

Ordinance Banning Unregulated Deposit Schemes - Prohibiting a valid contract whether retroactive?

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Sandeep Bagmar R.
(Advocate, Kaar Vidhi,
Tax Lawyers &
Consultants)

On February 21, 2019 the Central Government notified the Banning of Unregulated Deposit Schemes Ordinance, 2019. The preamble to the ordinance states that it provides a comprehensive mechanism to ban the unregulated deposit schemes and to protect the interest of depositors and matters connected therewith.

CONSTITUTIONAL LEGALITY

At the outset, I have serious reservations as to validity of the legislation, whether the Parliament has the competence to enact a law to regulate money lending business. In pith and substance, the ordinance is a law to regulate and impose ban on money-lending and money lenders and this is exclusive domain of the State under Entry 30 of the State List provided under the Seventh Schedule to the Constitution. In my view, the enacted ordinance cannot root its source from the following entries of the Union List, being 45 - Banking; 46 - Bills of exchange, cheques, promissory notes and other like instruments. Even under the Concurrent list the Parliament is unable to establish its source. Therefore, the entire ordinance is unconstitutional and vulnerable to a serious challenge. This apart, the ordinance has overriding effect and will prevail over any other laws, including laws made by any State or Union territory.^[1] However, where there is no conflict and even other laws can be made enforceable to the deposits, application of such laws is not barred.^[2]

In relation to my argument of competency of the Parliament, it is necessary to highlight that the acceptance of deposit by unincorporated bodies was already prohibited under section 45S of the Reserve Bank of India Act, 1934. This provision was challenged on the grounds of legislative competence and the Supreme Court upheld the provision on the ground that the Parliament is competent to enact laws in relation to acceptance of deposits which is similar to banking business, therefore, will fall under Entry 45 of List I of the Seventh Schedule to the Constitution^[3]. The prohibition in the challenge under section 45S was that of acceptance of deposit by inviting people to make deposit by offering higher rate of interest which were utilised by deposit taker for lending out, this activity according to the court was found to be in nature of banking activity and consequently, fell within the domain of Entry 45 - Banking. In my view the said judgment may not be applicable to the present ordinance because this ordinance not only prohibits deposits but also prohibits money-lending activity. This is so because the definition of deposit under section 2(4) of the ordinance is very wide and specifically targets advances and loans or amounts of similar nature. Therefore, in my view, in pith and substance the present ordinance is a law to prohibit money-lending activity which will be the prerogative of the State Government under Entry 30 of List II to the Seventh Schedule of the Constitution.

EFFECT OF PROHIBITION

Section 3 of the ordinance prohibits unregulated deposit schemes. This ban comes into effect from February 21, 2019 and there is no reference to any savings provision in respect of deposits which were not regulated earlier but were still validly enforceable under contractual law. Section 2(4) of the ordinance defines 'deposits' and section 2(17) defines 'unregulated deposit scheme'. Those deposits which are regulated are provided in the first schedule and deposits which do not fall under the first schedule will be deemed to be unregulated deposits. There may be other unregulated deposit schemes but same are outside the purview of the provisions of the ordinance as the same have been specifically excluded from the definition of expression 'deposit'. These include, contribution of capital by partners to partnership firm, loan from relatives, advance towards purchase, deposits by members of self-help groups, advances and payments relating to genuine business. However, few simple loans and advances, which in my view, are now banned may be as follows:

1. Gold schemes by jewellery shops;
2. Loan and advances to employees by its employer whether with or without interest;
3. Hand loan from non-relatives;
4. Prize chits and money circulation scheme (already banned);

Serious question arises as to what is the impact of the above deposits which were not banned earlier. Neither there is any mechanism to regularise the existing deposits which were not governed by any regulatory authority. The deposits which are defined to be regulated are provided in the schedule to the ordinance and will cover deposits which are registered with any regulatory body in India constituted or established under a statute. The schedule also provides for schemes which can be notified by the central government and which will eventually fall under the expression regulated deposit schemes.

However, there is no trace in the ordinance as to how the unregulated deposits which are already in force will get affected. The prohibition comes into force only from February 21, 2019, which means that the deposits made prior to this date are legal and not prohibited deposits. However, the question remains unanswered, as to whether such deposits can be continued, or the amount taken under such deposits must be repaid immediately or the deposit can continue without any further payment to be made. Sections 1 and 3 of the ordinance make it clear that the prohibition is prospective and not retrospective. The ordinance will only affect a new contract of deposits and not contracts which are already entered into by the parties and enforceable under the Indian Contract Act, 1872.

The prohibition comes into force under section 3 and is on the following acts:

1. Promotion of unregulated deposit scheme;
2. Operation of unregulated deposit scheme;
3. Advertisement soliciting participation in unregulated deposit scheme; and

4. Acceptance of deposits in an unregulated deposit scheme.

But there is no clarity as to what happens to the existing scheme wherein the parties have bound themselves by a contract enforceable under the law. Section 3 only prohibits operation of an unregulated deposit scheme. Which would mean that the scheme operating and enforceable under the contract cannot be operational anymore. A serious issue arises as to whether the rights and liabilities, and duties and obligations of the deposit taker and the depositor will continue or not? If their rights as per the contract do not continue in view of section 3, then this prohibition will be detrimental to both deposit taker and depositor. Though the ordinance portrays to protect the interest of depositors but causing such a serious anomaly by banning the operation of unregulated deposit scheme seriously affects the rights and obligations of the depositors.

In my view section 3 of the ordinance is prospective but has a retroactive effect as it takes away a vested right of the parties who have come together and entered into a legally enforceable contract. The effect of section 3 is that it not only overwrites the contract but also cancels such a contract, this consequence has not been addressed in the ordinance and will lead to confusion in the minds of the depositors and does not give them any protection of whatsoever. However, the law cannot have such retroactive effect to take away vested right accrued by the parties by entering into a legally enforceable contract. Therefore, the ordinance in my view will have to be read as prospective and not to be given a retroactive effect. If a retroactive effect is sought to be given, then the same will be contrary to doctrine of fairness and will be vulnerable to Article 14 of the Constitution as the action of the state will be arbitrary at large. Consequently, the deposits prior to February 21, 2019 are not prohibited and will not get affected by the ordinance. Their operation is banned but in absence of any savings provision or any explicit provision as to how its operation is banned, the existing deposit is to be treated as not prohibited and should be given the benefit of omission in the ordinance.

Unlike provisions of sub-section (2) of section 45S as of the Reserve Bank of India Act wherein the prohibition of acceptance of deposits by unincorporated bodies was introduced, the said provision allowed the deposit taker to repay the deposits immediately upon them being due or within three years from the date of the prohibition. However, in the present ordinance there is no such savings clause which protect the unregulated deposit schemes.

Interestingly the penalty provision for violation of the provisions of section 3 of the ordinance does not provide for any punishment for operating an unregulated deposit scheme the punishment is only restricted to solicitation and acceptance and default, this raises further confusion as to whether an unregulated deposit scheme which is banned under section 3 can continue to operate.

CONCLUSION

The ordinance has set at stage completely new controversy not only trespassing on the powers vested with the State Governments to regulate money lenders but has also placed serious roadblocks in administration of business as the ordinance has retroactive effect. One will only have to wait for further clarification from the Central Government to have the air cleared on the issue.

[1] Section 34 of the Ordinance.

[2] Section 35 of the Ordinance.

[3] *Kanta Mehta v UOI* 62 Comp Cas 769 (Del); *Velayudhan Achari v UOI* (1993) 2 SCC 582; *Kerala Small Financers Assn. v UOI* (2002) 10 SCC 537.