Article

Inapplicability of money lending laws to regulated NBFCs

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Introduction

In the year 2011, there was a landmark judgment of the hon'ble Gujarat High Court (the 'Gujarat Ruling') in *Radhe Estate Developers Vs. Versus Mehta Integrated Finance Co. Ltd. and Ors*[1]. contesting the very fact of the applicability of the Bombay Money Lending Act, 1946 to non- banking financial companies (NBFCs). The same is being cleped as a landmark one, considering the fact that there has been various other rulings contesting for, and on the similar matters and grounds, as were contested therein thereafter, and almost in all, the Gujarat Ruling has been referred to. This article is being prepared, primarily with a focus on the Bengal Money Lending Act, 1940 (BML Act) and the relevant provisions thereunder, and an analysis on the applicability of BML Act to the NBFCs based on the decisions of various Courts in India including the Gujarat Ruling as aforesaid.

A brief about the Bengal Money Lenders Act, 1940[2]

The Bengal Money Lenders Act, 1940 is one of the earliest enactment, and the same came into force with effect from August 1, 1940. BML Act was enacted by the State of West Bengal by virtue of the powers conferred under Article 246(3) of the Constitution of India, wherein the States in India are empowered to enact laws with regard to such matters as enumerated in Entry 30 of List-II of the VIIth Schedule of the Constitution of India including laws related to money lending. It is worthwhile to mention here that the preamble of the said Act says that the same was enacted to make further and better provision for the control of money-lenders and for the regulation and control of money-lending in the State of West Bengal.

In general, money lending laws are concerned about protection of the interest of the borrowers by way of imposing a ceiling of rate of interest, mandatory licence requirement for the money lenders etc. These laws also place an embargo on the Court's power on entertaining a suit, wherein the money lender is an unlicenced one. BML Act also covers similar provisions.

Power of enactment of money lending laws

Article 246 of the Constitution of India empowers the Parliament and Legislatures of the States to make laws in respect to any of the matters enumerated in List-I and List-II in the VIIth Schedule respectively. List-III in the said Schedule is a concurrent list in relation to which Parliament and Legislatures of the States both have the powers to make law. It is to be noted here that the States have been vested conditional power by virtue of Article 246 which also provides for the power of the Parliament with respect to any matter for any part of the territory of India not included in a State notwithstanding that such matter is a matter enumerated in the State List.

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[1] https://indiankanoon.org/doc/1357712/

[2] http://www.wbrsrsa.org/exam_pdf/Bengal%20Money-Lenders%20Act,%201940.pdf

Entry 30 of List II *inter alia* relates to money lending and money lenders. Therefore, the States may enact their own laws to specifically make it applicable to such States. The Money Lending Acts were also enacted by the States in India by virtue of the aforesaid power vested through Article 246.

The contested matter

Considering the powers of a State Legislature as vested under the aforesaid Article 246, the matter that was contested in the Gujarat Ruling was about the applicability of the Bombay Money Lenders Act, 1946 to an NBFC which is already regulated by a central law i.e. the RBI Act, 1934. The Court had held that Legislature of a State has exclusive power to make law for such State or any part thereof, but it will be subject to clause (1) and (2) of Article 246 of the Constitution. Therefore, if any law has been made by the Parliament in its exclusive power in respect to matters enumerated in List-I or List-III in the VIIth Schedule, the law in respect of such matter, if any, enacted by the Legislature of any State, shall be subject to the law made by the Parliament. Thus, a State Act is always subject to a Central Act.

The Court had also made a reference to the provisions of Chapter IIIB of the RBI Act and held that RBI has full control over the NBFCs and can take all type of regulatory measures, and in an appropriate case, it can take penal action like winding up, etc. in the interest of its customers, namely, the depositors. Therefore, the total power and control of the RBI over such NBFCs is evident from the said provisions under Chapter IIIB. Further, the RBI Act has already occupied the field with regard to control, penal action, etc., against those companies, and thereby the State law, namely, the Bombay Money-Lenders Act, 1946, cannot transgress on the field occupied by the law of Parliament and in view of Section 45Q the provisions of Chapter IIIB of the RBI Act shall have an overriding effect on the Bombay Money Lenders Act, 1946.

The Court further noticed the fact that the Bombay State Government has not issued any notification under Section 2(10)(b) with regard to any banking, financial or any institution, such as NBFCs, bringing it within the meaning of 'money-lender' as defined in the said Section of the Bombay Money-Lenders Act since the NBFC in the present case did not fall under the definition of 'company' as provided in the said Act which included a company incorporated under the Companies Act, 1913 only making it out of the purview of the definition of `money-lender' as defined under Section 2(10)(iiia) read with Section 2(4) of the said Act. In view of the absence of any such notification, the State Government or its authorities have no jurisdiction to take any regulatory measure or penal measures under the Bombay Money Lenders Act, 1946 which was a primary ground for the Court to conclude about the non- applicability of the state law to the NBFCs.

Position post Gujarat Ruling

The Gujarat Ruling was decided on April 26, 2011 and thereafter, the date i.e. May 2, 2011 has been appointed by the Gujarat Government as the date of enforcement of the new Gujarat Money Lenders Act, 2011 (GML Act) repealing the erstwhile Bombay Money Lenders Act, 1946. During the said period, there was another special civil application pending with the Gujarat High Court in the matter of *Sundaram Finance Limited & others vs. State of Gujarat*[3], wherein it was prayed for declaration of the provisions of the Gujarat Money-Lenders Act, 2011 (which was then in the form of a Bill) and its applicability to the petitioner being an NBFC registered under the RBI Act, as illegal and *ultra vires* the Constitution, and for further declaration of the said Act, if enforced as unconstitutional in so far as it applies to the petitioner company being an registered NBFC in the absence of legislative competence. The petitioner has further prayed for restraining the respondent being the Gujarat State Government from issuing any notification under Section 1(3) of the GML Act, notifying the Act to come into force.

It is to be noted here that the GML Act has prescribed the definition of 'company' to mean a company as defined under the Companies Act, 1956 and in terms of Section 2(10), a 'money lender' for the purpose of the said Act includes a 'company'. Further, the Act also provided a doctrine of implied registration under the Act for the NBFCs registered with RBI. Also, the definition of a 'loan' under Section 2(9) excludes the deposit of money or other property in Bank, Govt. Post Office, a Company or a Cooperative Society, but the same does not exclude the activities of a company which is registered under Chapter IIIB of the RBI Act. Accordingly, the enforcement of the new GML Act had created lots of perplexity, *inter alia,* to include the following-

a. Whether the GML Act was being enacted to overcome the earlier judgment in the Gujarat Ruling and on that ground can it be declared as *ultra vires*?

b. Whether the GML Act encroaches upon the field of legislation of the Parliament so as to declare any part thereof as *ultra vires*?

The Court held that the new GML Act is *ultra vires* the Constitution of India for legislative incompetence of the State Legislature only to the extent it seeks to have control over the NBFCs registered under the RBI Act in the matter of carrying on their business under Chapter IIIB of the RBI Act after considering, *inter alia,* the grounds enumerated hereunder-

A. The petitioner has been registered under Chapter IIIB of the RBI Act and in the matter of exercising its right as an NBFC, which is the subject-matter of the RBI Act, it is bound to follow guidance of Reserve Bank of India and no other State law can interfere with its business activities if it conforms to the provisions of the RBI Act. However, if in addition to its activity which is governed under Chapter IIIB, the petitioner wants to enter into the field of the State laws, it is bound to comply with the relevant provisions of the State laws.

[3] http://www.janalakshmi.com/wp-content/uploads/Lending_act.pdf

Therefore, for the purpose of carrying on the business of NBFC, the petitioner should not be bound by any restriction imposed by any other State law. According to the GML Act, it appears that if an NBFC is registered under the RBI Act, it automatically becomes registered under the GML Act and comes within the purview of the State legislation. To that extent, the GML Act encroaches upon the provisions of the RBI Act.

B. The Court also raised question considering Section 2(9) of the GML Act as, if a bank is excluded from the operation of the said Act, there is no reason why an NBFC, which is also controlled by the RBI in the same way a banking corporation is controlled, should not be excluded from its operation. To bring an entity, which is under the control of the Reserve Bank of India in performance of its business prescribed in Chapter IIIB of the RBI Act, under the purview of the GML Act amounts to encroachment upon the field of Central law and to that extent, the same is violative of the provisions of the Constitution of India for legislative incompetence.

C. It is not a case of incidental trenching upon the field of RBI Act but one of direct interference over non banking activity of an institution registered under the RBI Act and the State could not have imposed any restriction as it has restrained itself from its operation over the activities of the other banks doing similar business under the direct supervision of the RBI Act in the same way the petitioner is performing its business including lending in any manner.

D. If the petitioner restricts its activities strictly within the provisions of Chapter IIIB of the RBI Act, the GML Act cannot impose any further restriction upon the petitioner in addition to ones imposed by the Reserve Bank of India in exercise of the power under the RBI Act.

   As provided in Section 45 I (f) of the RBI Act, the petitioner is entitled to run its principal business of lending in any manner in accordance with the RBI Act and thus, no encroachment in that field is permissible at the instance of the GML Act. Thus, within the scope of the activity of an NBFC as provided in the RBI Act, the State Legislation has encroached upon by imposing its control over it in addition to that imposed under the RBI Act and the moment it tries to impose its authority upon an NBFC registered under Chapter IIIB in performance of its activity provided under said Chapter, direct repugnancy arises.

E. In a case where there is even scope of conflict having regard to the field of legislation of Central law, to that extent, the State law should restrain itself from interfering. The GML Act, so far as it intends to take control over an NBFC due to its registration under the RBI Act, definitely interferes with the subject matters governed under the RBI Act.

It is worthwhile to be noted that the Court also did not agree with the decision of Kerala High Court in the case of *M/s. Sundaram Finance Ltd.* (supra), wherein it was held that Kerala Money Lenders Act, 1958 is not violative and both the RBI Act and the provisions of the

Kerala Money Lenders Act simultaneously apply to the NBFCs. The matter was decided in September, 2014.

Applicability of BML Act on the NBFCs operating in Bengal

In August, 2015, there was a ruling of Hon'ble Calcutta High Court in the matter of *M/S. Arjun Shyam & Co. (P) Ltd vs M/S. Sagar Trading Co. & Ors*[4]. The aforesaid matter was primarily based on the question of maintainability of the application as also maintainability of the suit considering the provisions contained in the BML Act with respect to mandatory licence requirement for the money lenders and the entitlement of an institution who holds a licence under the RBI Act, 1934 to maintain a suit on money lent and advanced without requiring it to hold a licence under the BML Act. A question was also raised with regard to encroachment upon the activity of an NBFC duly registered with RBI, which permits an entity/person or an institution to do non-banking financial business to recovery such money merely because the said institution and/or person does not hold a licence under the BML Act.

Section 8 of the BML Act requires all the money lenders in the State to mandatorily obtain licence for the purpose of carrying out their activities of money lending. Further, Section 13 of the said Act also provides for non- maintainability or non- enforceability of a suit in case of not holding a licence.

The Court held that the NBFCs are not covered by the definition of 'money-lenders' which reads as

"money-lender" means a person who carries on the business of money-lending in West Bengal or who has a place of such business in West Bengal, and includes a pawnee as defined in section 172 of the Indian Contract Act, 1871."

The Court further referred to Chapter IIIB of the RBI Act and formed a view that it has an overriding effect over any law inconsistent therewith for the time being in force or any instrument having effect by virtue of any such law. It was held that once an NBFC holds the licence by virtue whereof the said NBFC can carry on the business anywhere in the country unless a State legislature specifically requires an NBFC to obtain a licence under the State legislation, the claim of an NBFC to realize money cannot be defeated. It was also not in dispute that the petitioner is holding a licence and is registered as a non-banking financial institution. Even though the decision of the Court was in favour of the petitioner NBFC, however, it still provides a room for ambiguity so as to, what if the BML Act is amended to the effect of including an NBFC under its purview.

In *L & T Finance Limited versus M/s. Saumya Mining Ltd. and others*[5], wherein the petitioner lender i.e. L & T Finance was operated from the jurisdiction of Kolkata. The Hon'ble Bombay

[4] https://indiankanoon.org/doc/141157628/
[5] https://indiankanoon.org/doc/13135124

High Court relied on the interpretation of the Hon,ble Gujarat High Court in the matter of *Sundaram Finance Limited & others vs. State of Gujarat* as discussed aforesaid and held that if the laws held by the Parliament is to operate the earlier laws made by the State Government, it would be reasonable to hold that the companies which are covered under chapter IIIB of the Reserve Bank of India Act would not be falling under the BML Act, as the term money lending under the provisions of the BML Act and Bombay Money Lenders Act are in *pari material*. This was decided on July, 2014.

Further to mention, there was a special civil application in the matter of *Fullerton India Credit Company Limited and Ors. vs State of Gujarat*[6], wherein the writ petitioners have prayed for issue of an appropriate writ, order or direction declaring that the petitioners being NBFCs registered with RBI would not come within the purview of GML Act. It was also prayed for declaration that the provisions of the GML Act, 2011 and its applicability to the petitioners are illegal and ultra vires the Constitution.

The Chief Justice relied on the decision of the same Court in *Sundaram Finance Limited & others vs. State of Gujarat* declaring the GML Act as ultra vires the Constitution of India for legislative incompetence of the State Legislature to the extent it seeks to have control over the NBFCs registered under the RBI Act 1934 in the matter of carrying on their business under Chapter IIIB of the said Act. The same was provided in January, 2013.

Conclusion

Considering the Calcutta High Court ruling, it has already been mentioned in this article that the decision of the Court still creates a room for confusing and ambiguous situation. Therefore, for the time being, it may be noted that in absence of any notification of the State Government for inclusion of NBFCs under the BML Act, the NBFCs operated in Bengal also remain out of the purview of the BML Act and accordingly, the provisions of the same would not apply to such NBFCs.

It also seems that the non- applicability of the provisions of state laws only applies to those NBFCs which are regulated by the RBI by virtue of getting registered with RBI. Therefore, those entities which are not so regulated by RBI and carrying on the activities of lending will still be covered under the state laws and they cannot take benefit of the aforesaid decisions of the Courts.

[6] https://indiankanoon.org/doc/110239622/