2022 INSC 545

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION/
CRIMINAL ORIGINAL JURISDICTION

CIVIL APPEAL NO. 5233 0F 2012

NEDUMPILLI FINANCE COMPANY LIMITED … APPELLANT(S)

VERSUS

STATE OF KERALA & ORS. … RESPONDENT(S)

WITH

CIVIL APPEAL NO. 5230 OF 2012

CIVIL APPEAL NO. 5190 OF 2012

CIVIL APPEAL NO. 5191 OF 2012

CIVIL APPEAL NO. 5184 OF 2012

CIVIL APPEAL NO. 5241 OF 2012

CIVIL APPEAL NO. 5185 OF 2012

CIVIL APPEAL NO. 5111 OF 2012

CIVIL APPEAL NO. 5188 OF 2012

CIVIL APPEAL NO. 5187 OF 2012

CIVIL APPEAL NO. 5183 OF 2012

CIVIL APPEAL NO. 5113 OF 2012

CIVIL APPEAL NO.3857 OF 2022
(*@Special Leave Petition (Civil) No.8331 of 2015)*

TRANSFER PETITION (CRL.) NO. 359 OF 2015

CIVIL APPEAL NO. 5186 OF 2012

CIVIL APPEAL NO. 5192 OF 2012

CIVIL APPEAL NO. 5189 OF 2012

CIVIL APPEAL NO. 5112 OF 2012

CIVIL APPEAL NO. 5232 OF 2012

CIVIL APPEAL NO. 5231 OF 2012

CIVIL APPEAL NO. 5234 OF 2012

CIVIL APPEAL NO. 5237 OF 2012

CIVIL APPEAL NO. 5238 OF 2012

CIVIL APPEAL NO. 5315 OF 2012

CIVIL APPEAL NOS. 18786-18787 OF 2017

CIVIL APPEAL NO. 1324 OF 2015

CIVIL APPEAL NO. 7836 OF 2012

J U D G M E N T

V. RAMASUBRAMANIAN, J.

1. The question as to whether Non-Banking Financial Companies (for short "*NBFCs*") regulated by the Reserve Bank of India, in terms of the provisions of Chapter III-B of the Reserve Bank of India Act, 1934 (hereinafter referred to as "*RBI Act*") could also be regulated by State enactments such as Kerala Money Lenders Act, 1958 (hereinafter referred to as "*Kerala Act*") and Gujarat Money Lenders Act, 2011 (hereinafter referred to as "*Gujarat Act")*, has arisen for our consideration in these appeals, with the Kerala and Gujarat High Courts taking opposite views.

2. We have heard the learned counsel for the respective parties, the learned senior counsel appearing for the State of Kerala, the learned standing counsel appearing for the State of Gujarat and the learned counsel appearing for RBI.

FACTUAL MATRIX

3. A brief sojourn into the factual matrix may provide the setting, in the context of which, the above question of law has arisen. It goes as follows:-

KERALA

3.1 The legislature of the State of Kerala passed the Kerala Act, 1958, with the professed object of providing for the regulation and control of the business of money lending in the State of Kerala. The statement of objects and reasons spelt out, that by passing the said enactment, "*it was intended to regulate the interest to be charged by money lenders and to provide protection to borrowers*". At the time when this Act was enacted, the concept of non-banking financial companies was not very familiar in India. Therefore, the Reserve Bank of India and the Parliament had not stepped in to regulate financial companies which were not banks or banking companies.

3.2 It appears that after the mushroom growth of NBFCs, the Government of Kerala started insisting upon NBFCs to take a license under the Kerala Act, failing which penal consequences were threatened. Therefore, after unsuccessfully approaching the

Government of Kerala for exemption, NBFCs filed a batch of writ petitions on the file of the High Court of Kerala.

3.3 A learned Judge of the High Court of Kerala dismissed the batch of writ petitions and the said order was confirmed by the Division Bench of the High Court. Therefore, NBFCs operating in the State of Kerala have come up with the above batch of appeals.

3.4 All the appeals, by the NBFCs operating in the State of Kerala, arise out of writ petitions seeking a declaration that NBFCs registered under the RBI Act will not come within the purview of the Kerala Act. Apart from several appeals, there is also a petition in Transfer Petition (Crl.) No.359 of 2015, filed by the Chief Executive Officer of one NBFC by name Bajaj Finance Limited, seeking a transfer of the quash petition pending on the file of the High Court of Kerala under Section 482 of the Code of Criminal Procedure praying for quashing an FIR registered under the Kerala Act.

GUJARAT

3.5 The Bombay Money Lenders Act, 1946, which was applicable in the State of Gujarat, was sought to be invoked by the Registrar in the office of the Prevention of Money Lenders, against NBFCs

operating in the State of Gujarat, in the year 2009. Challenging the action so initiated, NBFCs filed a batch of special civil applications before the High Court of Gujarat. When it was pending, the decision of the Kerala High Court came. But disagreeing with the view taken by the Kerala High Court, a learned Judge of the Gujarat High Court quashed the notices issued to the NBFCs under the Bombay Money Lenders Act, by a judgment dated 13.01.2010.

3.6 Thereafter, the legislature of the State of Gujarat passed the Gujarat Act, 2011 (Gujarat Act 14 of 2011) which received the assent of the Governor on 6.04.2011 and was published in the Gujarat Government Gazette on 8.04.2011.

3.7 Therefore, a fresh batch of special civil applications were filed, seeking a declaration that the provisions of the Gujarat Act 14 of 2011 are not applicable to NBFCs registered under the RBI Act. The Division Bench of the High Court allowed the special civil applications holding that Gujarat Act 14 of 2011 is *ultra vires* the Constitution for legislative incompetence, to the extent that it seeks to have control over NBFCs registered under the RBI Act. A consequential direction was also issued by the Gujarat High Court

restraining the State Government from applying the provisions of the Gujarat Act against NBFCs registered under the RBI Act. Therefore, the State of Gujarat has come up with Civil Appeals.

Scheme of Kerala Act, Gujarat Act and RBI Act

4. In the background of the facts narrated above, the legal issue arising for consideration has to be resolved by looking at the scheme of the two State enactments, the scheme of RBI Act and the relevant Entries in the appropriate List of the Seventh Schedule, to which these enactments can be traced.

4.1 List-I of the Seventh Schedule to the Constitution contains three entries which may be taken note of. They are:-

(i) **Entry No.38**: Reserve Bank of India

(ii) **Entry No.43**: incorporation, regulation and winding up of trading corporations including banking, insurance and financial corporations but not including cooperative societies.

(iii) **Entry No.45**: Banking

4.2 List II (State List) of the Seventh Schedule contains an entry in **Entry No.30**, which reads: "*money lending and money lenders; relief of agricultural indebtedness*".

4.3 Therefore, any State enactment regulating the business of money lending and intended to afford protection to borrowers, may fall under Entry No.30 of List-II. But at the same time any parliamentary enactment dealing with incorporation, regulation and winding up of financial corporations, would fall under Entry No.43 in List-I.

4.4 Therefore, at the outset, it is clear that the competence of the legislatures of the States of Kerala and Gujarat to enact a law for the regulation of the business of money lending cannot be questioned, as their power is traceable to Entry 30 of List-II of the Seventh Schedule. But at the same time, we will have to see whether after the enactment of a law by the Parliament for the incorporation and regulation of financial corporations, such financial corporations would continue to be regulated also by the State enactments, on the ground that they may also fall within the definition of the expression "*money lenders*" under the State enactments.

4.5 For finding an answer to the above question, it may be useful to take a bird's eye view of the scheme of the Kerala and Gujarat State enactments.

Broad scheme of Kerala Act

4.6 In a way, the Kerala Act is a legacy of the Madras Pawn Brokers Act, 1943, whose provisions continued to be in force in the Malabar District, even after the States Reorganisation Act, 1956, until it was repealed by Kerala Money Lenders (Amendment) Act 33 of 1963.

4.7 As seen from the statement of objects and reasons, the only object of the Kerala Money Lenders Act was to afford protection to borrowers from unscrupulous money lenders who advanced usurious loans. Though it was proclaimed in the statement of objects, in general terms, that it was intended to regulate the business of money lending, the Act was primarily intended only to cover one aspect of the business of financing.

4.8 Section 2(7) of the Kerala Act, defines a "money lender" as follows:-

*"**2. Definitions**. xxx xxx xxx*

***(7) "money-lender"** means a person whose main or subsidiary occupation is the business of advancing and realising loans or acceptance of deposits in the course of such business and includes any person appointed by him to be in charge of a branch office or branch offices or a liaison office or any other office by whatever name called, of his principal place of business and a pawn broker, but does not include-*

(a) a bank or a co-operative society; or

(b) the Life Insurance Corporation of India established under section 3 of the Life Insurance Corporation Act, 1956 (Central Act 31 of 1956); or

(bb) the Industrial Credit and Investment Corporation of India Limited incorporated under the India Companies Act, 1913 (7 of 1913);

(c) the Industrial Finance Corporation established under section 3 of the Industrial Finance Corporation Act, 1948 (Central Act 15 of 1948); or

(d) x x x x

(e) the State Financial Corporation established under section 3 of the State Financial Corporation Act, 1951 (Central Act 63 of 1951); or

(f) any institution established by or under an Act of Parliament or the Legislature of a State, which grants any loan or advance in pursuance of the provisions of that Act or,

(g) any other institution in the public sector, whether incorporated or not exempted by the Government by notification.

Explanation I.— Where a person, who carries on in the State of
Kerala the Business of advancing and realising loans is resident outside the State, the agent of such person resident in the State shall be deemed to be the money-lender in respect of that business for the purposes of this Act.

Explanation II.— For the purposes of this Clause, clause (7A), Proviso to sub-section (1) of section 3, clause (a) of sub-section (3) of section10, [section 16B] and section 17, the word "person" shall include "a firm or a joint family;""

4.9 As seen from the definition, 7 different types of business entities are excluded from the definition of the expression "*money lending*". A financial corporation which is not a bank and which is otherwise known as NBFC, is not listed as one of the entities excluded from the definition of the expression "*money lender*".

4.10 A bank is excluded from the definition of the expression "*money lender*", by virtue of clause (a). But the word "*bank*" is defined in Section 2(1A) as follows:-

*"**Sec. 2 (1A) "bank"** means-*

(i) a banking company to which the Banking Regulation Act, 1949 (Central Act 10 of 1949), applies;

(ii) the State Bank of India constituted under the State Bank of India Act, 1955 (Central Act 23 of 1955);

(iii) a subsidiary bank as defined in clause (k) of section of the State Bank of India (Subsidiary Banks) Act. 1939 (Central Act 38 of 1959);

(iv) the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (Central Act 18 of 1964);

(v) a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (Central Act 5 of 1970);

(vi) a Regional Rural Bank established under the Regional Rural Banks Act, 1976 (Central Act 21 of 1976);

(vii) a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (Central Act 40 of 1980);

(viii) the Export Import Bank of India established under the Export Import Bank of India Act, 1981, (Central Act 28 of 1981);

(ix) the National Bank for Agriculture and Rural Development established under the National Bank for Agriculture and Rural Development Act, 1981 (Central Act 61 of 1981);

(x) the Industrial Reconstruction Bank of India established under the Industrial Reconstruction Bank of India Act, 1984 (Central Act 62 of 1984);

4.11 The Banking Regulation Act, 1949 defines a "*banking company*" under Section 5(c) as follows:-

*"**5. Interpretation** –*

xxx xxx xxx

(c) "banking company" means any company which transacts the business of banking in India;

Explanation. - Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;"

4.12 The word "*banking*" itself is defined in Section 5(b) of the Banking Regulation Act, 1949 as follows:-

"***5. Interpretation*** –

xxx xxx xxx

(b) "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise;"

4.13 By virtue of the definition of the word "*banking*" contained in Section 5(b) of the Banking Regulation Act, 1949, an institution or business entity which does not accept deposits of money from the public, either for the purpose of lending or for the purpose of investment, will not be a banking company. While a banking company may be involved in both the business of accepting deposits and lending money, a financial institution which is engaged only in the business of lending, may not be covered by the definition of the expression "*banking company*" under the Banking Regulation Act, 1949.

4.14 Since NBFCs which do not accept deposits from the public do not come within the purview of the Banking Regulations Act, the Reserve Bank of India Act, 1934 had to step in. To make things more clear that there is no duplication of control, Section 45-H of the RBI Act states that the provisions of Chapter III-B shall not

apply to a Banking Company as defined in Section 5 of the Banking Regulation Act.

4.15 But the definition of "*money lender*" in the Kerala Act excludes only a "*bank*" to which the Banking Regulation Act applies**.** It does not exclude a non banking institution from the definition. Therefore, the Kerala State authorities started claiming and technically rightly so, that NBFCs are not excluded from the definition of "*money lender*"*.* Though the NBFCs claimed that under clause (f) of sub-section (7) of Section 2, "*any institution established by or under an Act of Parliament or the Legislature of a State*" are excluded from the definition of the expression "*money-lender*" and that NBFCs are established under a Parliamentary enactment, this argument was found by the State to be based on a convoluted logic. We also think that the State was right in thinking so, since ***NBFCs are not established by or under an Act of Parliament or the legislature of a State. Incorporation/registration of a business entity under an Act of Parliament or the Legislature of a State, is completely different from being established by or under an Act.*** For instance, all companies are incorporated under

the Companies Act. But a corporation like the LIC of India, is established under the LIC of India Act. Therefore, the appellants were not right in claiming that they fall under the exclusion clause in clause (f) of sub-section (7) of Section 2. Keeping this aspect in mind, let us now see the scheme of the Kerala Act.

4.16 The scheme of the Kerala Act is:-

(i) To make it obligatory for a money lender to obtain a licence under the Act;

(ii) To prohibit any person from carrying on or continuing the business of money lending without licence;

(iii) To prevent money lenders from charging interest at a rate higher than the rate prescribed under the Act;

(iv) To prevent money lenders from giving any gifts, commissions or presents other than the interest provided in Section 4(2) to any depositor;

(v) To enable the debtor to deposit the money due in respect of a loan, into any Court having jurisdiction to entertain a suit for recovery of the loan and to seek the recording of full or part satisfaction of the loan;

(vi) To make it mandatory for money lenders to keep books of accounts and to give receipts;

(vii) To make it compulsory for a pawn broker to issue a pawn ticket, the possession of which will give rise to a presumption that the holder of the pawn ticket has a right to redeem the pledge;

(viii) To prescribe the procedure for redemption of pledge, sale of pledge and compensation for depreciation of pledge;

(ix) To appoint inspectors with certain powers of inspection and search;

(x) To empower the licensing authority to demand additional security from the money lender, if there is excess of liabilities over the assets of the money lenders at any time; and

(xi) Providing for cancellation of licence, forfeiture of security and imposing penalty for violation of the provisions of the Act.

5. Gujarat Act

5.1 The Gujarat Act defines a ***"money lender"***, in Section 2(10) to mean "***an individual, a HUF, a company, a pawn-broker or unincorporated company (i) who/which carries on the business of money lending in the State or (ii) who/which has his principal or subsidiary place of such business in the State"***.

5.2 The expression "***business of money lending***" is defined in Section 2(3) to mean "***the business of advancing loans, whether in cash or kind and whether or not in connection with or in addition to any other business and includes the business of payment of loan by an agreement under any law for the time being in force***".

5.3 By virtue of the aforesaid definitions, the application of the Gujarat Act to any business entity/individual revolves around the definition of the word "*loan*". It is defined in Section 2(9) as follows:

> *"loan" means an advance whether of money or in kind, at an interest, with or without security, and includes advance, discount, money paid for or on account of or on behalf of or at the request of any person, or the forbearance to require payment of money owing on any account whatsoever, and every agreement under any law for the time being in force (whatever its terms or form may be) which is in substance or effect a loan of money, but does not include –*
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> *(a) a deposit of money or other property in a Government post office, a bank, a company or a co-operative society;*
>
> *(b) a loan to, or by, or a deposit with any society or association registered under the Societies Registration Act, 1860, or any other enactment relating to a public, religious or charitable object;*
>
> *(c) a loan advanced by the State Government or by any local authority authorized by the State Government;*

(d) a loan advanced to a Government employee from a fund, established for the welfare or assistance of Government employees and which is sanctioned by the State Government;

(e) a deposit of money with or a loan advanced by a cooperative society;

(f) an advance made to a subscriber to, or a depositor in, a provident fund from the amount standing to his credit in the fund in accordance with the rules of the fund;

(g) a loan to or by an insurance company as defined in the Insurance Act, 1938;

(h) a loan advanced by a Government company as defined in the Companies Act, 1956;

(i) an advance made bona fide by any trader carrying on any business, other than money-lending, if such advance is made in the regular course of such business;

(j) a loan advanced by the National Bank for Agriculture and Rural Development established under the National Bank for Agriculture and Rural Development Act, 1981;

(k) a loan advanced by the Export-Import Bank of India established under the Export-Import Bank of India Act, 1981;

(l) a loan advanced by the Small Industries Development Bank of India, established under the Small Industries Development Bank of India Act, 1989;

(m) a loan advanced by the National Housing Bank, constituted under the National Housing Bank Act, 1987 ;

(n) a loan advanced by State Financial Corporations established under the State Financial Corporations Act, 1951 ; and

(o) a loan advanced by any institution - (1) established by or under an Act of Parliament or the legislature of a State, which grants any loan or advance in pursuance of the provisions of that Act, or (2) notified in this behalf by the State Government, in consultation with the Reserve Bank;

5.4 By virtue of the aforesaid definitions, the authorities under the Gujarat Act sought to apply the provisions of the Act to NBFCs also. Therefore, it is essential that we look at the scheme of the Act.

5.5 The broad scheme of the Gujarat Act is :

(i) To provide for the registration of money lenders;

(ii) To prohibit any person from carrying on the business of money lending without a valid certificate of registration in respect of the area concerned;

(iii) To empower the Registrar General, Registrar and other officers appointed under the Act to require the production of records and documents and to carry out searches and seizures;

(iv) To mandate every money lender to keep and maintain proper books of Accounts and other registers;

(v) To make it obligatory for money lenders to file yearly statement of accounts of each of the debtors;

(vi) To prohibit the disposal of any article taken by a money lender from a debtor as a bond, pledge or security for the loan advanced, for a period of two years from the date stipulated for financial repayment of the loan;

(vii) To regulate the powers of the Civil Court while deciding the suits to which the Act applies, so that the Court is satisfied that the provisions of the Act are complied with;

(viii) To curtail the power of the Court to award interest in a sum greater than the principal of the loan due on the date of the decree;

(ix) To empower the Court to allow payment of the decretal amount by instalments;

(x) To empower the Court even to reopen past transactions;

(xi) To enable the borrower to deposit the amounts due in respect of a loan into Court;

(xii) To empower the State Government to fix the maximum rate of interest, for any local area or class of business;

(xiii) To prohibit money lenders from receiving from the debtor, any amount by way of costs, charges or expenses;

(xiv) To make it obligatory for the money lender to provide advance information, whenever the loan is assigned to a third party;

(xv) To prohibit money lenders from accepting any promissory note, acknowledgment, bond or other writing which does not state the actual amount of loan or which states the amount wrongly or which contains erasures or over-writing; and

(xvi) To provide for penalties for contravention of the provisions of the Act.

5.6 It may be of interest to note that Section 39 of the Gujarat Act contains a very strange provision which reads as follows:-

> *"Notwithstanding anything contained in this Act or any other law for the time being in force, no money lender shall recover the principal of the loan advanced by him or the interest thereon either in part or in whole except in cash."*

5.7 Though we are not concerned with the validity of such a provision we could not resist the temptation to take note of the said provision which is in the teeth of Section 269-SS of the Income Tax Act, 1961.

6. Role of RBI, the scheme of Chapter III-B of the RBI Act and the Regulatory measures taken by RBI from time to time

6.1 As observed by this Court in ***Internet and Mobile Association of India*** vs. ***Reserve Bank of India***[1]**,** *"the role of a Central Bank such as the Reserve Bank, in an economy, is to manage* ***(i)*** *the currency;* ***(ii)*** *the money supply and* ***(iii)*** *interest rates".* One of the objects the Reserve Bank of India Act, 1934 as spelt out in its preamble is "*to operate the currency and credit system of the country to its advantage*".

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6.2 Therefore, in contrast to the state enactments regulating the business of money lending, whose one-eyed focus is only the protection of borrowers, the RBI Act takes a holistic approach to the business of banking, money lending and operation of the currency and credit system of the country. But when RBI Act was enacted, the business of banking and finance was not as complicated as it later turned out to be.

6.3 In the early 1960s, the Government found it necessary to regulate institutions which were not banks, but which were carrying on other businesses allied to banking. Therefore, a bill to amend the RBI Act, The Banking Companies Act, 1949, and the State Bank of India (Subsidiary Banks) Act, 1959 was introduced in November, 1963. The Statement of Objects and Reasons spelt out that the existing enactments relating to banks did not provide for any control over such banks or institutions and that therefore it was felt necessary that the RBI should be enabled to regulate the conditions on which deposits may be accepted by non-banking companies or institutions, for the purposes of ensuring more effective supervision and management of the monetary and credit

system by the Reserve Bank. One of the important objects spelt out in the Statement of Objects and Reasons reads as follows:-

> *"The Reserve Bank should also be empowered to give to any financial institution or institutions directions in respect of matters, in which the Reserve Bank, as the central banking institution of the country, may be interested from the point of view of the control of credit policy"*

Clause (5) of the Notes on Clauses accompanying the Bill read as follows:-

> "*Clause 5.*-A new Chapter is proposed to be introduced in the Reserve Bank of India Act for enabling that bank to obtain returns and information from (a) certain financial institutions, namely, firms, companies or other bodies corporate which are financing trade, industry, commerce or agriculture, or are carrying on as a part of their business the acquisition of shares, stocks, bonds, debentures or other securities, or are engaged mainly in the financing of hire-purchase transactions and (b) non-banking institutions accepting deposits from members of the general public. The objects in view are to provide for-
>
> *(i)* the supervision and control of the financial institutions mentioned above in the interests of better or more effective control of credit, and
>
> *(ii)* the regulation of the business of acceptance of deposits by these and other non-banking institutions, in the public interest.
>
> The Reserve Bank will be empowered to provide, by general or special order, for the forms in which returns and information are to be furnished to it, and also to give directions to any class of institutions or to any institution in particular for the purposes specified. The Reserve Bank will also be enabled to carry out inspections, where necessary, for carrying out the purposes of the new Chapter."

6.4 Accordingly, the Banking Laws (Miscellaneous Provisions Act), 1963, was enacted, amending the provisions of the aforesaid three Parliamentary enactments. It was by this amendment which came into force on 01.02.1964 that Chapter III-B was inserted in RBI Act. The Chapter heading for this Chapter read as, "*Provisions Relating to Non-Banking Institutions Receiving Deposits and Financial Institutions*". However, this Chapter III-B was made inapplicable under Section 45-H to a banking company as defined in Section 5 of the Banking Companies Act, 1949. Section 45-I defined a '*financial institution*' under clause (c) to mean any non-banking institution which carries on the business of financing or the business of acquisition of shares, stocks etc., or the business of hire-purchase transactions.

6.5 Chapter III-B as it was introduced by the Banking Laws (Miscellaneous Provisions Act), 1963, contained no spell-binding or path-breaking provisions. Broadly, Chapter III-B as it was originally introduced in 1963, ***(i)*** empowered RBI to regulate or prohibit the issue of prospectus or advertisement soliciting deposits of money; ***(ii)*** empowered the RBI to collect information from non-banking

institutions about deposits and to give directions; ***(iii)*** empowered the RBI to call for information from financial institutions and to give directions, for the purpose of regulating the credit system of the country; ***(iv)*** obliged the non-banking institutions to furnish statements to the RBI; ***(v)*** provided for inspection by RBI; ***(vi)*** prescribed penalties for any violation and conferred overriding effect to Chapter III-B over other laws.

6.6 After the introduction of Chapter III-B under Act 55 of 1963, three amendments which are not relevant for our purpose, were made to the provisions contained in Chapter III-B, under Act 51 of 1974, Act 21 of 1976 and Act 1 of 1984.

6.7 Post the insertion of Chapter III-B under Act 55 of 1963, the working of non-banking financial intermediaries came to be reviewed by two study groups, one under the chairmanship of Dr. Bhabhatosh Datta in 1971 and another under the chairmanship of Shri James Raj in 1975. Certain recommendations were made by these two study groups. Thereafter, the issue was considered by three other committees namely, ***(i)*** the Committee to Review the Working of the Monetary System (Chakravarty Committee-1985);

(ii) the Working Group on the Money Market (Vaghul Committee-1987); and ***(iii)*** the Committee on the Financial System (Narasimham Committee-1991).

6.8 Those reports and various socio-economic and political factors led to the liberalisation of the economy in 1991. The liberalisation of the economy saw the growth of non-banking financial services sector in India accompanied by a corresponding growth in the number of NBFCs offering a diversified range of financial services and products. Therefore, a need was felt for rationalisation of the regulatory framework for these companies keeping in view the trend towards liberalisation of economy in general and the financial sector in particular. In order to make an in-depth study of the role of NBFCs and to suggest regulatory and control measures to ensure healthy growth and operations of these companies, RBI constituted a Working Group under the Chairmanship of Dr. A.C. Shah, in May, 1992. The terms of reference of the Working Group in simple terms[2] were:-

2 Report of the Working Group on Financial Companies C.R. 483 submitted in September, 1992

(i) To review the role of various categories of non-banking financial intermediaries;

(ii) To review the provisions of the RBI Act, 1934; Non-Banking Financial Companies (Reserve Bank) Directions 1977, Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977; Residuary Non-Banking companies (Reserve Bank) Directions, 1987; The National Housing Bank Act, 1987 and The Housing Finance Companies (NHB) Directions, 1989;

(iii) To enquire into the methods of operation of non-banking financial intermediaries and to recommend measures for ensuring their orderly growth and in particular, the eligibility criteria for their entry, growth and exit, their viability, capital adequacy, liquidity ratio, debt equity ratio, credit concentration ratio, disclosure requirements and other prudential norms;

(iv) To consider the adequacy of the supervision and control of RBI over such institutions and suggest measures for further strengthening them;

(v) To examine the adequacy of protection to depositors' money; and

(vi) To make recommendations on any other related matter.

6.9 The Working Group chaired by Dr. A.C. Shah, took note of the fact that the total number of NBFCs which stood at 7063 in 1981 increased to 24,009 by 1990 and that there were different categories of NBFCs operating in the country such as loan companies, investment companies, hire-purchase finance companies, equipment leasing companies, mutual benefit finance companies, miscellaneous finance companies, miscellaneous non-banking companies, residuary non-banking companies and housing finance companies. This Working Group actually recommended in paragraph 6.72 of its Report that though NBFCs were being regulated by the directions issued under Chapter III-B of the RBI Act and Chapter-V of the NHB Act, it would be better to enact a separate legislation. The Working Group went to the extent of recommending that such a legislation should be put under Schedule IX of the Constitution.

6.10 All the above led to the promulgation of the Reserve Bank of India (Amendment) Ordinance, 1997 on 09.01.1997. Subsequently, a bill was introduced which became the Reserve Bank of India (Amendment) Act, 1997. This Act completely revamped Chapter III-B

by amending the definition provision in Section 45-I and inserting certain new provisions such as Section 45-IA, 45-IB, 45-IC, 45-JA, 45-MB, 45-MC etc. After the amendment made to Chapter III-B by Act 23 of 1997, this Chapter has become a complete Code in so far as NBFCs are concerned. This can be seen from various provisions of Chapter III-B, which is summarized in the form of a table for easy reference as follows:-

PROVISION	**REQUIREMENT**
Section 45- IA	(i) Certificate of Registration mandatory for a NBFC to commence or carry on the business of a non-banking financial institution. (ii) Such NBFC should have a net-owned fund of Rs.25 lakhs or such other amount not exceeding Rs. 100 crores, as the RBI may prescribe. (iii) The application for registration shall be considered by RBI subject to certain parameters prescribed in sub-section (4)
Section 45-IB	(i) NBFCs have to invest in un-encumbered approved securities, such amount which shall not be less than 5% or such higher percentage not exceeding 25% prescribed by RBI. (ii) Every NBFC should furnish a return to RBI, so as to ensure compliance with the provisions of this Section. (iii) Penal interest is liable to be levied if there was a shortfall in the investment.
Section 45-IC	(i) Every NBFC should create a reserve fund and transfer to the said fund a sum not less than 20% of its net profit every year. No part of the reserve

	fund shall be appropriated by the NBFC except for a purpose stipulated by RBI.
Section 45-ID	(i) RBI is entitled to remove the Director of an NBFC from office, if it is satisfied that it is necessary to do so in public interest or to prevent the affairs of a NBFC being conducted in a manner detrimental to the interest of the depositors or creditors or financial stability or for securing the proper management of such company.
Section 45-IE	(i) RBI will have the power of supersession of the Board of Directors of a NBFC in public interest etc.
Section 45-J	(i) RBI will have the power to regulate or prohibit the issue of prospectus or advertisement soliciting deposits of money.
Section-45JA	(i) In public interest or for the regulation of the financial system of the country to its advantage or to prevent the affairs of any NBFC being conducted in a manner prejudicial to the interest of the depositors or prejudicial to the interest of the NBFC, RBI may determine the policy and give directions.
Section 45-K	(i) RBI may demand every non-banking institution to furnish such statements of information or particulars relating to or connected with the deposits received by the NBFCs.
Section 45-L	(i) RBI will have the power to require financial institutions to furnish such statements, information or particulars relating to the business of such financial institutions and to give such directions.
Section 45-M	(i) It shall be the duty of every NBFC to furnish the statements, information or particulars called for and to comply with any direction issued by RBI.
Section 45-MA	RBI will have the power to issue directions to the Auditors of NBFCs relating to balance-sheet, profit and loss account, disclosure of liabilities in

	the books of accounts or any other matter.
Section 45- MAA	RBI can take action against the Auditors who fail to comply with any of the directions.
Section 45-MBA	RBI may frame schemes providing for the amalgamation of NBFCs or the reconstruction of a NBFC etc., if RBI is satisfied upon inspection of the books of accounts that it is in public interest or in the interest of financial stability to do so.
Section 45-MC	RBI will be entitled to move an application for the winding up of an NBFC, under certain circumstances.
Section 45-N	Power of inspection.
Section 45-NAA	RBI may at any time direct a NBFC to annex to its financial statements, such statements and information relating to the business or affairs of any group company of NBFC.
Section 45-NC	RBI may exempt a NBFC from the application of any or all of the provisions of Chapter III-B

6.11 The above scheme of Chapter III-B of the RBI Act shows that the power of intervention available for the RBI over NBFCs, is from the cradle to the grave. In other words, no NBFC can carry on business without being registered under the Act and a NBFC which takes birth with the registration under the Act is liable to be wound up at the instance of the RBI. The entire life of a NBFC from the womb to the tomb is also regulated and monitored by RBI.

6.12 At this juncture it may be ideal to extract some of the relevant provisions of Chapter III-B.

6.13 A Non-banking financial company is defined in clause (f) of Section 45-I as follows:-

> **"45-I.**
> **(f)** "non-banking financial company" means –
> (i) a financial institution which is a company;
> (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
> (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify."

6.14 Section 45-JA which gives power to the RBI to determine the policy and issue directions, reads as follows:-

> **"45JA. Power of Bank to determine policy and issue directions**. -- (1) If the Bank is satisfied that, in the public interest or to regulate the financial system of the country to its advantage or to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of the non-banking financial company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any of the non-banking financial companies relating to income recognition, accounting standards, making of proper provision for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds by a non-banking financial company or a class of non-banking financial companies or

non-banking financial companies generally, as the case may be, and such non-banking financial companies shall be bound to follow the policy so determined and the direction so issued.

(2) Without prejudice to the generality of the powers vested under sub-section (1), the Bank may give directions to non-banking financial companies generally or to a class of non banking financial companies or to any non-banking financial company in particular as to--

(a) the purpose for which advances or other fund based or non-fund based accommodation may not be made; and

(b) the maximum amount of advances or other financial accommodation or investment in shares and other securities which, having regard to the paid-up capital, reserves and deposits of the non-banking financial company and other relevant considerations, may be made by that non-banking financial company to any person or a company or to a group of companies."

6.15 Section 45-K which empowers the RBI to collect information reads as follows:-

"**45K. Power of Bank to collect information from non-banking institutions as to deposits and to give directions**. –

(1) The Bank may at any time direct that every non-banking institution shall furnish to the Bank, in such form, at such intervals and within such time, such statements information or particulars relating to or connected with deposits received by the non-banking institution, as may be specified by the Bank by general or special order.

(2) Without prejudice to the generality of the power vested in the Bank under sub-section (1), the statements, information or particulars to be furnished under sub-section (1), may relate to all or any of the following matters, namely, the amount of the deposits, the purposes and periods for

which, and the rates of interest and other terms and conditions on which, they are received.

(3) The Bank may, if it considers necessary in the public interest so to do, give directions to non-banking institutions either generally or to any non-banking institution or group of non-banking institutions in particular, in respect of any matters relating to or connected with the receipt of deposits, including the rates of interest payable on such deposits, and the periods for which deposits may be received.

(4) If any non-banking institution fails to comply with any direction given by the Bank under sub-section (3), the Bank may prohibit the acceptance of deposits by that non-banking institution.

[1][***]

(6) Every non-banking institution receiving deposits shall, if so required by the Bank and within such time as the Bank may specify, cause to be sent at the cost of the non-banking institution a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the non-banking institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the Bank."

6.16 Section 45-L empowers RBI to call for information and to give directions. It reads as follows:-

"45L. Power of Bank to call for information from financial institutions and to give directions.--(1) If the Bank is satisfied for the purpose of enabling it to regulate the credit system of the country to its advantage it is necessary so to do, it may--

(a) require financial institutions either generally or any group of financial institutions or financial institution in particular, to furnish to the Bank in such form, at such intervals and within such time, such statements, information or particulars relating to the business of such financial institutions or institution, as may be

specified by the Bank by general or special order;

(b) give to such institutions either generally or to any such institution in particular, directions relating to the conduct of business by them or by it as financial institutions or institution.

(2) Without prejudice to the generality of the power vested in the Bank under clause (a) of sub-section (1), the statements, information or particulars to be furnished by a financial institution may relate to all or any of the following matters, namely, the paid-up capital, reserves or other liabilities, the investments whether in Government securities or otherwise, the persons to whom, and the purposes and periods for which, finance is provided and the terms and conditions, including the rates of interest, on which it is provided.

(3) In issuing directions to any financial institution under clause (b) of sub-section (1), the Bank shall have due regard to the conditions in which, and the objects for which, the institution has been established, its statutory responsibilities, if any, and the effect the business of such financial institution is likely to have on trends in the money and capital markets."

6.17 One of the most important provisions contained in Chapter III-B is Section 45-Q. It reads as follows:-

> **"45Q. Chapter IIIB to override other Laws**.—The provisions of this Chapter 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."

6.18 It is too long in the day to dispute the fact that the directions issued by RBI are statutory in character and binding on all NBFCs.

It is so, in respect of the directions issued both under the RBI Act and under the Banking Regulation Act.

6.19 ***Once it is found that Chapter III-B of the RBI Act provides a supervisory role for the RBI to oversee the functioning of NBFCs, from the time of their birth (by way of registration) till the time of their commercial death (by way of winding up), all activities of NBFCs automatically come under the scanner of RBI. As a consequence, the single aspect of taking care of the interest of the borrowers which is sought to be achieved by the State enactments gets subsumed in the provisions of Chapter III-B.***

Regulations/Master Circulars/Directions issued by RBI from time to time

6.20 Apart from the provisions of Chapter III-B, the regulations, directions and Master Circulars issued by RBI from time to time, also bind the NBFCs. There is a long list of Regulations/directions or Master Circulars issued by RBI from 1977 onwards, which shows that even before the 1997 Amendment to the RBI Act, some kind of

control was exercised by RBI over NBFCs. After the 1997 amendment, every aspect of the business of NBFCs, including loans, is covered by Master Circulars/ Directions issued by RBI. In other words, the only field occupied by the State enactments stand appropriated by the Master Circulars/Directions. For demonstrating that even the subject of grant of loans is covered by these Master Circulars/Directions, we present in the Table below, the relevant circulars/directions.

Title of the Circular/ directions	**The provision under which it was issued**	**Subject matter in general and provision dealing with loans and rate of interest**
Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions 2007	**Section 45JA**	General policy *including loans* Clause 7: Need for Policy on Demand/ Call Loans Board to frame policy with respect to ● Cut off date for repayment or call up ● Rate of interest ● Reasons in writing for effecting Moratorium and sanctioning interest free loans
Revisions on the Guidelines of Securitisation Transactions **incorporated in the Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021**	**Sections 21 and 35A of the Banking Regulation Act, 1949; Chapter IIIB of the Reserve Bank of India Act, 1934**	Securitisation of Standard Assets **Clause 1.2: Minimum Holding Period** ● Loans to be securitised only after minimum holding period **Clause 1.3: Minimum Retention Requirement (MRR)** ● NBFC to have continued stake in performance of securitised asset to ensure proper due diligence of

		sanctioned loans
Master Circular- Fair Practices Code, 2014		General Fair Practices Guidelines including in loan appraisal and disbursement Clause 2A(ii): Loan Appraisal and Terms and Conditions: ● Sanction letter to contain loan amount and annualised Rate of Interest **in vernacular language.** ● **NBFCs shall mention the penal interest so charged on late repayment in bold in loan agreement.** **Clause 2A(iii): Disbursement of loans including changes in terms and conditions** ● NBFC to give notice of any change in terms of a loan including disbursement schedule, rate of interest etc **in vernacular.** ● **NBFCs should effect change in rate of interest prospectively only.** **Clause 2A(viii): Regulation of excessive interest charged by NBFCs** ● Board of each NBFC to adopt an interest rate model taking into account cost of funds, margin, risk premium etc. Rate of interest and the approach for gradations of risk and rationale for charging different rates of interest for different categories of borrowers shall be disclosed to the borrower and **communicated explicitly in the sanction letter.**
Non-Banking Financial Company - Non-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016	**Sections 45JA, 45L and 45M of the RBI Act**	**Chapter IV: Prudential Regulations** **Clause 11: Need for policy on demand/call loans :** ● Board of Directors shall frame policy for applicable NBFCs which stipulate: 1. Cut-off date for repayment of

And Non-Banking Financial Company-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016		demand or call loan shall be demanded with reasons in writing if the cut-off date extends beyond a period of 1 year from date of sanction. 2. Rate of interest which shall be payable on such loans. Such interest shall be payable either at monthly or quarterly rests. Reasons in writing if moratorium is granted or no interest is stipulated. **Chapter V: Fair Practices Code for applicable NBFC** **Clause 28: Applications for loans & their processing** ● Communications to borrower to be in vernacular language/language understood by them. ● Loan application forms to include necessary information which affects interest of the borrower & to indicate documents required to be submitted. ● To devise a system of giving acknowledgement for receipt of all loan applications with time frame within which applications will be disposed of. **Clause 29: Loan Appraisal & Terms/Conditions** ● Communication regarding amount of loan sanctioned along with T&C including annualised rate of interest & method of application etc. in vernacular language to the borrower. Interest rate will have to be clearly specified. ● Not furnishing a copy of loan

		agreement is unfair practice. **Clause 36: Regulation of excessive interest charged by applicable NBFC** ● Board of NBFCs shall adopt interest rate model accounting for relevant factors: cost of funds, margin & risk premium & determine rate of interest to be charged for loans & advances etc. ● Explicit reasons to be given for different rates of interest to different categories of borrowers. **Clause 37: Complaints about excessive interest charged by Applicable NBFCs** Board of NBFCs shall lay out appropriate internal principles & procedures in determining interest rates & processing and other charges
Non-Banking Financial Company-Housing Finance Company Directions 2021	**Section 45L, Section 45MA of RBI Act**	**<u>Regulation of excessive interest on loans (Clause 80 and 81)</u>** i) Rate of interest on loans to be made available on company website as an annualised rate. ii) Board to adopt interest rate model taking account of cost of funds, margin, risk premium etc iii) Company to place internal mechanism to monitor fixing rate of interest. The chapter pertaining to 'Fair Practices' shall be applicable to interest on loans.
RBI (Regulatory Framework for Microfinance Loans) Directions 2022	**Section 21, Section 35A and Section 56 of the Banking Regulation Act, 1949; Chapter IIIB of the Reserve Bank of India Act, 1934**	Pricing of loans **(Clause 6)**: i) policy containing well-documented interest rate model including factors such as risk premium, margin, a ceiling applicable to microfinance loans etc ii) Rate of interest **not to be usurious. This shall be subject to scrutiny by RBI** iii) change in rate of interest to be informed to borrower well in advance
Ombudsman Scheme for NBFC- 2018	**Section 45L**	Rule 8 empowers any person to file a complaint with the Ombudsman for the

		grounds mentioned in the rule. The procedure for filing a complaint is given in Rule 9. Rule 11 provides for settlement of the complaint by agreement between the parties. Rule 12 provides for the alternative where if the complaint is not settled by agreement, the Ombudsman can pass an award. Rule 14(4) also mandates that the NBFC must implement the award and send a report of the same to RBI within 15 days of the award becoming final

Since the Regulations, Master Circulars and Directions issued by RBI are binding on NBFCs, it is clear from the above that all aspects of NBFCs are regulated by RBI and nothing is left untouched. However, there are certain categories of NBFCs, which may be exempt, by RBI itself, in exercise of the power conferred by section 45-NC of the Act, from the application of the provisions of RBI Act. Let us also take note of them now.

NBFCs Exempt from RBI Act

6.21 Section 45-NC of the RBI Act confers power upon the RBI to declare by notification in the Official Gazette, that any or all of the provisions of Chapter III-B shall not apply to a NBFC or any class of NBFCs, either generally or for a specified period, subject to such

restrictions, limitations and conditions. In exercise of the power so conferred, RBI has been issuing Master Directions from time to time. A Master Direction issued on 25.08.2016, updated as on April 01, 2022 lists various categories of NBFCs exempt from the application of certain specified provisions of Chapter III-B. This is for the reason that some of those exempted companies are regulated by other regulatory bodies. For instance, Housing Finance Institutions are regulated by the National Housing Bank; Merchant Banking companies, Venture Capital Fund Companies and the like are regulated by SEBI; Nidhi companies and mutual benefit companies are regulated by the Ministry of Corporate affairs; Chit Fund companies are regulated by State Governments; and Insurance Companies are regulated by IRDA. We are not concerned in this case with the exempted companies, as the dispute on hand is confined only to NBFCs registered under the RBI Act.

Is Chapter III-B a complete code?

7. To find out whether NBFCs registered under Chapter III-B of the RBI Act and regulated by RBI could still be controlled by the State enactments, because of the definition of the expression

"*money lender*", we may first have to see whether Chapter III-B of the RBI Act is a complete code or not. In ***Integrated Finance Company Limited*** *vs.* ***Reserve Bank of India and Others***[3], this Court held in para 47 of the Report that "*Chapter III-B of the RBI Act is a complete code in itself*".

7.1 We have seen that no NBFC can commence or carry on business without obtaining the certificate of registration under the Act. We have also seen that their continuation in business would depend upon compliance with certain prescriptions found in the RBI Act as well as the circulars/directions issued by RBI. The RBI has the power to supersede the Board of Directors of a NBFC and has power even to wind up a NBFC. Thus the supervision and regulation of NBFCs, by the RBI, is from the time of birth till the time of death. If a statutory enactment which provides for such a type of control and supervision is not a complete code in itself, we do not know what else could be a complete code.

7.2 It was argued by Mr. Jaideep Gupta, learned senior counsel appearing for the State of Kerala that the Reserve Bank of India

3 (2015) 13 SCC 772

does not control the rate of interest charged by NBFCs on the loans advanced by them and that, therefore, a State enactment which seeks to control this aspect, namely, the rate of interest cannot be said to be repugnant. According to the learned senior counsel, a statutory enactment which does not deal with such an important issue as the rate of interest chargeable on the loans, cannot be said to be a complete code in itself. Reliance was placed by the learned senior counsel in this regard on a Constitution Bench decision of the Supreme Court in ***Deep Chand*** *vs.* ***State of U.P***[4].

7.3 But we do not agree. NBFCs which play a very vital role in contributing to the financial health of the country and whose operations are controlled by RBI with the avowed object of operating the currency and credit system of the country to its advantage, have as their life line, the income received by way of interest on the loans advanced. Therefore, to say that RBI has no say in such a matter of vital interest, will strike at the very root of the statutory control vested in RBI.

4 AIR 1959 SC 648

7.4 It may be true that many times RBI may not be controlling the rate of interest charged by NBFCs on the loans advanced by them. It does not mean that they have no power to step in. The power to determine policy and issue directions, available under Section 45-JA can always be invoked by RBI.

7.5 However, it was contended by Mr. Jaideep Gupta, learned senior counsel for the State of Kerala that the power of the RBI under Section 45-JA to determine the policy and give directions, are circumscribed by the words "*relating to income recognition, accounting standards, making of proper provision for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds*".

7.6 But we do not think that the words "*relating to*" appearing in Section 45-JA(1) can be taken to restrict the power of RBI to give directions, only in relation to the matters mentioned after the words "*relating to*". The items mentioned after the words "*relating to*" can only be taken to be illustrative and not exhaustive. This is for the

reason that the power conferred by Section 45-JA is both for determining the policy and for issuing directions.

7.7 Moreover, Sub-section (1) of Section 45-JA deals only with the powers in general. This is made clear by the words "*without prejudice to the generality of the powers vested under sub-Section (1)*", appearing in sub-Section (2) of Section 45-JA.

7.8 In any case, Section 45L(1)(b) confers power upon the RBI to give directions to NBFCs "*relating to the conduct of business by them*". Therefore, to say that RBI has no power in respect of such an important aspect, may not be correct. The fact that RBI generally leaves it to the market forces to determine the rate of interest, without any direct intervention, is not something that could be taken advantage of by the State of Kerala to step in and prescribe the maximum rate of interest chargeable by NBFCs on the loans advanced by them.

7.9 In ***Deep Chand*** (supra), the Constitution Bench of this Court reiterated three important tests of inconsistency or repugnancy, namely, ***(i)*** whether there is direct conflict between the two

provisions; ***(ii)*** whether Parliament intended to lay down an exhaustive Code in respect of the subject matter replacing the Act of the State legislature; and ***(iii)*** whether the law made by Parliament and the law made by State legislature occupy the same field. Therefore, more than supporting the case of the State, ***Deep Chand*** (supra) actually supports the case of the NBFCs, as we have found that Chapter III-B is a complete code in itself.

Doctrine of Eclipse, conflict and repugnancy

8. As indicated by the Constitution Bench in ***Deep Chand*** (supra), ***a law may be valid when made, but a shadow may be cast on it by supervening constitutional inconsistency or supervening existing statutory inconsistency***. Assuming that the Kerala Act was valid in its application to NBFCs when it was made, on the ground that the business of money lending is traceable to Entry 30 of List II, it has to give way for the parliamentary enactment. ***The moment the Parliament stepped in to codify the law relating to registration and regulation of NBFCs, by inserting certain provisions in Chapter III-B of the***

RBI Act, the same would cast a shadow on the applicability (even assuming it is applicable) of the provisions of the Kerala Act to NBFCs registered under the RBI Act and regulated by RBI.

8.1 In ***Innoventive Industries Limited*** *vs.* ***ICICI Bank and Anr***.[5], this Court was concerned with a professed conflict between the Insolvency and Bankruptcy Code, 2016 and the Maharashtra Relief Undertakings (Special Provisions) Act, 1958. After taking note of Section 107 of the Government of India Act, 1935 and Article 254 of the Constitution, this Court analysed the Constitutions of other jurisdictions on the question of inconsistency of laws and summarized the propositions of law as follows:

> "51. The case law referred to above, therefore, yields the following propositions :
>
> 51.1. Repugnancy under Article 254 arises only if both the Parliamentary (or existing law) and the State law are referable to List III in the Seventh Schedule to the Constitution of India.
>
> 51.2. In order to determine whether the Parliamentary (or existing law) is referable to the Concurrent List and whether the State law is also referable to the Concurrent List, the doctrine of pith and substance must be applied in order to find out as to where in pith and substance the competing statutes *as a whole* fall. It is only if both fall, as a whole,

5 (2018) 1 SCC 407

within the Concurrent List, that repugnancy can be applied to determine as to whether one particular statute or part thereof has to give way to the other.

51.3. The question is what is the subject-matter of the statutes in question and not as to which entry in List III the competing statutes are traceable, as the entries in List III are only fields of legislation; also, the language of Article 254 speaks of repugnancy not merely of a statute as a whole but also "any provision" thereof.

51.4. Since there is a presumption in favour of the validity of statutes generally, the onus of showing that a statute is repugnant to another has to be on the party attacking its validity. It must not be forgotten that that every effort should be made to reconcile the competing statutes and construe them both so as to avoid repugnancy--care should be taken to see whether the two do not really operate in different fields qua different subject-matters.

51.5. Repugnancy must exist in fact and not depend upon a mere possibility.

51.6. Repugnancy may be direct in the sense that there is inconsistency in the actual terms of the competing statutes and there is, therefore, a direct conflict between two or more provisions of the competing statutes. In this sense, the inconsistency must be clear and direct and be of such a nature as to bring the two Acts or parts thereof into direct collision with each other, reaching a situation where it is impossible to obey the one without disobeying the other. This happens when two enactments produce different legal results when applied to the same facts.

51.7. Though there may be no direct conflict, a State law may be inoperative because the Parliamentary law is intended to be a complete, exhaustive or exclusive code. In such a case, the State law is inconsistent and repugnant, even though obedience to both laws is possible, because so long as the State law is referable to the same subject-matter as the Parliamentary law to any extent, it must give way. One test of seeing whether the subject-matter of the Parliamentary law is encroached upon is to find out whether the Parliamentary statute has adopted a plan or scheme

which will be hindered and/or obstructed by giving effect to the State law. It can then be said that the State law trenches upon the Parliamentary statute. Negatively put, where Parliamentary legislation does not purport to be exhaustive or unqualified, but itself permits or recognises other laws restricting or qualifying the general provisions made in it, there can be said to be no repugnancy.

51.8. A conflict may arise when Parliamentary law and State law seek to exercise their powers over the same subject-matter. This need not be in the form of a direct conflict, where one says "do" and the other says "don't". Laws under this head are repugnant even if the rule of conduct prescribed by both laws is identical. The test that has been applied in such cases is based on the principle on which the rule of implied repeal rests, namely, that if the subject-matter of the State legislation or part thereof is identical with that of the Parliamentary legislation, so that they cannot both stand together, then the State legislation will be said to be repugnant to the Parliamentary legislation. However, if the State legislation or part thereof deals not with the matters which formed the subject-matter of Parliamentary legislation but with other and distinct matters though of a cognate and allied nature, there is no repugnancy.

51.9. Repugnant legislation by the State is void only to the extent of the repugnancy. In other words, only that portion of the State's statute which is found to be repugnant is to be declared void.

51.10. The only exception to the above is when it is found that a State legislation is repugnant to Parliamentary legislation or an existing law if the case falls within Article 254(2), and Presidential assent is received for State legislation, in which case State legislation prevails over Parliamentary legislation or an existing law within that State. Here again, the State law must give way to any *subsequent* Parliamentary law which adds to, amends, varies or repeals the law made by the Legislature of the State, by virtue of the operation of Article 254(2) proviso."

8.2 In ***Innoventive Industries Limited*** (supra), this Court considered almost all earlier decisions starting from ***Zaverbhai Amaidas*** *vs.* ***State of Bombay***[6]; ***Tika Ramji*** *vs.* ***State of U.P***.[7], ***Deep Chand vs. State of U.P*** and so on and so forth. In sum and substance, ***this Court held that repugnancy under Article 254 would arise only if both the Parliamentary law and the State law are referable to List-III***.

8.3 Once it is clear that the RBI Act is traceable only to the Entries in List-I and the State enactments are traceable only to an Entry in List-II, the question of repugnancy under Article 254 does not arise, as has been held in ***Innoventive Industries Limited.*** But in cases of this nature, Article 246(1) would squarely apply. Article 246(1) reads as follows:-

> **"246. Subject-matter of laws made by Parliament and by the Legislatures of States:** -
>
> (1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List")."

6 AIR 1954 SC 752
7 AIR 1956 SC 676

8.4 In ***UCO Bank and Another*** *vs.* ***Dipak Debbarma and Others***[8], a sale Notification issued under the Securitisation Act was challenged on the ground that it constituted an infraction of Tripura Land Revenue and Land Reforms Act, 1960. This Court found that the Securitisation Act is traceable to Entry-45 of List-I and the Tripura Act is traceable to Entries 18 and 45 of the State List. After referring to the Constitution Bench decision in ***State of West Bengal and Others vs. Committee for Protection of Democratic Rights, West Bengal and Others***[9] and other decisions, this Court held that the Securitisation Act, being a Parliamentary legislation is the dominant legislation. To come to the said conclusion, this Court referred to the *non-obstante* clause in Article 246(1).

8.5 Many times, this Court has invoked the doctrine of eclipse, in relation to pre-constitutional laws with reference to Article 13(1) of the Constitution. But in later years, this doctrine came to be used even in different contexts. For instance in ***Kailash Sonkar vs. Smt. Maya Devi***[10], this Court invoked the doctrine of eclipse to

8 (2017)2 SCC 585
9 (2010) 3 SCC 571
10 (1984) 2 SCC 91

hold that when a person is converted to Christianity or other religion, the original caste remains under eclipse and that as soon as during his life time he is reconverted to the original religion, the eclipse disappears and the caste automatically revives.

Is the argument of Conflict, a mirage?

9. It was argued on behalf of the State that without pointing out any area of conflict between the two enactments the NBFCs cannot invoke either Article 246 or Article 254.

9.1 But the above argument has no substance. Once it is admitted that the RBI Act is traceable to an entry in List-I, Article 246(1) comes into play. In any case, there are also areas of conflict. The Kerala Act, for instance, empowers the debtor under Section 8(1) to deposit the money due to money lender, into a Civil Court. Section 8(2) empowers the Civil Court to pass orders recording full or part satisfaction of the loan.

9.2 But the jurisdiction of the Civil Court stands ousted by Section 34 of the Securitisation Act, 2002. By virtue of a notification bearing No. S.O.856(E) dated 24th February, 2020, issued in exercise of the powers conferred by Section 2(1)(m)(iv), the Central

Government have specified such NBFCs as defined in Section 45-I(f) of the RBI Act having assets worth rupees one hundred crore and above to be entitled for enforcement of security interest in secured debts of Rupees fifty lakhs and above. This Notification was issued in supersession of the earlier notifications. Therefore, it is clear that certain NBFCs are entitled to enforce security interest without the intervention of the Civil Courts and the remedy of the borrower lies only before the Debt Recovery Tribunal. This is one major area of conflict, which can be readily pointed out.

9.3 We have taken the above example only as a sample, for testing the validity of the argument of the learned counsel for the State and we find that the question of conflict does not go to the rescue of the State.

Overriding Effect

10. Section 45-Q which we have extracted elsewhere confers overriding effect upon Chapter III-B, over other laws. Therefore, the States of Gujarat and Kerala cannot contend that the laws made by them are in addition to the provisions of Chapter III-B.

10.1 Though it was contended by the learned counsel appearing for the State of Gujarat that the Gujarat Act exempts NBFCs registered under the RBI Act from seeking registration under the Gujarat Act, we do not think that the same would go to the rescue of State of Gujarat. Under Section 5(2) of the Gujarat Act, NBFCs registered under the RBI Act are deemed to have been registered under the Gujarat Act. Therefore, all other provisions of the Gujarat Act are sought to be applied to NBFCs operating in the State of Gujarat. The other provisions of the Gujarat Act include the ***(i)*** power of search and seizure; ***(ii)*** requirement to maintain certain books and registers and to furnish statements; and ***(iii)*** the mandate not to dispose of any article taken from a debtor as a pawn, pledge or security, before a period of two years from the date stipulated for final payment, etc. The Gujarat Act also empowers the Civil Court under Section 30 to reopen certain transactions and to limit the interest recoverable. Section 32 of the Gujarat Act empowers the borrower to deposit the money before a Civil Court and the civil Court to assume jurisdiction of the adjudication of the dispute.

10.2 Interestingly, Gujarat Act, 2011 tacitly recognizes the regulation of NBFCs under the RBI Act. Yet the State got the assent of only the Governor.

Conclusion

11 In view of the above, we are of the considered opinion that the Kerala Act and the Gujarat Act will have no application to NBFCs registered under the RBI Act and regulated by RBI. Therefore, all the appeals filed by NBFCs against the judgment of the Kerala High Court are allowed. Likewise the appeals filed by the State of Gujarat against the judgment of the Gujarat high Court are dismissed.

11.1 As a consequence, Transfer Petition (Crl.) No.359 of 2015, shall also stand allowed and the First Information Report filed against the officer of the NBFC for violation of the provisions of the Kerala Act shall stand quashed.

11.2 An application for impleadment has been filed by one Mr. Davidson Dharmaraj in Civil Appeal No.5238 of 2012, claiming that he has lodged a criminal complaint against the appellant and

its officers in the Civil Appeal, namely M/s. Muthoot Finance Private Limited, for alleged offences under the Indian Penal Code, but relying upon the provisions of the Tamil Nadu Pawn Brokers Act and the rules framed there under and that any decision rendered in the appeals arising out of the decisions of the Kerala and Gujarat High Courts may have an impact on his criminal complaint. Though we have not examined the provisions of the Tamil Nadu Pawn Brokers Act and the Tamil Nadu Money Lenders Act, the principles of law laid down herein, would apply equally to these State enactments also. Therefore, the application for impleadment namely I.A. No.2 of 2015 is dismissed.

11.3 There will be no order as to costs.

.....J.
(Hemant Gupta)

.....J.
(V. Ramasubramanian)

New Delhi
May 10, 2022