sahara Housing Investment Corporation Limited (for short 'SHICL'), appellants herein (conveniently called Saharas), are the companies controlled by Sahara Group. Saharas have raised almost identical issues on facts as well as on questions of law before us and hence we are disposing off both the appeals by way of a common judgment.

4. SIRECL, in its Extraordinary General Meeting held on 3.3.2008, resolved through a special resolution passed in terms of Section 81(1A) of the Companies Act to raise funds through unsecured OFCDs by way of private placement to friends, associates, group companies, workers/employees and other individuals associated/affiliated or connected in any manner with Sahara Group of Companies (for short 'Sahara Group') without giving any advertisement to general public. Company authorized its Board of Directors to decide the terms and conditions and revision thereof, namely, face value of each OFCD, minimum application size, tenure, conversion and interest rate. Board of Directors, consequently, held a meeting on 10.3.2008 and resolved to issue unsecured OFCDs by way of private placement, the details of which were mentioned in the Red Herring Prospectus (for short 'RHP') filed with the Registrar of Companies (for short "RoC"), Kanpur. SIRECL had specifically indicated in the RHP that they did not intend to get their securities listed on any recognized stock exchange. Further, it was also stated in the RHP that only those persons to whom the Information Memorandum (for short 'IM') was circulated and/or approached privately who were associated/affiliated or connected in any manner with Sahara Group, would be eligible to apply. Further, it was also stated in the RHP that the funds raised by the company would be utilized for the purpose of financing the acquisition of townships, residential apartments, shopping complexes etc. and construction activities would be undertaken by the company in major cities of the country and also would finance other commercial activities/projects taken up by the company within or apart from the above projects. RHP also indicated that the intention of the company was to carry out infrastructural activities and the amount collected from the issue would be utilized in financing the completion of projects, namely, establishing/constructing the bridges, modernizing or setting up of airports, rail system or any other projects which might be allotted to the company from time to time in future. RHP also highlighted the intention of the company to engage in the business of electric power generation and transmission and that the proceeds of the current issue or debentures would be utilized for power projects which would

be allotted to the company and that the money, not required immediately, might be parked/invested, inter alia, by way of circulating capital with partnership firms or joint ventures, or in any other manner, as per the decision of the Board of Directors from time to time. SIRECL, under Section 60B of the Companies Act, filed the RHP before the RoC, Uttar Pradesh on 13.3.2008, which was registered on 18.3.2008. SIRECL then in April 2008, circulated IM along with the application forms to its so-called friends, associated group companies, workers/employees and other individuals associated with Sahara Group for subscribing to the OFCDs by way of private placement. Then IM carried a recital that it was private and confidential and not for circulation.

6. I may also indicate that all the bonds stipulated that bond holders could avail of loan facility as per the terms and conditions of the application forms. Nirmaan and Real Estate Bonds prescribed an additional feature of death risk cover as well. Clause 13 of RHP imposed no restriction on the transfer of the OFCDs.

7. SIRCEL, therefore, floated the issue of the OFCDs as an open-ended scheme and collected an amount of ₹19400,86,64,200 (Nineteen thousand four hundred crores, eighty-six lakhs, sixty-four thousand and two hundred only) from 25.4.2008 to 13.4.2011. Company had a total collection of ₹17656,53,22,500 (Seventeen thousand six hundred and fifty-six crores, fifty-three lakhs, twenty-two thousand and five hundred only) as on 31.8.2011, after meeting the demand for premature redemption. The above-mentioned amounts were collected from 2,21,07,271 investors.

8. SHICL, a member of Sahara Group companies, also convened an Annual General Meeting on 16.9.2009 to raise funds by issue of OFCDs, by way of private placement, to friends, associated group companies, workers/employees and other individuals associated/affiliated or connected in any manner with the Sahara Group companies. Later, SHICL issued OFCDs of the nature of Housing Bond; conversion price of ₹ 5,000/- for each five bonds, Income Bond, conversion price of ₹ 6,000/- for six bonds; Multiple Bond, conversion price of ₹ 24,000/- for two bonds. Interest accrued on each of the three types of bonds was to be refunded to the bond holders.

9. SEBI, as already indicated, had come to know of the large-scale collection of money from the public by Saharas through OFCDs, while processing the RHP submitted by Sahara Prime City Limited, another Company of the Sahara Group, on 12.1.2010 for its initial public offer. SEBI then addressed a letter dated 12.1.2010 to Enam Securities Private Limited, merchant bankers of Sahara Prime City Limited about the complaint received from one Roshan Lal alleging that Sahara Group was issuing Housing bonds without complying with Rules/Regulations/Guidelines issued by RBI/MCA/NHB. Merchant Banker sent a reply dated 29.1.2010 stating that SIRECL and SHICL were not registered with any stock exchange and were not subjected to any rule / regulation / guidelines / notification / directions framed thereunder and the issuance of OFCDs were in compliance with the applicable laws. Following the above, another letter dated 26.2.2010 was also sent by the Merchant Banker to SEBI stating that SIRECL and SHICL had issued the OFCDs pursuant to a special resolution under Section 81(1A) of the Companies Act, 1956 passed on 3.3.2008 and 16.9.2009 respectively. Further, it was also pointed out that they had issued and circulated an IM prior to the opening of the offer and that RHP issued by SIRECL dated 13.3.2008 was filed with RoC, U.P. and Uttarakhand and RHP issued by SHICL dated 6.10.2009 was filed with RoC, Maharashtra.

10. SEBI on 21.4.2010 addressed a letter to the Regional Director, Northern and Western Regions of Ministry of Corporate Affairs (for short 'MCA') enclosing the complaint received in respect of OFCDs issued by Saharas. SEBI had stated that those companies had solicited and issued OFCDs violating statutory requirements and that they were not listed companies and had not filed the RHP with SEBI.

11. It was urged that Regulations 3 and 6 of ICDR 2009 would not apply, since there was no public issue either in the nature of an initial public offer or further public offer as defined by Regulation 2(zc), 2(p) and/or 2(n) of ICDR 2009. OFCDs, it was pointed out, were restricted to a select group (as distinguished from general public), however large they might be and hence the issuance of OFCDs

was not a public offer to attract the provisions of Regulations 3 and/or 6 of ICDR 2009. Company had stated that issuance of OFCDs of 2008 was also not covered by the SEBI (Issue and Listing Securities) Regulations, 2008, since it would apply to non-convertible debt securities, whereas the OFCDs issued by SIRECL were convertible securities. SIRECL, therefore, requested SEBI to withdraw the summons.

14. SEBI, in the meanwhile, issued a notice dated 24.11.2010 informing both SIRECL and SHICL that the issuance of OFCDs was a public issue and, therefore, securities were liable to be listed on a recognized stock exchange under Section 73 of the Companies Act. From the preliminary analysis, it was pointed out that the issuance of OFCDs by Saharas was *prima facie* in violation of Sections 56 and 73 of the Act and also various clauses of DIP Guidelines and SHICL had also *prima facie* violated Regulations 4(2), 5(1), 6, 7, 16(1), 20(1), 25, 26, 36, 37, 46 and 57 of ICDR 2009. Both the companies were, therefore, directed to show cause why action should not be initiated against them including issuance of direction to refund the money solicited and mobilized through the prospectus issued with respect to the OFCDs, since they had violated the provisions of the Companies Act, SEBI Act, erstwhile DIP Guidelines and ICDR 2009.

20. Saharas then sent a detailed reply dated 30.5.2011 pointing out that the appellants had made private placement of OFCDs to persons who were associated with Sahara Group and those issues were not public issues. Further, it was also urged that OFCDs issued were in the nature of “hybrid” as defined under the Companies Act and SEBI did not have jurisdiction to administer those securities since Hybrid securities were not included in the definition of 'securities' under the SEBI Act, SCR Act etc. Further, it was also urged that such hybrids were issued in terms of Section 60B of the Companies Act and, therefore, only the Central Government had the jurisdiction under Section 55A(c) of the Companies Act. Further, it was also pointed out that Sections 67 and 73 of the Companies Act could not be made applicable to Hybrid securities, so also the DIP Guidelines and ICDR 2009. Further, it was reiterated that the company had raised funds by way of private placement to friends, associates, group companies, workers/employees and other individuals associated/affiliated with Sahara Group, without giving any advertisement to the public. Further, it was also pointed out that RoC, Kanpur and Maharashtra had registered those RHPs without any demur and, therefore, it was unnecessary to send it to SEBI.

21. SEBI passed its final order through its whole-time member (WTM) on 23.6.2011. SEBI examined the nature of OFCDs issued by Saharas and came to the conclusion that OFCDs issued would come within the definition of “securities” as defined under Section 2(h) of SCR Act. SEBI also found that those OFCDs issued to the public were in the nature of Hybrid securities, marketable and would not fall outside the genus of debentures. SEBI also found that the OFCDs issued, by definition, design and characteristics intrinsically and essentially, were debentures and the Saharas had designed the OFCDs to invite subscription from the public at large through their agents, private offices and information memorandum. SEBI concluded that OFCDs issued were in fact public issues and the Saharas were bound to comply with Section 73 of the Companies Act, in compliance with the parameters provided by the first proviso to Section 67(3) of the Companies Act. SEBI took the view that OFCDs issued by Saharas should have been listed on a recognized stock exchange and ought to have followed the disclosure requirement and other investors' protection norms.

Questions of Law framed:

(1) Whether SEBI has jurisdiction or power to administer the provisions of Sections 56, 62, 63, 67, 73 and the related provisions of the Companies Act, after the insertion of Section 55A(b) w.e.f. 13.12.2000, by the Companies (Amendment) Act, 2000, so far as it relates to issue and transfer of securities by listed public companies, which intend to get their securities listed on a recognized stock exchange and public companies which have issued securities to fifty persons or more without listing their securities on a recognized stock exchange;

- (2) Whether the public companies referred in question no. (a) is legally obliged to file the final prospectus under Section 60B(9) with SEBI and whether Section 60B, as it is, falls under Section 55A of the Companies Act;
- (3) Whether Section 67 of the Companies Act implies that the company's offer of shares or debentures to fifty or more persons would *ipso facto* become a public issue, subject to certain exceptions provided therein and the scope and ambit of the first proviso to Section 67(3) of the Act, which was inserted w.e.f. 13.12.2000 by the Companies (Amendment) Act, 2000;
- (4) What is the scope and ambit of Section 73 of the Companies Act and whether it casts an obligation on a public company intending to offer its shares or debentures to the public, to apply for listing of its securities on a recognized stock exchange once it invites subscription from fifty or more persons and what legal consequences would follow, if permission under sub-section (1) of Section 73 is not applied for listing of securities;
- (7) Whether after the insertion of the definition of 'securities' in Section 2(45AA) as "including hybrids" and after insertion of the separate definition of the term "hybrid" in Section 2(19A) of the Act, the provision of Section 67 would apply to OFCDs issued by Saharas and what is the effect of the definition clause 2(h) of SCR Act on it;
- (8) Whether OFCDs issued by Saharas are convertible bonds falling within the scope of Section 28(1)(b) of the SCR Act, therefore, not 'securities' or, at any rate, not listable under the provisions of SCR Act;

Issue 1

Instances are many where securities market have collapsed in England, USA, India etc. due to high-profile corporate fraud cases, leading to legislative intervention in various countries including India.

55. India is also not an exception. Harshad Mehta, a Broker, was charged for diverting funds from the Bank to the tune of ₹ 4000 crores to stock brokers between 1991-92; Ketan Parekh Securities Scam in the year 2001 in which investors, it was reported, had lost heavily; so also the Banks in the UTI scam 2001, where it was reported that heavy funds were collected from small investors and money was used to fund large business houses and huge amounts were invested in junk bonds; Satyam Computers Scam of 2008, where it was reported that, over a number of years, Satyam Computer account was manipulated and money was raised through shares.

56. The Companies Act 1956 in India was enacted with the object to protect the interests of a large number of shareholders, safeguard the interests of the creditors to attain the ultimate ends of social and economic policy of the Government. Provisions have also been incorporated making provisions for prospectus, allotment and other matters relating to issue of shares and debentures etc. Parliament has also enacted the SEBI Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. SEBI was established in the year 1988 to promote orderly and healthy growth of the securities market and for investors' protection. SEBI Act, Rules and Regulations also oblige the public companies to provide high degree of protection to the investor's rights and interests through adequate, accurate and authentic information and disclosure of information on a continuous basis.

57. SEBI Act is a special law, a complete code in itself containing elaborate provisions to protect interests of the investors. Section 32 of the Act says that the provisions of that Act shall be in addition to and not in derogation of the provisions of any other law.

58. SEBI Act is a special Act dealing with specific subject, which has to be read in harmony with the provisions of the Companies Act 1956. In fact, 2002 Amendment of the SEBI Act further re-emphasize the fact that some of the provisions of the Act will continue to operate without prejudice to the provisions of the Companies Act, qua few provisions say that notwithstanding the regulation and order made by SEBI, the provisions of the Companies Act dealing with the same issues will remain

unaffected. I only want to highlight the fact that both the Acts will have to work in tandem, in the interest of investors, especially when public money is raised by the issue of securities from the people at large.

60. Referring to section 11, 11A and 11B of SEBI Act, I find all the above quoted provisions are inter-related and inter-connected and the main focus is on Investor Protection. Power is also conferred on SEBI under Section 11C to conduct investigation if the transactions are being dealt with in a manner detrimental to the investors or securities market. Mandatory listing of securities in case of offer to public would cast an obligation on the issuers to ensure the transparency of information and other continuing obligations to provide information by means of prospectus and to follow disclosure provisions.

61. I may, in the above background, examine the various provisions of the Companies Act which cast a legal obligation on the public companies which offer securities to the public and the SEBI's power or jurisdiction to administer those companies and the legal requirement to be followed while making offer of securities to the public. When we interpret and deal with the provisions like Sections 55A, 60B, 67, 73 etc. of Companies Act, we have to always bear in mind the various provisions of the SEBI Act, especially Sections 11, 11A, 11B, 11C, 32 etc. because as we have already indicated, those provisions shall be in addition to and not in derogation of the provisions of the Companies Act.

Issue 2

71. We, therefore, hold that, so far as the provisions enumerated in the opening portion of Section 55A of the Companies Act, so far as they relate to issue and transfer of securities and non-payment of dividend is concerned, SEBI has the power to administer in the case of listed public companies and in the case of those public companies which intend to get their securities listed on a recognized stock exchange in India. In any other case, i.e. rest of the matters, that is excluding matters relating to issue and transfer of securities and non-payment of dividend be administered by the Central Government in the case of listed public companies and those companies which intend to get their securities listed on any recognized stock exchange in India. Explanation to that section further clarifies the position so as to remove doubts, saying all powers relating to other matters including the matters relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares, should be exercised by the Central Government, Tribunal or the Registrar of Companies, as the case may be. Section 55A, therefore, makes it clear that SEBI has the power to administer the above mentioned select provisions of the Companies Act relating to matters specified therein. Contention raised by Saharas that without regulations being framed under Section 642(4) of the companies Act, SEBI cannot exercise powers of administration, is totally unfounded and is rejected.

Issue 3

72. Prospectus is the principal medium through which the investors get information of the strength and weakness of the company, its creditworthiness, credence and confidence of promoters and the company's prospects. Section 55 of the Act provides that a prospectus issued by or on behalf of a company or in relation to an intended company shall be dated and that date shall be taken as the date of its publication. The matters to be stipulated and reports to be set out are provided under Section 56 of the Act, read with Part 1 of Schedule 11 of the Companies Act, which also calls for the details of the stock exchange where application was made for listing of issue of securities. Section 60 of the Act deals with registration of the prospectus. Section 60(3) specifically states that the Registrar shall not

register a prospectus unless the requirements of Sections 55, 56, 57 and 58 and sub-sections (1) & (2) of that section have been complied with. Securities can be listed on a recognized stock only after the prospectus is prepared and approved by the RoC, SEBI, as the case may be. Section 62 imposes civil liability for mis-statements in prospectus and Section 63 criminal liability. Section 68 provides imprisonment for a term which may extend to five years, or with fine which may extend to one lakh rupees, or with both, for fraudulently inducing persons to invest money. In other words, either to offer transferrable securities for sale to the public or to request the admission of securities for trading on a regulated market without prospectus, or to offer transferrable securities for sale to the public, by way of shares and debentures, in violation of the first proviso to Section 67(3) may attract civil and criminal liability. Saharas, in this case, published RHPs with the approval of RoC, but did not get them approved by SEBI or their securities listed on a recognized stock exchange.

85. The first proviso to Section 67(3) was inserted by the Companies (Amendment) Act, 2000 w.e.f. 13.12.2000, which clearly indicates, nothing contained in Sub-section (3) of Section 67 shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more. Resultantly, after 13.12.2000, any offer of securities by a public company to fifty persons or more will be treated as a public issue under the Companies Act, even if it is of domestic concern or it is proved that the shares or debentures are not available for subscription or purchase by persons other than those receiving the offer or invitation. A public company can escape from the rigor of provisions, if the offer is made by companies mentioned under Section 67(3A), i.e. by public financial institutions specified under Section 4A or by non-banking financial companies referred to in Section 45I(f) of the Reserve Bank of India Act, 1934.

Following situations, it is generally regarded, as not an offer made to public.

- Offer of securities made to less than 50 persons;
- Offer made only to the existing shareholders of the company (Right Issue);
- Offer made to a particular addressee and be accepted only persons to whom it is addressed;
- Offer or invitation being made and it is the domestic concern of those making and receiving the offer.

86. Resultantly, if an offer of securities is made to fifty or more persons, it would be deemed to be a public issue, even if it is of domestic concern or proved that the shares or debentures are not available for subscription or purchase by persons other than those received the offer or invitation.

87. I may, in this connection, point out that the position in England is almost the same. The Companies Act, 2006 in England also says that it is unlawful for transferring securities to others, certain listed securities, such other transferable securities, as may be specified in prospectus rules, to be offered to the public, unless approved prospectus has been made available to the public before the offer is made. For the purpose of the Companies Act, 2006 (Sections 755-760), 'offer to the public' includes an offer to any section of the public, however, selected. Companies Act, 2006, Financial Services and Market Act, 2000, Prospectus Regulations, 2005 etc. applicable in England, if read together we get a complete picture of the securities laws in that country. Indian Companies Act, as I have already indicated has its foundation on the English Companies Act.

89. Alastair Hudson in his book 'Securities Law' First Edition (Sweet & Maxwell), 2008 at page 342, refers to 'Restricted Offers' and noticed that there is no contravention of Section 85 of FSMA 2000, if: "(b) the offer is made to or directed at fewer than 100 persons, other than qualified investors, per EEA State". The purpose underlying that exemption, the author says, is mainly the fact that the offer is not being made to an appreciable section of "the public" such that the policy of the prospectus rules generally is not affected. Further, the author says that "Self-evidently, while an offer to 99 ordinary members of the public would be within the literal terms of the exemption, it would not be the sort of activity anticipated by the legislation. Moreover, if a marketing campaign were arranged such that ordinary members of the people were approached in groups of 99 people at a time in an effort to avoid

the prospectus rules, then that would not appear to be within the spirit of the regulations and might be held to contravene the core principle that a regulated person must act with integrity.”

90. I may, therefore, indicate, subject to what has been stated above, in India that any share or debenture issue beyond forty-nine persons, would be a public issue attracting all the relevant provisions of the SEBI Act, regulations framed thereunder, the Companies Act, pertaining to the public issue. Facts clearly reveal that Saharas have issued securities to the public more than the threshold limit statutorily fixed under the first proviso to Section 67(3) and hence violated the listing provisions which may attract civil and criminal liabilities.

Issue 4

91. Principles of listing, which I may later on discuss, is intended to assist public companies in identifying their obligations and responsibilities, which are continuing in nature, transparent in content and call for high degree of integrity. Obligations are imposed.

92. Section 73, the listing provision, which deals with the allotment of shares and debentures of which Sub-sections (1), (1A) and (2) are relevant for our purpose and hence given below:

“73. Allotment of shares and debentures to be dealt in on stock exchange.-

(1) Every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for the shares or debentures intending to be so offered to be dealt with in the stock exchange or each such stock exchange.

(1A) Where a prospectus, whether issued generally or not, states that an application under sub-section (1) has been made for permission for the shares or debentures offered thereby to be dealt in one or more recognized stock exchanges, such prospectus shall state the name of the stock exchange or, as the case may be, each such stock exchange, and any allotment made on an application in pursuance of such prospectus shall, whenever made, be void, if the permission has not been granted by the stock exchange or each such stock exchange, as the case may be, before the expiry of ten weeks from the date of the closing of the subscription lists.

93. Section 73(1) of the Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing of its securities. Such companies have no option or choice but to list their securities on a recognized stock exchange, once they invite subscription from over forty-nine investors from the public. If an unlisted company expresses its intention, by conduct or otherwise, to offer its securities to the public by the issue of a prospectus, the legal obligation to make an application on a recognized stock exchange for listing starts. Sub-section (1A) of Section 73 gives indication of what are the particulars to be stated in such a prospectus. The consequences of not applying for the permission under sub-section (1) of Section 73 or not granting of permission is clearly stipulated in sub-section (3) of Section 73. Obligation to refund the amount collected from the public with interest is also mandatory as per Section 73(2) of the Act.

94. Listing is, therefore, a legal responsibility of the company which offers securities to the public, provided offers are made to more than 50 persons. In view of the clear statutory mandate, the contention raised, based on Rule 19 of the SCR Rules framed under the SCR Act, has no basis. Legal obligation flows the moment the company issues the prospectus expressing the intention to offer shares or debentures to the public, that is to make an application to the recognized stock exchange, so that it can deal with the securities. A company cannot be heard to contend that it has no such intention or idea to make an application to the stock exchange. Company's option, choice, election, interest or design does not matter, it is the conduct and action that matters and that is what the law demands.

95. The maxim '*acta exterior indicant interiora secreta*' (external action reveals inner secrets) applies with all force in the case of Saharas, which I have already demonstrated on facts as well as on law.

Conduct and actions of Saharas indicate their intention, we have to judge their so-called intention from their subsequent conduct. Subsequent illegality shows that Saharas contemplated illegality. A person's inner intentions are to be read and understood from his acts and omissions. Whenever, in the application of an enactment, a person's state of mind is relevant, the above maxim comes into play. (*Ref. Bennion on Statutory Interpretation, 5th Edn., p. 1104*)

96. We have to apply the various provisions of the Companies Act and SEBI Act and the rules and regulations framed thereunder to Saharas' conduct and their inner intentions are to be understood from their acts and omissions, by applying the above maxim. Saharas' acts and omissions have clearly violated the provisions of Section 73, their failure to list the securities offer to the public was, therefore, intentional and the plea that they did not want their securities listed, is not an answer, since they were legally bound to do so. The duty of listing flows from the act of issuing securities to the public, provided such offer is made to fifty or more than fifty persons. Any offering of securities to fifty or more is a public offering by virtue of Section 67(3) of the Companies Act, which the Saharas very well knew, their subsequent actions and conducts unquestionably reveal so.

98. The above discussion clearly indicates that from the years 1988 to 2000, private placement of preferential allotment could be made to fifty or more persons if the requirements of Clauses (a) and (b) of Section 67(3) are satisfied. However, after the amendment to the Companies Act, 1956 on 13.12.2000, every private placement made to fifty or more persons becomes an offer intended for the public and attracts the listing requirements under Section 73(1). Even those issues which satisfy Sections 67(3)(a) and (b) would be treated as an issue to the public if it is issued to fifty or more persons, as per the proviso to Section 67(3) and as per Section 73(1), an application for listing becomes mandatory and a legal requirement.

99. Saharas, in my view, have not followed any of those statutory requirements. On a combined reading of the proviso to Section 67(3) and Section 73(1), it is clear that the Saharas had made an offer of OFCDs to fifty persons or more, consequently, the requirement to make an application for listing became obligatory leading to a statutory mandate which they did not follow.

Issue 7

106. Saharas also raised a contention that after the insertion of the definition of "securities" in Section 2(45AA) as "including hybrid" and after insertion of the separate definition of "hybrid" in Section 2(19A) of the Act, the provisions of Section 67 are not at all applicable to OFCDs, which have been held to be "hybrid". Further, it was also contended that OFCDs issued were convertible bonds falling within the scope of Section 28(1)(b) of SCR Act and they were not "securities" or at any rate the provisions of SEBI Act and Section 67 were not at all applicable to OFCDs, which have been found to be "hybrid".

108. OFCDs issued by Saharas undoubtedly were unsecured debentures by name and nature. Section 2(12) of the Companies Act deals with the definition of the word "debentures" and includes any "other securities". The same reads as follows:

"2(12). 'Debenture' includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not."

Section 2(h) of the SCR Act, 1956 reads as follows:

"2(h) 'securities' include—

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

- (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (id) units or any other such instrument issued to the investors under any mutual fund scheme;
Explanation.- For the removal of doubts, it is hereby declared that “securities” shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938);
- (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- (ii) Government securities;
- (iia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interest in securities.”

109. The word “hybrid” under Section 2(19A) was inserted in the Companies Act, vide the Companies (Amendment) Act, 2002 w.e.f. 13.12.2000 and reads as follows:

“2(19A). “hybrid” means any security which has the character of more than one type of security, including their derivatives.”

110. Hybrid securities, therefore, generally means securities, which have some of the attributes of both debt securities and equity securities, means a security which, in the term of a debenture, encompassing the element of indebtedness and element of equity stock as well.

111. Section 2(h) of the SCR Act gives emphasis to the words “other marketable securities of a like nature”, which gives a clear indication of the marketability of the securities and gives an expansive meaning to the word securities. Any security which is capable of being freely transferrable is marketable. The definition clause in Section 2(h) of SCR Act is a wide definition, an inclusive one, which takes in hybrid also, which I have already indicated, defined vide Section 2(19A) of the Companies Act.

112. OFCDs issued have the characteristics of shares and debentures and fall within the definition of Section 2(h) of SCR Act, which continue to remain debentures till they are converted. In other words, OFCDs issued by Saharas are debentures *in presenti* and become shares *in futuro*. Even if OFCDs are hybrid securities, as defined in Section 2(19A) of the Companies Act, they shall remain within the purview of the definition of “securities” in Section 2(h) of SCR Act. Further, it may be noted that Saharas have treated OFCDs only as debentures in the IM, RHP, application forms and also in their balance sheet. The terms “Securities” defined in the Companies Act has the same meaning as defined in the SCR Act, which would also cover the species of “hybrid” defined under Section 2(19A) of the Companies Act. Since the definition of “securities” under Section 2(45AA) of the Companies Act includes “hybrids”, SEBI has jurisdiction over hybrids like OFCDs issued by Saharas, since the expression “securities” has been specifically dealt with under Section 55A of the Companies

Issue 8

113. Saharas raised yet another contention that OFCDs issued by them are convertible bonds issued on the basis of the price agreed upon at the time of issue and, therefore, the provisions of SCR Act are

not applicable in view of Section 28(1)(b) thereof. Further, it was also contended that convertible bonds having been issued at a price agreed upon at the time of issue are not listable in view of the exception granted under Section 28(1) of the SCR Act.

114. Section 28 was inserted by the SCR Act. The object of the amendment as stated in the Bill was to exempt convertible bonds by foreign financial institutions that had an option to obtain shares at a later date. Preamble of SCR Act provided “prohibition on options in securities” as a mode “to prevent the undesirable transactions in securities”. Resultantly, Section 28 had to be amended to make so inapplicable to such options in the bonds and to delete the words “by prohibiting options in securities” to facilitate such options. Parliament never intended to take away convertible debentures from the purview of SCR Act. For easy reference, I may refer to Section 28, which reads as follows:

“28. Act not to be apply in certain cases.

(1) The provisions of this Act shall not apply to-

(a) the Government, the Reserve Bank of India, any local authority or any corporation set-up by a special law or any person who has effected any transaction with or through the agency of any such authority as is referred to in this clause;

(b) any convertible bond or share warrant or any option or right in relation thereto, in so far as it entitles the person in whose favour any of the foregoing has been issued to obtain at his option from the company or other body corporate, issuing the same or from, any of its shareholders or duly appointed agents shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise, on the basis of the price agreed upon when the same was issued.

(2) Without prejudice to the provisions contained in sub- section (1) if the Central Government is satisfied that in the interests of trade and commerce or the economic development of the country it is necessary or expedient so to do, it may, by notification in the Official Gazette, specify any class of contracts as contracts to which this Act or any provision contained therein shall not apply, and also the conditions, limitations or restrictions, if any, subject to which it shall not so apply. ”

Section 28(1)(b) makes it clear that the Act will not apply to the ‘entitlement’ of the buyer, inherent in the convertible bond. Entitlement may be severable, but does not itself qualify as a security that can be administered by the SCR Act, unless it is issued in a detachable format. Therefore, the inapplicability of SCR Act, as contemplated in Section 28(1)(b), is not to the convertible bonds, but to the entitlement of a person to whom such share, warrant or convertible bond has been issued, to have shares at his option. The Act is, therefore, inapplicable only to the options or rights or entitlement that are attached to the bond/warrant and not to the bond/warrant itself. The expression “insofar as it entitles the person” clearly indicates that it was not intended to exclude convertible bonds as a class. Section 28(1)(b), therefore, clearly indicates that it is only the convertible bonds and share/warrant of the type referred to therein that are excluded from the applicability of the SCR Act and not debentures which are separate category of securities in the definition contained in Section 2(h) of SCR Act. Section 20 of SCR Act, which was omitted, by Securities Laws (Amendment) Act, 1995, with effect from 25.1.1995, stated that all options entered into after the commencement of the Act would be illegal. The introduction of Sections 28(1)(b) and 28(2) became necessary because of the provisions of Sections 13, 16 and 20. Section 20 was deleted in the year 1995, but SEBI notification No. 184 dated 1.3.2000 continued to prohibit options. Consequently, OFCDs issued by Saharas to the public cannot be excluded from the purview of listing requirements, any interpretation to the contrary would contravene the mandatory requirements contained in Section 73(1) and proviso to Section 67(3) of the Companies Act.

117. The above discussion will clearly indicate that OFCDs issued by Saharas were public issue of debentures, hence securities. Once there is an intention to issue shares or debentures to the public, it

is/was obligatory to make an application to one or more recognized stock exchanges, prior to such issue. Registration of RHPs by the Office of the Registrar does not mean that the mandatory provisions of Sections 67(3), 73(1) and DIP Guidelines be not followed. Saharas could not have filed RHP or any prospectus with RoC, without submitting the same to SEBI under Clauses 1.4, 2.1.1. and 2.1.4 of DIP Guidelines. Unlisted companies like Saharas when made an offer of shares or debentures to fifty or more persons, it was mandatory to follow the legal requirements of listing their securities. Once the number forty-nine is crossed, the proviso to Section 67(3) kicks in and it is an issue to the public, which attracts Section 73(1) and an application for listing becomes mandatory which fall under the administration of SEBI under Section 55A(1)(b) of the Companies Act.

118. SEBI, I have already indicated, has a duty under Section 11A of the SEBI Act to protect the interests of investors in securities either listed or which are required to be listed under the law or intended to be listed. Under Section 11B, SEBI has the power to issue appropriate directions in the interests of investors in securities and securities market to any person who is associated with securities market.

119. I have already referred to the power of SEBI under the SEBI Act in the earlier part of this judgment. SEBI Act, it may be noted, is a special law, distinct in form, but related to the Company Law, 1956. Purpose and object behind establishing a body like SEBI under the SEBI Act has also been highlighted by us. The impugned orders, as already stated, were issued by SEBI in exercise of its powers conferred under Sections 11, 11A and 11B of SEBI Act and Regulations 107 of ICDR 2009.

120. SEBI, in the facts and circumstances of the case, has rightly claimed jurisdiction over the OFCDs issued by Saharas. Saharas have no right to collect ₹ 27,000 crores from three million (3 crore investors) without complying with any regulatory provisions contained in the Companies Act, SEBI Act, Rules and Regulations already discussed. MCA, it is well known, does not have the machinery to deal with such a large public issue of securities, its powers are limited to deal with unlisted companies with limited number of shareholders or debenture holders and the legislature, in its wisdom, has conferred powers on SEBI. I, therefore, find on facts as well as on law, no illegality in the proceedings initiated by SEBI and the order passed by SEBI (WTM) dated 23.6.2011 and SAT dated 18.10.2011 are accordingly upheld.

ORDER

We, therefore, find, on facts as well as on law, no illegality in the proceedings initiated by SEBI as well as in the order passed by SEBI (WTM) dated 23.6.2011 and SAT dated 18.10.2011 and they are accordingly upheld. The order passed by this Court in C.A. No.9813 of 2011 filed by SIREC and in C.A. No.9833 of 2011 filed by SHICL, praying for extending the time for refund of the amount of ₹ 17,400 crores, as ordered by SAT, stands vacated and consequently the entire amount, including the amount mentioned above will have to be refunded by Saharas with 15% interest. We have gone through each other's judgment and fully concur with the reasoning and the views expressed therein and issue the following directions in modification of the directions issued by SEBI (WTM) which was endorsed by SAT:

1. Saharas (SIRECL & SHICL) would refund the amounts collected through RHPs dated 13.3.2008 and 16.10.2009 along with interest @ 15% per annum to SEBI from the date of receipt of the subscription amount till the date of repayment, within a period of three months from today, which shall be deposited in a Nationalized Bank bearing maximum rate of interest.
2. Saharas are also directed to furnish the details with supporting documents to establish whether they had refunded any amount to the persons who had subscribed through RHPs dated 13.3.2008 and 16.10.2009 within a period of 10 (ten) days from the pronouncement of this order and it is for the SEBI (WTM) to examine the correctness of the details furnished.
3. We make it clear that if the documents produced by Saharas are not found genuine or acceptable, then the SEBI (WTM) would proceed as if the Saharas had not refunded any amount to the real and genuine subscribers who had invested money through RHPs dated 13.3.2008 and 16.10.2009.

4. Saharas are directed to furnish all documents in their custody, particularly, the application forms submitted by subscribers, the approval and allotment of bonds and all other documents to SEBI so as to enable it to ascertain the genuineness of the subscribers as well as the amounts deposited, within a period of 10 (ten) days from the date of pronouncement of this order.

5. SEBI (WTM) shall have the liberty to engage Investigating Officers, experts in Finance and Accounts and other supporting staff to carry out directions and the expenses for the same will be borne by Saharas and be paid to SEBI.

6. SEBI (WTM) shall take steps with the aid and assistance of Investigating Authorities/Experts in Finance and Accounts and other supporting staff to examine the documents produced by Saharas so as to ascertain their genuineness and after having ascertained the same, they shall identify subscribers who had invested the money on the basis of RHPs dated 13.3.2008 and production of relevant documents evidencing payments and after counter checking the records produced by Saharas.

7. SEBI (WTM), in the event of finding that the genuineness of the subscribers is doubtful, an opportunity shall be afforded to Saharas to satisfactorily establish the same as being legitimate and valid. It shall be open to the Saharas, in such an eventuality to associate the concerned subscribers to establish their claims. The decision of SEBI (WTM) in this behalf will be final and binding on Saharas as well as the subscribers.

8. SEBI (WTM) if, after the verification of the details furnished, is unable to find out the whereabouts of all or any of the subscribers, then the amount collected from such subscribers will be appropriated to the Government of India.

9. We also appoint Mr. Justice B.N. Agarwal, a retired Judge of this Court to oversee whether directions issued by this Court are properly and effectively complied with by the SEBI (WTM) from the date of this order. Mr. Justice B.N. Agarwal would also oversee the entire steps adopted by SEBI (WTM) and other officials for the effective and proper implementation of the 6.10.2009 and refund the amount to them with interest on their directions issued by this Court. We fix an amount of ₹ 5 lakhs towards the monthly remuneration payable to Mr. Justice B.N. Agarwal, this will be in addition to travelling, accommodation and other expenses, commensurate with the status of the office held by Justice B.N. Agarwal, which shall be borne SEBI and recoverable from Saharas. Mr. Justice B.N. Agarwal is requested to take up this assignment without affecting his other engagements. We also order that all administrative expenses including the payment to the additional staff and experts, etc. would be borne by Saharas.

10. We also make it clear that if Saharas fail to comply with these directions and do not effect refund of money as directed, SEBI can take recourse to all legal remedies, including attachment and sale of properties, freezing of bank accounts etc. for realizations of the amounts.

11. We also direct SEBI(WTM) to submit a status report, duly approved by Mr. Justice B.N. Agarwal, as expeditiously as possible, and also permit SEBI (WTM) to seek further directions from this Court, as and when, found necessary.

Appeals are accordingly dismissed subject to the above directions. However, there will be no order as to costs. We record our deep appreciation for the valuable assistance rendered by learned senior counsel appearing on either side for resolving the very intricate and interesting questions of law which arose for our consideration in these appeals.

* * * * *

The Chairman, SEBI v. Shriram Mutual Fund & Anr.

(2006) 5 SCC 361

Dr. A.R. Lakshmanan, J. - 1. The Securities and Exchange Board of India (hereinafter referred to as 'the SEBI') is the appellant in the present appeal under Section 15-Z of the Securities and Exchange Board of India Act, 1992. This appeal was filed against the final judgment and order dated 21.08.2003 passed by the Securities Appellate Tribunal, Mumbai (hereinafter referred to as 'the Tribunal') in appeal No. 50 of 2002 and 51 of 2002 raising an important question of law as to whether once it is conclusively established that the Mutual Fund has violated the terms of the Certificate of Registration and the statutory Regulations i.e. SEBI (Mutual Funds) Regulations, 1996 (hereinafter referred to as 'the Regulations') the imposition of penalty becomes a sine qua non of the violation.

The respondents have not chosen to enter appearance though they were served with the notice. Since the service is complete and the appeals are ready for hearing, the above appeals were listed for final hearing.

2. The Appellant Board, a body corporate, has been established under the Securities and Exchange Board of India Act, 1992 by the Central Government, inter alia, to protect the interest of the investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith.

3. Shriram Mutual Fund was registered in the year 1994. It had floated 5 schemes. It conducted business through brokers associated with its sponsor in excess of the permissible limits prescribed under Regulation 25(7)(a) of the Regulations, 1996 on 12 occasions. The respondent failed to comply with the terms and conditions attached to the Certificate of Registration which are statutory in nature, as prescribed by Regulation 15 (D)(b) of the Securities and Exchange Board of India Act, 1992.

4. The Chairman, SEBI in exercise of the powers conferred on it under Section 15(I) of the said Act and Rule 3 of the SEBI (Procedure for Holding Enquiry and Imposing Penalty by Adjudicating Officer) appointed an Adjudicating Officer to enquire into the violations of exceeding by the respondents of the permissible limit of 5% of aggregate purchases and sales of securities made by the Mutual Fund in all its Schemes, as prohibited under Regulations 25(7)(a) of the said Regulations. The Appellant-Board issued notice dated 01.04.2002 under Rule 4 of Rules, 1995 calling upon the respondents to show cause as to why an inquiry should not be held and penalty imposed under the Rules, 1995. The respondents filed a common reply before the Enquiry and Adjudicating Officer, SEBI. The Adjudicating Officer, after hearing the parties, imposed penalty of ₹ 5 lakhs under Section 15E on respondent No.2 for failure to comply with Regulations 25 (7)(a) of SEBI (Mutual Funds) Regulations, 1996 with regard to routing of transactions through associate brokers.

5. The Adjudicating Officer also imposed a penalty of ₹ 2 lakhs under Section 15D(b) of SEBI Act, 1992 on respondent No.1 for its failure to comply with the terms and conditions of Certificate of Registration granted to it. Aggrieved by the order dated 24.06.2002 passed by the Adjudicating Officer, the respondents filed appeals before the Securities Appellate Tribunal, Mumbai on 21.08.2003, inter alia, contending that the transactions with the associate brokers were related to thinly traded Securities, for which there were no ready markets available through the normal Stock Exchange, or were relating to securities which did not have any large volume or trade in the market. It was further contended that these securities were either thinly traded, or did not have any volumes. It was submitted that the percentage of excess business carried out with associate brokers were as high as 91.68% and 52.42%, while the total volume of business done with the associate brokers was ₹ 4.55 lakhs.

6. The Tribunal set aside the order of the Adjudicating Officer on the purported ground that the penalty to be imposed for failure to perform a statutory obligation is a matter of discretion. The Tribunal has held that the penalty is warranted by the quantum which has to be decided by taking into consideration the factors stated in Section 15-J. Aggrieved by the order dated 21.08.2003, the

Chairman, SEBI filed the above statutory appeal under Section 15-Z of the Act of 1992 as amended by the Securities and Exchange Board of India (Amendment) Act, 2002. Our specific attention was drawn to Regulation 25 (7)(a) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and Sections 15-D(b), 15-E, 15-I, 15-J, and 12-B of the SEBI Act, 1992 which are extracted hereunder:

"25. Asset management company and its obligations:

1. _ to 6. _

7. (a) An Asset management company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5% or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes;

Provided that for the purpose of this sub- regulation, aggregate purchase and sale of security shall exclude sale and distribution of units issued by the mutual fund:

Provided further that the aforesaid limit of 5% shall apply for a block of any three months".

"15-D Penalty for certain defaults in case of mutual funds:

(a) If any person, who is

(b) Registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;"

"15-E Penalty for failure to observe rules and regulations by an asset management company _ Where any asset management company of a mutual fund registered under this Act fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less."

"15(I) For the purpose of adjudging under Sections 15A, 15B, 15C, 15D, 15E, 15F, 15G and 15H, the Board shall appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an enquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

(2) While holding an inquiry the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections."

"15-J. While adjudging quantum of penalty under Section 15-I, the adjudicating officer shall have the due regard to the following factors, namely:-

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default."

7. Statutory Scheme Chapter VI-A of the SEBI Act provides for Penalties and Adjudication, which provisions were introduced in SEBI Act by the Amendment Act 9 of 1995. Section 15-A to Section 15 HB are in the form of mandatory provisions imposing penalty in default of the provisions of the SEBI Act and Regulations. The provisions of penalty for non-compliance of the mandate of the Act is with an object to have an effective deterrent to ensure better compliance of the provisions of the SEBI Act and Regulations, which is crucial for the appellants Board in order to protect the interests of investors in securities and to promote the development of the securities market. Section 15-I of the

SEBI ACT envisages appointment of Adjudicating Officer for holding an inquiry in the prescribed manner, after giving reasonable opportunity of being heard for the purpose of imposing any penalty. Section 15-J provides various factors which are to be taken into consideration while adjudging the question of penalty under Section 15-I namely, the amount of disproportionate gain or unfair advantage whenever quantifiable, loss caused to an investor or group of investors and the repetitive nature of default. The legislature in its wisdom had not included *mens rea* or deliberate or wilful nature of default as a factor to be considered by the Adjudicating Officer in determining the quantum of liability to be imposed on the defaulter. Sections 15A to 15H and 15HA employ the words "shall be liable" and, therefore, mandatorily provides for imposition of monetary penalties for respective breaches or non-compliance of provisions of the SEBI Act and the Regulations. Default or failure, as contemplated under the Act includes : 15A Failure to furnish information, return 15B Failure to enter into agreement with clients 15C Failure to redress investors' grievances 15D Default in case of mutual funds 15E Failure to observe rules and regulations by an asset management company 15F Default in case of stock brokers 15G For insider trading 15H Non-disclosure of acquisition of shares and takeovers 15HA Fraudulent and unfair trade practices 15HB Penalty, if not separately provided The Scheme of the SEBI Act of imposing penalty is very clear. Chapter VI nowhere deals with criminal offences. These defaults for failures are nothing, but failure or default of statutory civil obligations provided under the Act and the Regulations made thereunder. It is pertinent to note that Section 24 of the SEBI Act deals with the criminal offences under the Act and its punishment. Therefore, the proceedings under Chapter VI A are neither criminal nor quasi-criminal. The penalty leviable under this Chapter or under these Sections, is penalty in cases of default or failure of statutory obligation or in other words breach of civil obligation. In the provisions and scheme of penalty under Chapter VI A of the SEBI Act, there is no element of any criminal offence or punishment as contemplated under criminal proceedings. Therefore, there is no question of proof of intention or any *mens rea* by the appellants and it is not essential element for imposing penalty under SEBI Act and the Regulations. As already noticed, the Tribunal allowed the appeals of the respondent on the ground that there was no mala fide intention to act in violation of Regulation 25 (7)(a) and Section 15(D)(b) of the SEBI Act but due to circumstances respondents were forced to act in excess of the limits prescribed under Regulation 25(D)(b) of the said Regulation.

8. Question of law The important question of law which arises for consideration in the present appeal is whether the Tribunal was justified in allowing the appeals of the respondent herein and that whether once it is conclusively established that the Mutual Fund has violated the terms of the Certificate of Registration and the statutory Regulations i.e. the SEBI (Mutual Funds) Regulation, 1996, the imposition of penalty becomes a sine qua non of the violation.

9. In other words, the breach of a civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether the contravention was made by the defaulter with any guilty intention or not. Mr. Rao took us through the orders passed by the Adjudicating Authority. It is seen that the respondents themselves have admitted the violation of the Regulations during a continuous period of 2 years in 12 instances, covering 6 quarters. Regulation 25 (7)(a) of the Regulation provides that an Asset Management Company shall not through any broker associated with sponsor, purchase or sell securities, which is average of 5% or more of the aggregate purchases and sale of securities made by the Mutual Fund in all its schemes. The second proviso to the said Regulation clearly provides that the aforesaid limit shall apply for a block of 3 months. Hence, there has been a repetitive violation of the said Regulation, and the terms of the Certificate of Registration. In these circumstances, the learned senior counsel submitted that the Tribunal has erroneously allowed the appeals filed by the respondents against the order passed by the Adjudicating Officer on 24.06.2002. The Tribunal has given a clear finding that the respondent No.1 Fund has admittedly exceeded the prescribed limit of more than 5% when it had transacted business through brokers, associated with its sponsors which is in contravention of provisions of Regulation 25(7)(a) of the SEBI (Mutual Funds) Regulation, 1996. We have already noticed the instances of excess transactions conducted by the respondents and reproduced the same in paragraphs (supra). It is an admitted fact that the respondent had on 12 occasions routed transactions through its associated brokerage houses in excess of the permissible

limits prescribed under Regulation 25 (7)(a) of the Regulations. In the present case, the contesting respondent is a Mutual Fund and the Asset Management Company. During the period from June, 1998 to September, 1999, the respondent had conducted business through associated brokers, in excess of the limits prescribed under Regulation 25 (7)(a) of the Regulations on 12 occasions covering 6 quarters. The respondent had failed to comply with the terms and conditions attached to the Certificate of Registration granted to it, inasmuch as it did not exercise diligence to ensure that the transactions by its own Asset Management Company were confined to the permissible limits. In this case, the SEBI appointed an Adjudicating Officer in terms of Section 15-I to inquire into and adjudge the alleged contravention of Section 15-E of the Act of 1992. The Adjudicating Officer, after inquiry, confirmed the charges and imposed a sum of ₹ 5 lakhs as penalty on respondent No.2 under Section 15-E of the said Act for failure to comply with Regulation 25 (7)(a) and ₹ 2 lakhs on the other respondent for failure to comply with the terms and conditions attached to the Certificate of Registration.

10. Mr. Rao submitted that under Regulation 25 (7)(a) an Asset Management Company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5% or more of the aggregate purchases and sale of securities made by Mutual Funds in all its schemes and that the aforesaid limit of 5% shall apply for a block of any three months. In the present case, the respondents on their own admission have violated the aforesaid statutory Regulations during 6 quarters. Hence Mr. Rao submitted that the violation is *ex facie* wilful and hence the penalty imposed by the Adjudicating Officer ought not to have been set aside by the single member Tribunal. Mr. Rao further argued that unless the language of the statute indicates the need to establish the element of *mens rea* it is generally sufficient to prove that a default in complying with the statute has occurred. Under Sections 15-D(b) and 15-E of the Act, there is nothing which requires that *mens rea* must be proved before penalty can be imposed under these provisions. Hence, it was contended that once the contravention is established, the penalty has to follow.

11. The Tribunal set aside the order passed by the Adjudicating Officer on the ground that the penalty to be imposed for failure to perform a statutory obligation is a matter of discretion which has to be exercised judicially and on a consideration of all the relevant facts and circumstances. The Tribunal also held that the Adjudicating Officer has to be satisfied with the material placed before him that the violation deserves punishment. It was held that the penalty is warranted by the quantum which has to be decided by taking into consideration the factors stated in Section 15J of SEBI Act. In our opinion, the Tribunal has miserably failed to appreciate that by setting aside the order of the Adjudicating Officer the Tribunal was setting a serious wrong precedent whereby every offender would take shelter of alleged hardships to violate the provisions of the Act. In our opinion, *mens rea* is not an essential ingredient for contravention of the provisions of a civil act. In our view, the penalty is attracted as soon as contravention of the statutory obligations as contemplated by the Act is established and, therefore, the intention of the parties committing such violation becomes immaterial. In other words, the breach of a civil obligation which attracts penalty under the provisions of an Act would immediately attract the levy of penalty irrespective of the fact whether the contravention was made by the defaulter with any guilty intention or not. The intention of the parties is wholly irrelevant since there has been a clear violation of the statutory Regulations and provisions repetitively, covering a period of 6 quarters. Hence, we hold that the respondents have wilfully violated statutory provisions with impunity and hence the imposition of penalty was fully justified.

12. The Tribunal, in this context, failed to appreciate that every Mutual Fund has to redeem the units as per terms and conditions of the scheme on the request of the unit holders and this cannot, in any manner, be considered as an extraordinary circumstance or something which was not known to the respondents. The facts and circumstances of the present case in no way indicate the existence of special circumstances so as to waive the penalty imposed by the Adjudicating Officer. A perusal of the order passed by the Adjudicating Officer would clearly go to show that factors such as small size of the funds, low volume of transactions, thinly traded securities, administrative and operational exigencies were duly considered and appreciated by the Adjudicating Officer while passing the order and that is why the Adjudicating Officer did not impose the maximum permissible penalty. The

Tribunal failed to appreciate that the objective behind imposing certain limit on the business that can be conducted by mutual fund through the associate broker is to eliminate any undue advantage to the class of brokers by virtue of their close association with the Asset Management Company, sponsors etc. In other words, the object of imposing such limits is to ensure that there is no concentration of business only in such entities, so that there is an indirect pecuniary advantage to the person associated with the Asset Management Company, sponsors etc. Any undue concentration on the business of the mutual fund with its affiliated brokers by paying huge commissions to such brokers is neither desirable nor in the interest of the unit holders. It is a matter of record that in the 12 admitted instances of violation by the respondents, the percentage of the business through the associated brokers was as high as 91.68% and 52.2% in certain factors. This apart, the respondent's excessive exposure to the associate brokers is not only established from the record, but has also been admitted by respondents.

13. It is settled law that when a penalty is imposed by an Adjudicating Officer, it is done so in adjudicatory proceedings and not by way of fine as a result of prosecution of an accused for commission of an offence in a criminal proceeding. In the instant case, the Tribunal has failed to appreciate that the respondents had given undue and unfair advantage to the associated brokers, which is detrimental to the interest of the unit holders.

14. In the present case, it has been established by the Adjudicating Officer as well as admitted by the respondents that there has been a conscious disregard of the obligation inasmuch as the respondents were aware that they were acting in violation of the provisions of Regulations. The Adjudicating Officer had, after taking into account all the facts and circumstances of the case, imposed only a token of ₹ 5 lakhs against the respondents for its failure on 12 occasions though the charging section permits imposition of a maximum penalty of ₹ 5 lakhs for each such violation.

15. The Appellant Board has been established by the Parliament under the Securities and Exchange Board of India Act, 1992 to protect the interest of investors in securities and to promote the development of, and to regulate the securities market and for matter connected therewith or incidental thereto. The Board was set up to promote orderly and healthy growth of the securities market and for investors protection SEBI has been monitoring and regulating the activities of Stock Exchanges, Mutual Funds and Merchant Bankers, etc. to achieve these goals. The Capital market has witnessed tremendous growth in recent times, characterized particularly by the increasing participation of the Public. Investors' confidence in the capital market can be sustained largely by ensuring investors protection. That it became imperative to impose monetary penalties also in addition to other penalties in cases of default. *Mens rea* : Whether an essential element for imposing penalty for breach of civil obligations? This Court in a catena of decisions have held that mens rea is not an essential element for imposing penalty for breach of civil obligations.

(a) *Director of Enforcement v. MCTM Corporation Pvt. Ltd. & Ors.*, (1996) 2 SCC 471 "It is thus the breach of a "civil obligation" which attracts "penalty" under Section 23(1)(a) FERA, 1947 and a finding that the delinquent has contravened the provisions of Section 10 FERA 1947 that would immediately attract the levy of "penalty" under Section 23, irrespective of the fact whether the contravention was made by the defaulter with any "guilty intention" or not. Therefore, unlike in a criminal case, where it is essential for the 'prosecution' to establish that the 'accused' had the necessary guilty intention or in other words the requisite 'mens rea' to commit the alleged offence with which he is charged before recording his conviction, the obligation on the part of the Directorate of Enforcement, in cases of contravention of the provisions of Section 10 of FERA, would be discharged where it is shown that the "blameworthy conduct" of the delinquent had been established by wilful contravention by him of the provisions of Section 10, FERA 1947. It is the delinquency of the defaulter itself which establishes his 'blameworthy' conduct, attracting the provisions of Section 23(1)(a) of FERA, 1947, without any further proof of the existence of "mens rea".

(b) *J.K. Industries Ltd. & Ors. v. Chief Inspector of Factories and Boilers & Ors.*, (1996) 6 SCC : "The offences under the Act are not a part of general penal law but arise from the breach of a duty provided in a special beneficial social defence legislation, which creates absolute or strict liability without proof of any mens rea. The offences are strict statutory offences for which establishment of

mens rea is not an essential ingredient. The omission or commission of the statutory breach is itself the offence. Similar type of offences based on the principle of strict liability, which means liability without fault or mens rea, exist in many statutes relating to economic crimes as well as in laws concerning the industry, food adulteration, prevention of pollution etc. in India and abroad.

"Absolute offences" are not criminal offences in any real sense but acts which are prohibited in the interest of welfare of the public and the prohibition is backed by sanction of penalty____"

(c) *R.S. Joshi Sales Tax Officer, Gujarat & Ors. v. Ajit Mills Ltd. & Anr. etc.* , (1977) 4 SCC 98

"____Even here we may reject the notion that a penalty or a punishment cannot be cast in the form of an absolute or no-fault liability but must be preceded by mens rea. The classical view that 'no mens rea, no crime' has long ago been eroded and several laws in India and abroad, especially regarding economic crimes and departmental penalties, have created severe punishments even where the offences have been defined to exclude mens rea. Therefore, the contention that Section 37(1) fastens a heavy liability regardless of fault has no force in depriving the forfeiture of the character of penalty."

(d) *M/s Gujarat Travancore Agency, Cochin v. C.I.T.* , (1989) 3 SCC 52.

"...It is sufficient for us to refer to Section 271(1)(a), which provides that a penalty may be imposed if the Income Tax Officer is satisfied that any person has without reasonable cause failed to furnish the return of total income, and to Section 276-C which provides that if a person wilfully fails to furnish in due time the return of income required under Section 139(1), he shall be punishable with rigorous imprisonment for a term which may extend to one year or with fine. It is clear that in the former case what is intended is a civil obligation while in the latter what is imposed is a criminal sentence. There can be no dispute that having regard to the provisions of Section 276-C, which speaks of wilful failure on the part of the defaulter and taking into consideration the nature of the penalty, which is punitive, no sentence can be imposed under that provision unless the element of mens rea is established. In most cases of criminal liability, the intention of the legislature is that the penalty should serve as a deterrent. The creation of an offence by statute proceeds on the assumption that society suffers injury by the act or omission of the defaulter and that a deterrent must be imposed to discourage the repetition of the offence. In the case of a proceeding under Section 271(1)(a), however, it seems that the intention of the legislature is to emphasise the fact of loss of revenue and to provide a remedy for such loss, although no doubt an element of coercion is present in the penalty. In this connection, the terms in which the penalty falls to be measured is significant. Unless there is something in the language of the statute indicating the need to establish the element of mens rea it is generally sufficient to prove that a default in complying with the statute has occurred. In our opinion, there is nothing in Section 271(1)(a) which requires that mens rea must be proved before penalty can be levied under that provision."

(e) *Swedish Match AB and Anr. Vs. SEBI & Anr.* , (2004) 11 SCC 641.

"____The provisions of Section 15-H of the Act mandate that a penalty of rupees twenty-five crores may be imposed. The Board does not have any discretion in the matter and, thus the adjudication proceeding is a mere formality. Imposition of penalty upon the appellant would, thus, be a forgone conclusion. Only in the criminal proceedings initiated against the appellants, existence of mens rea on the part of the appellants will come up for consideration."

(f) *SEBI vs. Cabot International Capital Corporation*, (2005) 123 Comp. Cases 841 (Bom).

"Thus, the following extracted principles are summarised:

(A) Mens rea is an essential or sine qua non for criminal offence.

(B) Strait jacket formula of mens rea cannot be blindly followed in each and every case.

Scheme of particular statute may be diluted in a given case.

(C) If, from the scheme, object and words used in the statute, it appears that the proceedings for imposition of the penalty are adjudicatory in nature, in contra-distinction to criminal or quasi criminal proceedings, the determination is of the breach of the civil obligation by the offender. The word "penalty" by itself will not be determinative to conclude the nature of proceedings being criminal or quasi-criminal. The relevant considerations being the nature of the functions being discharged by the authority and the determination of the liability of the contravener and the delinquency.

(D) Mens rea is not essential element for imposing penalty for breach of civil obligations or liabilities_.

(E) There can be two distinct liabilities, civil and criminal under the same Act.

16. The SEBI Act and the Regulations are intended to regulate the Security Market and related aspects, the imposition of penalty, in the given facts and circumstances of the case, cannot be tested on the ground of "no mens rea no penalty". For breaches of provisions of SEBI Act and Regulations, according to us, which are civil in nature, mens rea is not essential. On particular facts and circumstances of the case, proper exercise or judicial discretion is a must, but not on a foundation that mens rea is an essential to impose penalty in each and every breach of provisions of the SEBI Act.

17. However, we are not in agreement with the appellate authority in respect of the reasoning given in regard to the necessity of mens rea being essential for imposing the penalty. According to us, mens rea is not essential for imposing civil penalties under the SEBI Act and Regulations."

18. In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulation is established and hence the intention of the parties committing such violation becomes wholly irrelevant. We also further held that unless the language of the statute indicates the need to establish the presence of mens rea, it is wholly unnecessary to ascertain whether such a violation was intentional or not. On a careful perusal of Section 15(D)(b) and Section 15-E of the Act, there is nothing which requires that mens rea must be proved before penalty can be imposed under these provisions. Hence once the contravention is established then the penalty is to follow. In our view, the impugned judgment of the Securities appellate Tribunal has set a serious wrong precedent and the powers of the SEBI to impose penalty under Chapter VIA are severely curtailed against the plain language of the statute which mandatorily imposes penalties on the contravention of the Act/Regulations without any requirement of the contravention having been deliberate or contumacious. The impugned order sets the stage for various market players to violate statutory regulations with impunity and subsequently plead ignorance of law or lack of mens rea to escape the imposition of penalty. The imputing mens rea into the provisions of Chapter VI A is against the plain language of the statute and frustrates entire purpose and object of introducing.

19. Chapter VIA to give teeth to the SEBI to secure strict compliance of the Act and the Regulations. In the result, the Civil Appeal Nos. 9523 and 9524 of 2003 are allowed and the order passed by the Securities Appellate Tribunal, Mumbai dated 21.08.2003 in Appeal Nos. 50 and 51 of 2002 are set aside. No costs.

* * * * *

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)

Mardia Chemicals Ltd. v. U.O.I. & Ors. on 8 April, 2004
(2004) 4 SCC 311

Bench: V.N. Khare, C.J., Brijesh Kumar, Arun Kumar, J.J.

BRIJESH KUMAR, J.

2. By means of the above noted bunch of cases some of those having been transferred to this court, the validity of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002) (for short 'the Act') has been challenged. Some writ petitions were filed in different High Courts on promulgation of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (Second Ordinance), 2002. However, the Act 54 of 2002 was enacted and enforced, vires of which is in question, more particularly, the provisions as contained in Sections 13, 15, 17 and 34 of the Act. Besides others, we may, for the sake of convenience, refer to the averments made and documents filed in Transferred Case Nos.92-95 of 2002 - *M/s. Mardia Chemicals Ltd. v. Union of India & Ors.*

3. It appears that a notice dated July 24, 2002 was issued to the petitioner - Mardia Chemicals Ltd. by the Industrial Development Bank of India (for short 'the IDBI') under Section 13 of the Ordinance, then in force, requiring it to pay the amount of arrears indicated in the notice within 60 days, failing which the IDBI as a secured creditor would be entitled to enforce the security interest without intervention of the court or Tribunal, taking recourse to all or any of the measures contained in sub-section (4) of Section 13 namely, by taking over possession and/or management of the secured assets. The petitioner was also required not to transfer by way of sale, lease or otherwise any of the secured assets. Similar notices were issued by other financial institutions and banks under the provisions of Section 13 of the Ordinance/Act to different parties who filed petitions in different High Courts.

4. The main contention challenging the vires of certain provisions of the Act is that the banks and the financial institutions have been vested with arbitrary powers, without any guidelines for its exercise and also without providing any appropriate and adequate mechanism to decide the disputes relating to the correctness of the demand, its validity and the actual amount of dues, sought to be recovered from the borrowers. The offending provisions as contained under the Act, are such that, it all has been made one sided affair while enforcing drastic measures of sale of the property or taking over the management or the possession of the secured assets without affording any opportunity to the borrower. Before further detailing the grounds of attack, we may peruse some of the relevant provisions of the Act.

5. The term "borrower" has been defined in clause (f) of Section 2, which provides as under :

"borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;"

6. "Financial Assistance" has been defined in clause (k), which reads as under:

"financial assistance" means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution;"

7. Similarly, the term "default" is defined in clause (j), as quoted below :

"default" means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor in accordance with the directions or guidelines issued by the Reserve Bank"

8. "Non Performing Asset" has been defined in clause(o) of Section 2 which means :

"non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or under guidelines relating to asset classifications issued by the Reserve Bank".

9. "Reconstruction company" has been defined in clause(v) of Section 2 which means :

"Reconstruction company" means a company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of asset reconstruction;

10. "Secured asset" has been defined in clause(zc) of Section 2 which means :

"Secured Asset" means the property on which security interest is created."

11. "Secured creditor" has been defined in clause(zd) of Section 2 which means :

"Secured Creditor" means "any bank or financial institution or any consortium or group of banks or financial institutions and includes -

(i) debenture trustee appointed by any bank or financial institution; or

(ii) securitization company or reconstruction company; or

(iii) any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;"

12. "Secured Debt" has been defined in clause(ze) of Section 2 which means :

"Secured Debt" means a debt which is secured by any security interest."

13. "Security interest" has been defined in clause(zf) of Section 2 which means :

"Security Interest" means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31."

14. Section 13, which is relevant for our present purpose, provides:

"Enforcement of security interest.- (1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any

secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4).

(3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;

(b) take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset;

(c) appoint any person (hereafter referred to as the manager) to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

(5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(6) Any transfer of secured asset after taking possession thereof or take over of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditors shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(8) If the dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer or sale of that secured asset.

(9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors:

Provided that in the case of a company in liquidation, the amount realized from the sale of secured assets shall be distributed in accordance with the provisions of section 529 A of the Companies Act, 1956 (1 of 1956).

Xxx xxx xxx (10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(11) Without prejudice to the rights conferred on the secured creditor under or by this section, secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of sub-section (4) in relation to the secured assets under this Act.

Xxx xxx xxx (13) No borrower shall, after receipt of notice referred to in sub-section (2), transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor."

17. Referring to Section 13 of the Act it is submitted on behalf of the petitioners that a security interest can be enforced by the secured creditor straightaway without intervention of the court just on default in repayment of an instalment and non-compliance of a notice of 60 days in that regard, declaring the loan as non-performing asset. Under sub-section 4 of Section 13 the secured creditor is entitled to take possession of the secured assets and may transfer the same by way of lease, assignment or sale as provided under clause (a) or under clause (b) to take over the management of the secured assets including the right to transfer any secured assets or to appoint any person as provided in clause (c) to manage the secured assets taken over by the creditor. Under clause (d) by means of a notice any person who has acquired any of the secured assets from the borrower or who has to pay to the borrower any amount which may cover the secured debt, can be asked to pay it to the secured creditor. All that is provided is that if all the dues with costs and charges and expenses incurred by the creditor is tendered before the date fixed for sale of the assets no further steps shall be taken for sale of the property.

18. It is submitted that the mechanism provided for recovery of the debt under Section 13 indicated above does not provide for any adjudicatory forum to resolve any dispute which may arise in relation to the liability of the borrower to be treated as a defaulter or to see as to whether there has been any violation or lapse on the part of the creditor or in regard to the correctness of the amount sought to be recovered and the interest levied thereupon. On the other hand, Section 34 bars the jurisdiction of the civil court to entertain any suit in respect of any matter which a Debt Recovery Tribunal or the appellate Tribunal is empowered to determine. It also provides that no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under Act or under the Recovery of Debts due to Banks and Financial Institutions Act, 1993. Section 35 gives an overriding effect to the provisions of the Act over the provisions contained under any other law. The submission, therefore, is that before any action is taken under Section 13, there is no forum or adjudicatory mechanism to resolve any dispute which may arise in respect of the alleged dues or the NPA.

19. It is further submitted that the provision of appeal as contained in Section 17 of the Act is also illusory since an appeal may be preferred within the specified time from the date on which measures under sub-section 4 of Section 13 have been taken, is to say that the appeal would be maintainable after the possession of the property or the management of the secured assets has been taken over or the property has been sold. Further, an appeal is not entertainable unless 75% of the amount claimed in the notice is deposited by the borrower with the Debt Recovery Tribunal. It would be a matter in the discretion of the Debt Recovery Tribunal to waive the condition of pre deposit or to reduce the amount, for reasons to be recorded therefor. It is submitted that a remedy which is available, after the damage is done and on fulfilment of such an onerous condition as deposit of 75% of the demand, is illusory and a mere farce. It is no real remedy available to a borrower before he is subjected to harsh steps as provided under sub-section (4) of Section 13. It is further submitted that after the possession of the secured assets or its management has been taken over by the secured creditor or the property is leased out or sold to any other person, it would not be possible to raise and deposit 75% of the amount claimed by the secured creditor. It is also submitted that once the secured assets are taken over there is hardly any occasion for deposit of 75% of the claim since it is already secured and the management and the possession of the secured assets moves into the hands of the creditor. The position thus is that the borrower is gagged into a helpless position where he cannot ventilate his grievance against the drastic steps taken against him. The doors of the civil court are closed for him and no adjudicatory mechanism is provided before steps are taken under sub-section (4) of Section 13. Such a law, it is submitted, is arbitrary and suffers from the vice of unreasonableness.

20. In so far it relates to Section 19 of the Act which provides, in case it is found that possession of the secured assets was wrongfully taken by the secured creditor he may be directed to return the secured assets to the borrower who may also be entitled to such compensation as may be determined by the debt recovery Tribunal or the appellate Tribunal, it is submitted that it is hardly a consolation after harsh steps as provided under sub-section 4 of section 13 have been taken.

21. Shri Ashok Desai, learned counsel appearing in one of the matters namely, the case of M/s Modern Terry Towel Ltd. leaving aside the questions of fact, submits that for exercise of power under Section 13, certain enquiries would be necessary as to whether a person to whom notice is given is under a liability to pay as also the question of extent of the liability etc. Further the questions pertaining to law of limitation and bar under consortium agreements, claim of set off/counter claim, creditors defaults as bailee or its failure to disburse the credit in time, the chargeability of penal interest or compound interest or non-appropriation of amount already paid and so on and so forth, all these questions need to be decided. Bar of Section 22 of the Sick Industrial Companies Act (for short 'SICA) may have to be considered. But there is no adjudicatory body provided for dealing with such disputes. Relying on a decision of this Court reported in 2002(5) SCC p.685, Indian National Congress (I) Vs. Institute of Social Welfare and others, observations made by one of us (Chief Justice V.N. Khare) have been relied upon as quoted below:- "Thus, where there is a *lis* or two contesting parties making rival claims and the statutory authority under the statutory provision is required to decide such a dispute, in the absence of any other attributes of a quasi- judicial authority, such a statutory authority is quasi-judicial authority.

22. It is submitted any power which is exercised by a party to enforce security by way of sale etc. without any determination of disputed questions, as in the existing law, under Section 13 of the Act, is unconstitutional. It is further submitted that legislature has vested the beneficiary to exercise the power without any determination of disputed questions excluding the judicial remedies till the power stands exercised. It renders the Act procedurally and substantively unfair, unreasonable and arbitrary. Power of judicial determination, it is submitted, is manifestation of sovereign power to determine the legal rights which cannot be vested in private bodies as foreign

banks, cooperative banks or non-banking financial institutions etc. Stress has also been given upon the condition of deposit of 75% of claim before entertainment of the appeal.

23. It is next submitted that power under Section 69 of the Transfer of Property Act is hedged with various restrictions to prevent abuse of power including mortgagor's right to have recourse to court both before and after the sale. In this connection, he has referred to decisions of the Madras High Court reported in AIR 1955 Madras P. 135, V.Narasimhachariar vs. Egmore Benefit Society, and also AIR 1955 Madras 343, V.P.Padmavati vs. P.S.Swaminathan Iyer. It is submitted that English mortgage is in the nature of conveyance or absolute transfer of mortgage property with provision of retransfer upon discharge of mortgage and referred to AIR 1969 Mysore p.280, Bank of Maharashtra Ltd., Puna Vs. Official Liquidator, High Court Buildings. It is submitted that the scope of Section 13 of the Act is fundamentally different from the scope of power under Section 69 of the Transfer of Property Act.

24. Taking an overall view of the rival contentions of the parties, we feel the main questions which broadly fall for consideration by us are :

- I. Whether it is open to challenge the statute on the ground that it was not necessary to enact it in the prevailing background particularly when another statute was already in operation?
- II. Whether provisions as contained under Section 13 and 17 of the Act provide adequate and efficacious mechanism to consider and decide the objections/disputes raised by a borrower against the recovery, particularly in view of bar to approach the civil court under Section 34 of the Act?
- III. Whether the remedy available under Section 17 of the Act is illusory for the reason it is available only after the action is taken under Section 13(4) of the Act and the appeal would be entertainable only on deposit of 75% of the claim raised in the notice of demand?
- IV. Whether the terms or existing rights under the contract entered into by two private parties could be amended by the provisions of law providing certain powers in one sided manner in favour of one of the parties to the contract?
- V. Whether provision for sale of the properties without intervention of the court under Section 13 of the Act is akin to the English mortgage and its effect on the scope of the bar of the jurisdiction of the civil court?
- VI. Whether the provisions under Sections 13 and 17(2) of the Act are unconstitutional on the basis of the parameters laid down in different decisions of this Court?
- VII. Whether the principle of lender's liability has been absolutely ignored while enacting the Act and its effect?

34. Some facts which need be taken note of are that the banks and the financial institutions have heavily financed the petitioners and other industries. It is also a fact that a large sum of amount remains unrecovered. Normal process of recovery of debts through courts is lengthy and time taken is not suited for recovery of such dues. For financial assistance rendered to the industries by the financial institutions, financial liquidity is essential failing which there is a blockade of large sums of amounts creating circumstances which retard the economic progress followed by a large number of other consequential ill effects. Considering all these circumstances, the Recovery of Debts Due to Banks and Financial Institutions Act was enacted in 1993 but as the figures show it also did not bring the desired results. Though it is submitted on behalf of the petitioners that it so happened due to inaction on the part of the governments in creating Debt Recovery Tribunals and appointing Presiding Officers, for a long time. Even after leaving that margin, it is to be noted that things in the concerned spheres are desired to move faster. In the present-day global economy, it may be difficult to stick to old and conventional methods of financing and recovery of dues. Hence, in our view, it cannot be said that a step taken towards securitisation of the debts and to evolve means for faster recovery of the NPAs was not called for or that it was superimposition of undesired law since one legislation was already operating in the field namely

the Recovery of Debts due to Banks and Financial Institutions Act. It is also to be noted that the idea has not erupted abruptly to resort to such a legislation. It appears that a thought was given to the problems and Narasimham Committee was constituted which recommended for such a legislation keeping in view the changing times and economic situation whereafter yet another expert committee was constituted then alone the impugned law was enacted. Liquidity of finances and flow of money is essential for any healthy and growth-oriented economy. But certainly, what must be kept in mind is that the law should not be in derogation of the rights which are guaranteed to the people under the Constitution. The procedure should also be fair, reasonable and valid, though it may vary looking to the different situations needed to be tackled and object sought to be achieved.

35. As referred to above, the Narasimham Committee was constituted in 1991 relating to the Financial System prevailing in the country. It considered wide ranging issues relevant to the economy, banking and financing etc. Under Chapter V of the Report under the heading 'Capital Adequacy, Accounting Policies and other Related Matters' it was opined that a proper system of income recognition and provisioning is fundamental to the preservation of the strength and stability of banking system. It was also observed that the assets are required to be classified, it also takes note of the fact that the Reserve Bank of India had classified the advances of a bank, one category of which was bad debts/doubtful debts. It then mentions that according to the international practice, an asset is treated as non-performing when the interest is overdue for at least two quarters. Income of interest is considered as such, only when it is received and not on the accrual basis. The Committee suggested that the same should be followed by the banks and financial institutions in India and an advance is to be shown as non-performing assets where the interest remains due for more than 180 days. It was further suggested that the Reserve Bank of India should prescribe clear and objective definitions in respect of advances which may have to be treated as doubtful, standard or sub-standard, depending upon different situations. Apart from recommending to set up of special Tribunals to deal with the recovery of dues of the advances made by the banks the committee observed that impact of such steps would be felt by the banks only over a period of time, in the meanwhile, the Committee also suggested for reconstruction of assets saying "the Committee has looked at the mechanism employed under similar circumstances in certain other countries and recommends the setting up of, if necessary by special legislation, a separate institution by the Government of India to be known as 'Assets Reconstruction Fund (ARF) with the express purpose of taking over such assets from banks and financial institutions and subsequently following up on the recovery of dues owed to them from the primary borrowers." While recommending for setting up of special Tribunals, the Committee observed : "Banks and financial institutions at present face considerable difficulties in recovery of dues from the clients and enforcement of security charged to them due to the delay in the legal processes. A significant portion of the funds of banks and financial institutions is thus blocked in unproductive assets, the values of which keep deteriorating with the passage of time. Banks also incur substantial amounts of expenditure by way of legal charges which add to their overheads. The question of speeding up the process of recovery was examined in great detail by a committee set up by the Government under the Chairmanship of the late Shri Tiwari. The Tiwari Committee recommended, inter alia, the setting up of Special Tribunals which could expedite the recovery of process...."

37. Next we come to the question as to whether it is on whims and fancies of the financial institutions to classify the assets as non-performing assets, as canvassed before us. We find it not to be so. As a matter of fact, a policy has been laid down by the Reserve Bank of India providing guidelines in the matter for declaring an asset to be a non-performing asset known as "RBI's prudential norms on income recognition, asset classification and provisioning - pertaining to advances" through a Circular dated August 30, 2001.

38. We may now consider the main enforcing provision which is pivotal to the whole controversy namely, Section 13 in Chapter III of the Act. It provides that a secured creditor may enforce any security interest without intervention of the court or Tribunal irrespective of Section 69 or Section 69A of the Transfer of Property Act where according to sub-section (2) of Section 13, the borrower is a defaulter in repayment of the secured debt or any instalment of repayment and further the debt standing against him has been classified as a non- performing asset by the secured creditor. Sub-section (2) of Section 13 further provides that before taking any steps in direction of realizing the dues, the secured creditor must serve a notice in writing to the borrower requiring him to discharge the liabilities within a period of 60 days failing which the secured creditor would be entitled to take any of the measures as provided in sub-section (4) of Section 13. It may also be noted that as per sub-section (3) of Section 13 a notice given to the borrower must contain the details of the amounts payable and the secured assets against which the secured creditor proposes to proceed in the event of non- compliance with the notice given under sub-section (2) of Section 13.

39. Sub-section (4) provides for four measures which can be taken by the secured creditor in case of non- compliance with the notice served upon the borrower.

40. Now coming to Section 17, it provides for filing of an appeal to the Debt Recovery Tribunal within 45 days of any action taken against the borrower under sub-section (4) of Section 13 of the Act. It reads as under : "17. Right to appeal .- (1) Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorized officer under this Chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measures had been taken.

(2) Where an appeal is preferred by a borrower, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the Debts Recovery Tribunal seventy-five per cent of the amount claimed in the notice referred to in sub-section (2) of section 13 :

Provided that the Debts Recovery Tribunal may, for reasons to be recorded in writing, waive or reduce the amount to be deposited under this section.

(3) Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and rules made thereunder."

It is thus clear that an appeal under sub-section (1) of Section 17 would lie only after some measure has been taken under sub-section (4) of Section 13 and not before the stage of taking of any such measure. According to sub-section (2), the borrower has to deposit 75% of the amount claimed by the secured creditor before his appeal can be entertained.

41. So far jurisdiction of Civil Court is concerned we find that there is a bar to it as provided under Section 34 of the Act quoted below:-

"34. Civil Court not to have jurisdiction - No Civil Court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action

taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993)."

42. Mainly it is to be considered as to whether there is absolute bar of any remedy to the borrower, before an action is taken under sub-section (4) of Section 13 of the Act in view of non-obstante clause under sub-section (1) of Section 13 and the bar of the jurisdiction of the civil court under Section 34 of the Act. Sub-section (1) of Section 13 begins with "Notwithstanding anything contained" under Section 69 of the Transfer of Property Act any secured interest can be enforced without intervention of the court or Tribunal. Section 69 of the Transfer of Property Act provides as follows : "*69. Power of sale when valid.-(1) A mortgagee, or any person acting on his behalf, shall, subject to the provisions of this section, have power to sell or concur in selling the mortgaged property, or any part thereof, in default of the payment of mortgage-money, without the intervention of the Court.*

"35. The provisions of this Act to override other laws.- The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."

43. It may, however, be worthwhile to mention here as to why and in what circumstances it had been thought necessary to provide a non-obstante clause in sub-section (1) of Section 13 of the Act. In a nutshell, the position as prevailed in 1882 when the Transfer of Property Act was enacted has undergone a sea-change. What was conceived correct in the situation then prevailing may not be so in the present-day situation. Functions of different institutions including the banking and financial institutions have changed and new functions have been introduced for financing the industries etc. New economic and fiscal environment is around more than 100 years later after the enactment of the Transfer of Property Act. In this connection it has been pointed out on behalf of the respondents that Rajamannar Committee was appointed by Government of India which submitted its report in 1977 indicating the effect of the changed situation and the relevance of the provisions of the Transfer of Property Act in context thereof. Mr. Salve has drawn our attention to the Rajamannar Committee report as quoted in the Narasimham Committee Report 1998, which reads as under :

In fact, in extending credit, the necessity for suitable safeguards to banks and other financing institutions is now rightly stressed. It is understandable that the legal framework is essentially conceived to deal with unscrupulous moneylenders is no longer appropriate to deal with credit given by banks and other financing institutions..."

47. This will also be in keeping with the concept of right to know and lender's liability of fairness to keep the borrower informed particularly the developments immediately before taking measures under sub-section (4) of Section 13 of the Act. It will also cater the cause of transparency and not secrecy and shall be conducive in building an atmosphere of confidence and healthy commercial practice. Such a duty, in the circumstances of the case and the provisions is inherent under Section 13(2) of the Act.

48. The next safeguard available to a secured borrower within the framework of the Act is to approach the Debt Recovery Tribunal under Section 17 of the Act. Such a right accrues only after measures are taken under sub-section (1) of Section 13 of the Act.

49. On behalf of one of the respondents Shri Andhyarujina submitted that as a matter of fact Section 13 of the Act leaves more scope and provides wider protection to the borrower as compared to in the case of English mortgage and in connection with the above submission it has been pointed out that in case of an English mortgage there is no scope of intervention of the court

unless a case is made out before the court that action of the mortgagee is fraudulent or it is a case of the like nature. Otherwise as provided under sub-section (3) of Section 69 a mortgagor shall only be entitled to the damages for the wrongful or irregular sale of the property. Whereas, it is submitted, under the Securitisation rules it is provided that before putting the property on sale the authorized officer has to obtain the valuation of immovable property, a reserved price is to be fixed and a notice of 30 days before sale is to be served on the borrower. In this connection, Rule 9, is the relevant provision of the Security Interest (Enforcement) Rules, 2002.

Therefore, during this period which would be in all more than 60 days it would be open for a borrower to approach the Debt Recovery Tribunal and file a petition for any appropriate relief and if a case is so made out, he can even get a relief of stay, in exercise of ancillary power which vest in the Tribunal as per decisions referred and reported in 1969 (2) SCR p.65, *ITO v. Mohd. Kunhi* and 1999 (6) SCC p.755, *Allahabad Bank, Calcutta v. Radha Krishna Maity & Ors.* Again referring to Section 19 of the Act it is pointed out that in case in the end the Tribunal finds that the secured assets have been wrongfully transferred or taken possession of an order for return of such assets can be passed and the borrower in that even shall also be entitled for compensation.

50. It has also been submitted that an appeal is entertainable before the Debt Recovery Tribunal only after such measures as provided in sub-section (4) of Section 13 are taken and Section 34 bars to entertain any proceeding in respect of a matter which the Debt Recovery Tribunal or the appellate Tribunal is empowered to determine. Thus before any action or measure is taken under sub-section (4) of Section 13, it is submitted by Mr. Salve one of the counsel for respondents that there would be no bar to approach the civil court. Therefore, it cannot be said no remedy is available to the borrowers. We, however, find that this contention as advanced by Shri Salve is not correct. A full reading of section 34 shows that the jurisdiction of the civil court is barred in respect of matters which a Debt Recovery Tribunal or appellate Tribunal is empowered to determine in respect of any action taken "or to be taken in pursuance of any power conferred under this Act". That is to say the prohibition covers even matters which can be taken cognizance of by the Debt Recovery Tribunal though no measure in that direction has so far been taken under sub-section (4) of Section 13. It is further to be noted that the bar of jurisdiction is in respect of a proceeding which matter may be taken to the Tribunal. Therefore, any matter in respect of which an action may be taken even later on, the civil court shall have no jurisdiction to entertain any proceeding thereof. The bar of civil court thus applies to all such matters which may be taken cognizance of by the Debt Recovery Tribunal, apart from those matters in which measures have already been taken under sub-section (4) of Section 13.

51. However, to a very limited extent jurisdiction of the civil court can also be invoked, where for example, the action of the secured creditor is alleged to be fraudulent or their claim may be so absurd and untenable which may not require any probe, whatsoever or to say precisely to the extent the scope is permissible to bring an action in the civil court in the cases of English mortgages. We find such a scope having been recognized in the two decisions of the Madras High Court which have been relied upon heavily by the learned Attorney General as well appearing for the Union of India, namely *V. Narasimhachariar (supra)* p.135 at p.141 and 144, a judgment of the learned single Judge where it is observed as follows in para 22:

"The remedies of a mortgagor against the mortgagee who is acting in violation of the rights, duties and obligations are twofold in character. The mortgagor can come to the Court before sale with an injunction for staying the sale if there are materials to show that the power of sale is being exercised in a fraudulent or improper manner contrary to the terms of the mortgage. But the pleadings in an action for restraining a sale by mortgagee must clearly disclose a fraud or irregularity on the basis of which relief is sought:

54. In so far the argument advanced on behalf of the petitioners that by virtue of the provisions contained under sub-section (4) of Section 13 the borrowers lose their right of redemption of the mortgage. In reply it is submitted that rather such a right is preserved under sub-section (8) of Section 13 of the Act. Where a borrower tenders to the creditor the amount due with costs and expenses incurred, no further steps for sale of the property are to take place. In this connection, a reference has also been made by the learned Attorney General to a decision reported in 1977(3) SCC p.247, *Naraindas Kavsondas v. S.A.Katam* which provides that a mortgagor can exercise his right of redemption any time until the final sale of the property by execution of a conveyance. Sri Sibal, however, submits that it is the amount due according to the secured creditor which shall have to be deposited to redeem the property. Maybe so, some difference regarding the amount due may be there but it cannot be said that right of redemption of property is completely lost. In cases where no such dispute is there, the right can be exercised and in other cases the question of difference in amount may be kept open and got decided before sale of property.

55. We may then turn to the arguments raised on behalf of the petitioners that the remedy before the Debt Recovery Tribunal under Section 17 of the Act, is illusory burdened with onerous and oppressive condition of deposit of 75% of the amount of the demand notice before an appeal can be entertained by the Tribunal. We feel that it would be difficult to brush aside the challenge made to the condition of such a deposit. Sub-section (2) of Section 17 itself says that no appeal shall be entertainable unless the borrower has deposited the aforesaid sum of amount claimed. Much stress has been given in reply to the proviso to sub-section (2) of Section 17, according to which the Tribunal has power to waive or reduce the amount. While waiving the condition of deposit the amount or reducing it, the Tribunal is required to record reasons for the same. It is submitted for the respondents that in an appropriate case, the DRT which is presided over by a Member of a Higher Judicial Service, would exercise its discretion and may waive or reduce the amount required to be deposited in deserving cases. It is, therefore, not an absolute condition which must in all cases and all circumstances be fulfilled irrespective of the special features of a particular case.

56. The contention of the petitioners is that in the first place such an oppressive provision should not have been made at all. It works as a deterrent or as a disabling provision impeding access to a forum which is meant for redressal of the grievance of a borrower. It is submitted where the possession of the secured assets has already been taken over or the management of the secured assets of the borrower including the right to transfer the same, in that event it would not at all be necessary to burden the borrower doubly with deposit of 75% of the demand amount. In a situation where the possession of the secured assets have already been taken over or its management, it is highly unreasonable further to ask for 75% of the amount claimed before entertaining the grievance of the borrower.

57. Secondly, it is submitted that, it would not be possible for a borrower to raise funds to make deposit of the huge amount of 75% of the demand, once he is deprived of the possession/management of the property namely, the secured assets. Therefore, the condition of deposit is a condition of impossibility which renders the remedy made available before the DRT as nugatory and illusory. The learned Attorney General refutes the aforesaid contention. It is further submitted that such a condition of pre-deposit has been held to be valid by this Court earlier and a reference has been made to a decisions reported in 1975 (2) SCC p.175 at p.202, *Anant Mills Co. Ltd. v. State of Gujarat* to submit that such a provision is made to regulate the exercise of the right of an appeal conferred upon a person. The purpose is that right of appeal may not be abused by any recalcitrant party and there may not be any difficulty in enforcing the order appealed against if ultimately it is dismissed and there may be speedy recovery of the amount of tax due to the corporation.

64. The condition of pre-deposit in the present case is bad rendering the remedy illusory on the grounds that (i) it is imposed while approaching the adjudicating authority of the first instance, not in appeal, (ii) there is no determination of the amount due as yet (iii) the secured assets or its management with transferable interest is already taken over and under control of the secured creditor (iv) no special reason for double security in respect of an amount yet to be determined and settled (v) 75% of the amount claimed by no means would be a meagre amount (vi) it will leave the borrower in a position where it would not be possible for him to raise any funds to make deposit of 75% of the undetermined demand. Such conditions are not alone onerous and oppressive but also unreasonable and arbitrary. Therefore, in our view, sub-section (2) of Section 17 of the Act is unreasonable, arbitrary and violative of Article 14 of the Constitution.

75. In relation to the argument on behalf of the petitioners that they are entitled to be heard before a notice under sub-section (2) of Section 13 is issued failing which there is denial of principles of natural justice, a reference has been made to certain decisions to submit that in every case, it is not necessary to make a provision for providing a hearing.

77. It is also true that till the stage of making of the demand and notice under Section 13(2) of the Act, no hearing can be claimed for by the borrower. But looking to the stringent nature of measures to be taken without intervention of court with a bar to approach the court or any other forum at that stage, it becomes only reasonable that the secured creditor must bear in mind the say of the borrower before such a process of recovery is initiated. So as to demonstrate that the reply of the borrower to the notice under Section 13(2) of the Act has been considered applying mind to it. The reasons howsoever brief that may be for not accepting the objections, if raised in the reply, must be communicated to the borrower. True, presumption is in favour of validity of an enactment and a legislation may not be declared unconstitutional lightly more so, in the matters relating to fiscal and economic policies resorted to in the public interest, but while resorting to such legislation it would be necessary to see that the persons aggrieved get a fair deal at the hands of those who have been vested with the powers to enforce drastic steps to make recovery.

78. It was sought to be argued that fairness cannot be a one-way street. The plea of absence of natural justice lies ill in the mouth of chronic defaulters who have not paid the principal amounts admittedly due to the banks. The said argument pre-supposes admission of the liability by the borrowers and all of them to be chronic defaulters. It would only be pre-judging an issue. We hope it was not meant to be said that all those who defaulted according to the banks and financial institutions must be condemned unheard who might not deserve any hearing to place their side of the case, unless they must go through the crushing pre-conditions of deposit of 75% of the amount demanded over and above their secured assets already having been taken possession of. We feel this can well be one example of hitting below the belt.

79. Some submissions have been made pointing out that in certain circumstances it would not be clear as to in what manner the provisions of the Act would be workable. We feel the objections pointed out are not such which render the statute invalid or unconstitutional. Such problems about working of any particular provision of the Act in any particular factual situation, may be considered as and when it may arise. We, therefore, do not think it necessary to go into those questions.

80. Under the Act in consideration, we find that before taking action a notice of 60 days is required to be given and after the measures under Section 13(4) of the Act have been taken, a mechanism has been provided under Section 17 of the Act to approach the Debt Recovery Tribunal. The above noted provisions are for the purposes of giving some reasonable protection to the borrower. Viewing the matter in the above perspective, we find what emerges from different provisions of the Act, is as follows :-

I. Under sub-section (2) of Section 13 it is incumbent upon the secured creditor to serve 60 days' notice before proceeding to take any of the measures as provided under sub-section (4) of Section 13 of the Act. After service of notice, if the borrower raises any objection or places facts for consideration of the secured creditor, such reply to the notice must be considered with due application of mind and the reasons for not accepting the objections, howsoever brief they may be, must be communicated to the borrower. In connection with this conclusion we have already held a discussion in the earlier part of the judgment. The reasons so communicated shall only be for the purposes of the information/knowledge of the borrower without giving rise to any right to approach the Debt Recovery Tribunal under Section 17 of the Act, at that stage.

II. As already discussed earlier, on measures having been taken under sub-section (4) of Section 13 and before the date of sale/auction of the property it would be open for the borrower to file an appeal (petition) under Section 17 of the Act before the Debt Recovery Tribunal.

III. That the Tribunal in exercise of its ancillary powers shall have jurisdiction to pass any stay/interim order subject to the condition at it may deem fit and proper to impose.

IV. In view of the discussion already held on this behalf, we find that the requirement of deposit of 75% of amount claimed before entertaining an appeal (petition) under Section 17 of the Act is an oppressive, onerous and arbitrary condition against all the canons of reasonableness. Such a condition is invalid and it is liable to be struck down.

V. As discussed earlier in this judgment, we find that it will be open to maintain a civil suit in civil court, within the narrow scope and on the limited grounds on which they are permissible, in the matters relating to an English mortgage enforceable without intervention of the court.

81. In view of the discussion held in the judgment and the findings and directions contained in the preceding paragraphs, we hold that the borrowers would get a reasonably fair deal and opportunity to get the matter adjudicated upon before the Debt Recovery Tribunal. The effect of some of the provisions may be a bit harsh for some of the borrowers but on that ground the impugned provisions of the Act cannot be said to be unconstitutional in view of the fact that the object of the Act is to achieve speedier recovery of the dues declared as NPAs and better availability of capital liquidity and resources to help in growth of economy of the country and welfare of the people in general which would subserve the public interest.

82. We, therefore, subject to what is provided in paragraph 80 above, uphold the validity of the Act and its provisions except that of sub-section (2) of Section 17 of the Act, which is declared ultra vires of Article 14 of the Constitution of India.

83. Before we part with the case, we would like to observe that where a secured creditor has taken action under Section 13(4) of the Act, in such cases it would be open to borrowers to file appeals under Section 17 of the Act within the limitation as prescribed therefor, to be counted with effect from today.

* * * * *

***Pandurang Ganpati Chaugule v. Vishwasrao Patil Murgud Sahakari
Bank Limited***

Supreme Court Judgment dated: 20 May 2020

Bench: Arun Mishra, Indira Banerjee, Vineet Saran, M.R. Shah, Aniruddha Bose, J.J.

Arun Mishra, J.

1. The matters have been referred in view of conflicting decisions in *Greater Bombay Coop. Bank Ltd. v. United Yarn Tex (P) Ltd. and Ors.* [(2007) 6 SCC 236], *Delhi Cloth & General Mills Co. Ltd. v. Union of India and Ors.* [(1983) 4 SCC 166], *T. Velayudhan Achari and Anr. v. Union of India and Ors.* [(1993) 2 SCC 582], and *Union of India and Anr. v. Delhi High Court Bar Association and Ors.* [(2002) 4 SCC 275]. The question relates to the scope of the legislative field covered by Entry 45 of List I viz. 'Banking' and Entry 32 of List II of the Seventh Schedule of the Constitution of India, consequentially power of the Parliament to legislate. The moot question is the applicability of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (for short, 'the SARFAESI Act') to the cooperative banks.

18. Following questions arise for consideration:

(1) Whether 'cooperative banks', which are cooperative societies also, are governed by Entry 45 of List I or by Entry 32 of List II of the Seventh Schedule of the Constitution of India, and to what extent?

(2) Whether 'banking company' as defined in Section 5(c) of the BR Act, 1949 covers cooperative banks registered under the State Cooperative Laws and also multistate cooperative 29 (1955) 1 SCR 773 30 (1964) 5 SCR 975 societies?

(3)(a) Whether cooperative banks both at the State level and multistate level are 'banks' for applicability of the SARFAESI Act?

(3)(b) Whether provisions of Section 2(c) (iva) of the SARFAESI Act on account of inclusion of multi-State cooperative banks and notification dated 28.1.2003 notifying cooperative banks in the State are ultra vires?

IN REFERENCE QUESTION NO.1:

23. Initially, the provisions of the Banking Regulation Act, 1949, applied only to banking companies. The provisions of the BR Act, 1949, were extended to cooperative banks by Act No.23 of 1965, w.e.f. 1.3.1966.

26. Various amendments were carried out in the Reserve Bank of India Act to make it applicable to the cooperative banks. The 'central cooperative bank' was defined by substituting clause (bi) to Section 2 of the Reserve Bank of India Act, 1934. Similarly, 'cooperative bank', 'cooperative credit society' and 'cooperative society' were defined by substituting Section 2(bii), Section 2(biii) and Section 2(biv) respectively.

Section 22 of the BR Act, 1949, as amended in its application with respect to the cooperative banks, provides that no cooperative society shall carry on banking business in India unless it is a primary credit society or a cooperative bank and holds a licence issued in that behalf by the

Reserve Bank. Thus, it was necessary that only primary credit society could involve in the banking business in India and to hold a licence from the Reserve Bank of India.

Thus, it is apparent that deep and pervasive control by the Reserve Bank of India is provided on primary credit society, which is involved in banking. As per the provisions of the BR Act, 1949, no business can be done by any cooperative society without obtaining a licence from the Reserve Bank of India. The very existence of the co-operative banks is dependent and is governed by the Reserve Bank of India Act as well as the BR Act, 1949. The aforesaid legislations are under Entry 38 and Entry 45, respectively, of List I of the Constitution of India.

It was provided by Section 56(a) of the BR Act, 1949 that throughout the Act, unless the context otherwise requires, references to a banking company or the company or such company shall be construed as references to a cooperative bank. Section 56(a)(i) and(ii) is extracted hereunder:

“56. The provisions of this Act, as in force for the time being, shall apply to, or in relation to, co operative societies as they apply to, or in relation to banking companies subject to the following modifications, namely:—

(a) Throughout this Act, unless the context otherwise requires,—

(i) references to a “banking company” or, “the company” or “such company” shall be construed as references to a cooperative bank,

(ii) references to “commencement of this Act” shall be construed as references to commencement of the Banking Laws (Application to Cooperative Societies) Act, 1964”

27. Before proceeding further, it is necessary to consider the provisions contained in the SARFAESI Act. The SARFAESI Act has been enacted to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith and incidental to that. It was considered that banks do not have the power to take possession of the property and sell them. The legal system related to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms.

STATEMENT OF OBJECTS AND REASONS is referred.

Under Section 13 of the SARFAESI Act, it is open to the Bank to enforce the security interest without intervention of the court or tribunal in accordance with the provisions of the Act, and the appeal to Debts Recovery Tribunal is provided. The Appellate Tribunal has been defined to mean Debts Recovery Appellate Tribunal, and the right to appeal/application against the action has been provided in Section 17 to the Debts Recovery Tribunal. Thus, Debts Recovery Tribunal is constituted under the RDB Act, 1993.

29. What is of significance is the definitions of ‘bank’ and ‘banking’ which have been provided in the SARFAESI Act in Section 2(1)(c) and 2(1)(d) respectively thus:

“2. Definitions.—(1) In this Act, unless the context otherwise requires,—

(d) “bank” means—

(i) a banking company;

(ii) a corresponding new bank;

(iii) State Bank of India;

(iv) a subsidiary bank; or

(v) a Regional Rural Bank;

(vi) a multistate cooperative bank;”

(d) “banking company” shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);”

30. In exercise of power conferred under Section 2(1)(c)(v) of the SARFAESI Act, a notification was issued by the Ministry of Finance and Company Affairs on 28.1.2003 specifying cooperative banks as defined in clause (cci) of Section 5 of the BR Act, 1949 for the purpose of the SARFAESI Act. Following notification was issued:

“S.O.105 (E).— In exercise of the powers conferred under item (v) of clause (c) of Sub section (1) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), the Central Government hereby specifies “Cooperative Bank” as defined in clause (cci) of Section 5 of the Banking Regulation Act 1949 (10 of 1949) as ‘bank’ for the purpose of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002).”

32. We have to examine the legislative competence of the Parliament with respect to cooperative banks within the State as the MSCS Act, 2002 is enacted in exercise of power under Entry 44 List I of the Seventh Schedule of the Constitution of India. The legislative competence of Parliament regarding the MSCS Act, 2002 is not in issue.

33. The main issue is as to the meaning of ‘banking’ used in Entry 45 of List I of the Seventh Schedule of the Constitution of India. It is necessary to understand the meaning of ‘bank’ and ‘banking.’ Before the Constitution was promulgated, banking was dealt with by the erstwhile Banking Companies Act, 1949. Upon its extension to co-operative banks run by co-operative societies, it was renamed as the BR Act, 1949. Before we consider the definition of ‘banking’ under the BR Act, 1949, it is necessary to understand the meaning of ‘bank’ and ‘banking.’ The bank ordinarily means any establishment which carries the business of banking.

The expression ‘bank’ has been defined in various enactments relating to it.

34. The ‘Reserve Bank’ has been defined in Section 5(l) to mean Reserve Bank of India constituted under Section 3 of the Reserve Bank of India Act, 1934 (2 of 1934). Section 5(ha) defines the ‘National Bank’ to mean the National Bank for Agriculture and Rural Development established under Section 3 of the National Bank for Agriculture and Rural Development Act, 1981. The ‘State Bank of India’ is defined in Section 5(nc) to mean the State Bank of India constituted under Section 3 of the State Bank of India Act, 1955 (23 of 1955).

35. The term ‘banking’ used in Entry 45 List I, came up for consideration in Rustom Cavasjee Cooper, in which 11 Judge Bench of this Court considered the question of ‘banking’ and observed:

“27. The argument raised by Mr Setalvad, intervening on behalf of the State of Maharashtra and the State of Jammu and Kashmir, that the Parliament is competent to enact Act 22 of 1969, because the subject matter of the Act is “with respect to” regulation of trading corporations and matters subsidiary and incidental thereto, and on that account is covered in its entirety by Entries 43 and 44 of List I of the Seventh Schedule, cannot be upheld. Entry 43 deals with incorporation, regulation and winding up of trading corporations including banking companies. Law regulating the business of a corporation is not a law with respect to regulation of a corporation. In List I entries expressly relating to trade and commerce are Entries 41 and 42. Again several entries in List I relate to activities commercial in character. Entry 45 “Banking”; Entry 46 “Bills of exchange, cheques, promissory notes and other like instruments”;

Entry 47 “Insurance”; Entry 48 “Stock Exchanges and future markets”; Entry 49 “Patents, inventions and designs”. There are several entries relating to activities commercial as well as non-commercial in List II — Entry 21 “Fisheries”; Entry 24 “Industries X X X”; Entry 25 “Gas and Gas works”; Entry 26 “Trade and commerce”; Entry 30 “Moneylending and money-lenders”; Entry 31 “Inns and Inn keeping”; Entry 33 “Theatres and dramatic performances, cinemas etc.”. We are unable to accede to the argument that the State Legislatures are competent to legislate in respect of the subject matter of those entries only when the commercial activities are carried on by individuals and not when they are carried on by corporations.

31. The expression “banking” is not defined in any Indian statute except in the Banking Regulation Act, 1949. It may be recalled that by Section 5(b) of that Act “banking” means “the accepting for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheque, draft or otherwise”. The definition did not include other commercial activities which a banking institution may engage in.

35. In modern times in India as elsewhere, to attract business, banking establishments render, and compete in rendering, a variety of miscellaneous services for their constituents. If the test for determining what “banking” means in the constitutional entry is any commercial activity which bankers at a given time engage in, great obscurity will be introduced in the content of that expression. The coverage of constitutional entry in a Federal Constitution which carves out a field of legislation must depend upon a more satisfactory basis.

36. The legislative entry in List I of the Seventh Schedule is “Banking” and not “Banker” or “Banks”. To include within the connotation of the expression “Banking” in Entry 45, List I, power to legislate in respect of all commercial activities which a banker by the custom of bankers or authority of law engages in, would result in rewriting the Constitution. Investment of power to legislate on a designated topic covers all matters incidental to the topic. A legislative entry being expressed in a broad designation indicating the contour of plenary power must receive a meaning conducive to the widest amplitude, subject however to limitations inherent in the federal scheme which distributes legislative power between the Union and the constituent units.

36. It was argued on behalf of appellants that the BR Act, 1949 recognises two categories of finance activity which a bank may undertake such as (1) the banking business under Section 5(b), i.e., core banking business; and (2) any other business as provided in Section 6(1). For the purpose, reliance has been placed on *Rustom Cavasjee Cooper*.

40. In our opinion, the framers of the Constitution cannot be said to have confined the meaning of 'banking' to a particular definition, as given in the BR Act, 1949. The word 'banking' has been incorporated in Entry 45 of List I. The decision in *Rustom Cavasjee Cooper* vividly leaves no room for doubt that banking done by the cooperative bank is covered within the ambit of Entry 45 of List I. The decision in *Gannon Dunkerley & Co., (Madras) Ltd.* stands neutralised by introduction of Article 366(29A) of the Constitution of India and the meaning of the said term has been redefined. Entries have to be given full effect in pith and substance considering forms of business of co operative banks performing the activities of banking under a licence. The same is covered within the purview of Entry 45 of List I.

43. In our opinion, Section 6 deals with the forms of business in which banking companies may engage. There cannot be any form of activity/business of banking without there being an entity. Section 6 is not a provision of the conferral of the status of the banking company. The definitions of 'banking' and 'banking company' are contained in Section 5(b) and 5(c) of the BR Act, 1949 respectively, and when reading with Section 56(a), it means cooperative banks also. The cooperative bank falls within the definition of Section 5(c), and its activity is of banking, and

in addition to the business of banking, a cooperative bank may engage in any of the business as enumerated in Section 6.

EFFECT OF ENTRIES 43 AND 45 OF LIST I AND ENTRY 32 OF LIST II OF THE SEVENTH SCHEDULE OF THE CONSTITUTION OF INDIA

44. Entry 43 of List I of the Seventh Schedule of the Constitution of India has been pressed into service on behalf of appellants. It confers upon the Parliament the competence to pass the law pertaining to 'incorporation, regulation and winding up' of the trading corporation, more particularly, a banking corporation. However, cooperative societies are expressly excluded from the purview of the Parliament's competence. No doubt about it that in Entry 43 of List I 'incorporation, regulation and winding up' of the cooperative societies have been kept out of the purview of the Union List by specifically excluding the cooperative societies, otherwise, they would have been included for 'incorporation, regulation and winding up' in Entry 43 of List I. The terms "incorporation, regulation and winding up of co operative societies" were reserved as State subjects under Entry 32 of List II, it was so omitted from List 43 of List I. But the exclusion from Entry 43 of List I taking out 'incorporation, regulation and winding up' of cooperative societies out of the purview of the Parliament, does not advance the cause of the cooperative banks. As a corollary to the aforesaid submission, it was also urged that the banking company was defined and governed by Sections 277F to Section 277N under Chapter XA of the Companies Act (VII of 1913). It was inserted vide Amendment Act No.22 of 1936. On 10.3.1949, the Banking Companies Act, 1949, was enforced. The primary objective of the Banking Companies Act, 1949, was to provide a comprehensive definition of 'banking' to bring within its scope all the institutions which receive deposits repayable on demand or otherwise for lending or investment. At the relevant time, the Government of India Act, 1935, which dealt with the subject of 'banking' as well as 'trading corporation,' was in List I (Federal Legislative List), thus:

"Entry 38 in relation to "banking": "Banking," that is to say, the conduct of banking business by corporations other than corporations owned and controlled by a federated state and carrying on business only within that State.

Entry 38 of the Government of India Act was re-enacted as 'banking' in Entry 45 of List I, while Entry 33 was bifurcated in Entries 43 and 44. Learned Counsel further argued that up to 1965, the primary entity which was regulated by the Parliament was a company that found a place in Entry 43. Thus, both in its function, i.e., banking and as an entity, fell in List I (banking under Entry 45 and company under Entry 43). Therefore, it was within the control of the Parliament.

47. We are of the opinion that recovery of dues would be an essential function of any banking institution and the Parliament can enact a law under Entry 45 of List I as the activity of banking done by cooperative banks is within the purview of Entry 45 of List I. Obviously, it is open to the Parliament to provide the remedy for recovery under Section 13 of the SARFAESI Act. Co-operative bank's entire operation and activity of banking are governed by a law enacted under Entry 45 of List I, i.e., the BR Act, 1949, and the RBI Act under Entry 38 of List I.

48. *In UCO Bank and Anr. v. B. Dipak Debbarma and Ors.* [(2017) 2 SCC 585], the question arose under the SARFAESI Act vis-a-vis the provisions of Section 187 of Tripura Land Revenue and Land Reforms Act, 1960 as under the Tripura Act there was a legislative embargo on the sale of mortgaged properties by the bank to any person who is not a member of a Scheduled Tribe. The auction purchasers in the case were not members of the Scheduled Tribe. This Court observed that provisions of the SARFAESI Act enable the bank to take possession of any property where a security interest has been created in its favour and sell such property to any person to realise dues. This Court observed that the Parliament enacted the law traceable to Entry

45 dealing exclusively with activities relating to the sale of secured assets, which being Central legislation would prevail.

“Sale of mortgaged property by a bank is an inseparable and integral part of the business of banking. The object of the State Act, as already noted, is an attempt to consolidate the land revenue law in the State and also to provide measures of agrarian reforms. The field of encroachment made by the State Legislature is in the area of banking. So long there did not exist any parallel Central Act dealing with sale of secured assets and referable to 31 (2017) 2 SCC 585 Entry 45 of List I, the State Act, including Section 187, operated validly. However, the moment Parliament stepped in by enacting such a law traceable to Entry 45 and dealing exclusively with activities relating to sale of secured assets, the State law, to the extent that it is inconsistent with the 2002 Act, must give way. The dominant legislation being the Parliamentary legislation, the provisions of the Tripura Act, 1960, pro tanto, (Section 187) would be invalid. It is the provisions of the 2002 Act, which do not contain any embargo on the category of persons to whom mortgaged property can be sold by the bank for realisation of its dues that will prevail over the provisions contained in Section 187 of the Tripura Act, 1960.”

49. In *State Bank of India v. Santosh Gupta and Anr.* [(2017) 2 SCC 538], the question arose concerning the rights of banks to enforce security interests outside the court's process by acting under Section 13 of the SARFAESI Act and its applicability to the State of Jammu and Kashmir. The recovery of debts and adjudicatory mechanisms provided in the SARFAESI Act; therefore, it comes within the purview of subject 'banking' in Entry 45 of List I of the Seventh Schedule. The Presidential order under Article 370 empowered the Parliament to legislate on the Seventh Schedule List I Entry 45 read with Entry 95 in respect of the State of Jammu and Kashmir. The SARFAESI Act can be validly applied to the State of Jammu and Kashmir even if Section 140 of the Transfer of Property Act of J&K, 1920, conflicts with the SARFAESI Act. Thus, the transfer of property by way of sale or assignment is only one of the several ways for recovery of debts and, (2017) 2 SCC 538 thus, the SARFAESI Act as a whole cannot be said to be in pith and substance an Act relating to the subject of transfer of property. The sale and mortgage of property for recovering loans/debts is also an integral part of 'banking'. The setting up of an adjudicatory body like the banking tribunal would also fall under Entry 45 of List I of the Seventh Schedule. Thus, State law can operate if there is no Central law regarding the same. The State law cannot encroach upon the Central law by operation of the principle of repugnancy if there is a Central law. The Parliament is qualified with exclusive power to make law concerning banking. It is not possible to dissect the provisions of the SARFAESI Act and attach them to different entries under different lists. In pith and substance, the SARFAESI Act does not deal with the transfer of property in Entry 6 of List III of the Seventh Schedule but deals with the recovery of debt owing to banks and financial institutions. It was observed

*“30. When it came to SARFAESI itself, this Court has held in *Central Bank of India v. State of Kerala*, (2009) 4 SCC 94: (SCC p. 116, para 36) “36. Undisputedly, the DRT Act and the Securitisation Act have been enacted by Parliament under Schedule VII List I Entry 45 whereas the Bombay and Kerala Acts have been enacted by the State Legislatures concerned under Schedule VII List II Entry 54. To put it differently, two sets of legislations have been enacted with reference to entries in different lists in the Seventh Schedule. Therefore, Article 254 cannot be invoked per se for striking down State legislations on the ground that the same are in conflict with the Central legislations. That apart, as will be seen hereafter, there is no ostensible overlapping between two sets of legislations.*

*Therefore, even if the observations contained in *Kesoram Industries case*, (2004) 10 SSC 201, are treated as law declared under Article 141 of the Constitution, the State legislations cannot be struck down on the ground that the same are in conflict with Central legislations.”*

37. *Applying the doctrine of pith and substance to SARFAESI, it is clear that in pith and substance the entire Act is referable to Entry 45 List I read with Entry 95 List I in that it deals with recovery of debts due to banks and financial institutions, inter alia through facilitating securitisation and reconstruction of financial assets of banks and financial institutions, and sets up a machinery in order to enforce the provisions of the Act. In pith and substance, SARFAESI does not deal with “transfer of property”. In fact, insofar as banks and financial institutions are concerned, it deals with recovery of debts owing to such banks and financial institutions and certain measures which can be taken outside of the court process to enforce such recovery. Under Section 13(4) of SARFAESI, apart from recourse to taking possession of secured assets of the borrower and assigning or selling them in order to realise their debts, the banks can also take over the management of the business of the borrower, and/or appoint any person as manager to manage secured assets, the possession of which has been taken over by the secured creditor. Banks as secured creditors may also require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom money is due or payable to the borrower, to pay the secured creditor so much of the money as is sufficient to pay the secured debt. It is thus clear that the transfer of property, by way of sale or assignment, is only one of several measures of recovery of a secured debt owing to a bank and this being the case, it is clear that SARFAESI, as a whole, cannot possibly be said to be in pith and substance, an Act relatable to the subject matter “transfer of property”.*

50. In *Delhi Cloth & General Mills Co. Ltd.*, the question came up for consideration concerning legislation whether it falls within one entry or the other. However, some portion of the subject matter of the legislation incidentally trenched upon and might enter a field under another list; then, it must be held to be valid in its entirety.

53. In *Central Bank of India v. State of Kerala and Ors.*, the question came up for consideration concerning Entry 45 of List I and Entry 54 of List II.

93. *The enactment of the Securitisation Act can be treated as one of the most radical legislative measures taken by the Government for ensuring that dues of secured creditors including banks, financial institutions are recovered from the defaulting borrowers without any obstruction. For the first time, the secured creditors have been empowered to take measures for recovery of their dues without the intervention of the courts or tribunals.*

110. *The Securitisation Act drastically changed the scenario inasmuch as it enabled banks, financial institutions and other secured creditors to recover their dues without intervention of the courts or tribunals. The Securitisation Act also made provision for registration and regulation of securitisation/reconstruction companies, securitisation of financial assets of banks and financial institutions and other related provisions.*

116. *The non obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the Securitisation Act give overriding effect to the provisions of those Acts only if there is anything inconsistent contained in any other law or instrument having effect by virtue of any other law. In other words, if there is no provision in the other enactments which are inconsistent with the DRT Act or the Securitisation Act, the provisions contained in those Acts cannot override other legislations. Section 38C of the Bombay Act and Section 26B of the Kerala Act also contain non obstante clauses and give statutory recognition to the priority of the State’s charge over other debts, which was recognised by Indian High Courts even before 1950. In other words, these sections and similar provisions contained in other State legislations not only create first charge on the property of the dealer or any other person liable to pay sales tax, etc. but also give them overriding effect over other laws.”*

This Court found no conflict in the provisions of the Central Act and that of the State.

It is apparent that ‘incorporation, regulation and winding up’ of the cooperative societies are covered under Entry 32 of List II of the Seventh Schedule of the Constitution of India, whereas ‘banking’ is covered by Entry 45 of List I. Thus, aspect of ‘incorporation, regulation and winding up’ would be covered under Entry 32 of List II. However, banking activity of such cooperative societies/banks shall be governed by Entry 45 of List I. The said banks are governed and regulated by legislation related to Entry 45 of List I, the BR Act, 1949 as well as the Reserve Bank of India Act under Entry 38 of List I. In the matter of licencing and doing business, a deep and pervasive control is carved out under the provisions of the BR Act, 1949 and banking activity done by any entity, primary credit societies, is a bank and is required to submit the accounts to the Reserve Bank of India, and there is complete control under the aforesaid Act. For activity of banking, these banks are governed by the legislation under Entry 45 of List I. Thus, recovery being an essential part of the banking, no conflict has been created by providing additional procedures under Section 13 of the SARFAESI Act. It is open to the bank to adopt a procedure which it may so choose. When banking in pith and substance is covered under Entry 45 of List I, even incidental trenching upon the field reserved for State under Entry 32 List II is permissible.⁵⁸ There can be various aspects of an activity. The cooperative societies may be formed under the provisions of the State Cooperative Acts. The State law provides for ‘incorporation, regulation and winding up’ under Entry 32 of List II, a membership registration, and other matters can be governed by Entry 32 of List II, and, at the same time, the aspects relating to the banking, licensing, accounts, etc. can be covered under Entry 45 List I.

58. There can be various aspects of an activity. The cooperative societies may be formed under the provisions of the State Cooperative Acts. The State law provides for ‘incorporation, regulation and winding up’ under Entry 32 of List II, a membership registration, and other matters can be governed by Entry 32 of List II, and, at the same time, the aspects relating to the banking, licensing, accounts, etc. can be covered under Entry 45 List I.

59. As held in *Goodricke Group Ltd.*, 1995 Supp (1) SCC 707 which we have held as correctly decided, this Court held that

In our opinion, there is no question of conflict solely on account of two aspects of the same transaction being utilised by two legislatures for two levies both of which may be taxes or fees or one of which may be a tax and the other a fee falling within two fields of legislation respectively available to the two.” The legislation and entries are to be considered in pith and substance is the settled principles of law, and incidental trenching is permissible. Thus, we are of the opinion that section 2(c)(iv)(a) of the SARFAESI Act and the notification dated 28.2.2003 cannot be said to be ultra vires. They are within the ken of Entry 45 List I of the Seventh Schedule to the Constitution of India.

EFFECT OF CONSTITUTIONAL PROVISIONS

60. Our aforesaid conclusion finds support by the Constitutional provisions inserted by way of the Constitution (Ninety Seventh Amendment) Act, 2011. Article 43B has been added concerning the management of cooperative societies. Article 43B is extracted hereunder:

“43B. Promotion of cooperative societies.— The State shall endeavour to promote voluntary formation, autonomous functioning, democratic control and professional management of cooperative societies.”

61. Article 243ZI provides that the legislature of a State may, by law, make provisions with respect to ‘incorporation, regulation and winding up’ of cooperative societies.

62. The Ninety Seventh Amendment also incorporated Article 243ZL dealing with supersession and suspension of the board and interim management.

65. In Greater Bombay Coop. Bank Ltd., as to the scope of Entries 43, 44 and 45 of List I and Entry 32 of List II of the Seventh Schedule of the Constitution of India, it was observed

89. In R.C. Cooper v. Union of India, (1970) 1 SCC 248, this Court observed that power to legislate for setting up corporations to carry on banking and other business and to acquire, hold and dispose of property and to provide for administration of the corporations is conferred upon Parliament by Entries 43, 44 and 45 of the Constitution. Therefore, the express exclusion of cooperative societies in Entry 43 of List I and the express inclusion of cooperative societies in Entry 32 of List II separately and apart from but along with corporations other than those specified in List I and universities, clearly indicated that the constitutional scheme was designed to treat cooperative societies as institutions distinct from corporations. Cooperative societies, incorporation, regulation and winding up are State subjects in the ambit of Entry 32 of List II of the Seventh Schedule to the Constitution of India. Cooperatives form a specie of genus "corporation" and as such cooperative societies with objects not confined to one State are read in with the Union List as provided in Entry 44 of List I of the Seventh Schedule of the Constitution; the MSCS Act, 2002 governs such multistate cooperatives. Hence, the cooperative banks performing functions for the public with a limited commercial function as opposed to corporate banks cannot be covered by Entry 45 of List I dealing with "banking". The subject of cooperative societies is not included in the Union List rather it is covered under Entry 32 of List II of the Seventh Schedule appended to the Constitution."

69. The concept of regulating nonbanking affairs of society and regulating the banking business of society are two different aspects and are covered under different Entries, i.e., Entry 32 of List II and Entry 45 of List I, respectively. The law dealing with regulation of banking is traceable to Entry 45 of List I and only the Parliament is competent to legislate. The Parliament has enacted the SARFAESI Act. It does not intend to regulate the incorporation, regulation, or winding up of a corporation, company, or cooperative bank/co operative society. It provides for recovery of dues to banks, including cooperative banks, which is an essential part of banking activity. The Act in no way trenches on the field reserved under Entry 32 of List II and is a piece of legislation traceable to Entry 45 of List I.

IN REFERENCE QUESTION NO.2:

70. The next question is of the effect of Section 56(a) on the definition of 'banking company' as defined in Section 5(1)(b) of the BR Act, 1949. It is necessary to consider the definition of 'banking' as contained in the SARFAESI Act. The term 'bank' has been defined in Section 2(1)(c) to mean 'banking company', a corresponding new bank, a subsidiary bank or a multistate cooperative bank or such other bank which the Central Government may by notification specify for the Act. The term 'banking company' under Section 2(d) shall have the meaning assigned to it in Section 5(c) of the BR Act, 1949. Thus, the definition of 'banking company' stands incorporated in Section 2(1)(d) of the SARFAESI Act, which came into force on 21.6.2002. Section 56(a) was incorporated in the BR Act, 1949 by Act No.23 of 1965, w.e.f. 1.3.1966. On that date, Section 56(a) became part of the statute. Section 5(c) of the BR Act, 1949 defines 'banking company' means any company which transacts the business of banking. By virtue of Section 56(a), a reference to a 'banking company' or 'the company' or 'such company' shall be construed as references to a co operative bank for the application of the Act to the co-operative banks. Section 5(c) was not amended, and other provisions were also not amended where they were placed. However, amendments were incorporated by a different Chapter V by way of various provisions incorporated in Section 56 as it was necessary to retain certain provisions in the existing form as they applied to other banks and companies considering that the amendments and certain modifications which were necessary and were extensively required. The

provisions in amended form in their application to the co-operative banks were separately provided. When the BR Act, 1949 was applied to the co-operative bank, all the provisions under the Act concerning 'incorporation, regulation and winding up' were omitted insofar as the Act of 1949 is applied to cooperative banks, though they continue to exist in the Act for other entities but not concerning cooperative banks. It was mentioned in the advice given to the President under Article 117 that these matters were specifically not covered under Entry 45 of List I of the Seventh Schedule and formed the subject matter of Entry 32 of List II. Thus, when we apply the provisions of the Act of 1949 to a cooperative bank, the definition of 'banking company' has to be read to include a cooperative bank. Section 56(a) becomes part of Section 5(c), although it is located in a separate place. As only Part V of the Act applies to the cooperative banks, Section 56(a) amends the definition of the 'banking company,' and it becomes an integral part of Section 5(c), as the full effect is required to be given.

78. It is apparent that in order to avoid verbatim reproduction of the earlier provisions, which did not apply to a cooperative bank, a device was carved out in Section 56(a) to read 'company' as 'banking company' or 'the company' or 'such company' as references to a co operative bank. If the definition in Section 5(c) and interpretation clause are not read as incorporated and having been amended, the interpretation clause and the entire amendment of Part V will become unworkable. It was not practical to amend the entire Act of 1949 as it dealt with 'incorporation, regulation and winding up' of other entities relatable to List I, as such the provisions were required to be retained, and such matters concerning cooperative societies/banks, relatable subject matter under Entry 32 of List I of the Seventh Schedule of the Constitution of India, were to be excluded. As various provisions were to be omitted in their application to the cooperative societies and other provisions were to apply in a modified form, the amendments were made in the provisions in their application to the cooperative banks by providing a separate Chapter. Thus, it was not considered necessary nor would have been appropriate to amend the definition of Section 5(c) where it existed, in fact it was so amended in Section 56(a). Entire Chapter V was enacted concerning the application of the Act to the cooperative banks and has to be given full effect. Merely because the procedure for recovery of dues is provided in the Co operative Societies Act, could not have come in the way of interpretation of that expression 'cooperative bank' which was included in the definition and interpretation clause of Section 5 of the BR Act, 1949. It was open to the Parliament to deal with the subject of 'banking' in Entry 45 of List I and this Court in Greater Bombay Coop. Bank Ltd. (supra) itself opined that the BR Act, 1949 applies to co-operative banks which is the enactment related to Entry 45 of List I and third proviso to Article 243ZL(1) of the Constitution of India also provides that the BR Act shall also apply. Thus, the Parliament considered it appropriate to provide additional remedy for speedy recovery which is an alternative even if there is an incidental encroachment on the field reserved for the State under Entry 32 of List II, as in pith and substance, the 'banking' is part of Entry 45 of List I and recovery procedure is covered within the ken of Entry 45 of List I. Thus, considering the Doctrine of Pith and Substance and incorporation by amendment made, we are of the considered opinion that cooperative banks are included in the definition of 'bank' and 'banking company' under Section 2(1)(c) and 2(1)(d) of the SARFAESI Act.

79. In Greater Bombay Coop. Bank Ltd. concerning the BR Act, 1949, it was held

On a plain reading of every clause of Section 56 of the BR Act, it becomes clear that what is contained therein is only for the purpose of application of provisions that regulate banking companies to cooperative societies. According to the expression "cooperative societies" used in Section 56 means a "cooperative society", the primary object or principal business of which is the transaction of banking business. In other words, first it is a cooperative society, but carrying on banking business having the specified paid-up share capital. Other definitions also make it clear that the entities are basically cooperative societies."

(a) Concerning the SARFAESI Act, following observations were made:

“41. Parliament had enacted the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“the Securitisation Act”) which shall be deemed to have come into force on 2162002. In Section 2(d) of the Securitisation Act same meaning is given to the words “banking company” as is assigned to it in clause (e) of Section 5 of the BR Act. Again the definition of “banking company” was lifted from the BR Act but while defining “bank”, Parliament gave five meanings to it under Section 2(c) and one of which is “banking company”. The Central Government is authorised by Section 2(c)(v) of the Act to specify any other bank for the purpose of the Act. In exercise of this power, the Central Government by notification dated 281 2003, has specified “cooperative bank” as defined in Section 5(cci) of the BR Act as a “bank” by lifting the definition of “cooperative bank” and “primary cooperative bank” respectively from Section 56, clauses 5(cci) and (ccv) of Part V. Parliament has thus consistently made the meaning of “banking company” clear beyond doubt to mean “a company engaged in banking, and not a cooperative society engaged in banking” and in Act 23 of 1965, while amending the BR Act, it did not change the definition in Section 5(c) or even in Section 5(d) to include cooperative banks; on the other hand, it added a separate definition of “cooperative bank” in Section 5(cci) and “primary cooperative bank” in Section 5(ccv) of Section 56 of Part V of the BR Act. Parliament while enacting the Securitisation Act created a residuary power in Section 2(c)(v) to specify any other bank as a bank for the purpose of that Act and in fact did specify “cooperative banks” by notification dated 2812003.

82. The reason is given in Greater Bombay Coop. Bank Ltd. (supra) that comprehensive machinery is provided in the State Act, could not have come in the way of Parliament enacting a law as to recovery within the purview of 'banking' in Entry 45 of List I as the same is its essential part. Even incidental trenching upon other fields cannot invalidate legislation. Equally futile is the argument that the Parliament did not amend Section 5(c) of the BR Act, 1949; in fact, the Parliament did so under Section 56(a) concerning its application to co-operative banks. A large number of provisions added in Chapter V by way of amending Section 56 cannot be ignored and set at naught. The extensive amendments made in Part V of the BR Act, 1949, have to be given full effect. In case cooperative banks are kept outside the purview of the BR Act, 1949, and other legislation under Entry 45 and RBI Act, no licence can be granted, and they cannot do banking as that is not permissible without compliance of various provisions as provided in the BR Act, 1949. They would have to close down and stop the business forthwith.

83. The cooperative banks, which are governed by the BR Act, 1949, are involved in banking activities within the meaning of Section 5(b) thereof. They accept money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise. Merely by the fact that lending of money is limited to members, they cannot be said to be out of the purview of banking. They perform commercial functions. A society shall receive deposits and loans from members and other persons. They give loans also, and it is their primary function. Thus, they are covered under 'banking' in Entry 45 of List I.

IN REFERENCE QUESTION NOS. 3(a) AND 3(b)

85. Even assuming for the time being that definition of 'bank' in Section 5(c) of the BR Act, 1949 did not cover the cooperative banks; the expression 'bank' has been defined in the SARFAESI Act under Section 2(1)(c), and the provisions contained in Section 2(1)(c)(v) authorises the Central Government to specify 'such other bank' for that Act. Thus, the notification issued on 28.1.2003 notifying 'co operative bank' as the 'bank' is covered by Entry 45 of List I as they are regulated by the BR Act, 1949, and the RBI Act. For the 'banking' activity under Entry 45 of List I, the Parliament had the power to enact such a provision defining 'bank' to authorise and prescribe the recovery procedure for such a bank as provided in Section 13 of the SARFAESI Act; However, we are of the view that cooperative societies/banks stand included by

incorporation in Section 5(1)(c) of the BR Act and the notification was issued *ex abundanti cautela*. By virtue of Section 56(a), cooperative banks, as defined in Section 56(cci) of the BR Act, 1949, are included in Section 5(1)(c). Similarly, multistate cooperative banks were also covered.

86. The earlier procedure for recovery of dues was differently provided for general banks and the cooperative banks through the Civil Court or Tribunal. In the SARFAESI Act, a procedure has been prescribed under Section 13 without the intervention of the court/tribunal to keep pace with the time. Thus, the malady of inordinate delay with which the order of civil court suffered as well as of the cooperative tribunals or summary procedure under the Co operative Societies Act, was sought to be redressed. Apart from that, it is permissible for the Parliament to enact the law to provide recovery procedures for bank dues that have been done by providing speedy recovery of secured interest without intervention of the court/tribunal.

98. In this regard, the judgment of this Court in *M.V. Narasimhan*, (1975) 2 SCC 377, can be usefully noticed where the Court after analysing various judgments, summed up the exceptions to this rule as follows: (SCC p. 385, para 15)

*“(a) where the subsequent Act and the previous Act are supplemental to each other;
(b) where the two Acts are in pari materia;
(c) where the amendment in the previous Act, if not imported into the subsequent Act also, would render the subsequent Act wholly unworkable and ineffectual; and
(d) where the amendment of the previous Act, either expressly or by necessary intendment, applies the said provisions to the subsequent Act.”*

148. Having perused and analysed the various judgments cited at the Bar we are of the considered view that this rule is bound to have exceptions and it cannot be stated as an absolute proposition of law that wherever legislation by reference exists, subsequent amendments to the earlier law shall stand implanted into the later law without analysing the impact of such incorporation on the object and effectuality of the later law. The later law being the principal law, its object, legislative intent and effective implementation shall always be of paramount consideration while determining the compatibility of the amended prior law with the later law as on relevant date.

173. The doctrine of pith and substance can be applied to examine the validity or otherwise of a legislation for want of legislative competence as well as where two legislations are embodied together for achieving the purpose of the principal Act. Keeping in view that we are construing a federal Constitution, distribution of legislative powers between the Centre and the State is of great significance. Serious attempt was made to convince the Court that the doctrine of pith and substance has a very restricted application and it applies only to the cases where the court is called upon to examine the enactment to be ultra vires on account of legislative incompetence.

*174. We are unable to persuade ourselves to accept this proposition. The doctrine of pith and substance finds its origin from the principle that it is necessary to examine the true nature and character of the legislation to know whether it falls in a forbidden sphere. This doctrine was first applied in India in *Prafulla Kumar Mukherjee v. Bank of Commerce Ltd.*, (194647) 74 IA 23 : AIR 1947 PC 60. The principle has been applied to the cases of alleged repugnancy and we see no reason why its application cannot be extended even to the cases of present kind which ultimately relates to statutory interpretation founded on source of legislation.”*

99. We find that 'banking' relating to cooperatives can be included within the purview of Entry 45 of List I, and it cannot be said to be over inclusion to cover provisions of recovery by cooperative banks in the SARFAESI Act. It cannot be said to be overinclusion on the anvil of the principles laid down by this Court.

102. Resultantly, we answer the reference as under:

(1)(a) The cooperative banks registered under the State legislation and multistate level co-operative societies registered under the MSCS Act, 2002 with respect to 'banking' are governed by the legislation relatable to Entry 45 of List I of the Seventh Schedule of the Constitution of India.

(b) The cooperative banks run by the cooperative societies registered under the State legislation with respect to the aspects of 'incorporation, regulation and winding up', in particular, with respect to the matters which are outside the purview of Entry 45 of List I of the Seventh Schedule of the Constitution of India, are governed by the said legislation relatable to Entry 32 of List II of the Seventh Schedule of the Constitution of India.

(2) The cooperative banks involved in the activities related to banking are covered within the meaning of 'Banking Company' defined under Section 5(c) read with Section 56(a) of the Banking Regulation Act, 1949, which is a legislation relatable to Entry 45 of List I. It governs the aspect of 'banking' of cooperative banks run by the cooperative societies. The cooperative banks cannot carry on any activity without compliance of the provisions of the Banking Regulation Act, 1949 and any other legislation applicable to such banks relatable to 'Banking' in Entry 45 of List I and the RBI Act relatable to Entry 38 of List I of the Seventh Schedule of the Constitution of India.

(3)(a) The cooperative banks under the State legislation and multistate cooperative banks are 'banks' under section 2(1)(c) of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The recovery is an essential part of banking; as such, the recovery procedure prescribed under section 13 of the SARFAESI Act, a legislation relatable to Entry 45 List I of the Seventh Schedule to the Constitution of India, is applicable.

(3)(b) The Parliament has legislative competence under Entry 45 of List I of the Seventh Schedule of the Constitution of India to provide additional procedures for recovery under section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 with respect to co-operative banks. The provisions of Section 2(1)(c)(iva), of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, adding "ex abundanti cautela", 'a multistate co-operative bank' is not ultra vires as well as the notification dated 28.1.2003 issued with respect to the co-operative banks registered under the State legislation. The civil appeals, writ petitions and the pending applications, if any, are disposed of accordingly. No costs.

* * * * *

The Takeover Code - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011)

SEBI v. Akshya Infrastructure Pvt. Ltd.

(2014) 11 SCC 112

Author: S S Nijjar

Bench: Surinder Singh Nijjar, A.K. Sikri

SURINDER SINGH NIJJAR, J.

1. This appeal under Section 15Z of the Securities and Exchange Board of India Act, 1992 (the ‘SEBI Act’) is directed against the judgment and final order of the Securities Appellate Tribunal, Mumbai (SAT) dated 19th June, 2013 rendered in Appeal No.3 of 2013, by which the appeal filed by M/s. Akshya Infrastructure Private Limited – the respondent herein against the directions issued by SEBI on 30th November, 2012 has been allowed.

2. The fundamental issue which arises in this appeal is whether an open offer voluntarily made through a Public Announcement for purchase of shares of the target company can be permitted to be withdrawn at a time when the voluntary open offer has become uneconomical to be performed.

3. In this case, the respondent herein, M/s Akshya Infrastructure Pvt. Ltd., is a part of the Promoter Group of MARG Limited (‘the Target Company’). For the years 2006-07, 2007-08 and 2010-11, the gross acquisition by the Promoter Group of shares in the Target Company was as under :

“Financial Year	Percentage	Date triggered on
2006-07	14.34%	30.03.2007
2007-08	5.64%	12.10.2007
2010-11	7.11%	19.02.2011”

As a consequence of the foregoing acquisitions, the acquirers breached the 5% creeping acquisition limit and were required to comply with the provisions of Regulation 11 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as the “Takeover Regulations”).

4. On 20th October, 2011, the respondent made a voluntary open offer through a Public Announcement in major National Newspapers, under Regulation 11 of the Takeover Regulations wherein the public shareholders of the Target Company were given an opportunity to exit at an offer price of ₹ 91/- per equity share. This price represents a premium of 10.3% over the average market closing price for the two weeks preceding the Public Announcement. The tendering period was scheduled to commence on 1st December, 2011 and conclude on 20th December, 2011. The consideration for the tendered shares was to be paid on or before 4th January, 2012. As on the date of the open offer, the list of Promoters/Promoter Group Entities was as under:-

Sl. No.	Name
1.	Mr. G.R.K. Reddy
2.	Mr. G. Raghava Reddy
3.	Ms. V.P. Rajini Reddy
4.	Mr. G. Madhusudan Reddy
5.	GRK Reddy & Cons (HUF)
6.	M/s. Global Infoserve Ltd.
7.	M/s. Marg Capital Markets Limited
8.	M/s. Exemplarr Worldwide Limited

9. M/s. Marg Projects and Infrastructure Limited (formerly Marg Holdings and Financial Services Limited)

10. M/s. Akshya Infrastructure Private Limited

5. However, due to certain events, which have been highlighted by both the parties, the respondent by letter dated 29th March, 2012 through M/s. Motilal Oswal Investment Advisors (P) Ltd., the Managers to the Issue (hereinafter referred to as the “Merchant Banker”), addressed to SEBI, sought to contend that the open offer in question had become outdated, thereby outliving its necessity and, therefore, the same ought to be permitted to be withdrawn. It was also contended that the amount of ₹ 17.46 crores deposited by the respondent in an escrow account towards the open offer ought to be allowed to be withdrawn. The letter emphasizes that the public announcement was in nature of a voluntary open offer under Regulation 11 of the Takeover Regulations for consolidation of shareholding of the Promoter Group in the Target Company. The offer price of ₹ 91/- per equity share of the Target Company was aimed at presenting a commercially reasonable opportunity to the public shareholders to exit and at the same time it was meant to consolidate the shareholding of the promoter in the Target Company. It was further stated that due to the unjustified delay by SEBI in taking a decision as to whether to approve the draft letter of offer has rendered the entire open offer exercise academic and meaningless. It was claimed that the transaction envisaged by the respondent is no longer justifiable on any ground, including the grounds of economic rationale and commercial reasonableness. The respondent sought the withdrawal of open offer made under the public announcement in terms of Regulation 27 of the Takeover Regulations. The exact prayer made by the respondent was as follows:-

“Consequently, we hereby seek withdrawal of the open offer made under the public announcement in terms of Regulation 27 of the Takeover Regulations (the benefit of which continue to accrue to us in terms of Regulation 35(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 “New Takeover Regulations”). Regulation 23(1)(d) of the New Takeover Regulations equally empowers withdrawal of an open offer.”

6. The appellant by letter dated 30th November, 2012 conveyed its comments in terms of the proviso to Regulation 16(4) of the Takeover Regulations on the draft letter of offer. Certain information was sought in the aforesaid letter. No reference was made in this letter with regard to the request made by the respondent for permission to withdraw the open offer. Rather it was stated as under :

“Please note that failure to carry out the suggested changes in the letter of offer as well as violation of provisions of the Regulations will attract appropriate action. Please also ensure and confirm that apart from above, no other changes are carried out in the letter of offer submitted to us.” The aforesaid comments of SEBI were challenged by the respondent before SAT in Appeal No.3 of 2013.

7. The respondent claimed that the impugned directions, ostensibly in the form of comments and observations on the draft letter of offer, reject the plea of the petitioner that the delay caused by SEBI in clearance of the draft letter of offer, now renders the open offer unviable and academic. Further, the impugned directions purport to bind the appellant and thereby constitute an order by which the respondent was aggrieved; and necessitated the appeal before the SAT.

8. In the appeal before SAT, the respondent claimed that the directions contained in the impugned letter of SEBI dated 30th November, 2012, incorrectly allege that prima facie requirement to make an open offer was triggered by the promoters and the promoter group entities of the Target Company (Promoter Group) under Regulation 11(1) of the Takeover Regulations on three past occasions, viz. March 30, 2007, October 12, 2007 and February 19, 2011 (Alleged Triggers). It was further claimed that the directions to revise the offer price, on account of the requirement to make open offers pursuant to the alleged triggers was illegal and without jurisdiction. It was also claimed that the directions contained in the impugned letter has caused severe civil consequences to the respondent. It was also claimed that the submissions on the issues presented by the respondent before the appellant have neither been considered nor appreciated.

9. The appeal was contested by the appellant by filing a detailed affidavit on 12th April, 2013. As noticed above, the aforesaid appeal has been allowed by SAT in terms of prayer clause (a),

(b) and (c) of Para 7 of the appeal filed by the respondent, which are as under:-

“(a) That this Hon’ble Tribunal be pleased to set aside the Impugned Direction;

(b) That this Hon’ble Tribunal be pleased to order and direct the respondent to allow the appellant to withdraw the open offer without any adverse orders or directions against the appellants or the Promoter Group;

(c) That this Hon’ble Tribunal be pleased to order and direct the respondent to allow the appellant to withdraw the amount of ₹ 17.46 crores deposited in escrow in lieu of the Open Offer.”

10. It was, however, made clear that SAT has not made any observation on the merits of the issue regarding the three alleged triggers and the contentions of the parties in this regard were kept open. Aggrieved by the aforesaid impugned judgment, SEBI has filed the present Civil Appeal.

11. We have heard the learned counsel for the parties at length.

12. Mr. C.U. Singh, learned senior counsel appearing for the appellant, has submitted that the issues raised by the appellant herein are squarely covered against the respondent by an earlier judgment of this Court in Nirma Industries Ltd. & Anr. Vs. Securities and Exchange Board of India.

13. At this stage, Mr. R.F. Nariman, learned senior counsel appearing for the respondent, has raised certain preliminary objections with regard to the maintainability of the appeal. He submits that the directions issued by the SEBI are based on a misconception of the law applicable to the peculiar facts of this case. He submits that firstly: this is a case where the respondent had made voluntary open offer. It was not a case of an open offer made because of a triggered mechanism under the Takeover Regulations; secondly: since the open offer was a pure and simple voluntary offer, no prejudice has been caused to any shareholder; thirdly: the present case does not fall within the ambit of Regulation 27 of Takeover Regulations. According to Mr. Nariman, Regulation 27 ought to be read in a manner that it would only govern mandatory open offers and not voluntary open offers; fourthly: SEBI has without any justification intermingled acquisition of shares by the respondent on the three earlier occasions in 2006-07, 2008-09 and 2009-10;

fifthly: SEBI unjustifiably and arbitrarily took 13 months to offer comment(s) on the draft letter of offer. Even then the clarification sought by the appellant pertained to the past alleged triggers which had no connection with the voluntary open offer. It is submitted that even if the case of the respondent falls within the ambit of Regulation 27, the withdrawal is permissible in such circumstances which in the opinion of SEBI (the Board) merit withdrawal; sixthly: the judgment in Nirma Industries (supra) is distinguishable; lastly: the judgment in Nirma Industries (supra) is incorrect and needs reconsideration.

14. Mr. C.U. Singh, learned senior counsel appearing for the appellant, has submitted that the correspondence exchanged between the parties would show that the delay in consideration of the letter of offer was caused by the respondent by not giving the necessary information. He relies on the voluminous correspondence between the parties in support of his submission which, if necessary, shall be considered later. His second submission is that the request for withdrawal of open offer is to be considered strictly under the provision of Regulation 27 of the Takeover Regulations.

15. The respondent had made a Public Announcement on 20th October, 2011 which clearly informed the public shareholders of the Target Company that they were being given an opportunity to exit at an offer price of ₹ 91/- per equity share, which represented a premium of 10.3% over the average market closing price for the two weeks preceding the Public Announcement. This Public Announcement and the Public Offer was sought to be withdrawn on 29th March, 2012. He points out that in the aforesaid letter; the request for withdrawal is specifically made under Regulation 27 of the Takeover Regulations. Therefore, Mr. Nariman cannot be permitted to, now, submit that Regulation 27 is not applicable to the open offer in the present case.

16. Mr. C.U. Singh then submits that the respondents have consciously proceeded with an open offer and they have rightly not been permitted to withdraw the same by the appellant. The next submission of Mr. C.U. Singh is that Regulation 27 deals with only withdrawal of 'Public Offer' and not withdrawal of 'Public Announcement'. In any event, according to learned senior counsel, submission with regard to withdrawal of Public Announcement has been made, only, at the time of arguments before this Court. It was neither pleaded nor raised before the SEBI/SAT, nor even in the counter affidavit before this Court. He next submitted that under the provisions of Regulation 27, public offer is a rule and withdrawal is an exception. Relying on the interpretation of Regulation 27 in Nirma Industries Ltd.(supra), he submits that an offer can be permitted to be withdrawn only if it becomes virtually impermissible to carry out. Permitting public offers once made to be withdrawn on the ground that it has become uneconomical would compromise the integrity of the Securities Market. This would be contrary to the scheme of the Takeover Code. Mr. C.U.

Singh then submits that there is no distinction under Regulation 27 between the voluntary open offer and mandatory open offer which is the result of a triggered acquisition. Relying on Regulations 11 to 14 of the Takeover Regulations, he submits that all the different types of open offers are set out therein. Each one of the open offers has the same effect on shareholders and the market. Therefore, the provisions contained in Regulation 27 have to be strictly adhered to in considering the request for withdrawal of the open offer. It is further submitted that the appellant had fixed the offer price under the relevant regulations and in accordance with the law laid down by this Court in Clariant International Ltd. & Anr. Vs. Securities & Exchange Board of India.

17. According to Mr. C.U. Singh, in normal circumstances, withdrawal can only be made under Regulation 27(1)(b), (c) and (d). He submits that in the letter dated 29th March, 2012, the respondent claims that the offer has become "outdated due to the sheer efflux of time". The

second reason given is the delay in clearance of open offer from SEBI. The letter also indicates that the respondent does not agree with the views of the SEBI on the fact situation. Another reason given is that “even if the SEBI were to approve the draft letter of offer today, the open offer exercise would be entirely academic and meaningless.” Another reason given is that “the transaction then envisaged by us is no longer justifiable on any ground including grounds of economic rationale and commercial reasonableness.” All these factors, according to Mr. C.U. Singh, will not be covered by any of the clauses in Regulation 27(1)(b)(c)(d). He then submitted that even if there is a delay by SEBI, the ordinary investor in shares of the Target Company should not be made to suffer. According to Mr. C.U. Singh, the controversy raised in the appeal is squarely covered against the respondent by judgment of this Court in Nirma Industries Ltd. (supra).

18. Mr. Nariman has rebutted the aforesaid submissions of Mr. C.U. Singh. He submits that the single most important distinction between Nirma and this case is that it pertains to a voluntary public offer. This Court had no occasion to deal with a voluntary public offer in Nirma Industries Ltd. (supra). In reply to the other submissions made by Mr. C.U. Singh, Mr. Nariman has also relied on some correspondence. He has also relied upon a table to substantiate the submission that the law laid down in Nirma Industries would not be applicable in the facts and circumstances of this case. Dealing with the issue of delay, it is submitted by Mr. Nariman that there was an unjustifiable and inexplicable delay by SEBI in issuing its comments on the draft letter of offer. In support of this submission, he has relied on some correspondence.

19. He relies on letter dated October 20, 2011, whereby the respondent made a voluntary open offer by Public Announcement under Regulation 11 of the Takeover Regulations. He points out that Clause 11.4 of the Public Announcement clearly states that voluntary open offer can be withdrawn by the respondent at any time. He then points out that on 25th October, 2011, SEBI called upon the respondent to provide information on the changes in shareholding and capital build-up of the Target Company, along with compliance of the SEBI Regulations. He submits that although the information sought pertains to the earlier acquisition it was duly provided on November 4, 2011 and November 8, 2011. Mr. Nariman submits that under Regulation 18(1) of the Takeover Regulations, the draft letter of offer is required to be filed with SEBI well within 14 days from the date of the Public Announcement. Once the letter of offer is filed, SEBI was required to dispatch the same to the shareholders immediately after 21 days. During 21 days, SEBI is permitted to stipulate the changes required to be made in the letter of offer which the Merchant Banker and the Acquirer shall incorporate in the letter of offer, before it is dispatched to the shareholders. In case, SEBI receives a complaint or it initiates an enquiry or investigation in respect of public offer, it can call for a revised letter of offer. In this case, he submits that the draft letter of offer was given on October 28, 2011 well within 14 days period stipulated under Regulation 18(1). But SEBI did not issue its comments on the draft letter of offer within 21 days, as required. Not only there was a non-compliance of Regulation 18(1) but there was no occasion to invoke proviso to Regulation 18(2). SEBI did not inform or advise the respondent to revise the draft letter of offer on account of any inadequacy in the disclosure made by the respondent in the draft letter of offer in respect of the voluntary offer. All the queries were related to the past alleged triggers. These alleged triggers were wholly unrelated to the voluntary open offer for which the draft letter of offer was filed with the appellant. He then pointed out that by letter dated 17th November, 2011, the appellant again sought the same clarification on the alleged triggers, as stated in its letter dated November 11, 2011. He submitted that the Merchant Banker and the respondent provided all explanation regarding these acquisitions on November 28, 2011. The letter dated November 24, 2011 of the respondent was forwarded to the appellant by the Merchant Banker on November 28, 2011. This letter gave date wise explanation on all the issues raised as to why no open offer was made pertaining to the alleged triggers, as there was no violation of Regulation 11(1) and 11(2) of the Takeover Regulations. This explanation was

reiterated on December 14, 2011 by the respondent/Promoters but there was no response from the appellant to any of the aforesaid letters. This led the respondent to a reasonable belief that the explanation had been accepted. Subsequently, there was a telephonic request by the appellant to provide the same information on the alleged triggers in various formats. The respondent duly re-arranged the same information in the desired format and provided the same to the appellant on January 13, 2012, January 16, 2012 and February 3, 2012. In spite of all this, still there were no comments from the SEBI. Mr. Nariman emphasized that the unjustifiable, inexplicable and inordinate, delay on the part of the appellant in issuing comments on the draft letter of offer created a situation wherein it was impossible for the respondent to implement the voluntary open offer. By that time, the underlying decision to consolidate shareholding had become infructuous by sheer efflux of time. It was under these circumstances that the respondent intimated its decision to withdraw its voluntary open offer and sought withdrawal of the same in terms of the Regulation 27 of the Takeover Regulations.

20. It was pointed out by Mr. Nariman that the respondent specifically and expressly sought opportunity of a personal hearing on the aforesaid request for withdrawal, the appellant did not revert on the request. The respondent once again furnished the same information on the alleged triggers in different formats as required by the appellant through communications dated April 12, 2012; April 20, 2012;

May 10, 2012; May 21, 2012; June 6, 2012 and July 5, 2012. After a period of more than 13 months, from the date of filing of the draft letter of offer and after more than 8 months from the date of request for withdrawal, the appellant issued the impugned letter dated November 30, 2012. Mr. Nariman points out that the directions issued in the impugned letter are wholly unjustified. He points out to the following two directions :-

(a) Go ahead with the voluntary open offer on account of some alleged triggers (for creeping acquisitions under Regulation 11 of the Takeover Code, 1997) in the past i.e. 2006-07; 2007-08 and 2010-11.

(b) make an open offer with upward revision in price per share. The share prices offered by the respondent in 2009 were RS.91.00 per equity share and as on date the prices is RS.315.90 per equity share.

21. Mr. Nariman submitted that SAT without going into the merits and demerits of the alleged earlier acquisitions, has left it open for SEBI to take appropriate action in accordance with law with regard to the aforesaid three acquisitions. Therefore, clearly the aforesaid three acquisitions have no connection whatsoever with the voluntary offer under consideration in these proceedings.

22. The next submission of Mr. Nariman is the foundation of all his other submissions. According to Mr. Nariman, there is a fundamental difference between a mandatory public offer and a voluntary open offer. It cannot be placed on the same pedestal. According to learned senior counsel, in a mandatory public offer there exists an underlying transaction which triggers the Takeover Code under which the shareholders obtain a right to exit from the company. However, in a voluntary open offer, no such right accrues to the shareholders to exit the company, since the offer is not the result of a triggered acquisition. In the present case, the action of SEBI, according to Mr. Nariman, is contrary to Regulation 18. The letter of offer was not dispatched to the shareholders as per Regulation 18(1). Regulation 15(4) deems that the offer is made on the date on which the Public Announcement has appeared in any newspaper. But according to Mr. Nariman, this deeming fiction is for the purpose of price fixation for the offer. It has nothing to do with Regulation 18 which is to dispatch the actual offer to the shareholders. Therefore, according to Mr. Nariman, reliance placed by Mr. C.U. Singh on the expression "offer once made" in Regulation 27 is misconceived. This expression has to be understood in terms of

Regulation 18. Since Regulation 18 had not been complied with and there was no dispatch of the letter of offer to the shareholders, there was no question of any prejudice being caused to the interest of the shareholders. Mr. Nariman then submits that because of the inaction on the part of SEBI, the respondent would be squarely covered under Regulation 27(1)(b). The approval of the letter of offer by the appellant is statutory in nature. Since it had not been granted within the stipulated period of time, the respondent was entitled to assume that it had been refused. According to Mr. Nariman, it has been erroneously submitted by Mr. C.U. Singh that the claim of the respondent is not covered under Regulation 27(1)(b). Mr. Nariman then submits that the judgment in Nirma Industries is not applicable in the facts and circumstances of this case. Finally, he has submitted that the judgment in Nirma Industries (supra) requires reconsideration. In support of this submission, he submits that Regulation 27 has to be interpreted by keeping in mind the earlier Regulation 27(1)(a). In Nirma Industries, this Court has held that Regulation 27 (b), (c) and (d) are all in the nature of impossibility. Mr. Nariman made a mention about Regulation 27(1)(a) which was omitted by the SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2002 with effect from September 9, 2002. Prior to deletion, it read as under :

“(a) the withdrawal is consequent upon any competitive bid,” Based on this, he submits that economic viability of public offer was the genus of Regulation 27. The facts of this case would clearly place the request of the respondent for withdrawal of the public offer in the realm of impossibility. Mr. Nariman has submitted that for the interpretation of Regulation 27, the ejusdem generis principle would not apply as there is no common genus between Clauses 27(1)(b)(c) and (d).

23. Mr. C.U. Singh in rejoinder has submitted that in view of the law laid down in Nirma Industries, the public offer made by the respondent cannot be permitted to be withdrawn. Earlier incidence of the alleged triggers can be relied upon. According to him, the price has to be fixed on the basis of the public announcement/offer. He submits that Regulation 18(1) talks of 14 days of the Public Announcement. Furthermore, public offer cannot be said to be made only on dispatch of the letter of offer to the individual shareholders. The impact on the securities market would follow the public announcement. He reiterates that even the withdrawal letter seeks permission to withdraw the Public Offer under Regulation 27. Finally, he submits that the interpretation of Regulation 27 rendered in Nirma Industries Ltd. (supra) is correct. It fully applies to the facts of the present case. It is neither distinguishable nor does it require reconsideration.

24. We have considered the submission made by the learned counsel for the parties.

25. Factually, it cannot be denied that in the years 2006-07, 2007-08 and 2010-11, the respondent had acquired shares in excess of 5% which breached the 5% creeping acquisition limit. In our opinion, the respondent was required to comply with Regulation 11 and make a Public Announcement to acquire shares in accordance with law. The respondent admittedly not having complied with Regulation 11, in our opinion, the appellant was perfectly justified in taking the non-compliance into consideration whilst considering the feasibility of the public offer made on 20th October, 2011.

26. With regard to delay, we do not find much substance in the submission of Mr. C.U. Singh. Mr. Singh has sought to explain the delay on the ground that information sought by the appellant was not given by the respondent. In our opinion, this was no ground for the appellant to delay the issuance of comments on the letter of offer, especially not for a period of 13 months. In the event the information was not forthcoming, the appellant had the power to refuse the approval of the public offer. It is true that under Regulation 18(2), SEBI was required to dispatch the necessary

letters to the shareholders within a reasonable period. It is a matter of record that the comments were not offered for 13 months. Such kind of delay is wholly inexcusable and needs to be avoided. It can lead to avoidable controversy with regard to whether such belated action is bona fide exercise of statutory power by SEBI. By adopting such a lackadaisical, if not callous attitude, the very object for which the regulations have been framed is diluted, if not frustrated. It must be remembered that SEBI is the watchdog of the Securities Market. It is the guardian of the interest of the shareholders. It is the protective shield against unscrupulous practices in the Securities Market. Therefore, SEBI like any other body, which is established as a watchdog, ought not to act in a lackadaisical manner in the performance of its duties. The time frame stipulated by the Act and the Takeover Regulations for performing certain functions is required to be maintained to establish the transparency in the functioning of SEBI.

27. Having said this, we are afraid such delay is of no assistance to the respondent. It will not result in nullifying the action taken by SEBI, even though belated. Ultimately, SEBI is charged with the duty of ensuring that every public offer made is bona fide for the benefit of the shareholders as well as acquirers. In the present case, SEBI has found that permitting the respondent to withdraw the public offer would be detrimental to the overall interest of the shareholders. The only reason put forward by the respondent for withdrawal of the offer is that it is no longer economically viable to continue with the offer. Mr. Nariman has referred to a tabular statement and data to show that there is no substantial variation in the share prices that ensued making of the public offer. Having seen the table, we find substance in the submission of Mr. Nariman that there is hardly any variation in the shares of the Target Company from 20th October, 2011 till 30th November, 2011. The variation seems to have been between ₹78.10 (on 24.11.2011) and ₹ 87.60 (on 20.10.2011). Such a variation cannot be said to be the result of the public offer. But this will not detract from the well-known phenomena that Public Announcement of the public offering affects the securities market and the shares of the Target Company. The impact is immediate.

28. We are unable to agree with the submission of Mr. Nariman that Regulation 27 would not be applicable to a voluntary public offer. A perusal of Regulation 27(1) makes it patently clear that Regulation 27(1) reads “no public offer, once made, shall not be withdrawn except under the following circumstances.” Accepting Mr. Nariman’s submission would be to reconstruct the aforesaid provision. This Court, or any other court, whilst construing the statutory provision cannot reconstruct the same. The plain reading of the aforesaid regulation makes it clear that no public offer whether it is voluntary or triggered by Regulation 11 can be withdrawn, unless it satisfies the circumstances set out in Regulation 27(1)(b), (c) and (d). There can be no distinction between a triggered public offer and a voluntary public offer. Both have to be considered on an equal footing. We find substance in the submission made by Mr. C.U. Singh that Regulation 18(2) has no relevance to the case projected by the respondents having singularly failed to give the necessary information to SEBI with regard to the earlier three acquisitions.

29. We also do not agree with Mr. Nariman that Regulation 27 has to be read in the context of the Regulation as it existed when it was first enacted. As noticed earlier, Regulation 27(1)(a) before its deletion on September 9, 2002 permitted the public offer to be withdrawn, consequent upon any competitive bid. We see no reason to differ from the view taken in *Nirma Industries Ltd.* (supra) wherein we have observed as follows:

“62. A bare perusal of the aforesaid Regulations shows that Regulation 27(1) states the general rule in negative terms. It provides that no public offer, once made, shall be withdrawn. Since clause (a) has been omitted, we are required to interpret only the scope and ambit of clauses (b), (c) and (d). The three sub-clauses are exceptions to the general rule and, therefore, have to be construed very strictly. The exceptions cannot be construed in such a manner that would destroy

the general rule that no public offer shall be permitted to be withdrawn after the public announcement has been made. Clause (b) would permit a public offer to be withdrawn in case of legal impossibility when the statutory approval required has been refused. Clause (c) again provides for impossibility when the sole acquirer, being a natural person, has died. Clause (b) deals with a legal impossibility whereas clause (c) deals with a natural disaster. Clearly clauses (b) and (c) are within the same genus of impossibility. Clause (d) also being an exception to the general rule would have to be naturally construed in terms of clauses (b) and (c). Mr Divan has placed a great deal of emphasis on the expression “such circumstances” and “in the opinion” to indicate that the Board would have a wide discretion to permit withdrawal of an offer even though it is not impossible to perform. We are unable to accept such an interpretation.”

30. The submission with regard to the non-applicability of ejusdem generis for interpretation of the Takeover Regulations has been considered and rejected in Nirma Industries Ltd. (supra) (Paragraphs 63 to 71).

31. We are also not impressed by the submission of Mr. Nariman that it has now become economically impossible to give effect to the public offer. This very submission has been rejected in Nirma Industries Ltd. (supra). We reiterate our opinion in Nirma Industries Ltd. (supra) that under Clause 27(1)(b)(c) and (d), a Public Offer, once made, can only be permitted to be withdrawn in circumstances which make it virtually impossible to perform the Public Offer. In fact, the very purpose for deleting Regulation 27(1)(a) was to remove any misapprehension that an offer once made can be withdrawn if it becomes economically not viable. We are of the considered opinion that the distinction sought to be made by Mr. Nariman between a voluntary public offer and a triggered public offer is wholly misconceived. Accepting such a submission would defeat the very purpose for which the Takeover Code has been enacted.

32. We also do not find any merit in the submission of Mr. Nariman that the delay of 13 months by SEBI in issuing the impugned directions would permit the respondent to withdraw the Public Offer under Regulation 27(1)(b). The consideration by SEBI is as to whether a Public Offer is in conformity with the provisions of the SEBI Act and the Takeover Regulations. Delay in performance of its duties by SEBI cannot be equated to refusal of the statutory approval requires from other independent bodies, such as under the RBI, Taxation Laws and other regulatory statutes including Foreign Exchange Regulations. Delay by SEBI in taking a final decision in making its comments on the letter of offer would not fall under Regulation 27(1)(b).

33. This now brings us to the submission of Mr. Nariman that there was a breach of Rules of Natural Justice. It is matter of record that the respondent had asked for an opportunity of hearing but none was granted. But the question that arises is as to whether this is sufficient to nullify the decision of SEBI. In our opinion, the respondent has failed to place on the record either before SAT or before this Court the prejudice that has been caused by not observing Rules of Natural Justice. It is by now settled proposition of law that mere breach of Rules of Natural Justice is not sufficient. Such breach of Rules of Natural Justice must also entail avoidable prejudice to the respondent. This reasoning of ours is supported by a number of cases. We may, however, refer to the law laid down in Natwar Singh Vs. Director of Enforcement & Anr., wherein it was held that “there must also have been caused some real prejudice to the complainant; there is no such thing as a merely technical infringement of natural justice.”

34. All the information sought by SEBI related to the three earlier acquisitions when the creeping limit for acquisition has been breached for triggering the mandatory Takeover Regulations. In appeal, SAT has left the question with regard to the earlier three acquisitions open and to be decided in accordance with law. Therefore, clearly no prejudice has been caused to the respondent.

35. Finally, we are unable to accept the submission of Mr. Nariman that the ratio of law as declared in Nirma Industries Ltd. (supra) would not be applicable to the facts and circumstances of this case. As pointed out earlier, we do not accept the distinction sought to be made by Mr. Nariman with regard to voluntary open offer and mandatory open offer which is the result of a triggered acquisition. The consequences of both kinds of offers to acquire shares in the Target Company, at a particular price, are the same. As soon as the offer price is made public, the securities market would take the same into account in all transactions. Therefore, the withdrawal of the open offer will have to be considered by the Board in terms of Regulation 27(1)(b)(c) and (d). Further, the deletion of Regulation 27(1)(a) does not, in any manner, advance the case of the respondent. It rather reinforces the conclusion that an open offer once made can only be withdrawn in circumstances stipulated under Regulation 27(1)(b)(c) and (d). We also do not agree with Mr. Nariman that voluntary open offer made by the respondent ought to be permitted to be withdrawn under Regulation 27(1)(b) for the reasons already stated. We have already come to the conclusion that the delay in offering comments by the Board on the letter containing voluntary open offer, though undesirable, is not fatal to the decision ultimately taken by the Board. We, therefore, reiterate our conclusion in Nirma Industries (supra).

36. We also do not find substance in the submission of Mr. Nariman that the judgment in Nirma Industries (supra) needs reconsideration. In our opinion, the ejusdem generis principle is fully applicable for the interpretation of Regulation 27(1)(b)(c) and (d) as there is a common genus of impossibility. This impossibility envisioned under the aforesaid regulation would not include a contingency where voluntary open offer once made can be permitted to be withdrawn on the ground that it has now become economically unviable. Accepting such a submission, would give a field day to unscrupulous elements in the securities market to make Public Announcement for acquiring shares in the Target Company, knowing perfectly well that they can pull out when the prices of the shares have been inflated, due to the public offer. Such speculative practices are sought to be prevented by Regulation 27(1)(b)(c) and (d), that is precisely the reason why Regulation 27(1)(a) was deleted. Merely because there has not been any substantial change in the price of shares in this particular case, would not, in any manner, invalidate the conclusion reached in Nirma Industries (supra).

37. Last but not least, we are not able to approve the approach adopted by SAT in adopting the Issue of Capital and Disclosure Requirements Regulations, 2009 (ICDR) Regulation for interpreting the provisions contained in Regulation 27 of the Takeover Regulations. The regulations in Takeover Code have to be interpreted by correlating these regulations to the provisions of the SEBI Act.

38. In view of the above, the appeal is allowed. The impugned order passed by the SAT dated 19th June, 2013 in Appeal No.3 of 2013 is set aside and the directions issued by the appellant in the letter dated 30th November, 2012 are restored.

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Kosha Investments Ltd. v. Securities & Exchange Board of India & Another

2015 (9) SCALE 820

Bench: The Honourable Mr. Justice Vikramajit Sen & The Honourable Mr. Justice Shiva Kirti Singh

SHIVA KIRTI SINGH, J.

Both the appeals have been preferred by the same appellant under Section 15Z of the Securities & Exchange Board of India Act, 1992 (for short, 'SEBI Act'). The main appeal is of 2006 and requires detailed consideration. It is directed against order dated 08th August 2005 passed by the Securities Appellate Tribunal upholding and confirming the order of Securities & Exchange Board of India (SEBI) dated 27th January 2004 directing the appellant to make public announcement in terms of Regulation 11(1) of the Securities & Exchange Board of India (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 (hereinafter referred to as 'the Regulations of 1997'). The other appeal is directed against orders passed by SEBI and confirmed by the Tribunal to impose penalty upon the appellant for non-compliance with the order which is subject matter of the earlier appeal. It goes without saying that the latter appeal will follow the fate of the main appeal.

Before advertng to the issues of law raised on behalf of the appellant, the essential facts may be noticed only in brief. The appellant, Kosha Investments Ltd., acquired shares of another company Snowcem India Ltd. (hereinafter referred to as 'SIL') from one of the original promoters of SIL and thus itself became one of the promoters. An investigation by SEBI covered the period June 1999 to August 1999 when there was an initial upward movement in the price of shares of SIL and also substantial increase in the volume of their trade. As a result of such investigation the appellant faced charges in another proceeding under SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 and was also served with a show cause notice dated 14.11.2002 for alleged breach of provisions of Regulation 44 and 45(6) of the Regulations of 1997 read with provisions of Section 11 and 11B of the SEBI Act. The proposed action under Regulations of 1997 was based upon report of investigation showing that appellant had consistently bought and sold shares of SIL prior to June 1999 and also after August 1999. As per record it was holding 21,32,900 shares of SIL constituting 20.29% of total paid up capital of SIL. The appellant made additional purchase of shares amounting to 10.81% of the paid-up capital of SIL in violation of Regulation 11(1) of the Regulations of 1997 as it failed to make the required public announcement in terms of the said Regulation. After granting personal hearing and considering the appellant's reply to the show cause notice, in the final order SEBI came to a finding that as on 31st March 1999 appellant was actually holding only 21,32,900 shares as shown by SEBI and not 31,84,228 shares which was claimed by the appellant on the ground that it had already pledged its shares to lenders who had lent money to SIL. The plea of pledge raised by the appellant was found without any substance and only an attempt to conceal subsequent purchase. Hence, SEBI came to a conclusion that the appellant was already holding between 15% to 75% shares of the target company SIL and it could acquire additional shares of this company through creeping acquisition mode, that is, without public announcement only upto 5% of its paid-up capital during the period of 12 months ending on 31st March 2000. However, by acquiring 11,36,700 shares of SIL during June 1999 to August 1999 it acquired shares constituting more than 5% of the paid-up capital of SIL. For making such acquisition, the appellant was liable to make public announcement as required by Regulation 11(1) of the

Regulations of 1997. Since the appellant failed to do so, the Whole Time Member of SEBI held it guilty and issued the following directions on 27th January 2004 :

“15. In view of the findings above and in exercise of the powers conferred upon me under Section 19 read with Section 11B of SEBI Act read with regulations, I hereby direct the acquirer viz., Kosha Investments Ltd. to make public announcement in terms of regulation 11(1) of the said Regulations taking June 29, 1999 as the reference date for calculation of offer price. The public announcement shall be made within 45 days of passing of this order.

16. The Acquirers are hereby accordingly directed to pay interest @ 15% per annum to the shareholders for the loss of interest caused to the shareholders from October 28, 1999 till the date of actual payment of consideration for the shares to be tendered and accepted in the offer directed to be made by the Acquirers.

17. It is also noted that an order dated 3.12.03 was passed by me restraining the Kosha Investments Ltd. from buying, selling or dealing in securities in any manner, directly or indirectly, for a period of two years for violating the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995. However, I direct the said order dated 3.12.2003 shall not hamper the implementation of this order.” The appellant preferred an appeal before the Securities Appellate Tribunal to challenge the order dated 27th January 2004 passed by Whole Time Member of SEBI. The main contention of the appellant before the Tribunal is recorded in paragraph 7 of the impugned judgment and is as follows :

“Learned counsel for the appellant argued that KIL had been regularly purchasing and selling shares of SIL. He also argued that KIL had not acquired 5% or more than 5% shares or voting rights in respect of shares of SIL at any point of time in the period of 12 months. He submitted that out of 11,36,700 shares which were purchased during June, 1999 to August, 1999 during the same period KIL also sold number of shares of SIL. He pointed out that KIL was not holding more than 5% shares of SIL at any point during the year and therefore the provisions of Takeover Code did not trigger. He further argued that even if SEBI did not take into account the repurchases of pledged shares as return of shares, SEBI should accept that KIL did not acquire 5% or more shares at any point of time since sale and purchase of shares was being done simultaneously and did not trigger the Takeover Code. He argued that SEBI ought to have taken into account that KIL also sold shares during the relevant period. He went on to argue that it was erroneous to determine the total shareholding of KIL at any given point of time during the investigation by completely ignoring the sale of shares made by it during the relevant period. He said that such a lopsided interpretation of Takeover Code would be erroneous and not maintainable. He said that determining the shareholding of a person without netting off would give a distorted picture. He therefore concluded that for the reason mentioned above, the provisions of Takeover Code were not applicable in this case and no violation of SEBI Regulations has taken place.” The Tribunal accepted the counter arguments advanced on behalf of the SEBI to the effect that even during the period June 1999 to August 1999 the appellant had acquired 6,61,800 shares which constituted 6.29% of the paid up capital of SIL which was beyond the permissible limit of 5% and hence the requirement of making public announcement in terms of Regulation 11(1) had to be met by the appellant which the appellant failed to do. Before the Tribunal as well as before us the main contention of the appellant is that SEBI failed to consider that the appellant was not only a promoter having more than 15% shares of SIL but it was also in the business of sale and purchase of shares which was being done simultaneously and hence exceeding the limit of 5% at any one point of time was immaterial unless on a net accounting it could be found that such ceiling of 5% had been violated by appellant on account of its retaining more than 5% shares of SIL at the end of a financial year. On the other hand SEBI

have reiterated their stand before the Tribunal that the ceiling of making acquisition of only up to 5% of the paid up capital of target company was no doubt to be reckoned during a period of 12 months, that is, a financial year but the requirement of Regulation 11(1) of the Regulations of 1997 of making a public announcement was triggered not only on actual acquisition beyond the 5% limit but even on entering into an agreement for such acquisition or deciding to acquire such volume of shares or voting rights, in view of provisions of Regulation 14(1) of the Regulations of 1997. A strong emphasis was laid on Regulation 14(1) which requires the public announcement referred to in Regulation 10 or Regulation 11 to be made by the acquiring company (through its merchant banker), not later than four working days of the agreement or decision to acquire the requisite number of shares or voting rights which by itself triggers the requirement of Regulation 11. (emphasis added) Let us conceptualize the case of an entity holding 20 per cent of shareholding in a target company on 1st April of a given year. If it were to increase its holding by say 3 per cent and subsequently reduce it to 2 per cent. It at that point it intended to purchase 4 per cent shares again, whether by way of fractions or otherwise, it would cross the threshold of 5 per cent. It would then have to make compliance with Regulation 11. We hasten to clarify that if the aggregate percentage of acquisitions at any point of time during the financial year exceeds 5 per cent, the provision would get triggered. In other words, the provision of Regulation 11 mandating a public announcement will kick in at any stage whence the shareholding of the said entity in the target company would exceed 25 per cent.

It will be relevant at this stage to extract Regulations 11(1), 13, 14(1) and 14(2) in order to appreciate the submissions. These read as follows :

“11. (1) No acquirer who, together with persons acting in concert with him, has acquired, in accordance with the provisions of law, 15 per cent or more but less than fifty five per cent (55%) of the shares or voting rights in a company, shall acquire, either by himself or through or with persons acting in concert with him, additional shares or voting rights entitling him to exercise more than 5 per cent of the voting rights, in any financial year ending on 31st March unless such acquirer makes a public announcement to acquire shares in accordance with the regulations.

Before making any public announcement of offer referred to in regulation 10 or regulation 11 or regulation 12, the acquirer shall appoint a merchant banker in Category I holding a certificate of registration granted by the Board, who is not an associate of or group of the acquirer or the target company.

(1) The public announcement referred to in regulation 10 or regulation 11 shall be made by the merchant banker not later than four working days of entering into an agreement for acquisition of shares or voting rights or deciding to acquire shares or voting rights exceeding the respective percentage specified therein:

Provided that in case of disinvestment of a Public Sector Undertaking, the public announcement shall be made by the merchant banker not later than 4 working days of the acquirer executing the Share Purchase Agreement or Shareholders Agreement with the Central Government or the State Government as the case may be, for the acquisition of shares or voting rights exceeding the percentage of shareholding referred to in regulation 10 or regulation 11 or the transfer of control over a target Public Sector Undertaking.

(2) In the case of an acquirer acquiring securities, including Global Depository Receipts or American Depository Receipts which, when taken together with the voting rights, if any already held by him or persons acting in concert with him, would entitle him to voting rights, exceeding the percentage specified in regulation 10 or regulation 11, the public announcement referred to in sub-regulation (1) shall be made not later than four working days before he acquires voting rights

on such securities upon conversion, or exercise of option, as the case may be.” A careful reading of the aforesaid Regulations discloses that the public announcement should not be delayed beyond four working days of the agreement or decision to acquire the requisite number of shares or voting rights. We are in agreement with the finding of the Tribunal on this issue and find no merit in the contentions of the appellant. If the plea of appellant will be accepted then an acquirer can keep on violating Regulation 11(1) with impunity on as many occasions as he/it wants and avoid letting the public have the required knowledge through public announcements by simply making subsequent sale or transfer to another entity so as to reduce the so-called net acquisition in a financial year to within 5%. This interpretation will defeat the purpose of Regulation 11(1) and shall also render Regulation 14(1) otiose. The concept of permitting creeping acquisitions by permitting not more than 5% of the shares or voting rights in a company limits the period for such acquisition to a financial year ending by 31st March. But such concept does not dilute the requirement of making a public announcement within the time mentioned in Regulation 14(1) if the acquisition even if only once made and divested, is of more than 5% of shares or voting rights in the target company. In other words, even if such acquisition is followed by sale in the same financial year, the liability of making the public announcement would remain unaffected and shall attract action, as in this case. Hence, the main contention advanced on behalf of the appellant is found to be without any merit. The other contention is that Regulation 14(2) of the Regulations of 1997 postpones the time for required public announcement to acquisition of voting rights when purchased securities are actually converted. According to the contention, only when securities or shares are converted by the acquirer into voting rights by getting it registered or upon exercise of option to acquire voting rights, the liability of making public announcement can be fastened.

Aforesaid plea has been rightly countered by learned Senior Advocate for SEBI, Mr. C.U. Singh by pointing out that in case of acquisition of shares or voting rights the appropriate applicable provision is Regulation 14(1) and not Regulation 14(2) which applies only when the acquisition is of other securities including Global Depository Receipts, American Depository Receipts. It is only such securities which require conversion or exercise of option which is contemplated by Regulation 14(2). He also pointed out that no such plea was raised before the SEBI or the Tribunal and rightly because in the present case only Regulation 14(1) is applicable as it covers acquisition of either the shares or the voting rights or both which are the subject matter of Regulation 11(1). Mr. Singh has also referred to a judgment of this Court in the case of *Swedish Match AB and Another vs. Securities & Exchange Board of India and Another*, (2004) 11 SCC 641. This judgment in paragraphs 90 onwards considered the purpose and effect of Regulations 10, 11 and 12 of the Regulations of 1997 and in paragraph 102 held them to be mandatory statutory provisions. However, this judgment needs no elaborate consideration because no plea has been raised on behalf of appellant that the Regulations are directory or do not require compliance. We find that the plea that the matter at hand relates to Regulation 14(2) was not raised before the original authority or the Tribunal. We also find that it is a plea of desperation and undeserving of acceptance. In the final analysis we find no merit in these appeals and hence they are dismissed with consolidated cost of ₹ 50,000/- to be paid by the appellant to SEBI within eight weeks.

* * * * *

The Prevention of Money-Laundering Act, 2002

Rose Valley Real Estate v. Union of India

(2015) 2 Cal LT 617

Calcutta High Court Judgment dated: 30.03.2015

Bench – Manjula Chellur, C.J. and Joymalya Bagchi, J.

Joymalya Bagchi, J.:

The appeal is directed against the judgment and order dated 25th November, 2014 in W.P. No. 28728 (W) of 2014 whereby the learned Single Judge, inter alia, refused to quash impugned notice dated 19.09.2014 issued by respondent No.3 to the respondent banks to prohibit/freeze the withdrawal from the accounts maintained in the branches of the said banks by the appellant No.1 Group of Companies.

The factual matrix giving rise to the instant appeal is as follows:-

The appellant No.1 is a Public Limited Company which belongs to Rose Valley Group of Companies. The appellant No.1 Company had collected a sum of ₹ 12.82 crores by issuing non-convertible debentures from members of the public during the year 2001-02, 2004-05, 2005-06 and 2007-08 without filing proper documents either to Register of Companies or SEBI.

Over the aforesaid issue, Security and Exchange Board of India (hereinafter referred to as SEBI) issued summons dated 14th July, 2011 under section 11C(3) of SEBI Act, 1992 calling upon the appellant No.1 Company to furnish information and/or documents with regard thereto. Such summons were followed up by other successive summons.

Finally, an adjudication proceeding was initiated and by order dated 26th March, 2013 the appellant No.1 was held guilty of non-compliance of provisions of the SEBI Act and a monetary penalty of ₹ 1 crore was imposed upon it.

In appeal, Security Appellate Tribunal modified the penalty imposed upon the appellant and reduced the same to ₹ 10 lakhs. In the meantime, criminal proceeding being case No. C/1421 of 2013 was filed before the learned Chief Judicial Magistrate, Calcutta for violation of section 12A read with section 24 of the SEBI Act against the appellant. It appears that the said proceeding has been challenged before this Court in CRR No.20177 of 2013 and the same has been stayed.

It is pertinent to note that offence under section 24 of the SEBI Act is a 'scheduled offence' under the Prevention of Money Laundering Act, 2002 (hereinafter referred to as 'PML Act, 2002')

With reference to the aforesaid 'scheduled offence' investigation was initiated by the respondent No.3 being ECIR No. ECIR/KLZO/02/2014 against the appellant under the provisions of PML Act, 2002.

In connection with such investigation, respondent Nos.2 and 3 along with their officers conducted search at the offices of the appellant and seized monies to the tune of ₹ 37,0763.50 apart from compact discs and documents.

The appellant challenged the aforesaid search and seizure in W.P.No.17343 (W) of 2014 which was subsequently withdrawn with liberty to file afresh, if occasion arose.

In the meantime, the respondent authority issued show cause notice on the appellant No.1 calling upon him to show cause before the adjudicating authority as to why the seized properties be not retained under section 17(4) read with section 8(3) of PML Act, 2002.

On 22.07.2014 the aforesaid show cause notice under section 17(4)/8(3) of PML Act, 2002 was challenged by the appellants in W.P.No.20892 (W) of 2014, inter alia, on the ground that there was no jurisdiction to initiate proceeding against the appellants under the provisions of PML Act, 2002.

A learned Single Judge of this Court disposed of the aforesaid writ petition giving liberty to the appellant to take up the point of jurisdiction before the adjudicating authority under PML Act, being respondent No.5 herein.

In appeal, an Hon'ble Division Bench of this Court by order dated 28.07.2014 granted liberty to the appellant to agitate the point of jurisdiction before the respondent No.5 and specifically directed the latter to decide the same as a preliminary objection vice versa applicability of PML Act, 2002.

Pursuant thereto, the appellant filed its reply to the show cause notice being OA No.16 of 2014 wherein the appellant raised the issue of non-applicability of PML Act and the jurisdiction of the authority to invoke the same. The appellant reserved its right to deal with the factual allegations in the show cause notice subsequently.

By order dated 10.09.2014 the respondent No.5 rejected the contentions of the appellant and directed retention of the seized properties. In the meantime, Deputy Director of Enforcement Directorate, respondent No.3 herein, issued impugned letter dated 19.09.2014 upon Syndicate Bank requesting the latter to prohibit/freeze withdrawal from the accounts maintained in the branches of the said bank by Rose Valley Group of Companies with immediate effect. Karnataka Bank Limited, HDFC also intimated the appellant that they have received similar letters. The appellant challenged the impugned order dated 10.09.2014 passed by respondent No.5 authority and the letter dated 19.09.2014 issued by respondent No.3 upon the respondent banks requesting them to prohibit/freeze withdrawal from the accounts maintained in the branches of the said bank by Rose Valley Group of Companies with immediate effect.

A learned Single Judge of this Court by impugned order dated 25th November, 2014 set aside the order dated 10.09.2014 passed by the adjudicating authority, respondent No.5 herein, inter alia, on the premise that the said order was not in consonance with the direction passed by the Hon'ble Division Bench in its order dated 28.07.2014 in AST No.345 of 2014 and remanded the matter for fresh consideration by the adjudicating authority. However, the learned Single Judge refused to interfere with the impugned letter dated 19.09.2014 issued by respondent No.3 to respondent banks, as aforesaid. Hence, the present appeal.

Mr. Sarkar, learned senior counsel appearing for the appellants restricted his submission to the impugned letter dated 19.09.2014 issued by respondent No.3 to the respondent banks only. He submitted that the said letter in effect amounted to attachment/seizure of the accounts of the appellant No.1 Company. Such power could be exercised by the respondent authority only under section 5 or section 7 of the PML Act, 2002 after recording reasonable beliefs based on the materials in possession of the concerned authority. Impugned letter did not record such

reasonable belief and hence the same was without jurisdiction and liable to be quashed. He further submitted that the amounts collected from the public in respect of the non-convertible debentures issued by appellant No.1 Company had already been refunded and the same is recorded in the order of Securities Appellate Tribunal. Hence, there was no material in possession of the respondent authority to issue such letter in connection with the offence under section 24 of SEBI Act. He further submitted that criminal prosecution under SEBI Act has been stayed by the High Court. He accordingly prayed for quashing of the impugned letter dated 19.09.2014 issued by respondent No.3 upon various banks freezing accounts of the appellant No.1 Company.

He relied on various decisions in support of his contention.

Dr. Shamsuddin, learned counsel appearing for the respondents Enforcement Directorate at the very outset clarified that the impugned letter dated 19.09.2014 had not been issued either under section 5 or under section 7 of PML Act, 2002. Relying on the definition of 'proceeds of crime' under section 2(u) of PML Act, 2002 learned counsel argued that such expression was wide enough to cover other benefits/usufruct that had directly or indirectly accrued to appellant No.1 Company out of the funds illegally collected under the non-convertible debenture Scheme. Hence, refund of sums collected from the public under such Scheme per se did not absolve the appellant No.1 Company from the PML Act. He further submitted that the investigation in the instant case was not restricted to the 'scheduled offence' under SEBI Act, 1992 but also included within its ambit other 'scheduled offences' under the Indian Penal Code, namely section 420/120B IPC in respect of which investigation is being conducted by CBI against Rose Valley Group of Companies pursuant to direction of the Apex Court in the case of Subrata Chatteraj Vs. Union of India, 2014 (8) SCC 768. He submitted that failure to refer to other 'scheduled offences' in the ECIR file or in the impugned letter did not divest the jurisdiction of the respondent authority from carrying on investigation with regard thereto. He referred to section 68 of the Act in that regard.

He further submitted that the impugned letter was issued by the respondent No.3 in contemplation of exercise of powers under section 5/7 of PML Act, 2002. He submitted that the definition of the word 'investigation' in section 2(na) of PML Act, 2002 is an inclusive one and empowered the respondent authorities to take all incidental and consequential actions for collection of evidence for effective enforcement of the Act. He submitted that the respondent banks being 'reporting entities' under the Act were duty bound under section 54 of the Act to assist the authorities for its enforcement.

He further submitted that money laundering investigation is a highly specialized exercise which entails immediate tracing, identification, restraint, seizure and eventual attachment and confiscation of the 'proceeds of crime'. In the event amounts from the suspected accounts are not immediately restrained from being withdrawn, said amounts would be spirited away through electronic banking or otherwise to off shore accounts of non-contracting States which are beyond the domain of the legislation notwithstanding its extra territorial operation. He accordingly prayed for dismissal of the appeal.

In the course of hearing records of the investigation were produced before the Court. It appears from the records of investigation that the investigation initiated against the appellant No.1 Company under PML Act, 2002 is not restricted to offence under section 24 of SEBI Act alone. It has been extended in respect of other 'scheduled offences' under Indian Penal Code, namely sections 420/120B IPC and in respect of such offences investigation has also been initiated by CBI pursuant to directions of the Apex Court in Subrata Chatteraj (supra) with regard to the appellant's group of Companies duping innumerable depositors through collective investment schemes or other schemes floated by the aforesaid group of Companies.

In response thereto, Mr. Sarkar strenuously argued that the instant investigation is restricted to the scheduled offence under SEBI Act as it would appear from the ECIR case registered by respondent No.3 on 27.02.2014. He further submitted that there is no reference to the other scheduled offences in the show cause notice issued upon the appellant No.1 Company under section 17(4)/8(3) of PML Act, 2002 or the impugned letter dated 19.09.2014.

What therefore falls for decision is whether the direction given by the respondent No.3 in the impugned letter dated 19.09.2014 to the respondent banks to prohibit/freeze withdrawals from the accounts maintained by appellant's group of companies in the branches of the respondent banks is lawful or not.

Impugned letter reads as follows:-

'F.No.ECIR/KLZ0/2018/3937 Dated: 19.09.2014

To
The Chairman
Syndicate Bank,
Post Box No.1, Manipal – 576162,
Karnataka State.

Sir,

Sub.: Prohibiting/freezing withdrawal from the Accounts maintained in different branches Reg.

Investigation under provisions of the Prevention of Money Laundering Act, 2002 is going on in this office in the case of M/s. Rose Valley Group of Companies.

In this regard, it is requested to prohibit/freeze withdrawal from the Accounts (as per the list enclosed) maintained in different branches of your bank or if any other accounts found in the systems relating to the Rose Valley Group of Companies with immediate effect so that amount could not be siphoned off.

Encl.: As above.

Yours faithfully,

Sd/-Ashok Gautam,
Deputy Director'.

PML Act, 2002 was enacted to prevent money laundering and to provide for confiscation of property derived from or involved in money laundering and for matters connected therewith and incidental thereto.

The aforesaid legislation is a product of a unified global effort to ensure that all Nations who are members of the United Nations adopt similar domestic money laundering legislations and/or programmes to counter the menace of widespread money laundering arising out of organized transborder crimes, like terrorism, drug trafficking, corporate fraud and other grave offences which cause serious threat not only to the financial systems of the countries but also endanger their integrity and sovereignty. The evolved and effective manner in which 'proceeds of crime' are

placed, layered and integrated into the financial systems of the country through e-commerce and international trade necessitates a specialized agency with ample powers to investigate such crimes through vigilant surveillance, supervision, tracking and identification of suspicious transactions, restraint of suspicious accounts and ultimate seizure, retention, attachment and confiscation of assets which are reasonably believed to be 'proceeds of crime'. To achieve such end, the aforesaid legislation has been brought into force.

Let us examine the scheme of the Act. PML Act, 2002 empowers the authorities prescribed in Chapter VIII of the Act to carry on investigation in respect of offence of money laundering as defined in section 3 of the Act. Section 3 of the Act reads as follows:-

'3. Offence of money-laundering.-Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering.'

Proceeds of crime has been defined in 2(u) of the Act.

'2(u). 'proceeds of crime' means any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of any such property.'

A conjoint reading of the aforesaid provisions make it evident that the authorities under the Act are empowered to investigate any allegation relating to any process or activity connected with 'proceeds of crime' including its concealment, possession, acquisition or use and projecting or claiming the same as untainted property. Anyone who directly or indirectly indulges or attempt to indulge or knowingly assists or is a party involved in such process is said to have committed such offence.

Investigation is defined under section 2(na) of the Act as follows:-

'2(na). 'Investigation' includes all the proceedings under this Act conducted by the Director or by an authority authorized by the Central Government under this Act for the collection of evidence.'

It is an inclusive definition. Chapter III, IV, & V of the Act enumerates the various powers of the investigation agency. Sections 16, 17, 18, 20 and 21 of the Act provide for powers to survey, search, seizure and retention of proceeds of crime or any record or property relating thereto upon recording reasonable belief as required under the said provisions. Section 19 of the Act provides for power to arrest. Section 12 and 12-A of the Act casts duty upon 'reporting entities (as defined in section 2(wa) of the Act), that is, banks and financial institution to maintain records of transactions, identities of persons entering into such transactions and report the same to the authorities under the Act. Sections 5, 8 and 9 of the Act provide for attachment of proceeds of crime or records/properties related thereto upon recording reasonable belief thereto and eventual confiscation of such attached/retained properties under section 8 of the Act. Section 54 of the Act provides for duty of certain officers and others to assist the authorities for enforcement of the Act. Officers of reporting entities, that is, banks and financial institutions, fall in the aforesaid category.

It has been argued none of the aforesaid provisions empower the respondent authorities to issue the impugned letter dated 19.09.2014 directing respondent banks to prohibit/freeze withdrawal from the accounts maintained by the appellant's group of Companies. It has been submitted that such power could have been exercised only after recording requisite satisfaction as to reasonable

belief under section 5 or section 7 of the Act. Admittedly such notice has not been issued under the said provisions and is therefore liable to be quashed.

It has also been argued in view of the fact that the monies collected from the public issuing of non-convertible debentures having been refunded there was no reason to prohibit/freeze withdrawal from the accounts of the appellant No.1 Company.

With regard to the issue of refund of debenture money, one must bear in mind the wide definition of the word 'proceeds of crime' in the Act. Proceeds of crime under the Act is not only relates to property derived or obtained directly from the criminal activity but also extends to properties indirectly derived or obtained as a result of criminal activity which is a 'scheduled offence' or the value of such property. Hence, proceeds of crime in the instant case relating to the scheduled offence under SEBI Act would not only mean the amount directly collected from the public through the illegal debenture scheme but also to all other benefits or usufruct which have directly or indirectly accrued to the credit of the Company therefrom.

That apart, it appears although the investigation had initially commenced in respect of the 'scheduled offence' under SEBI Act it is no longer restricted to the same. In the meantime, investigation under PML Act has been extended to other scheduled offences under the Indian Penal Code, e.g., 420/120B of IPC which are being investigated by CBI pursuant to direction of the Apex Court in Subrata Chatteraj (supra) with regard to crores of monies collected from innocent depositors under various collective investment schemes floated by the appellant's group of Companies.

It has been strenuously argued that the investigation in the instant case cannot be extended to other scheduled offences inasmuch as same was initially registered for the scheduled offence under SEBI Act. We are unable to subscribe to such submission. Investigation of a crime is an ongoing dynamic process. It may commence in respect of a particular 'scheduled offence' but may in the course of its progresses encompass within its ambit other 'scheduled offences' too.

Whether investigation of such other 'scheduled offences' ought to have been done by registering a separate case/file number is a matter of administrative convenience and not one of inherent lack of jurisdiction of the respondent authority to carry on such investigation. Hence, we are unable to accept the submission of the learned senior counsel for the appellant that the investigation in the instant case could not have taken without its ambit other 'scheduled offences' under the Indian Penal Code for which the appellant's group of Companies are being proceeded with while issuing the impugned letter dated 19.09.2014 to its bankers.

Coming to the other issue as to lack of inherent jurisdiction to make request to the appellant's bankers for prohibition/freezing of withdrawal from the accounts maintained by the appellant's group of Companies without restoring to section 5 (attachment) or section 7 (seizure) of the Act, let us examine the same in the light of the various provisions of the Act. Section 2(na) defines 'investigation'. The definition is an inclusive one and therefore would empower investigating agency to take recourse to not only proceedings under the Act but also to all incidental and consequential acts that may be necessary for effectively pursuing such proceedings to ensure collection of evidence. The prime object of an investigation for an offence of money laundering is that the investigating agency must be empowered to take immediate steps so that monies credited in suspicious accounts are not spirited away rendering the proceedings under the Act nugatory and otiose.

It is true that existence of reasonable belief is the condition precedent for exercise of powers under section 5 (attachment) or section 7 (seizure of the property or asset) of an accused.

However, existence of reasonable belief is not a condition precedent for commencement of investigation under the Act. Such investigation may be commenced on reasonable suspicion that 'proceeds of crime' relating to 'scheduled offences' are being dealt with in a manner defined in section 3 of the Act.

In the course of such investigation, it may be necessary for the investigating agency to trace out suspicious transactions and/or the trail of monies in the accounts maintained by an accused who is being investigated for such offence. If during the course of such tracing, identification and verification, monies from such accounts are permitted to be withdrawn and/or siphoned off, the very purpose of investigation would be rendered futile and nugatory.

To obviate such futility, investigating agency must be held to possess an enabling and/or incidental power to request a reporting entity, namely, a banking company to temporarily prohibit withdrawal from the accounts of an accused who is being investigated into under the Act. No doubt such power must be exercised in contemplation of proceedings under the Act, e.g., proceedings for attachment or seizure under section 5/7 of the Act. To hold otherwise, would denude the authorities of the power to preserve the funds in the account of the accused person during investigation and would render the very powers of seizure/attachment of assets after arriving at a reasonable belief a dead letter of law. Temporary powers of prohibiting withdrawal from the accounts of an accused pending investigation are in aid of exercise of powers under section 5/7 under the Act and not to circumvent them.

Accordingly, the absence of reasonable belief as vigorously argued by the learned senior counsel does not denude the jurisdiction of the investigating agency to take incidental or consequential steps for preservation of evidence pending further investigation in contemplation of exercise of powers of seizure or attachment under the Act

It is settled law that when a statute confers power on an authority to do a thing, it gives powers by necessary implication to do all other things that are necessary for doing that thing. Hence, acts which are necessary and incidental for performance of a statutory power are to be inferred by necessary implication. Failure to do so, would render such statutory power a dead letter of law.

In *V.T. Khanzode & Ors. Vs. Reserve Bank of India & Anr.*, (1982) 2 SCC 7, the Apex Court held - '.....The doctrine of ultra vires in relation to the powers of a statutory corporation has to be understood reasonably and so understood, 'whatever may fairly be regard as incidental to, or consequential upon, those things which the legislature has authorized ought not (unless expressly prohibited) to be held by judicial construction, to be ultra vires'. (See *Attorney-General Vs. Great Easter Rly. Co.*, (1880) 5 AC 473 (HL).'

Similar view was reiterated in *Khargram Panchayat Samiti & Anr. Vs. State of West Bengal & Ors.*, (1987) 3 SCC 82.

It is well-accepted that the conferral of statutory powers on these local authorities must be construed as impliedly authorising everything which could fairly and reasonably be regarded as incidental or consequential to the power itself. See: *De Smith's Judicial Review of Administrative Action*. 4th edn., p. 95, *HWR Wade's Administrative Law*, 5th edn., p. 217, *Craies on Statute Law*, 6th edn., p. 276, *Attorney General v. Great Eastern Railway*, LR (1880) 5 AC 473; *Baroness Wenlock v. River Dee Co.*, LR (1885) 10 AC 354. De Smith in his celebrated work *Judicial Review of Administrative Action*, 5th edn. at p. 95 puts the law tersely in these words:

The House of Lords has laid down the principle that "whatever may fairly be regarded as incidental to, or consequent upon, those things which the Legislature has authorised, ought not

(unless expressly prohibited) to be held, by judicial construction, to be ultra vires.”.

This principle was enunciated by Lord Selborne in *Attorney General v. Great Eastern Railway* in these words: The doctrine of ultra vires ought to be reasonably and not unreasonably, understood and applied and whatever may be fairly regarded as incidental to or consequential upon, those things which the legislature has authorised ought not (unless expressly prohibited) to be held, by judicial construction, to be ultra vires.

These words have been quoted by Professor Wade in his monumental work *Administrative Law*, 5th edn. at p, 217 and also by Craies on *Statute Law*, 6th edn. p, 276. Craies also refers to the observations of Lord Watson in *Baroness Wenlock v. River Lee Co.* to the effect:

Whenever a corporation is created by Act of Parliament, with reference to the purposes of the Act, and solely with a view to arraying these purposes into execution, I am of opinion not only that the objects which the corporation may legitimately pursue must be ascertained from the Act itself, but that the powers which the corporation may lawfully use in furtherance of these objects must either be expressly conferred or derived by reasonable implication from its provisions.”

It ought to be borne in mind that the word 'investigation' in the Act is an inclusive one. It would, therefore, include within its fold all such incidental and consequential powers which may be necessary to achieve its end, namely, collection of evidence and thereby enforcement of the Act.

The authority of respondent No.3 to issue impugned letter is not traced to section 5 or section 7 of the Act. On the other hand, it is traceable to incidental or consequential powers exercised by an investigating authority to give effect to the provisions of the Act and for its effective enforcement. Hence, recording of reasonable belief is not a sine qua non for taking such temporary pre-emptive measure for preservation of evidence which are undertaken in contemplation of and in aid to the initiation of proceeding of seizure and attachment under the Act. In such view of the matter, ratio in *Rohtas Industries Ltd. Vs. S.D. Agarwal & Anr.*, AIR 1969 SC 707 which deals with existence of reasonable belief for exercise of statutory powers of investigation under the Companies Act is of no help to the appellant.

Respondents banks being 'reporting entities' under the Act are duty bound to act upon a request made by the authorities under section 54 of the Act.

PML Act, 2002 empowers the authorities to initiate all proceedings under the Act for collection of evidence. Attachment or seizure of properties which are reasonably believed to be proceeds of crimes or connected therewith are contemplated under section 5 or 7 of the Act. All incidental and consequential acts like temporary prohibition of withdrawal from accounts of an accused pending investigation for giving effect to such powers of seizure and attachment are, therefore, to be inferred for effective enforcement of the Act.

Failure to infer such power would result in siphoning off funds from accounts of accused persons pending investigation rendering powers of seizure/attachment under the Act otiose.

Viewed from such perspective, the impugned letter is neither an unlawful invasion of right to property nor is the same bereft of statutory sanction. Any other interpretation would frustrate the object or purpose of the law which seeks to create an effective machinery for investigation and collective of evidence in money laundering cases and render the same an illusory one.

In *Bijaya Kumar Agarwala Vs. State of Orissa*, (1996) 5 SCC 1, the Apex Court was considering the interpretation of the word 'storage' and held, the same would not include, 'transportation.' The

ratio is, therefore, wholly inapplicable while interpreting the inclusive definition of the word 'investigation' under the Act.

Similarly, in *Aslam Mohammad Merchant Vs. Competent Authority & Ors.*, (2008) 14 SCC 186 show cause notice was quashed as the same was issued on the mere direction of competent authority without recording reasons and/or application of mind

Finally, it has been argued that there is no reference to other scheduled offences apart from the scheduled offence in SEBI Act in the impugned letter.

Reliance has been made in *Chandre Singh Vs. State of Rajasthan* (paragraph 38).

Section 68 of the Act, inter alia, provides that notice or order or other proceeding under PML Act, 2002 shall not be rendered invalid by reason of any mistake, defect or omission in such notice, summon or order if such notice, summon or order is otherwise in conformity with the intent and purpose of the Act. Section 68 of the Act reads as follows:-

'68. Notice, etc., not to be invalid on certain grounds.-No notice, summons, order, document or other proceeding, furnished or made or issued or taken or purported to have been furnished or made or issued or taken in pursuance of any of the provisions of this Act shall be invalid, or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such notice, summons, order, document or other proceeding if such notice, summons, order, document or other proceeding is in substance and effect in conformity with or according to the intent and purpose of this Act.'

It appears that the impugned letter was issued in exercise of powers of investigation as defined under section 2(na) of the Act and has been done for the purpose of enforcement of the Act. Furthermore, records produced during hearing show that appellant is accused of commission of other 'scheduled offences' under the Act and is being investigated by CBI on that score. Hence, mere absence of reference to other 'scheduled offences' in the impugned letter cannot be a ground to invalidate the impugned notice under the Act.

In view of the saving clause engrafted in section 68 (supra) and the materials emanating from records of investigation, we are of the view *Chandre Singh* (supra) is inapplicable to the facts of the case.

It is also argued on behalf of the respondents relying on *Chandra Singh & Ors. Vs. State of Rajasthan & Anr.*, (2003) 6 SCC 545 the Court in exercise of discretionary jurisdiction under Article 226 may not interfere with an illegal order whereby substantial justice is being done.

Reference has also been made by the respondents to *B. Rama Raju Vs. Union of India*, (2011) 164 Com Cas 149 (AP) and unreported judgment dated 31.07.2013 of Gujarat High Court in Special Civil Application No.4171 of 2012 with Special Civil Application No.1059 of 2012, *Alive Hospitality & Food Private Ltd. Vs. Union of India*. None of the aforesaid cited cases deal with the issue raised in this appeal.

In *B. Rama Raju* (supra) vires of the Act was under challenge whereas in *Alive Hospitality & Food Pvt. Ltd.* (supra) the Court was seized with a case of provisional attachment.

In conclusion it is held as follows :-

(a) Impugned letter dated 19.09.2014 issued by respondent no. 3 requesting respondent banks (reporting entities under the Act) to prohibit/freeze withdrawal of monies from the

account of the appellant's group of Companies is to be read as an indispensable temporary measure for preservation of evidence pending investigation and has been issued in aid of proceedings for attachment and seizure contemplated under section 5 or 7 of the Act and not to supplant them. Such incidental and consequential power being in aid to proceedings contemplated under the Act is held to be vested in the investigating agency in view of the inclusive definition of "investigation" under section 2(na) of PML Act, 2002.

(b) Respondents banks being "reporting entities" under the Act are duty bound to assist the investigating agency in terms of section 54 of PML Act and therefore issuance of notice upon the respondent's banks cannot be said to be illegal.

(c) Failure to refer to other "scheduled offences" apart from the one under the SEBI Act in the impugned letter would not ipso facto invalidate the same in view the materials emanating from the records of investigation as also the saving provision engrafted in section 68 of the PML Act, 2002.

(d) Impugned letter dated 19.09.2014 having been held to be a temporary measure in aid of proceedings under the Act cannot be an end in itself. Hence, embargo contained in the said letter cannot continue indefinitely but is required to be restricted to a time frame within which the respondents may initiate appropriate proceedings under the Act in respect of the accounts/assets referred therein.

Accordingly, the impugned letter dated 19.09.2014 is modified and the embargo contained therein is directed to operate for a period of three months from date within which the respondent authorities are at liberty to initiate appropriate proceedings as contemplated under the Act, if not already done, in respect of the assets/accounts referred to therein. If the respondent authorities fail to initiate proceedings under the Act in respect of the accounts/assets referred to in the impugned letter within the aforesaid time frame, the respondent banks would be at liberty to permit the appellants to operate the said accounts/assets in accordance with law.

The appeal is partly allowed.

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TELECOM REGULATORY AUTHORITY OF INDIA ACT, 1997

Cellular Operators Association of India and Others v. Telecom Regulatory Authority of India and Others

Supreme Court Judgment dated: 11 May, 2016

Bench: Kurian Joseph, Rohinton Fali Nariman

R.F. Nariman, J.

2. This group of appeals before us is by various telecom operators who offer telecommunication services to the public generally. Various writ petitions were filed in the Delhi High Court challenging the validity of the Telecom Consumers Protection (Ninth Amendment) Regulations, 2015 (hereinafter referred to as the “Impugned Regulation”), notified on 16.10.2015, (to take effect from 1.1.2016), by the Telecom Regulatory Authority of India. The aforesaid amendment was made purportedly in the exercise of powers conferred by Section 36 read with Section 11 of the Telecom Regulatory Authority of India Act, 1997. By the aforesaid amendment, every originating service provider who provides cellular mobile telephone services is made liable to credit only the calling consumer (and not the receiving consumer) with one rupee for each call drop (as defined), which takes place within its network, upto a maximum of three call drops per day. Further, the service provider is also to provide details of the amount credited to the calling consumer within four hours of the occurrence of a call drop either through SMS/USSD message. In the case of a post-paid consumer, such details of amount credited in the account of the calling consumer were to be provided in the next bill.

3. A brief background is necessary in order to appreciate the controversy at hand. Under an Act of ancient vintage, namely, the Indian Telegraph Act, 1885, the Central Government or the Telegraph Authority is the licensing authority by which persons are licenced under Section 4(1) of the said Act for providing specified public telecommunication services. Given the fact that it is the Central Government or the Telegraph Authority who is the licensor in all these cases, the said licensor enters into what are described as licence agreements for the provision of Unified Access Services in the specified service areas. Various standard terms and conditions are laid down in these licences, some of which are described hereinbelow. Vide clause 2.1, such licences are granted to provide telecommunication services, as defined, on a non-exclusive basis in designated service areas. It is mandatory that the licensee provides such services of a good standard, by establishing a state-of-the-art digital network. Licences are usually given for a period of 20 years at a time with a 10-year extension if the licensor so deems expedient. Under clause 5 of the aforesaid licence agreement, the licensor reserves the right to modify, at any time, the terms and conditions of license, if in its opinion it is necessary or expedient so to do in public interest, in the interest of security of the State, or for the proper conduct of telegraphs. Under condition 28, which is of some relevance to determine the question involved in these appeals, the licensee shall ensure that the quality of service standards as prescribed either by the licensor or the Telecom Regulatory Authority of India shall be adhered to. The licensee is made responsible for maintaining performance and quality of service standards and is to keep a record of the number of faults and rectification reports in respect of a particular service which is to be produced before the licensor/TRAI as and when desired. It is also important that the licensee be responsive to complaints lodged by its subscribers and rectify the same. Under clause 34, which deals with roll-out obligations, the licensee is to ensure that coverage of a district headquarters/town would mean that at least 90% of the area bounded by municipal limits should get the required street and in-building coverage. Interestingly, under clause 35, liquidated damages are also provided for, in

case the licensee does not commission the service within 15 days of the expiry of the commissioning date and for certain other delays relatable to commissioning of service.

4. It may also be noted that right from September, 2005, TRAI has been lamenting the shortage and consequent distance of mobile towers from each other and both the Government as well as TRAI have been writing to the Chief Secretaries of various State Governments to grant timely permissions for establishing telecom towers. In this behalf, we have been shown guidelines issued by DOT to the Chief Secretaries dated 1.8.2013. We have also been shown an amendment to the Quality of Service Regulations dated 21.8.2014 by which TRAI has noticed practical difficulties that are faced due to various reasons by which cable breakdowns and indoor faults take place, with the Authority requiring the striking of a balance between the problems faced by the licensees and the need to ensure quality of service to customers. We were also shown a letter from the Ministry of Communications written to Chief Ministers of all the States to permit installation of towers on Government buildings. This letter is dated 3.8.2015. Further, there is a constant tussle between cell phone operators and municipal authorities, landing cell phone operators in court against municipal authorities, who seek to restrict the setting up of cell phone towers, given the apprehension that radiation from these towers has a direct causal link with cancer in human beings. It is also important to note that by a Quality of Service Regulation dated 20.3.2009, issued under Section 11 read with Section 36 of the TRAI Act, TRAI has provided, insofar as cellular mobile phone services are concerned, for a call drop rate of 2% averaged over a period of one month. It has also provided for financial disincentives in case there is a failure to meet this parameter by enacting a second amendment to the Quality of Service Regulations dated 8.11.2012 by which a service provider is liable to pay, by way of financial disincentive, an amount not exceeding ₹ 50,000/- per parameter that is contravened as the Authority may by order direct, and in the case of second or subsequent contravention, to pay an amount not exceeding ₹ 1,00,000/- per parameter for each such contravention as the Authority may by order direct. One day before the Impugned Regulation, i.e., on 15.10.2015, this financial disincentive was raised from ₹ 50,000/- to ₹ 1,00,000/-, and ₹ 1,00,000/- to ₹ 1,50,000/- for the second consecutive contravention, and ₹ 2,00,000/- for each subsequent consecutive contravention.

5. It is in this background that the impugned Ninth Amendment to the Telecom Consumers Protection Regulations of 2015 was made, on 16.10.2015. The Impugned Regulation reads as under:-

**TELECOM CONSUMERS PROTECTION (NINTH AMENDMENT) REGULATIONS,
2015 (9 OF 2015)**

No. 301/2015-F&EA ----- In exercise of the powers conferred by section 36, read with sub-clauses (i) and (v) of clause (b) of sub-section (1) of section 11, of the Telecom Regulatory Authority of India Act, 1997 (24 of 1997), the Telecom Regulatory Authority of India hereby makes the following regulations further to amend the Telecom Consumers Protection Regulations, 2012 (2 of 2012), namely:-

1. (1) These regulations may be called the Telecom Consumers Protection (Ninth Amendment) Regulations, 2015.

(2) They shall come into force from the 1st January, 2016. 2. In regulation 2 of the Telecom Consumers Protection Regulations, 2012 (hereinafter referred to as the principal regulations), after clause

(ba), the following clauses shall be inserted, namely:--

“(bb) “call drop” means a voice call which, after being successfully established, is interrupted prior to its normal completion; the cause of early termination is within the network of the service provider;”;

(bc) “calling consumer” means a consumer who initiates a voice call;”; 3. After Chapter IV of the principal regulations, the following chapter shall be inserted, namely :-

“CHAPTER V”

RELIEF TO CONSUMERS FOR CALL DROPS

16. Measures to provide relief to consumers.- Every originating service provider providing Cellular Mobile Telephone Service shall, for each call drop within its network,

(a) credit the account of the calling consumer by one rupee: Provided that such credit in the account of the calling consumer shall be limited to three dropped calls in a day (00:00:00 hours to 23:59:59 hours);

(b) provide the calling consumer, through SMS/USSD message, within four hours of the occurrence of call drop, the details of amount credited in his account; and

(c) in case of post-paid consumers, provide the details of the credit in the next bill.”

6. The explanatory memorandum to the aforesaid amendment makes interesting reading. In the first paragraph of the said memorandum, the 2009 Quality of Service Regulation referred to hereinabove, granting an allowance of an average of 2% call drops per month, is specifically referred to. Also, interestingly enough, the service providers have stated that they are meeting this benchmark completely with one or two minor exceptions. Despite this, the Authority has embarked on the Impugned Regulation, stating that consumers, at various fora, have raised the issue of call drops, complaining that in their experience, the quality of making voice calls has deteriorated. The Authority responded by issuing a consultation paper marked “Compensation to the Consumers in the event of dropped calls” dated 4.9.2015. Stakeholders were given till 21.9.2015 to submit their comments in writing with counter comments thereto being given one week thereafter, i.e., by 28.9.2015. The Authority records that written comments were received from 4 industry associations, 11 Cellular Mobile Telephone Service Providers, 2 consumer advocacy groups, 2 organizations, and 518 individual consumers. 5 counter comments were also received. The Authority notes that an open house discussion was held on 1.10.2015 in New Delhi with the stakeholders. According to the Authority, consumers wanted relief in the event of dropped calls under two broad heads – excess charging and inconvenience caused to them. In paragraphs 6 and 7, the arguments of service providers have been noted, in which service providers stated their difficulties in the matter of sealing/closing down existing sites for towers by municipal authorities and other related issues together with spectrum related issues. They specifically informed the Authority that a large proportion of call drops are beyond their control. In reply thereto, consumers spoke of the inconvenience caused to them by call drops. Some consumers also contended that the financial disincentive levied for failing to meet the benchmark for call drop rates should be revised upwards. (This was in fact done, as we have seen, just one day before the Impugned Regulation itself, i.e., on 15.10.2015). The Explanatory Memorandum then goes on to state:-

“18. Based on the above, it is clear that while all CMTSPs and the industry associations have argued that question for compensation to the consumers on call drops does not arise as it is neither justifiable nor practicable, most of the consumers and consumer advocacy groups have insisted that they should be compensated by the CMTSPs for the inconvenience caused to them.

19. After a careful analysis, the Authority has come to the conclusion that call drops are instances of deficiency in service delivery on part of the CMTSPs which cause inconvenience to the consumers, and hence it would be appropriate to put in place a mechanism for compensating the consumers in the event of dropped calls. The Authority is of the opinion that compensatory mechanism should be kept simple for the ease of consumer understanding and its implementation by the CMTSPs. While one may argue that amount of compensation should be commensurate to the loss/ suffering caused due to an event but in case of a dropped call it is difficult to quantify the loss/suffering/inconvenience caused to the consumers as it may vary from one consumer to another and also in accordance to their situations. Accordingly, the Authority has decided to mandate originating CMTSPs to credit one Rupee for a dropped call to the calling consumers as notional compensation. Similarly, the Authority has decided that

such credit in the account of the calling consumer shall be limited to three dropped calls in a day (00:00:00 hours to 23:59:59 hours). The Authority is of the view that such a mandate would compensate the consumers for the inconvenience caused due to interruption in service by way of call drops, to a certain extent.

20. The Authority is also aware that communication to the consumers is important and therefore, the Authority has decided to mandate that, each originating CMTSP, within four hours of the occurrence of call drop within its network, inform the calling consumer, through SMS/USSD message the details of amount credited in his account for the dropped call, if applicable.

21. The Authority is conscious of the fact that for carrying out the afore-mentioned mandate, the CMTSPs would have to make suitable provisions in their systems, which would require time and efforts. Accordingly, the Authority has decided that the afore-mentioned mandate would become applicable on the CMTSPs with effect from the 1st January, 2016.

22. The Authority shall keep a close watch on the implementation of the mandate as well as the measures being initiated by the CMTSPs to minimize the problem of dropped calls as given in their submissions during the consultation process and may review after six months, if necessary.”

7. At this stage, it is necessary to refer to a technical paper issued by the very same Authority a few days after the Impugned Regulation. On 13.11.2015, TRAI issued a paper called “Technical Paper on call drops in cellular network”. TRAI noticed that the consumer base in the country is growing very fast and that the mobile telecom infrastructure is not growing at the same pace. This leads to a dip in the quality of service provided. It is interesting to notice that TRAI specifically adverts to the fact that call drops can take place due to a variety of reasons. It pointed out that one of the reasons is due to the consumer’s own fault, and that 36.9% of call drops are attributable to consumer faults. It further went on to notice that the benchmark set for call drops is 2%, and it is seen that only 3 out of 12 licensees are not adhering to the said benchmark – 2 of them being BSNL, who is not an appellant before us, the other one being Aircel. The Authority ultimately concluded:-

“5.27. In light of the reasons discussed above about the increase in call drops, it must be realized that mobile towers do not have an unlimited capacity for handling the current network load. There is an urgent need to increase the number of the towers so as to cater to the demands of a growing subscriber base. At the same time, problems like removal of towers from certain areas by Authorities should be adequately addressed. This problem is particularly evident in urban areas. Moreover, with the increase in the usage of 3G networks, the growth rate of mobile towers supporting 2G networks has reduced. This must be addressed.

5.28. The previous sections highlighted some important countermeasures at the TSPs’ end. Measures like Dynamic Channel Allocation, multiple call routing and optimized resource management can be employed by the TSP’s besides usage of mobile signal boosters through the TSPs at users’ buildings or premises. Some prioritization schemes like MBPS, CAC, Guard Channels, Handoff Queuing and Auxiliary Stations essentially need to be incorporated by TSPs to reduce call drops.”

8. A Writ Petition, being Writ Petition (Civil) No.11596 of 2015, was filed before the Delhi High Court, together with various other petitions, in which the Ninth Amendment, being the Impugned Amendment to the Regulation pointed out hereinabove, was challenged. By the impugned judgment dated 29.2.2016, the Delhi High Court noticed the various arguments addressed on behalf of the various appellants, together with the reply given by Shri P.S. Narasimha, learned Additional Solicitor General of India appearing on behalf of TRAI. The High Court then went on to discuss the validity of the Impugned Regulation under two grounds – the ground of being ultra vires the parent Act, and the ground that the Regulation was otherwise unreasonable and manifestly arbitrary. The High Court repelled the challenge of the appellants on both the aforesaid grounds. added that the impossibility of identification of the reason for the call drop

was incorrect inasmuch as these reasons are network related, and that is something that has not been disputed by telecom equipment manufacturers like M/s. Nokia and M/s. Ericsson. It was further held that the Impugned Regulation attempted to balance the interest of consumers with the interest of service providers by limiting call drops that are to be compensated to only 3 and also mandating that only the calling consumer and not the receiving consumer was liable to be so compensated. In dealing with manifest arbitrariness, the High Court held that the 2% standard imposed by the Quality of Service Regulations is distinct and different from compensation provided to consumers for dropped calls. The High Court sought to make a distinction between the 2% tolerance limit as being a quality parameter for the entire network area, as against compensation provided which specifies an individual standard. On the plea that the difficulties faced by service providers in setting up mobile towers being something beyond their control, the High Court declined to enter into the said controversy since the High Court does not have the expertise to adjudicate on such rival claims. The validity of the Impugned Regulation was upheld and the Writ Petitions were dismissed.

9. At this stage, it would be important to notice the arguments made on behalf of the various appellants before us. We have heard learned senior advocates Shri Kapil Sibal, Dr. Abhishek Manu Singhvi, and Shri Gopal Jain. The arguments that were made by them can fall into four neat logical compartments. First and foremost, they argued that the Ninth Amendment to the Telecom Consumers Protection Regulations, 2015, is ultra vires Section 36 read with Section 11 of the Telecom Regulatory Authority of India Act, 1997. They argued that, in any event, these Regulations, being in the nature of subordinate legislation, were manifestly arbitrary and unreasonable, and therefore affected their fundamental rights under Article 14 and Article 19(1)(g) of the Constitution. They further went on to state that there was no power in the TRAI to interfere with their licence conditions which are contract conditions between the licensor and the licensee, and that the said Regulations in seeking to impose a penalty not provided for by the licence should be struck down as such. Fourthly, they argued that Section 11(4) of the said Act requires the Authority to be transparent in its dealings with the various stakeholders, and it has miserably failed in this also.

17. Having heard learned counsel for all the parties, it is first necessary to set out the relevant provisions of the Telecom Regulatory Authority of India Act, 1997. 18. The Statement of Objects and Reasons for the said Act is as follows: “

1. In the context of the National Telecom Policy, 1994, which amongst other things, stresses on achieving the universal service, bringing the quality of telecom services to world standards, provisions of wide range of services to meet the customers demand at reasonable price, and participation of the companies registered in India in the area of basic as well as value added telecom services as also making arrangements for protection and promotion of consumer interest and ensuring fair competition, there is a felt need to separate regulatory functions from service providing functions which will be in keeping with the general trend in the world. In the multi-operator situation arising out of opening of basic as well as value added services in which private operator will be competing with Government operators, there is a pressing need for an independent telecom regulatory body for regulation of telecom services for orderly and healthy growth of telecommunication infrastructure apart from protection of consumer interest.”

The Preamble of the Telecom Regulatory Authority Act of 1997 reads as under:

“Preamble - An act to provide for the establishment of the Telecom Regulatory Authority of India to regulate the telecommunication services, and for matters connected therewith or incidental thereto.”

Section 11(n) read as under:-

Functions of Authority – (1) Notwithstanding anything contained in the Indian Telegraph Act, 1885, the functions of the Authority shall be to – (n) settle disputes between service providers”

Parameters of Judicial Review of Subordinate Legislation

20. In *State of Tamil Nadu v. P. Krishnamoorthy*, (2006) 4 SCC 517, this Court after adverting to the relevant case law on the subject, laid down the parameters of judicial review of subordinate legislation generally thus:-

“There is a presumption in favour of constitutionality or validity of a subordinate legislation and the burden is upon him who attacks it to show that it is invalid. It is also well recognised that a subordinate legislation can be challenged under any of the following grounds: (a) Lack of legislative competence to make the subordinate legislation. (b) Violation of fundamental rights guaranteed under the Constitution of India. (c) Violation of any provision of the Constitution of India. (d) Failure to conform to the statute under which it is made or exceeding the limits of authority conferred by the enabling Act. (e) Repugnancy to the laws of the land, that is, any enactment. (f) Manifest arbitrariness/unreasonableness (to an extent where the court might well say that the legislature never intended to give authority to make such rules). The court considering the validity of a subordinate legislation, will have to consider the nature, object and scheme of the enabling Act, and also the area over which power has been delegated under the Act and then decide whether the subordinate legislation conforms to the parent statute. Where a rule is directly inconsistent with a mandatory provision of the statute, then, of course, the task of the court is simple and easy.

But where the contention is that the inconsistency or non-conformity of the rule is not with reference to any specific provision of the enabling Act, but with the object and scheme of the parent Act, the court should proceed with caution before declaring invalidity.” [paras 15 and 16]

21. In the present case, the appellants have raised pleas under paragraphs (b), (d) and (f) of paragraph 15 of the said judgment. We now move on to consider their arguments.

Ultra vires

22. The power to make the Impugned Regulation is traceable to Section 36(1) of the Telecom Regulatory Authority of India Act, 1997. This Court in *BSNL v. Telecom Regulatory Authority of India*, (2014) 3 SCC 222, after analysing the aforesaid provision in the backdrop of the Act held as follows:-

“We may now advert to Section 36. Under sub-section (1) thereof TRAI can make regulations to carry out the purposes of the TRAI Act specified in various provisions of the TRAI Act including Sections 11, 12 and 13. The exercise of power under Section 36(1) is hedged with the condition that the regulations must be consistent with the TRAI Act and the rules made thereunder. There is no other restriction on the power of TRAI to make regulations. In terms of Section 37, the regulations are required to be laid before Parliament which can either approve, modify or annul the same.

A reading of the plain language of Section 33 makes it clear that TRAI can, by general or special order, delegate to any member or officer of TRAI or any other person such of its powers and functions under the TRAI Act except the power to settle disputes under Chapter IV or make regulations under Section 36. This means that the power to make regulations under Section 36 is non-delegable. The reason for excluding Section 36 from the purview of Section 33 is simple. The power under Section 36 is legislative as opposed to administrative. By virtue of Section 37, the regulations made under the TRAI Act are placed on a par with the rules which can be framed by the Central Government under Section 35 and being in the nature of subordinate legislations, the rules and regulations have to be laid before both the Houses of Parliament which can annul or modify the same.

Thus, the regulations framed by TRAI can be made ineffective or modified by Parliament and by no other body.

In view of the above discussion and the propositions laid down in the judgments referred to in the preceding paragraphs, we hold that the power vested in TRAI under Section 36(1) to make regulations is wide and pervasive. The exercise of this power is only subject to the provisions of the TRAI Act and the rules framed under Section 35 thereof. There is no other limitation on the exercise of power by TRAI under Section 36(1). It is not controlled or limited by Section 36(2) or Sections 11, 12 and 13.” [paras 89, 98 – 100]

23. It will thus be seen that though the Regulation making power under the said Act is wide and pervasive, and is not trammelled by the provisions of Section 11, 12(4) and 13, it is a power that is non-delegable and, therefore, legislative in nature. Since the regulation making power has first to be consistent with the Act, it is necessary that it not be inconsistent with Section 11 of the Act, and in particular Section 11(1)(b) thereof. This is for the reason that the functions of the Authority are laid down by this Section, and that the Impugned Regulation itself refers to Section 11(1)(b)(i) and (v) as the source of power under which the Impugned Regulation has been framed. Since ensuring compliance with the terms and conditions of licence is the first thing that has been argued on behalf of the respondents, it is important to advert to the provisions of the licence between the service provider and the consumer. As has been mentioned above, two very important clauses of this licence refer to (i) the power to modify the licence conditions which is contained in clause 5 and (ii) the ensuring by the licensee that the quality of service shall be as prescribed by the licensor or TRAI by clause 28 thereof. Under clause 5, the licensor reserves the right to modify the terms and conditions of the licence if in the opinion of the licensor it is necessary or expedient so to do in public interest or in the interest of security of the State or for the proper conduct of telegraphs. It may be stated that no modification of the licence has in fact been attempted or has taken place in the facts of the present case.

24. Under clause 28 it is a condition that the licensee shall ensure the quality of service as prescribed by the licensor or TRAI, and shall adhere to such standards as are provided. Another important thing to notice is that under clause 28.2 the licensee has to keep a record of the number of faults and rectification reports in respect of its service, which will be produced before the licensor/TRAI as and when desired. This being the case, it is clear that the Impugned Regulation cannot be said to fall under Section 11(1)(b)(i) at all inasmuch as it does not seek to enforce any term or condition of the licence between the service provider and the consumer. Coming to sub-para (v) of Section 11(1)(b), the Impugned Regulation would again have no reference to the said paragraph, inasmuch as it does not lay down any standard of quality of service to be provided by the service provider. In order that clause (v) be attracted, not only do standards of quality of service to be provided by the service providers have to be laid down, but standards have to be adhered to by the service providers so as to protect the interests of the consumers. We find that the Impugned Regulation is not referable to Section 11(1)(b)(i) and (v) of the Act inasmuch as it has not been made to ensure compliance of the terms and conditions of the licence nor has it been made to lay down any standard of quality of service that needs compliance. This being the case, the Impugned Regulation is de hors Section 11 but cannot be said to be inconsistent with Section 11 of the Act. This Court has categorically held in the BSNL judgment that the power under Section 36 is not trammelled by Section 11. This being so, the Impugned Regulation cannot be said to be inconsistent with Section 11 of the Act. However, in attempting to protect the interest of the consumer of the telecom sector at the cost of the interest of a service provider who complies with the leeway of an average of 2% of call drops per month given to it by another Regulation, framed under Section 11(1)(b)(v), the balance that is sought to be achieved by the Act for the orderly growth of the telecom sector has been violated. Therefore, we hold that the Impugned Regulation does not carry out the purpose of the Act and must be held to be ultra vires the Act on this score.

Violation of Fundamental Rights

25. We have already seen that one of the tests for challenging the constitutionality of subordinate legislation is that subordinate legislation should not be manifestly arbitrary. Also, it is settled law that subordinate legislation can be challenged on any of the grounds available for challenge against plenary legislation

26. The test of “manifest arbitrariness” is well explained in two judgments of this Court. In **Khoday Distilleries Ltd. v. State of Karnataka**, (1996) 10 SCC 304, this Court held:

*“It is next submitted before us that the amended Rules are arbitrary, unreasonable and cause undue hardship and, therefore, violate Article 14 of the Constitution. Although the protection of Article 19(1) (g) may not be available to the appellants, the rules must, undoubtedly, satisfy the test of Article 14, which is a guarantee against arbitrary action. However, one must bear in mind that what is being challenged here under Article 14 is not executive action but delegated legislation. The tests of arbitrary action which apply to executive actions do not necessarily apply to delegated legislation. In order that delegated legislation can be struck down, such legislation must be manifestly arbitrary; a law which could not be reasonably expected to emanate from an authority delegated with the law-making power. In the case of *Indian Express Newspapers (Bombay) Pvt. Ltd. and Ors. v. Union of India and Ors.* [(1985) 1 SCC 641 : 1985 SCC (Tax) 121 : (1985) 2 SCR 287], this Court said that a piece of subordinate legislation does not carry the same degree of immunity which is enjoyed by a statute passed by a competent legislature. A subordinate legislation may be questioned under Article 14 on the ground that it is unreasonable; “unreasonable not in the sense of not being reasonable, but in the sense that it is manifestly arbitrary”. Drawing a comparison between the law in England and in India, the Court further observed that in England the Judges would say, “Parliament never intended the authority to make such Rules; they are unreasonable and ultra vires”. In India, arbitrariness is not a separate ground since it will come within the embargo of Article 14 of the Constitution. But subordinate legislation must be so arbitrary that it could not be said to be in conformity with the statute or that it offends Article 14 of the Constitution.” [para 13]*

29. Under Article 19(6) of the Constitution, the State has to conform to two separate and independent tests if it is to pass constitutional muster – the restriction on the appellants’ fundamental right must first be a reasonable restriction, and secondly, it should also be in the interest of the general public. Perhaps the best exposition of what the expression “reasonable restriction” connotes was laid down in **Chintaman Rao v. State of Madhya Pradesh**, 1950 SCR 759, as follows:-

“The phrase “reasonable restriction” connotes that the limitation imposed on a person in enjoyment of the right should not be arbitrary or of an excessive nature, beyond what is required in the interests of the public. The word “reasonable” implies intelligent care and deliberation, that is, the choice of a course which reason dictates. Legislation which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness and unless it strikes a proper balance between the freedom guaranteed in article 19(1)(g) and the social control permitted by clause (6) of article 19, it must be held to be wanting in that quality.” [at p.763]

32. This is for the reason that even if we accept the demarcation of the cause of call drops to be what the learned Attorney General says it is, the Impugned Regulation must be held to be manifestly arbitrary and an unreasonable restriction on the appellants’ fundamental rights to carry on business. According to the learned Attorney General, the cause for call drops is twofold – one owing to the fault of the consumer, and the other owing to the fault of the service provider. And, for this dichotomy, he has referred to the technical paper dated 13.11.2015, which shows that an average of 36.9% can be call drops owing to the fault of the consumer. If this is so, the Impugned

Regulation's very basis is destroyed: the Regulation is based on the fact that the service provider is 100% at fault. This becomes clear from a reading of the text of the said Regulation together with the Explanatory Memorandum set out hereinabove. This being the case, it is clear that the service provider is made to pay for call drops that may not be attributable to his fault, and the consumer receives compensation for a call drop that may be attributable to the fault of the consumer himself, and that makes the Impugned Regulation a regulation framed without intelligent care and deliberation.

33. But it was said that the aforesaid Regulation should be read down to mean that it would apply only when the fault is that of the service provider. We are afraid that such a course is not open to us in law, for it is well settled that the doctrine of reading down would apply only when general words used in a statute or regulation can be confined in a particular manner so as not to infringe a constitutional right.

35. It is clear that the language of the Regulation is definite and unambiguous – every service provider has to credit the account of the calling consumer by one rupee for every single call drop which occurs within its network. The Explanatory Memorandum to the aforesaid Regulation further makes it clear, in paragraph 19 thereof, that the Authority has come to the conclusion that call drops are instances of deficiency in service delivery on the part of the service provider. It is thus unambiguously clear that the Impugned Regulation is based on the fact that the service provider is alone at fault and must pay for that fault. In these circumstances, to read a proviso into the Regulation that it will not apply to consumers who are at fault themselves is not to restrict general words to a particular meaning, but to add something to the provision which does not exist, which would be nothing short of the court itself legislating.

38. The learned Attorney General has argued that the Impugned Regulation accords with the Statement of Objects and Reasons of the TRAI Act, 1997. As has been pointed out by us, the original Act was amended in the year 2000, in which its Preamble was substituted. The substitution indicates that the policy of the 1997 Act, as amended by the 2000 Act, is to protect the interests of service providers and consumers of the telecom sector together, so that the orderly growth of the telecom sector is ensured thereby. We are afraid that the orderly growth of the telecom sector cannot be ensured or promoted by a manifestly arbitrary or unreasonable regulation which makes a service provider pay a penalty without it being necessarily at fault.

39. We were then told that the Impugned Regulation was framed keeping in mind the small consumer, that is, a person who has a pre-paid SIM Card with an average balance of ₹ 10/- at a time, and that the Regulation goes a long way to compensate such person. The motive for the Regulation may well be what the Attorney General says it is, but that does not make it immune from Article 14 and the twin tests of Article 19(6). The Authority framing the Regulation must ensure that its means are as pure as its ends – only then will regulations made by it pass constitutional muster.

40. We were also told that huge profits were made by the service providers, and that the amount they would have to pay would not even be a flea bite compared to the profits they make, viewed in the background that they are not pouring in enough funds for infrastructure development. This was stoutly resisted by the appellants, pointing out that the so-called huge profits earned is misleading, as the figure of net debt is far greater than that of revenue earned, and that huge sums had been pumped in for infrastructure development. Without going into the factual controversy thus presented, there are two answers to this submission. First and foremost, whether the service providers make profits or losses cannot be said to be relevant for determining whether the Impugned Regulation is otherwise arbitrary or unreasonable. If the Attorney General were correct, then the converse proposition would also be true – namely, that even if all the service

providers were suffering huge losses, then such regulation, since it makes them fork out crores of rupees and add to their losses, would have to be held to be unconstitutional. Assuming that six out of the twelve service providers make profits, and the other six make losses, the Impugned Regulation cannot be held to be constitutional so far as those making a profit, and unconstitutional qua those making losses. And what if the same service provider makes a profit in one year and a loss in the succeeding year. Is the Impugned Regulation unconstitutional in the first year and constitutional in the succeeding year? Obviously not. Secondly, it is always open to the Authority, with the vast powers given to it under the TRAI Act, to ensure, in a reasonable and non-arbitrary manner, that service providers provide the necessary funds for infrastructure development and deal with them so as to protect the interest of the consumer. Consequently, this submission is also without substance.

42. In the present case, if the appellants had not gone to court when they did, the Regulation would have affected their fundamental rights on and from 1.1.2016. Further, they would have been denied interim and/or other relief on the ground that they have not moved the Court without undue delay. Also, to say that the Impugned Regulation is only an experimental measure that would last in its present form for six months is again wholly incorrect. The Impugned Regulation begins to tick on and from 1.1.2016, in which case three rupees per day, for call drops made not exclusively owing to the fault of the service provider, would have to be paid. Further, it is only the Explanatory Memorandum which says that the Authority may review the aforesaid Regulation after working of the said Regulation after six months, and that too only if found to be necessary. Obviously, this would not mean that the aforesaid Regulation would necessarily be reviewed at all, even after six months. We are, therefore, unable to subscribe to the aforesaid submission

43. We now come to a very important part of the submissions made on behalf of the appellants. The appellants have strongly contended that a 2% allowance of call drops on the basis of averaging call drops per month has been allowed to them by the Quality of Service Regulations already referred to hereinabove. This would amount to the Authority penalizing the service provider even when it complies with another regulation made under the same source of power, and for this reason alone, the Impugned Regulation must be held to be bad as being manifestly arbitrary. The learned Attorney General refuted this submission in two ways. First, he argued that Quality of Service Regulations and regulations made to benefit consumers must be viewed separately, as they are distinct regulations in parallel streams. He also argued that the 2% average allowance for call drops is different and distinct from paying compensation for call drops inasmuch as, conceivably, in a given set of facts, call drops may take place extensively in a given sector but not in other sectors so that an average of 2% per month is yet maintained, but the service provider would be penalized as it has not been able to maintain a 3% standard laid down qua deficiency of service in individual towers leading to call drops. However, the persons who suffer in the sector in which call drops are many and frequent would then have no protection. We are afraid neither of these reasons avails the Authority. First and foremost, the 2009 Quality of Service Regulation is made under Section 11(1)(b)(v), which is the very Section which is claimed to be the source of the Impugned Regulation. Secondly, both regulations deal with the same subject matter – namely, call drops, and both regulations are made in the interest of the consumer. If an average of 2% per month is allowable to every service provider for call drops, and it is the admitted position that all service providers before us, short of Aircel, and that too in a very small way, have complied with the standard, penalizing a service provider who complies with another Regulation framed with reference to the same source of power would itself be manifestly arbitrary and would render the Regulation to be at odds with both Articles 14 and 19(1)(g).

44. In **The Lord Krishna Sugar Mills Ltd. and Anr. v. Union of India and Anr.**, [1960] 1 SCR 39:

“It is, however, contended that though one can look at the surrounding circumstances, it is not open to the Court to examine other laws on the subject, unless those laws be incorporated by reference. In our opinion, this is a fallacious argument. The Court in judging the reasonableness of a law, will necessarily see, not only the surrounding circumstances but all contemporaneous legislation passed as part of a single scheme. The reasonableness of the restriction and not of the law has to be found out, and if restriction is under one law but countervailing advantages are created by another law passed as part of the same legislative plan, the Court should not refuse to take that other law into account.” [at para 56]

45. In view of the aforesaid, it is clear that the Quality of Service Regulations and the Consumer Regulations must be read together as part of a single scheme in order to test the reasonableness thereof. The countervailing advantage to service providers by way of the allowance of 2% average call drops per month, which has been granted under the 2009 Quality of Service Regulations, could not have been ignored by the Impugned Regulation so as to affect the fundamental rights of the appellants, and having been so ignored, would render the Impugned Regulation manifestly arbitrary and unreasonable.

46. Secondly, no facts have been shown to us which would indicate that a particular area would be filled with call drops thanks to the fault on the part of the service providers in which consumers would be severely inconvenienced. The mere *ipse dixit* of the learned Attorney General, without any facts being pleaded to this effect, cannot possibly make an unconstitutional regulation constitutional. We, therefore, hold that a strict penal liability laid down on the erroneous basis that the fault is entirely with the service provider is manifestly arbitrary and unreasonable. Also, the payment of such penalty to a consumer who may himself be at fault, and which gives an unjustifiable windfall to such consumer, is also manifestly arbitrary and unreasonable. In the circumstances, it is not necessary to go into the appellants’ submissions that call drops take place because of four reasons, three of which are not attributable to the fault of the service provider, which includes sealing and shutting down towers by municipal authorities over upon they have no control, or whether they are attributable to only two causes, as suggested by the Attorney General, being network related causes or user related causes. Equally, it is not necessary to determine finally as to whether the reason for a call drop can technologically be found out and whether it is a network related reason or a user related reason.

48. In the present case, also, a mandatory penalty is payable by the service provider for call drops that may take place which are not due to its fault, and may be due to the fault of the recipient of the penalty, which is violative of Articles 14 and 19(1)(g).

49. The reason given in the Explanatory Memorandum for compensating the consumer is that the compensation given is only notional. The very notion that only notional compensation is awarded, is also entirely without basis. A consumer may well suffer a call drop after 3 or 4 seconds in a voice call. Whereas the consumer is charged only 4 or 5 paise for such dropped call, the service provider has to pay a sum of rupee one to the said consumer. This cannot be called notional at all. It is also not clear as to why the Authority decided to limit compensation to three call drops per day or how it arrived at the figure of Re.1 to compensate inconvenience caused to the consumer. It is equally unclear as to why the calling party alone is provided compensation because, according to the Explanatory Memorandum, inconvenience is suffered due to the interruption of a call, and such inconvenience is suffered both by the calling party and the person who receives the call. The receiving party can legitimately claim that his inconvenience when a call drops, is as great as that of the calling party. And the receiving party may need to make the second call, in which case he receives nothing, and the calling party receives Re.1 for the additional expense made by the receiving party. All this betrays a complete lack of intelligent care and deliberation in framing such a regulation by the Authority, rendering the Impugned Regulation manifestly arbitrary and unreasonable.

53. Viewed at from a slightly different angle it is clear that if an individual consumer were to go to the consumer forum for compensation for call drops, he would have to prove that the call drop took place due to the fault of the service provider. He would further have to prove that he has suffered a monetary loss for which he has to be compensated, which the Explanatory Memorandum itself says is impossible to compute. Thus, the Impugned Regulation completely avoids the adjudicatory process, and legislatively lays down a penal consequence to a service provider for a call drop taking place without the consumer being able to prove that he is not himself responsible for such call drop and without proof of any actual monetary loss. Whereas individual consumers, either before the Consumer Forum, or in a dispute as a group with service providers before the TRAI, would fail in an action to recover compensation for call drops, yet a statutory penalty is laid down, applicable legislatively, and without any adjudication. This again makes the Impugned Regulation manifestly arbitrary and unreasonable.

54. We have seen that the 2000 Amendment has taken away adjudicatory functions from the TRAI, leaving it with administrative and legislative functions. By Section 14 of the Act, adjudicatory functions have been vested in an Appellate Tribunal, where disputes between a group of consumers and the service providers are to be adjudicated by the Appellate Tribunal. In stark contrast, under the scheme of the Electricity Act, 2003, the Central Electricity Regulatory Commission and the various State Electricity Regulatory Commissions have to discharge legislative, administrative, and quasi-judicial functions.

56. Obviously, when such compensation is to be paid to a person who is affected by breach of a standard of quality required under the Act, such compensation can only be for actual loss suffered, and only as a result of fault of the service provider being established before a quasi-judicial Tribunal. This may be notwithstanding the fact that the service provider otherwise meets the average of 2% call drops per month allowed to him by the 2009 Quality of Service Regulation. This is for the reason that once fault and actual loss suffered are established before a quasi-judicial Tribunal, it would not be open to plead, on the facts of an individual case, that an overall standard of performance has been met. For this reason, also, a legislatively pre-determined penalty, without fault or loss being established by evidence before a quasi-judicial authority, and

where the cause of a call drop may be because of the consumer himself, renders the Impugned Regulation manifestly arbitrary and unreasonable.

Modification of licence condition by Impugned Regulation

62. It is clear that the licence conditions, which are a contract between the service providers and consumers, have been amended to the former's disadvantage by making the service provider pay a penalty for call drops despite there being no fault which can be traceable exclusively to the service provider, and despite the service provider maintaining the necessary standard of quality required of it – namely, adhering to the limit of an average of 2% of call drops per month. We have already seen that condition 28 of the licence requires the licensee to ensure that the quality of service standards, as prescribed by TRAI, are adhered to, and that the Impugned Regulation does not lay down quality of service standards. This being so, it is clear that the laying down of a penalty *de hors* condition 28, which, as we have seen, also requires establishing of fault of the service provider when it does not conform to a quality of service standard laid down by TRAI, would amount to interference with the licence conditions of the service providers without authority of law. On this ground also, therefore, the Impugned Regulation deserves to be struck down.

Transparency

63. Section 11(4) of the Act requires that the Authority shall ensure transparency while exercising its powers and discharging its functions. “Transparency” has not been defined anywhere in the Act.

66. No doubt in the facts of the present case, the Authority did hold due consultations with all stakeholders and did allow all stakeholders to make their submissions to the Authority. However, we find no discussion or reasoning dealing with the arguments put forward by the service providers, that call drops take place for a variety of reasons, some of which are beyond the control of the service provider and are because of the consumer himself. Consequently, we find that the conclusion that service providers are alone to blame and are consequently deficient in service when it comes to call drops is not a conclusion which a reasonable person can reasonably arrive at.

69. The question of transparency raises a more fundamental question, namely, that of openness in governance. We find that the Right to Information Act of 2005 has gone a long way to strengthen democracy by requiring that the Government be transparent in its actions, so that an informed citizenry is able then to contain corruption, and hold Governments and their instrumentalities accountable to the people of India.

74. We find that, subject to certain well-defined exceptions, it would be a healthy functioning of our democracy if all subordinate legislation were to be “transparent” in the manner pointed out above. Since it is beyond the scope of this judgment to deal with subordinate legislation generally, and in particular with statutes which provide for rule making and regulation making without any added requirement of transparency, we would exhort Parliament to take up this issue and frame a legislation along the lines of the U.S. Administrative Procedure Act (with certain well defined exceptions) by which all subordinate legislation is subject to a transparent process by which due consultations with all stakeholders are held, and the rule or regulation making power is exercised after due consideration of all stakeholders’ submissions, together with an explanatory memorandum which broadly takes into account what they have said and the reasons for agreeing or disagreeing with them. Not only would such legislation reduce arbitrariness in subordinate legislation making, but it would also conduce to openness in governance. It would also ensure the redressal, partial or otherwise, of grievances of the concerned stakeholders prior to the making of subordinate legislation. This would obviate, in many cases, the need for persons to approach courts to strike down subordinate legislation on the ground of such legislation being manifestly arbitrary or unreasonable.

75. In the present case, we find that the High Court judgment is flawed for several reasons. The judgment is not correct when it says that there can be no dispute that the Impugned Regulation has been made to ensure quality of service extended to consumers by service providers. As has been pointed out hereinabove, the Impugned Regulation does not lay down any quality of service – what it does is to penalise service providers even though they conform to the 2% standard laid down by the Quality of Service Regulations, 2009. In holding that the Impugned Regulation therefore conforms to Section 11(1)(b)(v), the judgment is plainly incorrect. Similarly, the finding that notional compensation is given, and that therefore no penalty is imposed, is also wrong and set aside for the reasons given by us hereinabove. The finding that a transparent process was followed by TRAI in making the Impugned Regulation is only partly correct. While it is true that all stakeholders were consulted, but unfortunately nothing is disclosed as to why service providers were incorrect when they said that call drops were due to various reasons, some of which cannot be said to be because of the fault of the service provider. Indeed, the Regulation, in assuming that every call drop is a deficiency of service on the part of the service provider, is plainly incorrect. Further, the High Court judgment, when it speaks of the technical paper of

13.11.2015, seems to have mixed it up with the consultation paper dated 4.9.2015 referred to in the Explanatory Memorandum to the Impugned Regulation. The judgment has entirely missed the fact that the technical paper of 13.11.2015 unequivocally states that the causes for call drops are many and are often beyond the control of service providers and attributable to the extent of 36.9% to the consumers themselves. The judgment is also incorrect when it says that 100% performance is not demanded from service providers when call drops are made. We have already pointed out that the 2% standard has admittedly been met by almost all the service providers, and this being so, even if the very first call drop and all other subsequent call drops are made within the network of a service provider and are within the parameters of 2%, yet the penal consequence of the amended regulation must follow. The judgment is also incorrect in stating that the Impugned Regulation has attempted to balance the interest of service providers by limiting call drops to be compensated to only three and by limiting compensation to only the calling and not the receiving consumer. We have already pointed out that a penalty that is imposed without any reason either as to the number of call drops made being three, and only to the calling consumer, far from balancing the interest of consumers and service providers, is manifestly arbitrary, not being based on any factual data or reason. We also find that when the service provider argued that it was being penalised despite being within the tolerance limit of 2%, the answer given by the High Court is disingenuous, to say the least, when the High Court says that 2% is a quality parameter for the entire network as opposed to payment of compensation to an individual consumer. We are unable to appreciate the aforesaid reasoning. As has been held by us above, the two sets of Regulations have to be considered together when the Impugned Regulation is being tested on the ground of violation of fundamental rights. Also, the High Court did not advert to a large number of other submissions made by the appellants before them and/or answer them correctly in law. As a result, therefore, we set aside the judgment of the High Court and allow these appeals, declaring that the Impugned Regulation is *ultra vires* the TRAI Act and violative of the appellant's fundamental rights under Articles 14 and 19(1)(g) of the Constitution.

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