

CHAPTER – XI

LAWS APPLICABLE TO BANKS AND

FINANCIAL INSTITUTIONS

The growth of industry, economy and trade has brought the banks and financial Institutions in prominence and most individuals have to deal with them in one way or the other. In this thesis also, closer attention is given to recovery of dues of banks and financial institutions after analysing in detail the causes of delays in judicial procedure. The litigation by and against these institutions have increased tremendously. Hence a detailed study of the rights, powers, privileges, obligations and duties of such institutions will be necessary. In the course of research, the provisions of such 25 Acts have been examined and the more relevant of them have been covered in this Chapter. The latest addition to such laws is the Recovery of Debts due to Banks and Financial Institution Act, 1993. Separate chapter (Chapter – 14) in this thesis deals with exclusive Tribunals created for bank cases.

I

BANKING REGULATION ACT 1949

The Banking Regulation Act is the fundamental law governing banking activity and Banks in India. The main features of the Act are summarised below :^{**1}

- (a) Comprehensive definition of banking is given so as to bring within the scope of legislation all institutions which receive deposits, repayable on demand or otherwise for lending or investment.
- (b) Prohibiting non-banking companies from accepting deposits repayable on demand.

^{**1} BANKING REGULATION ACT, 1949.

- (c) Prohibition of Trading with a view to eliminate non-banking risks
- (d) Stipulating minimum capital standard.
- (e) Restricting payment of dividends.
- (f) Including foreign banks within scope of legislation
- (g) Introduction of comprehensive system of licensing of banks and their branches
- (h) Prescription of a special form of balance sheet and conferring power on RBI to call for periodical returns.
- (i) Inspection of books and accounts of bank by Reserve Bank
- (j) Empowering the Central Government to take action against banks conducting their affairs in a manner detrimental to the interest of depositors.
- (k) Provisions for closer supervision of banks by RBI.
- (l) Provisions of expeditious procedure for liquidation
- (m) Bringing the State Bank of India within purview of some provisions of bill.
- (n) Vesting wide powers in Reserve Bank to help the banking companies in emergency situations.

Some of the latest amendments made in the Act deserve a special reference. By Banking Laws Amendment Act, **2 1983, new section 21 A has been inserted. The section provides that notwithstanding anything contained in the Usurious Loans Act or any other law relating to indebtedness in force in any State, a transaction between a banking company and its debtor shall not be reopened by any Court on the ground that rate of interest charged by the banking company in respect of such transaction is excessive.

This section has vital importance because in several recovery cases filed by the banks the defendants used to take a plea of excessive interest and the matters used to get delayed. This section creates a statutory directive that the Courts should not entertain such pleas.

**2 ACT NO.1 OF 1984.

The section applies only to the interest charged upto date of suit. It is not applicable to interest from date of filing suit till realisation, for which discretion is vested under Section 34 of Civil Procedure Code on the Civil Courts.**3

The provision has no bearing on jurisdiction of Courts to give relief to an aggrieved party when the bank charged interest in excess of limit prescribed by RBI. The interest charged beyond that is illegal and void.**4 Under Section 34 A, a banking company is protected from production of documents of confidential nature in any proceedings.

The newly inserted section 45 Z of the Act makes provisions for nomination facility in case of accounts.

The Banking Regulation Act is thus, law of vital importance governing banks.

II

BANKING COMPANIES (PERIOD OF PRESERVATION OF RECORDS) RULES, 1985

With the increase in volume of business of banks, shortage of space to store the records and increase in rent of premises particularly in urban areas a need was felt to absolve the banks from preserving records beyond a certain limit. Under the rules the documents like chequebook registers, demand liability registers, vault registers etc. have to be preserved for atleast five years preceding the current calendar year.

**3 MANUAL OF BANKING AND FINANCIAL INSTITUTIONS LAWS BY N. N. JAIN, VOLUME 1, PAGE 30.

**4 H.P.K. REDDY V/s. CANARA BANK, AIR 1985, KARNATAKA 228.

More important records like personal ledgers, loan/advances registers, bills registers etc shall be preserved for a period not less than 8 years immediately preceding the current calendar year.

Under Section 35 A of the Act, the Reserve Bank is empowered to direct a bank to preserve the records for longer period.

If the special evidenciary value of the record in respect of any particular account is known and it may be required to be produced before any court or tribunal the same should be preserved for a longer period.

III

BANKING COMPANIES (ACQUISITION AND TRANSFER OF UNDERTAKINGS) ACT, 1970

Up to the year 1968 the management and control of most leading banks of the country was in hands of private sector. Need was felt to bring them under social control and hence leading banks were nationalised. The banks were nationalised under the provisions of Banking Companies (Acquisitions and Transfer of Undertakings) Act, 1970.

The bank nationalisation was made effective from 19/7/1969. However, the Supreme Court by a majority judgement dated 10/2/70, struck down the provisions of the Act as void. Consequently, the ownership of banks vested in parent banks. Later by this Act the ownership vested in corresponding new banks.**5

**5 R. C. COOPER V/s. UNION OF INDIA, AIR 1970 SC

The Preamble of the Act **6 stipulates that it is an Act to provide for acquisition and transfer of undertakings of certain banking companies, having regard to their size, resources, coverage and organisation in order to control the heights of the economy and to meet progressively, and serve better, the needs of development of the economy in conformity with national policy and objectives.

The banks having aggregate deposits of Rs.50 Crores and above were nationalised. Under the scheme corresponding new banks were created and entire undertakings of the existing banks stand transferred to and vested in such banks. The existing banks were to be paid compensation for the same. The corresponding new banks were to be governed by the policies of Central Government. The Government is also empowered to make a scheme in relation to capital structure, constitution of board, reconstitution of banks, if required.

Recently in exercise of the powers referred above, New Bank of India merged with Punjab National Bank.

Section 16 A of the Act provides for appointment of nominee Directors on Board of a borrower company, if any agreement so provides. Such directors are not governed by provisions in Articles.**7

IV

NATIONALISED BANKS (MANAGEMENT AND MISC. PROVISIONS) SCHEME, 1970.

In exercise of the powers conferred under the Act, Nationalised Banks (Management and Miscellaneous Provisions) Scheme 1970 is framed. It provides for nominee directors of employees on board of banks. The managing director is the Chief Executive officer of the bank. Disqualification for directors have been prescribed on the line of provisions in Companies Act. Under the scheme the board of directors have to meet atleast once in a quarter and for minimum six times a year.**8

**6 ACT NO.5 OF 1970.

**7 INSERTED BY BANKING LAWS AMENDMENT ACT, 1983.

**8 SECTION 10 OF THE SCHEME

V

STATE BANK OF INDIA ACT, 1955

State Bank of India is the largest bank in India and one of the largest in the world. State Bank has 8797 branches and its associate banks have 4292 branches as on 31/3/95.**9

The bank has total deposits of Rs.82,991 crores and associate banks have deposits of Rs.29,000 crores as on 5/1/96. The total advances by State Bank as on that date is Rs.51,611 crores and advances of its associates are Rs.19,000 crores **10. State Bank thus occupies a vital place in banking.**10

The State Bank of India was constituted consequent to take over of assets and liabilities of Imperial Bank of India. The scheme envisaged State Bank of India coming into existence and Imperial Bank of India going out of existence.

Recently, State Bank of India came out with public issue which was oversubscribed. Thus shares of the bank are widely held and freely transferable.

The Act provides for the authorised capital and restrictions on individual holdings. The bank's central office is at Bombay and general power of Superintendence and conduct of affairs is vested in Central Board. The central board will comprise of Chairman, Vice Chairman, Managing Director, and other directors as per criteria laid down.**11 The set up is decentralised and provision is made for Constitution of local boards, wherever local head office of the bank is

**9 STATE BANK OF INDIA MONTHLY REVIEW PAGE 98, FEB.1996 ISSUE

**10 STATE BANK OF INDIA MONTHLY REVIEW FEB, 96 STATISTICS.

**11 SECTION 19 OF SBI ACT.

situated.**12 The disqualification for directors have been laid down and if a person is director of other banking company or he is salaried officer of Government not specifically authorised to be appointed as director, or adjudged insolvent/or of unsound mind he disqualifies to be the director. The Central Government is vested with the power to remove any director including Chairman.

The State Bank is to act **13as agent of Reserve Bank wherever the later is not having branch and is also empowered to acquire business of other banks with the sanction of Central Government.

The State Bank is under statutory obligation to maintain integration and development fund and Reserve fund. The dividend can be declared only after making required provisions. The affairs of the bank shall be audited by 2 or more qualified auditors and they have to submit report to the Central Government and they have to opine whether the balance sheet reflects true and fair view of necessary particulars and there are any transactions which are beyond the powers of the banks.**14

The provisions of Companies Act governing winding up are not applicable to State Bank. The State Bank can not be would up except by order of Central Government. **15

The bank is empowered to appoint employees, officers etc. The bank, its directors and employees have to observe secrecy of information.

In exercise of the rule making powers conferred under the Act, State Bank of India regulations have been framed.

**12 SECTION 21 OF SBI ACT.

**13 SECTION 32 OF SBI ACT.

**14 SECTION 41 OF THE ACT.

**15 SECTION 45 OF THE ACT.

With disinvestment of shares by the Government and subsequent public issue of shares by the bank, the rights of shareholders have been increased. Nevertheless, the Government is having controlling interest in the Bank.

VI

REGIONAL RURAL BANKS ACT, 1976

After nationalisation of banks in 1969, need was felt to provide for the incorporation, regulation and winding up of Regional Rural Banks.**16 Such banks were intended to be instruments of rural development mainly of the agriculture, trade, commerce, industry and other productive activities in rural areas.

The Regional Rural Banks (RRB) are to synthesise the local knowledge and familiarity of rural problems which the cooperatives possess and the degree of business organisation. Ability to mobilise deposits, access to central money markets and modernised outlook which the commercial banks have.**17

The Regional Rural Banks will be sponsored by commercial banks, preferably the lead bank in that area and shall be established by notification in official gazette. They are capable to hold and dispose off the property. The initial authorised capital of each such bank will be one crore rupees. The general superintendence, direction and management of affairs of Regional Rural Banks have been vested in Board of Directors. The Central Government and sponsor banks can nominate 3 directors each while 2 directors can be nominated by the State Government. The directors hold office for the period of 2 years. The Regional Rural Banks have been empowered to engage in banking business specified under the Banking Regulations Act. The thrust is on granting of loans and advances, to small and marginal farmers, artisans, small entrepreneurs, etc.**18

**16 PREAMBLE OF RURAL BANKS ORDINANCE, 1975.

**17 JOURNAL OF INDIAN INSTITUTE OF BANKERS, 1975.

**18 SECTION 18 OF REGIONAL RURAL BANKS ACT, 1976.

The annual accounts of Regional Rural Banks have to be audited by auditors approved by the Central Government. A privileged status is given to Regional Rural Banks in respect of Income Tax. They are deemed to be cooperative societies for the purpose of taxation. The interest tax is not applicable to them. The bank is to have a whole time Chairman who is generally nominated by the sponsor banks.

The Regional Rural Banks scheme has partly succeeded. There are in total –196 - Regional Rural Banks of which 151 are loss making. **19 Problem of mounting bad debts and poor profitability has caused loss of capital in some of them.

VII

INDUSTRIAL DEVELOPMENT BANK OF INDIA ACT, 1964

After independence need was felt to establish institutions which will provide long term finance for developmental activities in various segments. IDBI constituted under the IDBI Act, 1964 is one of the most leading financial institutions of India. The extent of growth of IDBI and its contribution to the development can be understood from the following data :

**19 INDIAN BANKING NATURE AND PROBLEMS BY VASANT DESAI AT
PAGE 54.

TABLE
DISBURSEMENTS BY IDBI
TOTAL AMOUNT RS.30,700 CRORES
(AS ON 31/3/94)

<u>AS AT MARCH 31</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Total Sanctions	7343.0	6294.0	7159.0	9618.0	13195.0
Growth %	27.0	10.1	13.7	34.3	37.2
Total Disbursements	5085.0	4459.0	5763.0	6668.0	8071.0
Growth %	8.3	26.9	29.2	15.7	21.0
Total Outstandings	14.4	11.8	20.9	13.8	11.7

SOURCE : THE INDIAN FINANCIAL SYSTEM-THE SYSTEM THAT CARES BY
 SHRI VASANT DESAI AT PAGE-233.

INDUSTRIAL DEVELOPMENT BANK OF INDIA **20
DETAILS OF PAID UP CAPITAL, RESERVES AND ADVANCES

<u>YEAR</u>	<u>PAID UP</u>	<u>RESERVES</u>	<u>LOANS ADVANCES</u> <u>(RS. IN CRORES)</u>
1966	10.00	0.8	72.8
1971	30.00	14.8	158.2
1976	50.00	32.7	411.3
1981	115.00	92.2	2232.0
1986	445.00	485.6	6257.8
1988	495.00	815.2	1292.2
1989	540.00	880.7	11270.9
1990	637.00	1101.5	12856.3
1991	703.00	1380.1	15912.3
1992	753.00	1754.0	18618.3
1995**21			

**20 STATISTICAL ABSTRACT, INDIA 1992 PAGE 150.

**21 NEWS ITEM IN THE BUSINESS STANDARD.

IDBI recently made public issue which was oversubscribed. IDBI gives finance to industrial concerns which are engaged in vital activities like manufacture, shipping, mining, transport, power generation, fishing, technical development etc. **22 The initial authorised capital was Rs.100 crore which was increased to Rs.200 crores and thereafter increased from time to time. The Bank is managed by Board of Directors. The Chairman, Deputy Governor of RBI and other 20 directors, comprising of nominees from central government, financial institutions, banks and eminent persons in various connected fields, also thus form the governing body.**23 The business of the bank includes grant of loans and advances to State Financial Corporations, Public Financial Institutions, Scheduled Banks, Cooperative Banks, Export units, industrial concerns etc. It can also subscribe to the shares and stocks of other companies. The bank can also give guarantee. To augment funds of the banks, Central government can give interest free soft loans of rupees Ten crores payable over 15 years.

The bank can borrow from the market on its bonds and debentures. Recently it has issued shares to public. Under the Act the bank has to establish Development Assistance Fund and all amounts received will be credited in such fund. The bank while sanctioning loan or financial assistance stipulates the power to appoint director on board of borrower company. In such case notwithstanding anything contained in the Companies Act or articles regarding qualification shares, retirement, liability of directors etc. such nominee directors can hold office. The bank also reserves the right to convert its debt into equity at their discretion.

**22 ACT NO.72 OF 1982, SECTION 2.

**23 SECTION 9 OF IDBI ACT, 1964.

VIII

THE INDUSTRIAL FINANCE CORPORATION OF INDIA ACT, 1948

For the industrial growth, it was felt expedient to establish an Industrial Finance Corporation for the purpose of making medium and long term credit more readily available to industrial concerns in India particularly in circumstances where normal banking accommodation is inappropriate or resort to capital issue methods is impracticable. Over last 48 years IFCI has made tremendous progress and significantly contributed to the nation's industrial growth. The details below gives full particulars.

INDUSTRIAL FINANCE CORPORATION OF INDIA(IFCI) **24

DETAILS OF CAPITAL, LOANS AND ADVANCES GIVEN

<u>YEAR</u>	<u>PAID UP CAPITAL</u>	<u>RESERVES</u>	<u>LOANS AND ADVANCES (RS. IN CRORES)</u>
1952	500	2	655
1961	500	172	4074
1966	835	653	9543
1971	835	1506	15571
1976	1000	3173	22198
1981	1750	4699	53493
1986	4000	18288	153262
1990	10000	32741	417904
1991	13500	38945	536221
1992	14250	46132	678783

**24 STATISTICAL ABSTRACT, 1992, PAGE 148.

The initial authorised capital was Rs.10.00 crores which is increased from time to time. The general superintendence and management is vested in board of directors which has nominees from development banks, Central Government, scheduled banks and cooperative banks. A nominee director holds office during the pleasure of authority appointing him. A nominee director holds office for 4 years. IFCI can issue and sell bonds and debentures carrying interest for raising working capital. **25 Such bonds shall be guaranteed by the Central Government. IFCI is authorised to carry on business of guaranteeing loans, deferred payment loans, other credit arrangements, underwriting, transfer of instruments, subscription to stocks etc.**26 The Corporation can impose conditions while granting financial accommodation including the power to nominate directors on board of such industrial concern. Such directors hold office consequent to special provisions of IFCI Act. **27 Section 28, 29 and 30 of the Act deserve a special mention. These sections confer special powers on the Corporation in case of default in repayment. Section 28 provides that where any industrial concern which is liable to the Corporation commits default in complying with the terms of agreement, the Corporation has the following rights :

- i) Right to take over management or possession or both **28
- ii) Right to transfer by way of lease or sale and realise property pledged, mortgaged, hypothecated and assigned to IFCI.
- iii) Right to recover costs, charges and expenses incurred for exercise of such rights.
- iv) Right to recall the dues before the agreed period in case of certain developments.**29

**25 SECTION 21 OF IFCI ACT.

**26 SECTION 23 OF IFCI ACT.

**27 SECTION 25 OF IFCI ACT.

**28 INSERTED BY ACT 74 OF 1972.

**29 SECTION 30 OF IFCI ACT.

In case of take over of management IFCI is deemed to be the owner of the industrial concern. In case of transfer of property in exercise of its rights by IFCI, the transferee acquires all the rights of the borrower. Under section 30 special provisions have been made for enforcement of claims by IFCI.

If the industrial concern fails to make repayment without prejudice to the right of corporation under section 28, IFCI can apply to the District Court for following orders :

- a) For an order for sale of property pledged, mortgaged, hypothecated or assigned to the corporation.
- b) Transferring management of industrial concern to Corporation
- c) Ad interim injunction in case there is apprehension of machinery or equipment being removed.**30

If any liquidation proceedings have commenced against the industrial concern the section does not give any preference to IFCI over other creditors.

Whenever the management of a concern is taken over by IFCI in exercise of its powers, IFCI can nominate directors and the persons holding office of directors prior to that stage vacate office. **31

Making false statement in any bill or instrument given to IFCI as security is punishable with imprisonment up to 2 years. Using name of IFCI without its consent in any prospectus shall be punishable with imprisonment for term which may extend to 6 months.**32

**30 SECTION 30 OF IFCI ACT.

**31 SECTION 31 A OF THE ACT.

**32 SECTION 41 OF IFCI ACT.

IX**INDUSTRIAL RECONSTRUCTION BANK OF INDIA(IRBI)****ACT, 1984**

Industrial Reconstruction Bank of India (IRBI) is constituted to function as principal credit and reconstruction agency for industrial revival and coordinate similar work of the other institutions engaged therein and to assist and promote industrial development and to rehabilitate industrial concerns. **33 The bank functions with twin objective of industrial development and revival of sick industries. The assistance provided by the bank may be in form of direct finance or it may be in form of managerial or technical assistance. The initial authorised capital was Rs.200 crores which is further increased from time to time. The head office of the bank is at Calcutta.

The Bank is managed by Board of directors comprising of a Chairman, Deputy Governor of RBI, nominee director of IDBI and 15 other directors to be nominated by state financial institutions, public sector institutions etc.

IRBI is to function as the principal credit and reconstruction agency for industrial revival by undertaking modernisation, expansion, reorganisation, diversification or rationalisation of industries.**34

The Bank can undertake various types of activities like grant of loans and advances, guaranteeing the dues, subscribing/underwriting public issues, providing credit to State level agencies, etc.

**33 PREAMBLE OF IRBI ACT, 1984.

**34 'OBJECTS AND BUSINESS OF BANK' SECTION 18 OF THE ACT.

The bank is to establish 'Reconstruction Assistance Fund' to which all incomes, profits, repayments, recoveries etc will be credited.**35

Special powers have been conferred in favour of the bank when financial assistance is provided. Under section 36 IRBI can impose a condition to nominate director on board of assisted unit.

A simplified and summary procedure has been laid down when assistance is given against the security of immovable property. On the basis of a written declaration made by the borrower/guarantor and it is to be registered as document under Registration Act.**36

The Bank is vested with a right to call for repayment before agreed period in case of adverse developments, suppressions of facts etc. It has also the right to take over the management or possession of the assisted unit. The bank can also apply to the High Court having jurisdiction for sale of assets, injunctions etc. The Bank can also take over management or possession of the property given as primary or collateral security.**37

X

THE NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT ACT, 1981.

The National Commission of Agriculture had suggested for establishment of a national level institution for providing credit for promotion of agriculture, small scale industries, handicrafts etc. It was intended to be an apex level bank combining experience and expertise of all national level institutions. The bank provides refinance to various banks for their term lending in agriculture and rural activity. The bank acts in close coordination with Reserve Bank of India. The bank

**35 CHAPTER VI OF THE ACT DEALS WITH THIS FUND

**36 SECTION 37 OF THE ACT.

**37 SECTION 41 OF IRBI ACT.

is to promote agriculture and rural development. Agriculture includes activities like horticulture, animal husbandry, forestry, dairy etc. The term rural development means development of rural areas through any activities conducive to such development particularly production of goods, provisions for services etc.**38 The bank is established with authorised capital of Rs.100 Crores. The Board of Directors of NABARD comprises of Chairman, two directors amongst experts in rural economics etc, three directors with experience in cooperative banks, three nominated by Central Government, two nominated by State Government.

If due to unforeseen circumstances reschedulement of loans given to artisans, small scale industries etc by some bank/finance institutions is necessary it may provide to such bank financial assistance, The loan to State Cooperative Bank requires to be guaranteed by the concerned State Government.**39 Any direct loan given to institution other than a scheduled bank requires to be guaranteed by the Government. **40

The sums received by a borrowing institution in repayment or realisation of loans and advances refinanced either wholly or partly by nationalised banks shall be to the extent of accommodation granted by NABARD remaining outstanding, be deemed to be received by borrowing institution in trust for NABARD. Securities held by such institution will also be held in trust.**41

The validity of loans granted by NABARD can not be questioned on the basis of provisions of any other Act or violation of any contract, memorandum or articles. However, it does not make valid any loan granted in such violation of law. The provision looks contradictory because if the "validity" of loan is not there, it is questioned and provision of earlier part become redundant.**42 The income of NABARD is totally exempt from income tax.**43

**38 SECTION 9(A), 2(D) OF THE ACT.

**39 SECTION 23 OF NABARD ACT.

**40 SECTION 28 OF THE NABARD ACT.

**41 SECTION 29, IBID.

**42 SECTION 36 OF THE NABARD ACT, AN ANALYSIS

**43 SECTION 55 OF THE ACT.

XI

BANKERS' BOOKS EVIDENCE ACT, 1891

The records and accounts maintained by banks are voluminous and it will be difficult for a banker to produce the original ledger and records. There is an air of genuineness which blows around the banks and it is presumed that the same are maintained in a correct manner.**44 The Bankers Books Evidence Act confers special privilege on the bankers. The term Banker's Books includes ledgers, day books, cash books, account books and all other books used in ordinary course of business of bank. The Act provides that 'certified copy' of banker's book will be admissible in evidence. The term 'certified copy' means a copy of any entry in books of a bank together with a certificate written at the foot of such copy that it is a true copy of such entry, that such entry is contained in one of the ordinary books of the bank and was made in the usual and ordinary course of business and that such book is still in the custody of the bank, such certificate being dated and subscribed by the principal accountant or manager of the bank.**45

The most important provision of the Act is the privilege available to bankers under section 4 of the Act. The section provides that subject to the provisions of the Act, a certified copy of any entry in banker's book in legal proceedings, be received as prima facie evidence of existence of such entry and shall be admitted as evidence of matters, transaction and accounts recorded in every case where and to the same extent as, the original entry itself is by law admissible, but not further or otherwise. The term 'legal proceedings' means any proceeding or inquiry in which evidence may be given and includes arbitration and criminal proceedings.**46

**44 BANKING LAW IN THEORY AND PRACTICE BY S. N. GUPTA, PAGE 742.

**45 SECTION 2(8) OF THE BANKERS' BOOKS EVIDENCE ACT.

**46 SECTION 2(4) OF BANKER'S BOOKS EVIDENCE ACT.

However, the certified entry will need a corroborative evidence- No person can be charged with liability merely on the basis of entries in books of account. There has to be further evidence to prove payment of money. **47 The bank should rest its claims not only on the books of accounts but also adduce other oral and documentary evidence like confirmation slips, balance sheet, correspondence etc.**48

The Calcutta High Court has held that once prima facie evidence in form of certified copy is produced, no further evidence is required to pass a decree against the defendant even though defendant did not appear at trial.**49

The Act does not require that bank to specify which particular book or under which name that book is maintained. The court indeed has a power under section 6 of the Act to order a bank to supply a certified copy of entries in a bank account.

XII

INDIAN EVIDENCE ACT. 1872

The preamble of Indian Evidence Act states that it is enacted to consolidate, define and amend the law of evidence. The main principles of the law of evidence are - **50

- (i) Evidence must be confined to the matter in issue
- (ii) Hearsay evidence must not be admitted
- (iii) Best evidence must be given in all cases.

**47 AIR 1967 SC 1058, CASE OF CHANRADHAR V/s. GAUHATI BANK.

**48 ALLAHABAD BANK V/s. BHARAT VEGETABLE PRODUCTS AIR 1979 NOC. 15 (CAL).

**49 UCO BANK V/s. G. C. DEY, AIR 1974 CAL.155.

**50 THE LAW OF EVIDENCE BY RATANLAL AND DHIRAJLAL, 17TH EDITION PAGE 1.

For interpretation of sections of the Act, the Court can look to the relevant common law.**51

From the banker's point of view, definition of 'document' is important because most of the transactions are supported by documents. The term 'document' means any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means, intended to be used or which may be used for the purpose of recording the matter.

The term 'evidence' means and includes all statements which the court permits or requires to be made before it by witness, in relation to matters of fact under inquiry, such statements are called oral evidence. It also includes all documents produced for the inspection of courts, such documents are called documentary evidence.

A fact is said to be proved when after considering the matter before it, the Court either believes it to exist or considers its existence so probable that a prudent man ought, under the circumstances of the particular case, to act upon the supposition that it exists. Evidence may be given in any suit or proceeding of the existence or non-existence of every fact in issue and of such others as are relevant under Evidence Act.*52 Instances are not uncommon when the borrowers in written statement allege that the document was procured by improper means or without understanding its contents but there is no bar to its admissibility if it is relevant. The genuineness of circumstances under which it is produced have to be taken into consideration later.**53 When there is a question whether a particular act was done, the existence of any course or business according to which it naturally would have been done is a relevant fact. **54 Each one of the facts mentioned is

**51 STATE OF PUNJAB V/s. S. S. SINGH, AIR 1961, SC 493.

**52 SECTION 5 OF THE EVIDENCE ACT.

**53 MAGRAJ PATODIA V/s. R.K.BIRLA, AIR 1971 SC 1295.

**54 SECTION 16 OF INDIAN EVIDENCE ACT.

relevant, it can not be read as indicating that without a combination of these facts, no presumption can arise.**55 Section 92 of the Evidence Act is of crucial importance for banks/financial institutions. The section provides that when the terms of any contract or disposition of property or any matter required by law to be reduced to the form of document have been proved, no evidence of any oral agreement or statement shall be admitted, as between the parties to any such instrument or their representatives in interest for the purpose of contradicting, varying, adding to or subtracting from its terms.

In such cases, no evidence shall be given in proof of document except the document itself or secondary evidence of its contents in cases in which secondary evidence is admissible.**56

The expression 'terms' in the aforesaid sections relate to statements, assertions or representations contained in a written contract which relate to subject matter of contract. It has no application to provision in nature of condition precedent to very existence or formation of contract.**57

When a transaction is contained in more than one document all the documents should be read and interpreted together.**58

The Act provides that whoever desires the Court to give judgement as to any legal rights or liability dependent on existence of facts which he asserts, must prove it.**59

Section 114 of the Evidence Act provides that the court may presume the existence of a fact which it thinks likely to have happened, regard being had to the common course of natural events in their relation to facts of a particular case. From banker's point of view illustrations given in the section are important.

**55 MUBRIK AHMED V/s. STATE OF BOMBAY, AIR 1957 SC 857.

**56 SECTION 91 OF EVIDENCE ACT.

**57 P. B. BHATT V/s. V.R.THAKKAR(1971), 74 BOM LR 509.

**58 CHATTANATHA V/s. CENTRAL BANK OF INDIA, AIR 1965 SC 1856.

**59 'BURDEN OF PROOF' SECTION 101 OF EVIDENCE ACT.

Illustration C says that under this Section the Court may presume that a bill of exchange, accepted or endorsed was accepted or endorsed for good consideration. But the court may also have regard to such facts like the drawer of a bill of exchange being a man of business and the acceptor is a young and ignorant person completely under the influence of drawer.

When a document creating an obligation is in the hands of the obligor, the obligation has been discharged, unless it is proved the document is taken by fraud.**60 Hence the bank should be reluctant in parting with the possession of documents.

The Court shall presume that every document called for and not produced after notice to produce, was attested, stamped and executed in the manner required by law. Hence the person in possession of the document should produce it, otherwise he is debarred from raising any dispute about its validity.**61

XIII

INDIAN CONTRACT ACT, 1872.

The banks are corporate bodies and almost all their transactions with their constituents are affected by the provisions of Indian Contract Act in one way or the other. Bankers do not simply accept the deposits but invest the money for gain by giving loans, overdrafts etc and take guarantees, bailments, pledge/hypothecation of goods, work as agents, executor or trustees, let the safe deposit vaults. So the principles of law of contract are of vital importance.**62

**60 ILLUSTRATION (I) TO SECTION 114, EVIDENCE ACT.

**61 PRESUMPTION AS TO DUE EXECUTION, SECTION 89 OF THE EVIDENCE ACT.

**62 INDIAN JUDICIARY AND BANKERS BY A.J.PANDYA, PAGE 123.

A contract has been defined as an agreement enforceable by law.**63 All contracts are agreements but all agreements are not contracts. Section 1 to 75 of the Act provide for formation of contract by offer and acceptance, how contracts are made, what is competency to contract, void and voidable contracts, wagering agreements, contingent contract, discharge of contract, novations, quasi contracts, damages etc. The subsequent sections deal with bailment, pledge, indemnity, guarantee etc. A person is competent to contract if he is of the age of majority according to the law to which he is subject and who is of sound mind and not disqualified from contracting by any law to which he is subject.**64

Free consent is an essential ingredient of contract. Consent is said to be free when it is not caused by – (a) Coercion (b) undue influence (c) fraud (d) misrepresentation (e) mistake.**65

The term 'fraud' means and includes any of the following acts committed by a party to a contract or with his connivance or by his agent, with intent to deceive another party or to induce him to enter into contract:-**66

- (i) The suggestions as to a fact, of that which is not true by one who does not believe it to be true.
- (ii) The active concealment of fact by one having knowledge or belief of the fact.
- (iii) A promise made without any intention of performing it
- (iv) Any other act fitted to deceive
- (v) Any other act or omission as the law specially declares to be fraudulent.

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.

**63 SECTION 2(h) OF THE INDIAN CONTRACT ACT.

**64 SECTION 22 OF INDIAN CONTRACT ACT.

**65 SECTION 14 OF INDIAN CONTRACT ACT.

**66 SECTION 17 OF INDIAN CONTRACT ACT.

The considerations and object of a contract should be lawful. It is presumed to be lawful unless -**67

- It is forbidden by law
- Is of such nature that if permitted, it would defeat the provisions of any law.
- Is fraudulent
- Involves or implies injury to person or property of another, or
- The Court regards it as immoral, or opposed to public policy

Another important provision of the Contract Act applicable to banker is relating to consideration. When at the desire of the promisor, the promisee or any other person has done or abstained from doing; or promises to do or to abstain from doing something, such act or abstinence or promise is called consideration.**68 An agreement without consideration is void unless it is made out of natural love and affection and registered under the law for the time being in force, or a promise to compensate a person who has voluntarily done something for the promisor or is a promise to pay a time barred debt which is reduced in writing.**69

Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind is to that extent void. Agreements in restraint of legal proceedings are also void.**70 Even if such agreement limits the time within which such rights may be enforced it is void to that extent.

The parties to a contract must either perform or offer to perform their respective promises unless such performance is dispensed with**71

The promise should be performed by the promisor himself or any other competent person employed by him unless it was agreed that the promisor alone should perform it.**72

**67 SECTION 23 OF INDIAN CONTRACT ACT.

**68 SECTION 2(4) OF INDIAN CONTRACT ACT.

**69 SECTION 25 OF INDIAN CONTRACT ACT.

**70 SECTION 28 OF INDIAN CONTRACT ACT.

**71 SECTION 37 OF INDIAN CONTRACT ACT.

**72 SECTION 40 OF INDIAN CONTRACT ACT.

In the case of joint promise, unless a contrary intention appears, all the promisors can perform it jointly and after death of one or more of them the remaining along with the legal representatives of borrower must fulfill the promise. This provision is attracted in case of joint borrowers of banks. When a contract consists of reciprocal promises to be simultaneously performed no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.**73 The Contract Act makes elaborate provisions for appropriation of payments.**74 Where a debtor, owing several distinct debts to one person makes a payment to him, either with express intimation, or under circumstances implying that the payment if accepted must be applied accordingly.**75 Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied the creditor may apply it at his discretion to any lawful debt actually due and payable to him where neither party makes any appropriation, the payment shall be applied in discharge of the debt in order of time, whether they are or not barred by the law in force for limitation of suits.**76 If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed. This known as 'novation'.**77

The Contract Act recognises certain relations as resembling those created by contracts.**78 If a person, incapable of entering into a contract or anyone whom he is legally bound to support, is supplied by another person with necessities suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.**79 A person who is interested in the payment of money which another is

**73 SECTION 51 OF INDIAN CONTRACT ACT

**74 CLAYTON'S RULE UNDER THE ENGLISH LAW

**75 SECTION 59 OF INDIAN CONTRACT ACT.

**76 SECTION 61 OF INDIAN CONTRACT ACT.

**77 SECTION 62 OF INDIAN CONTRACT ACT.

**78 QUASI-CONTRACTS SECTION 68 TO 72 OF INDIAN CONTRACT ACT.

**79 SECTION 68 OF CONTRACT ACT.

bound by law to pay, and who therefore pays it, is entitled to be reimbursed by other. Where a person lawfully does anything to him not intending to do so gratuitously, and such other person enjoys the benefits thereof. The latter is bound to make compensation to the former in respect thereof.

When a contract has been broken, the party who suffers because of such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract to be likely to result from breach of it.**80

When a contract has been broken, if a sum is mentioned in the contract as the amount to be paid in case of such breach, or if contract contains any other stipulations by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to receive from the party who has broken the contract, reasonable compensation not exceeding the amount so named.**81 The banks face several actions claiming damages and principles laid down in section 73 and 74 of the Act are very relevant.

Contracts in nature of 'indemnity' and 'guarantee' are very often involved in the banking transactions. A contract by which one party promises to save the other from the loss caused to him by the conduct of promisor himself or by the conduct of some other person is called a contract of indemnity.**82

The person in whose favour the indemnity is given is entitled to recover from the promisor all damages which he may be compelled to pay in any suit in respect of which the promise to indemnify applies. The costs and amount paid for compromise of any such suit also can be recovered.

**80 HADLEY V/s. BEXANDLE CASE.

**81 SECTION 74 OF INDIAN CONTRACT ACT.

**82 SECTION 124 OF INDIAN CONTRAC ACT.

A contract of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called 'surety'.**83

The liability of surety is coextensive with that of principal debtor. The guarantee may extend to series of transactions and it is called continuing guarantee. Most of the guarantees obtained by the banks are in the nature of continuing guarantee. The death of a surety operates, in absence of any contract to the contrary, as revocation of continuing guarantee for future transactions. A surety gets discharged by variance in terms of contract or release of security. The position of surety's liability is as follows :-

- a) A surety is a favored debtor, as per the phrase used by Lord Westbund L. C.**84 "You can bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him"
- b) In case of ambiguity when all the rules of construction fail the courts interpret the guarantee contra against the guarantor.**85
- c) The liability can not be increased by merely reading the recitals.

If there is any loss of securities which the bank had at the time when the contract of guarantee was executed, without consent of guarantor the guarantor was discharged to that extent.**86

Mere forbearance to sue does not discharge the surety. However in absence of a contract to the contrary, a contract between creditor and principal debtor by which creditor makes composition with or promises to give time to, or not to sue principal debtor discharges the surety.**87

**83 SECTION 126 OF INDIAN CONTRACT ACT.

**84 SECTION 126 OF INDIAN CONTRACT ACT.

**85 STATE OF MAHARASHTRA V/s. M. N. KAUL, AIR 1967 SC 1634.

**86 AMRITLAL LALAN V/s. STATE BANK OF TRAVANCORE AIR 1968 SUPREME COURT 1432.

**87 SECTION 135 OF INDIAN CONTRACT ACT.

A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when contract of suretyship is entered into whether surety knows of existence of such security or not.**88

Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.**89

Provisions relating to 'bailment' and 'pledge' are important from banker's point of view. 'Bailment' is delivery of goods by one person to another for some purpose, upon a contract that they shall when the purpose is accomplished, be returned or otherwise disposed of according to the directions of person delivering them. The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. **90.

Delivery of tangible property is ordinarily essential to a valid pledge. Where however the law recognises that delivery of a tangible security involves a transfer of possession of property giving a symbolic possession takes the place of physical possession. **91 Thus delivery of railway receipt constitutes valid pledge. The pawnee has a right to retain the goods pledged, not only for the payment of the debt or performance of promise but for interest and all necessary expenses incurred by him in respect of possession or for preservation of pledged goods. The pawnee shall in absence of a contract to that effect retain the goods pledged for any debtor promise other than the debt or promise for which they are pledged but such contract in the absence of anything to the contrary shall be presumed with regard to subsequent advances.**92

**88 SECTION 141 OF INDIAN CONTRACT ACT.

**89 SECTION 143 OF INDIAN CONTRACT ACT.

**90 SECTION 172 OF INDIAN CONTRACT ACT.

**91 MORVI MERCANTILE BANK LTD.(THROUGH OFFICIAL LIQUIDATOR)
V/S. UNION OF INDIA (AIR 1965 SUPREME COURT 1954.)

**92 SECTION 174 OF INDIAN CONTRACT ACT.

If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise the pawnee may:-

- (a) Bring a suit against the pawnor for recovery of the debt and retain the pledged goods as collateral security, or
- (b) He may sell the things pledged after giving the pawnor a reasonable notice of sale.

If the sale proceeds are less than the amount due, the pawnor is liable to pay the balance. The pawnor has a right to redeem the goods till such time the goods are actually sold.

The provisions of Contract Act relating to 'Agency' are important for all banks/financial institutions because quite often the contract with agents or obtain/grant power of attorney. An agent is a person employed to do any act for another or represent another in dealings with third parties. Any person including a minor can be an agent as far as transactions with third parties are concerned. **93 No consideration is necessary to create agency. Authority of agent is express or implied.

An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. In an emergency, agent has further authority to do all such acts for the purpose of protecting his principle from loss as would be done by a person of ordinary prudence. **94

If the agent has exceeded authority, the principal may ratify or disown the acts.

An agency can be terminated by the principal. However, where the agent has himself an interest in the property which forms subject matter of agency it can not be terminated to prejudice such interest, If in case of a power of attorney, the power is coupled with interest and the obligation is not discharged the power can not be revoked. **95 The principal is not liable for the criminal acts of agents.

**93 SECTION 184 OF INDIAN CONTRACT ACT.

**94 SECTION 188 AND 189 OF INDIAN CONTRACT ACT.

**95 L. K. SETHIA V/s. JOHN AND OTHERS AIR 1969 SC 73.

XIV

THE RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993.

All the provision of this Act have been discussed at length in Chapter XIV of this thesis.

XV

INTEREST ACT, 1978.

The Interest Act, 1978 is a statute of importance since it prescribes the general law of interest which becomes applicable in absence of any contractual or statutory provisions dealing with the subject. The Law Commission of India had recommended revision of the Act enacted in 1839.**96 The Law commission was of the view that almost every phrase used in the act had given rise to problems of interpretation and judicial decisions disclosed divergence of views. The Act has six sections.

The term "current rate of interest" has been defined as the highest of maximum rates at which interest may be paid on different classes of deposits by different classes of banks in accordance with directions given by Reserve Bank of India.**97

The term 'debt' means any liability of an ascertained sum of money but does not include a judgement debt.

Section 3 is the main operative section of the Act. It provides that in any proceedings for the recovery of any debt or damages in which a claim for interest in respect of any debt or damages paid is made the court may, if it thinks fit allow interest at a rate not exceeding the current rate of interest, for the whole or part of the period commencing from the date mentioned in the written instrument, if any or from the date when the claim is made.

**96 SIXTY THIRD REPORT OF LAW COMMISSION OF INDIA.

**97 SECTION 2(b) OF THE ACT.

The section does not apply to any debt or damages upon which interest is payable as of right by virtue of agreement or debt or damages have been barred by some statutory enactment.**98 The section does not empower the court to grant interest on interest. It also does not affect the provisions of Negotiable Instruments Act, order 2 rule 2 of Civil Procedure Code and Section 34 of Civil Procedure Code.**99

XVI

DEPOSIT INSURANCE AND CREDIT GUARANTEE

CORPORATION ACT, 1961

After nationalisation of banks there is tremendous increase in terms of deposits and advances. Most of the deposits are from small and middle class of the society who invest their hard earned savings in banks. To sustain their faith in the system it is necessary to have some sort of insurance arrangement so that in case of failure or liquidation of the concerned bank the depositor does not suffer. Similarly the banks grant advances as per directives of the Government and if the repayment is not received as per the agreed schedule, the lending banks/institution may face resource crunch and may not be in a position to repay to the depositors. Hence some guarantee for the repayment is also required.

The Deposit Insurance Corporation was established in 1961 and at subsequent stage the function of Credit Guarantee was added.

The deposits and advances by banking companies, corresponding new banks, Regional Rural Banks, Cooperative Banks and financial institutions are covered under the Act. Such institutions are known as "credit institutions".**100

The amount is payable by DICGC when the concerned bank becomes defunct banking company. It means –

**98 PROVISIO TO SECTION (3) OF INTEREST ACT, 1978.

**99 SECTION (5) OF THE INTEREST ACT, 1978.

**100 SECTION 2 OF DICGC ACT.

- (i) The bank is prohibited from accepting fixed deposits
- (ii) If it is ordered to be wound up
- (iii) If it has transferred all its deposit liabilities in India to some other institution.
- (iv) In respect of which a liquidator is appointed or resolution for winding up is passed.
- (v) If an scheme of compromise arrangement, reconstruction is worked out or moratorium is given.**101

The term 'deposit' means the aggregate of unpaid balance due to a depositor in respect of all his accounts by whatever name called and includes credit balances in cash credit account.**102

The board of directors shall have the nominees from Central Government and Reserve Bank of India.

Every insured bank is required to pay premium as specified by the Corporation in respect of the deposits.**103 The insurance premium shall not exceed 15 paise for every hundred rupees. Where an order for winding up or liquidation is made the Corporation shall be liable to pay the amount to depositor not exceeding the maximum amount fixed.**104 The amount shall be paid with least possible delay and in no case later than 3 months from the date when liquidator assumes charge of his office.**105 The Corporation shall furnish details of the amount paid to the liquidator and at the time when the amount is realised it will be paid back to the Corporation by liquidator.

Chapter 3-A of DICGC Act deals with credit guarantee functions. The Corporation may guarantee credit facilities given by any credit institution and may also indemnify credit institutions in respect of credit facilities granted by them.**106

**101 SECTION 2(F) OF DICGC ACT.

**102 SECTION 2(G) OF DICGC ACT.

**103 SECTION 15 OF DICGC ACT.

**104 SECTION 16 OF DICGC ACT.

**105 SECTION 17 OF DICGC ACT.

**106 INSERTED BY ACT 21 OF 1978.

The corporation shall have Deposit Insurance fund, credit guarantee fund and general fund.

XVII

EXPORT IMPORT BANK OF INDIA ACT, 1981

(EXIM BANK ACT)

Prior to 1981, there was no apex level organisation in respect of financing for exports and imports. The EXIM Bank Act aims to establish a corporation to be known as the Export Import Bank of India for providing financial assistance to exporters and for functioning as the principal financial institution for coordinating the working of institutions engaged in financing export and import of goods and services with a view to promoting the country's international trade and other connected matters.**107

The Bank has its Head office at Bombay and its initial authorised capital is Rs.200 Crores.

The Chairman and Managing Director of the Bank is appointed by Central Government. The other directors are nominated from Government, Reserve Bank of India, Scheduled Banks and other persons with special knowledge in Exports and Imports.**108

The main business of EXIM Bank is to grant in or outside India loans or advances by itself or in outside India for the purpose of export or import and it shall also function as the principal financial institution for coordinating the working of institutions engaged in financing of the export and import in such manner as it may deem appropriate.**109

**107 PREAMBLE OF EXIM BANK ACT.

**108 SECTION 6 OF THE EXIM BANK ACT.

**109 SECTION 10 OF THE EXIM BANK ACT.

It can also grant (i) loans and advances to banks, (ii) underwrite shares/debentures of company engaged in export business, (iii) issue bid bonds/guarantees for the same, (iv) accept, collect and discount bills, (v) grant open, endorse or confirm letter of credit, (vi) grant line of credit, (vii) issue participation certificates and carry out related activities.

The EXIM Bank shall establish a special fund known as Export Development Fund.

The EXIM Bank during first 15 years of its existence (1981 to 1996) has made significant contribution for promoting exports and making available finance for this purpose to both individual borrowers and banks.

XVIII

THE STATE FINANCIAL CORPORATIONS ACT, 1951

Providing medium and long term loans is generally out of the purview of commercial banks. Industrial Finance Corporation of India (IFCI) is a national level institution which disburses such loans, Most of the States desired that such institutions should be established at State level also. Such corporations will confine their activities to financing medium and small scale industries and will as far as possible consider cases which are beyond the purview of IFCI.**110 Such Corporations have been established by special statute.

The corporations will provide financial assistance to industrial concerns, **111 engaged in manufacture, preservation or processing of goods, mining, hotel industry, transport or passengers, generation of power, maintenance. servicing of machinery etc.

**110 N. N. JAIN, MANUAL OF BANKING AND FINANCIAL INSTITUTION LAWS, PAGE 752.

**111 SECTION 2 STATE FINANCIAL CORPORATIONS ACT.

The Corporations shall have minimum authorised capital of Rs.50 lacs and maximum capital of Rs.50 Crores. For the purpose of carrying out its functions, such corporations can also borrow from Reserve Bank, IFCI and other institutions.

The corporation will be managed by board of directors on which four directors will be nominated by the State Government, one by RBI, two by Development bank and three will be elected directors. There will be a Managing Director who is whole time employee.**112

The question whether the State Financial Corporations are part of the 'State' or not was decided by the Supreme Court, **113 it was held that the State Financial corporation would be an instrumentality of the State and would be "other authority" under Article 12 of constitution.

The Financial corporation can transact the business mentioned in the Act.**114 It can grant loans and advances to industrial concerns, accept/discount promissory notes and bills, engage in under writing and guarantee business, act as agent of State/Central Govt. and provide connected services to the clients.

In performance of its statutory duty if the State Financial Corporation has entered into an agreement to provide finance and based on such agreement if the borrower incurred large expenses and liabilities to employment the project, the principle of promissory estoppel would stop corporation from backing out of its obligation.**115 The maximum amount up to which such Corporation can extend finance is fixed at Rs.60.00 lacs.**116 The financial Corporations can indulge in the business to guarantee loans raised by industrial concerns, underwriting the issue of stocks, acting as agent of IFCI, granting loans and advances to various industrial concerns etc.

**112 SECTION 17 OF STATE FINANCIAL CORPORATIONS ACT

**113 GUJARAT STATE FIN.CORPORATION V/s. LOTUS HOTEL PVT.LTD. AIR 1983 SC 848.

**114 SECTION 25 OF STATE FINANCIAL CORPORATION ACT.

**115 AIR 1983 SC 852 GSFC V/s. LOTUS HOTELS PVT. LTD.

**116 SECTION 26 OF THE ACT.

Special rights conferred on the Financial Corporations in case of default deserve a special mention.**117 It provides that where any industrial concern, which is under a liability to financial corporation under an agreement makes any default in repayment of any loan or advance or any installment thereof the Corporation shall have the right to take over the management or possession or both of the industrial concerns and also the right to transfer by way of sale or lease the unit or realise the property pledged, mortgaged, hypothecated or assigned to the Financial Corporation. All costs, charges and expenses for the same can also be recovered.

The rights conferred under Section 29 extends to the property of Surety also. The right however, can be enforced by taking recourse to the provisions of Transfer of Property Act and the Civil Procedure Code. The corporation also has the power to call for repayment before the agreed period.**118 Looking at the public money involved, special provisions have been made for enforcement of claims by financial corporations. Where an industrial concern, in breach of any agreement, makes any default in repayment of any loans or advances or any installment thereof or in meeting any obligation of guarantee or others i.e. fails to comply with terms of agreement, or where any financial corporation can exercise its right to recall the advance under section 30. Thus without prejudice to the powers under section 29 of the Act, any officer of the Corporation duly authorised in this behalf may apply to the District Court:-

- (i) For an order for sale of property pledged mortgaged, hypothecated or assigned.
- (ii) For enforcing liabilities of any Surety
- (iii) For transferring management of industrial concern.
- (iv) For ad interim injunction restraining the industrial concern from transferring the machinery.**119

**117 SECTION 29 OF THE STATE FINANCIAL CORPORATIONS ACT.

**118 SECTION 30 OF THE STATE FINANCIAL CORPORATIONS ACT.

**119 SECTION 31 OF THE STATE FINANCIAL CORPORATIONS ACT.

Necessary procedure for this purpose has been laid down under section 32 of the State Financial Corporation Act.**120

Despite the special powers vested in State Financial Corporations the recovery continues to be moderate. Looking at the several notices given in the newspapers by State Financial Corporations, it can be inferred that the corporation is not in a position to sell many assets as no buyers for the same are available. Some of the machinaries gets rusted or becomes worthless because of lack of maintenance. As a result, it is difficult for the financial institution to get the entire money outstanding and huge concessions in interest is also granted at the time of settlement.

XIX

THE COMMERCIAL DOCUMENTS EVIDENCE ACT.

The Act is enacted to amend the law of evidence with respect to certain commercial documents. The Act has only 4 sections and one schedule. Section 2 is of major importance and it provides that notwithstanding anything contained in the Indian Evidence Act, statement of facts in issue or of relevant facts made in any document included in Schedule, the Court shall presume relevance of the documents mentioned in part I of Schedule, the Court may presume relevance of documents mentioned in part II of Schedule, Documents like Lloyds register of shipping, loading list etc. have been included in part I. The documents like survey Report issued by Competent Authority, official log book, Dock Certificate etc are included in Part II.

The documents in the Schedule thus are conferred with a privileged status under the Act and special evidenciary value has been granted under the Act.

****120 PROCEDURE TO BE FOLLOWED BY DIST.JUDGE IN RESPECT OF APPLICATIONS UNDER SECTION 31.**

****121 ARTICLE 323 A OF CONSTITUTION OF INDIA.**

XX**THE ADMINISTRATIVE TRIBUNALS ACT, 1985**

The Constitution of India stipulates that Parliament may by law, provide for adjudication or trial by Administrative Tribunals of the disputes and complaints with respect to recruitment and conditions of Service of persons appointed to public services and posts in connection with the affairs of the Union or other local authority. **121 The Act gives effect to this provision by establishing administrative Tribunals for Union and States. It also provides for the jurisdiction, procedure and transfer of pending cases to Administrative Tribunals. The term "service matters" have been given wider meaning to include the disputes relating to remuneration, tenure of service, leave, disciplinary matters etc. in respect of affairs of any State of local or other authority or any corporation or society owned or controlled by the Government. The Banks and financial institutions are thus covered under the Act. The Central Government is empowered to establish by notification a Central Administrative Tribunal and upon being requested by the States, State Administrative Tribunals.**122 The Tribunal shall have a Chairman and Vice Chairman, who shall be qualified to be a High Court Judge and shall have judicial members as prescribed. The Central Administrative Tribunal (CAT) has jurisdiction and powers in relation to recruitment and matters concerning recruitment to any All India Service and service matters connected with the affairs of the Union. The State Administrative Tribunal has similar powers in respect of State Service.**123 The procedure to be followed by the Tribunal has been laid down under Chapter IV of the Act. Any person aggrieved by an order passed by the Govt. or any other officer or committee of the Government in respect of matter

**122 SECTION 4 OF CENTRAL ADMINISTRATION TRIBUNAL ACT.

**123 SECTION 14 AND 15 OF THE ACT.

within jurisdiction of Tribunal may make any application with prescribed fee (not exceeding one hundred rupees) The application should be accompanied by evidence and documents. The Tribunal shall not ordinarily admit an application unless it is satisfied that the applicant had availed of all the remedies available to him under the relevant service rules. Accordingly, either a final order should have been passed or in case an appeal is preferred six months have lapsed after such appeal. **124 The application should be filed within one year from date of passing of final order.**125

To reduce the technicalities of ordinary civil procedure, it is laid down that the tribunal shall not be bound by the procedure laid down in Civil Procedure Code. It is vested with all the powers of Civil Court.

The applicant can engage legal practitioner or can take assistance of presenting officer. The Tribunal can also make such interim orders as deemed fit.

Every suit or application pending before any court or other authority. If it falls within the jurisdiction of the Administrative Tribunal shall automatically stand transferred to the Tribunal established under the Act.**126

After establishment of the Tribunal all the cases involving industrial disputes between the Government, Government undertakings and employees relating to service matters have been transferred to the Tribunal. The pendency of the cases before the Tribunals also has increased. Detailed of performance of Tribunal in State of Gujarat is given in Chapter VII.

XXI

THE NEGOTIABLE INSTRUMENTS ACT, 1881

The Negotiable Instruments Act, is one of the most important laws governing banking activity in the country and all other countries having organised financial system.

**124 SECTION 20 OF THE CENTRAL ADMINISTRATION TRIBUNAL ACT, 1985.

**125 SECTION 21 OF THE ACT.

**126 SECTION 29 OF THE ACT.

The Act defines and amends the law relating to promissory notes, bills of exchanges and cheques. A 'promissory note' is defined as an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or to the order of a certain person or to the bearer of instrument.**127

A 'Bill of Exchange' is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of certain person or to the bearer of instrument. **128

A 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.**129

The 'holder' of a negotiable instrument is a person entitled in his own name to the possession of the same and to receive or recover the amount due thereon from the parties thereto.

'Holder in Due Course' is a person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or payee or endorse thereof, if payable to order, before the amount mentioned in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. **130

When the maker or holder of a negotiable instrument signs the same, for the purpose of negotiation on the back or face thereof he is said to 'indorse' the same.

The liability of various parties to negotiable instrument has been provided under Chapter III of the N. I. Act.

**127 PROMISSORY NOTE DEFINED UNDER SECTION 4 OF N I ACT.

**128 BILL OF EXCHANGE AS DEFINED UNDER SECTION 5 OF THE ACT.

**129 CHEQUE AS DEFINED UNDER SECTION 6 OF THE ACT.

**130 SECTION 9 OF N. I. ACT.

The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by the drawer.

In case of cheque, drawee is always the bank. The drawee of a cheque having sufficient funds in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default.**131 The maker of a promissory note and acceptor before maturity of a bill of exchange are bound to pay the amount as per apparent tenor of instrument. **132 The maker of a promissory note, the drawer of bill of exchange until acceptance and acceptor are liable as principal debtors and other parties are liable as Sureties.**133

The paying banker is protected when cheque payable to order purports to be endorsed by the payee, is paid and in case of bearer cheque payment made in due course to the bearer constitutes sufficient discharge. **134

When a promissory note or bill of exchange has been dishonoured for non-acceptance or non-payment, the holder may cause such dishonour to be noted by a Notary Public upon the instrument and get the same certified. **135 The certificate is known as 'protest'.

The Act provides for several statutory presumptions in respect of Negotiable Instruments like presumption for consideration stamping etc.

"Collecting Banker" who has in good faith and without negligence received payment for a customer of a cheque generally or specifically for himself shall not, in case title to the cheque proves defective incur any liability to the true owner of the cheque by reason only of having received such payment. Similar provisions have been made in respect of drafts also.

**131 SECTION 31 OF THE N. I. ACT.

**132 SECTION 32 OF THE N. I. ACT.

**133 SECTION 37 OF THE N. I. ACT.

**134 SECTION 85 OF THE N. I. ACT.

**135 'NOTING AND 'PROTEST SECTION 99 AND 100 OF ACT.

Under the recently enacted provisions dishonour of a cheque for insufficiency of funds in an account constitutes criminal offence, provided the requisite notice is given and criminal complaint is filed.**136 The person is punishable with imprisonment for one year and penalty upto twice the cheque amount.

XXII

THE SICK INDUSTRIAL COMPANIES

(SPECIAL PROVISIONS) ACT, 1985

The Sick Industrial Companies (Special Provisions) Act, 1985 has been enacted to secure timely detection of Industrial sickness and for speedy determination by a Special Board of preventive, ameliorative, remedial and other measures which need to be taken with respect to such industrial undertakings. It is a unique piece of legislation passed by the Parliament.**137 The blockage of sizeable national resources in Sick Industrial Companies and the cascading effect of sickness on all sectors of economic and social life of the nation, has prompted the Parliament to enact this legislation.**138

The term 'Sick industrial Company' has been defined as an industrial company (being a company registered for not less than 7 years) which has at the end of any financial year accumulated losses equal to or exceeding its net worth and has also suffered cash losses in such financial year and the financial year immediately preceeding such financial year. The term cash loss means loss as computed without providing for depreciation. Free reserves means all reserves credited out of the profits and shares premium account but does not include resources credited out of revaluation of assets, write back of depreciation etc.**139

**136 SECTION 138 OF N. I. ACT.

**137 JUSTICE BHAGWATI IN HIS CRITIQUE ON BOOK BY SHRI S.A. NAIK.

**138 SURESH A. SHROFF, LEADING SOLICITOR OF BOMBAY. QUOTED IN S. A. NAIK'S BOOK.

**139 SECTION 2(O) OF SICK INDUSTRIAL COMPANIES ACT.

Under the Act, a special Board named Board for Industrial and Financial Reconstruction has been created. An appellate board is also created.

Where an industrial company has become a Sick Industrial Company, the Board of Directors of a company is under an obligation, to make a reference to the Board for determination of measures to be adopted by the company. Such a reference can be made by the bank, financial institution and Govt.**140

Upon receiving such reference the board will decide whether the company has become a sick industrial company and appoint an operating agency to inquire into the same. The Board can also appoint special director to safeguard the interest of the company.**141

If after making inquiry as above the Board is satisfied that the company has become a sick company, the Board shall after considering all relevant facts and circumstances, decide whether it is practicable for the company to make its net worth positive and in such case give time to the company to make its net worth positive. The Board can also direct the operating agency to prepare scheme for revival.**142

The scheme can provide for any of the following measures namely –

- (i) Reconstruction, revival or rehabilitation of Sick Industrial Company.
- (ii) Proper management of the company by a change in or take over of management of company.
- (iii) Amalgamation of sick industrial company with any other company.
- (iv) Sale or lease of a part of a whole of Industrial undertaking.
- (v) Such other preventive and remedial measures as deemed appropriate.**143

**140 SECTION 15 OF THE SICK INDUSTRIAL COMPANIES ACT.

**141 SECTION 16 OF THE SICK INDUSTRIAL COMPANIES ACT.

**142 POWERS OF THE BOARD (BIFR) UNDER SECTION 17 OF THE ACT.

**143 SCOPE OF THE SCHEME UNDER SECTION 18.

Where the scheme relates to preventive ameliorative, remedial and other measures the scheme may provide for financial assistance by way of loans, advances or concessions and it will be circulated to such creditors. If such creditors do not give consent the Board may direct initiating such measures including winding up.

If Board forms the opinion that it is just and equitable to wind up the company it may forward its opinion to the High Court. The High Court may also appoint any of the officers of operating agency as liquidator and such liquidator shall have all the powers under the Act. The Board may also direct the operating agency to complete inventory in the matter.

Where in respect of any company the proceedings are pending before BIFR, no proceedings for winding up of the industrial company or for execution, distress or like against any of the properties of the company, can be taken up without the consent of Board.

The Board may by order also declare that operation of all or any contracts, assurances of property, agreements, settlements, awards, standing orders etc. shall remain suspended or that all or any of rights, privileges obligations and liabilities shall remain suspended.**144

As per the revised provisions, when a reference is made to BIFR even a guarantee given by the persons for advance given to the company can not be enforced without obtaining the permission from BIFR. In such cases, BIFR generally directs the creditor to wait till such time the possibility of rehabilitation is explored.

If in the course of scrutiny or implementation of any scheme or proposal it appears to the Board that any person has taken part in promotion, formation or management of the Sick Industrial Company or its undertaking has misapplied or retained funds or has been guilty of any misfeasance the Board may order him to repay the money. The board may also pass a directive that public financial institutions, scheduled banks and others shall not provide any loan to the

**144 SECTION 22 OF THE SICK INDUSTRIAL COMPANIES ACT 1985.

companies where such person is a director. Thus unscrupulous directors may be blacklisted from borrowing.**145

Any person aggrieved by an order of BIFR can prefer an appeal to the Appellate Forum. No order passed or proposal made under the Act can be challenged in any court and no injunction in respect of the same can be granted by any Civil Court.**146

XXIII

THE USURIOUS LOANS ACT, 1918

This Act is enacted specially to give powers to the courts to deal in cases of usurious loans of money or in kind. The term 'loan' means and includes loan whether of money or in kind and includes any transaction which is in substance a loan. The term 'interest' means rate of interest and includes the return to be made over and above what was actually lent:-

Where in any suit to which the Usurious loans Act applies, the court has reason to believe that the interest is excessive or the transaction was substantially unfair the court may exercise any of the following powers.

- (i) Reopen the transaction, take an account between the parties and relieve the debtor of all liability in respect of any excessive interest.
- (ii) Notwithstanding any agreement purporting to close previous dealings and to create new obligations reopen any account taken between them.
- (iii) Set aside or revise wholly or in part the security given **147

The term "excessive" means in excess of that which the court deems to be reasonable having regard to risk incurred. In considering whether the transaction is substantially unfair the court shall take into account all material circumstances. The section does not apply to any suit which is substantially for recovery of a loan or enforcement of security.**148

**145 SECTION 25 OF THE SICK IND. CO. ACT.

**146 SECTION 26 OF THE SICK IND. CO. ACT.

**147 SECTION 2 OF THE USURIOUS LOANS ACT.

**148 SECTION 3 OF THE USURIOUS LOANS ACT.

XXIV

RELEVANT PROVISIONS OF CIVIL PROCEDURE CODE **FOR BANKS/FINANCIAL INSTITUTIONS**

When a default is committed by the borrower in repayment of the dues, the bank/financial institution is required to initiate legal action and in such cases suit is filed before civil court. All suits involving amount over Rs.10 lacs are now decided by the Debt Recovery Tribunals. In the other recovery suits the bank can either resort to a summary suit or file a regular suit.

A summary suit can be filed in respect of –

- (i) Amount due under Bills of Exchange, hundies and Promissory Notes.
- (ii) Suits in which plaintiff seeks only to recover a debt or liquidated demand on a written contract or on a guarantee.**149

In such cases the plaintiff can serve on the defendant a summons along with a copy of the plaint and defendant may any time within 10 days of services of summons file an appearance. The plaintiff shall upon appearance of defendant serve a summons for judgement and unless leave to defend is granted judgement will follow.

The suit should be filed before the court having jurisdiction.**150

The provisions of the Act have been briefly summarised as follows

NATURE OF SUIT

JURISDICTION

Relating to Immovable Property	Where property is situated
Other suits	Where defendant actually and voluntarily resides or cause of action arose.

**149 ORDER 37, RULE 1 OF CIVIL PROCEDURE CODE.

**150 SECTION 16 TO 20 OF CIVIL PROCEDURE CODE.

The suit is initiated by filing a plaint along with the documents. All the necessary parties to the suit including the guarantors for advance have to be joined as party.**151 The next stage is service of summons. In case summons is not served through court process it can be served by way of Registered A. D. or by way of substituted service like newspaper notice.**152 Alongwith suit application for ad interim relief like attachment before judgement, injunction and appointment of receiver can also be made. **153 At times, before the creditor moves, the opponent may approach the Court for an ex-parte injunction and in such case it is advisable to file a caveat before the court. **154 The defendant is required to file written statement in reply to the plaint within stipulated time. After filing of written statement the court frames issues. 'Issues' are those aspects of pleadings on which the parties differ. The parties are thereafter required to lead evidence on their submissions. In the cases of banks/financial institutions most of the evidence is documentary. If the written statement is not filed, the court has power to give exparte judgement on basis of pleadings.**155 After hearing the case the court pronounces judgement. The court also has the power to award costs.**156 The Court has the power to grant interest. Usually such interest will not exceed 6% on the sum adjudged but in-case of commercial transactions, it may be at higher rate i.e. at the rate of lending of Nationalised Banks.**157 The party loosing the case can file an appeal before the appellate forum. Even his adversary can file cross objections. Unless a stay order is granted by Appellate Court the decree/order can be executed.**158 The execution application is to be filed before the executing

**151 ORDER 1 OF CIVIL PROCEDURE CODE.

**152 ORDER 5 OF CIVIL PROCEDURE CODE.

**153 ORDER 38, 39 AND 40 OF CIVIL PROCEDURE CODE.

**154 SECTION 148 A OF CIVIL PROCEDURE CODE.

**155 ORDER 8, RULE 10 OF CIVIL PROCEDURE CODE.

**156 ORDER 20, AND 20-A OF CIVIL PROCEDURE CODE.

**157 SECTION 34 OF CIVIL PROCEUDRE CODE.

**158 ORDER 41 OF CIVIL PROCEDURE CODE.

court.**159 In respect of mortgage suits separate procedure is prescribed. A preliminary decree and a final decree is required to be passed.**160

XXV

THE TRANSFER OF PROPERTY ACT

The Transfer of Property Act 1882 deals with the immovable properties. The transactions governing sale, lease, mortgage, gift of immovable properties are covered.

From the point of view of bank, provisions governing mortgage are of vital importance. A mortgage is a transfer of interest in specific immovable property for the purpose of securing payment of money advanced by way of loan or any present or future debt.**161

There are various types of mortgages as under :

- (i) Simple mortgage
- (ii) Mortgage by conditional sale
- (iii) Usufructuary mortgage
- (iv) English mortgage
- (v) Equitable mortgage
- (vi) Anomalous mortgage

The bankers/financial institutions opt for equitable mortgage by deposit of title deeds looking at simplicity of procedure. In case of default in paying mortgage debt in prescribed manner, a mortgagee can sell the property. The mortgager however is entitled to equity of redemption, i.e. A right to repay the dues and take back the property. In case of failure to make such payment, the mortgagee is entitled to 'foreclose' property which debars the mortgager from redeeming the property.

**159 ORDER 21 OF CIVIL PROCEDURE CODE.

**160 ORDER 34 OF CIVIL PROCEDURE CODE.

**161 SECTION 59 OF TRANSFER OF PROPERTY ACT.

XXVI**LIMITATION ACT, 1963**

The law requires that the rights should be enforced within the time prescribed by law. The Limitation Act provides for various periods of limitation within which a right can be enforced. The suit has to be filed within such period. In case of appeal or application the court has the power to condone the delay. In case of fraud, minority or defendant going abroad etc. the Act provides for exclusion of period.**162 If an acknowledgement in writing is given by the debtor within the period of limitation, it extends period of limitation.**163

Similarly if part payment is made by the borrower it extends limitation period. The suits on promissory notes and bills of exchange should be filed within 3 years from the date when money becomes due. In case of mortgage limitation period is 12 years. The limitation period for execution of decree is 12 years.**164

XXVII**THE COMPANIES ACT, 1956.**

Most of the large amount borrowers of banks/financial institutional are corporate bodies and brief reference of provisions of Companies Act will be useful.

A company can be a private company, public company or Govt. Company. In a private limited company, the maximum number of members is 50 and such company can not invite subscription to its shares from public. The right to transfer shares is restricted. A Govt. company is one in which more than 51% of shares are held by Government.**165 The provisions of Memorandum and Articles needs to be examined to ascertain that borrowing is within the powers and for the objects

**162 SECTION 15 OF LIMITATION ACT.

**163 SECTION 18 OF LIMITATION ACT.

**164. SCHEDULE TO THE LIMITATION ACT.

**165 SECTION 617 OF COMPANIES ACT.

of the company. The company should pass resolution in prescribed manner and execute the documents under common seal, if so required under the articles. The charges on the assets of the company should be registered within 30 days.**166 In case of public limited company, General body resolution for mortgage and borrowing in excess of paid up capital and free reserves is required.**167 If the company fails to pay its debt winding up proceeding can be initiated. The bank/financial institution as a secured creditor can also opt to remain out of winding up.**168

**166 SECTION 135 OF COMPANIES ACT.

**167 SECTION 293 OF COMPANIES ACT.

**168 SECTION 433 AND 442 OF COMPANIES ACT.

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