

**HON'BLE THE CHIEF JUSTICE
SRI PINAKI CHANDRA GHOSE
AND
HON'BLE SRI JUSTICE VILAS V. AFZULPURKAR**

**WRIT PETITION Nos.25891, 25894, 25999 of 2010
and 3823 of 2012**

11th February, 2013

Writ Petition No.25891 of 2010

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Between:**

M/s. SKS Microfinance Limited,
Represented by its Managing Director,
M.R. Rao, Begumpet, Hyderabad. ... Petitioner

And

The State of Andhra Pradesh,
Represented by its Chief Secretary,
Secretariat,
Hyderabad and others. ... Respondents

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HON'BLE SRI JUSTICE VILAS V. AFZULPURKAR**

**Writ Petition Nos. 25891, 25894, 25999 of 2010
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ORDER: (Per the Hon'ble the Chief Justice)

In these writ petitions, the petitioners seek to challenge the
validity of the Andhra Pradesh Micro Finance Institutions (Regulation

of Money Lending) Act, 2011 (for short, 'the Micro Finance Act') as being beyond the competence of the Andhra Pradesh Legislature by reason of Article 246 of the Constitution of India and violative of Articles 14, 19, 20 and 21 of the Constitution of India.

2) Since the issues raised in these four writ petitions are similar, all the writ petitions were clubbed together, heard and are being disposed of by this common order. For the sake of convenience, the facts in Writ Petition No.25891 of 2010 may be noticed.

3) The petitioner is a company registered under the Companies Act, 1956. The concept of micro finance was acclaimed all over the world and was introduced in the country some time in 2005. According to the petitioner, more than 800 micro finance institutions are functioning in India. The petitioner company has got 2226 branches all over India with a borrower membership of 73 lakh women. The petitioner disburses small loans ranging from Rs.2000/- to Rs.12,000/- repayable within one year. The loans are disbursed to a group of ten members without any collateral security and each borrower stands guarantee for the rest of nine. The loans are offered to the women belonging to lower strata of the society for various purposes. The activities of the petitioner company are spread over the States of Andhra Pradesh, Karnataka, Orissa and West Bengal. The petitioner states that the recovery rate is 99% and hence the company is able to maintain the capital adequacy ratio of 28.3 as against the prescription of 15% by the Reserve Bank of India.

4) Basing on a news item reported in a newspaper on 15.10.2010 that about 30 persons died in the State in the last 45 days due to harassment by micro finance institutions and that the Chief Minister directed the District Collectors and Superintendents of Police to act tough against the institutions, the Government of Andhra Pradesh recommended to the Governor to promulgate Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010 and accordingly it was promulgated by the Governor on 15.10.2010

and published in the Andhra Pradesh Gazette and subsequently the Ordinance was enacted as Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act, 2011 having received the assent of the Governor on 31.12.2010.

5) It is the case of the petitioner that the impugned Ordinance/Act is a colourable exercise of power without any legislative competence.

Entry No.45 of List 1 of the Seventh Schedule to the Constitution deals with Banking which is the exclusive domain of the Parliament. Banks and financial institutions are governed under the Reserve Bank of India Act, 1934 (hereinafter referred to as 'the RBI Act') and as such the provisions of the Money Lenders Act cannot be extended to the petitioner company as the petitioner is a financial institution engaged in banking. The State of Andhra Pradesh cannot trespass on the powers of the Union of India and bring about the enactment.

6) It is the further case of the petitioner that Section 2(d) of the Micro Finance Act defines 'Micro Finance Institution (MFI)' to mean a company registered under the Companies Act, a non-banking finance company defined under the RBI Act, societies registered under the Co-operative Societies Act or the Societies Registration Act and the like whose principal activity or incidental activity is to lend money or offer financial support of whatsoever nature to the below poverty line population, and it is beyond the legislative competence of the State Legislature to enact the Micro Finance Act as 'non-banking financial institution' as defined in the RBI Act is in the exclusive occupied field of the Parliament. According to the petitioner, the preamble of the Ordinance alleges that self-help groups are being exploited by the micro finance institutions by charging usurious rates of interest and coercive means of recovery resulting in their impoverishment and leading to suicides in some cases, and this is factually wrong as self-help groups are only a fraction of the borrowers from the micro finance institutions. The micro finance institutions like the petitioner lend amounts mostly to individual borrowers and not to groups.

7) The petitioner refers to various provisions of the Micro Finance Act and states that there are no guidelines for submission of application for registration and Section 3(2) places unreasonable restrictions on the right to carry on business and cannot be justified under Article 19 of the Constitution. Referring to Section 7, the petitioner states that the promissory notes executed by the borrowers stand released without payment or discharge and this inflicted irreversible damage and brought down the credit rating severely. Section 11(6) says that all tranches of repayment shall be made at the Gram Panchayat Office and this provision introduces total strangers into purely an individual transaction between the creditor and borrowers.

8) The petitioner further submits that Entries 43 and 45 of List I - Union List relate to incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations but not including co-operative societies; and banking, whereas, Entry 32 relates to incorporation, regulation and winding up of corporations, other than those specified in List I, and universities; un-incorporated trading, literary, scientific, religious and other societies and associations; co-operative societies, and the impugned Act cannot cover non-banking finance companies as they are regulated by the RBI Act. It is further stated that the impugned Act attempts to link every past suicide to the micro finance institutions and induces alleged victims to launch false complaints, and the State machinery to aid and abet such fake grievances, and thereby creates retrospective criminal liability which is violative of Article 20 of the Constitution. Under Entry 93 of the Union List, Parliament can provide for punishment for the offences with respect to any of the matters contained in List I, and the State Legislature lacks competence to provide for punishment for the offences committed by the entities which fall within Entries 43 and 44 of the Union List. The Parliament amended the RBI Act to incorporate the provisions in Chapter IIIB in relation to non-banking financial

companies and thus the entire field is occupied by the Central legislation. The State of Andhra Pradesh cannot carve out an area of legislation that falls in the Union List on the supposed hypothesis that the legislation enacted by the Parliament is not effective, and if there is any inefficacy in the law enacted by the Parliament, it should be addressed to it alone and nowhere else. It is further submitted that the constitutional validity of the impugned Act cannot be sustained even on the anvil of 'money lending and money lenders' in Entry 30 of the State List because the subject of banking and non-banking financial institutions fall within Entries 43 and 44 of the Union List and that Parliament alone is competent to enact any law.

9) Placing reliance on the judgments of the Supreme Court in **Indu Bhushan Bose v. Rama Sundari Devi**^[1] and **K. Ramanathan v. State of Tamil Nadu**^[2], the petitioner submits that the expression "regulation" used in Entries 43 and 44 of the Union List will include all its aspects that could be comprehended in the wide sense in which the entry has been designated, and that the power to regulate carries with it the full power over the thing subject to regulation.

10) The petitioner further states that the Parliament amended the RBI Act by inserting Chapter IIIB relating to non-banking institutions receiving deposits and financial institutions. According to clause (c) of Section 45-I, 'financial institution' means a non-banking institution which carries on as its business or part of its business any of the activities mentioned therein namely, financing of any activity other than its own; acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority, etc. Section 45JA of the RBI Act says that the RBI may determine the policy and give directions to non-banking financial companies relating to accounting system and regulate the financial system or to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors or prejudicial to its own interest.

Section 45MC gives power to the RBI to file a petition for winding up of a non-banking financial company if it is unable to pay its debt or its continuance is detrimental to the public interest or to the interest of deposits of the company.

11) The petitioner further avers that Article 246(1) of the Constitution confers exclusive power on the Parliament to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule notwithstanding anything in clauses (2) and (3). Clause (2) of Article 246 says that notwithstanding anything in clause (3), Parliament and, subject to clause (1), Legislature of the State, have power to make laws with respect to any of the matters enumerated in List III. Clause (3) of Article 246 is to the effect that the Legislature of the State has exclusive power to make laws with respect to any of the matters enumerated in List II in the Seventh Schedule. However, the impugned Act has transgressed into the field reserved for Parliament.

In relation to corporate entities, the impugned Act penalizes any default which is clearly within the purview of the sanctions imposed by the Companies Act, 1956, and the Act in question regulates by imposing penalties on transactions which Parliament has regulated by imposition of punishments. The State cannot take a ground that the legislation enacted by Parliament was deficient and the law had to be armed with teeth to penalize the wrong doers; this lies outside the competence of the State where the subject of legislation is with respect to an entry in the Union List. As per the constitutional scheme, public order is a subject reserved to the States and in the process of enacting legislation on public order, if the States regulate substantive areas which fall in the Union List, that would lead to destruction of the basic scheme envisaged in the distribution of legislative powers, and so, the impugned Act is not a legislation on public order, but a legislation on the subjects which fall within the Union List, therefore, unconstitutional.

12) A common counter affidavit is filed on behalf of respondent

Nos.1 and 2 *inter alia* contending that it is within the legislative competence of the State Legislature to enact the impugned Ordinance/Act and that the same is referable to Entry 30 of List II in the Seventh Schedule of the Constitution. It is stated that as could be seen from the statement of objects and reasons, it is the endeavour of the State to protect the interests of the self-help groups (SHGs) and relieve them from the undue hardship by regulating money lending transactions by the micro finance institutions providing loans to them with exorbitant interest rates and resorting to coercive means of recovery resulting in impoverishment and at times leading to suicides of the borrowers. Similar legislations have been upheld by the courts and no part of the impugned Act seeks to deal with the aspects of incorporation, regulation and winding up of trading companies or is it connected with banking referable to Entries 43 and 45 of List I.

13) The counter affidavit narrates the concept, structure and working of self-help groups (SHGs) by stating that the system of financial inclusion of rural poor through SHGs helped in reducing poverty and presently there are about 10 lakh SHGs in the State which have successfully reduced the influence of money lenders in the villages.

As regards micro finance, it is stated that this concept has been modeled on the Bangladesh's Grameena Bank. Initially, the MFIs in India started as 'no profit' NGOs and later they transformed into 'for profit' companies and some of them went for public issue and invited funds from foreign agencies also. The MFIs started using the already formed SHGs in the State and became stronger. For the purpose of recovering loans, the MFIs employed agents and the poor people are only an instrument for high profit and thus huge profits are achieved by charging very high interest rates ranging from 35% to 54%. These MFIs replaced money lenders in the villages and adopt the same practices as followed by money lenders claiming immunity from any regulation, whereas money lenders are regulated by an Act.

14) Narrating the circumstances leading to promulgation of the

impugned Ordinance and subsequent enactment, it is stated that the MFIs claimed that the credit provided by the banks directly to SHGs is inadequate for their needs and started advancing loans to them directly. They offer loans to the poor easily without asking any questions about the purpose of the loan or the recovery capacity, and ensure that all repayments are made on a weekly basis coinciding with the day of disbursal of their wages thereby every paise earned by them goes to repay the loans advanced by the MFIs. The recovery agents employed by MFIs resorted to abusing, insulting, molesting, kidnapping of children etc., thereby driving them to suicides and more than 75 cases of suicides were registered. Therefore, the Government had a series of consultations with RBI, Ministry of Finance and major MFIs, and the RBI opined that the State Government would be the most effective agency in controlling irregularities in regard to coercive interest rates. The State Government had also discussions with the MFIs like MFIN, SKS Micro Finance, Spandana and others on self-regulating the sector, however, the same did not work. Hence, after taking inputs from all stakeholders and considering the situation, the State Government had promulgated the impugned Ordinance which has subsequently taken the shape of an enactment. The salient features of the impugned Act and the Rules made thereunder are set out in the counter as follows: MFIs have to register with the authorities and have to maintain records; lending of loans already having bank loans without the approval of the registering authority is an offence punishable with imprisonment up to three years; coercion for recovery of loans is an offence punishable with imprisonment which may extend to three years or with fine which may extend to Rupees One lakh or with both.

15) It is further stated in the counter affidavit that the MFIs have an important role to play in States where the banking network is poor viz. Bihar, Jharkhand and North Eastern States, where the social mobilization of the poor has not reached any scale to make an impact.

In the case of Andhra Pradesh, the State Government through Society for Elimination of Rural Poverty (SERP) and Mission for Elimination of Poverty in Municipal Areas (MEPMA) invested in the social mobilization of the poor and formed them into SHGs and linked them with formal banking system by making huge investments of approximately Rs.1,000 Crores during the last ten years in training the SGH women on financial and organizational management issues.

According to NABARD estimations, the State of Andhra Pradesh accounts for 40% of the SHG bank linkage in the whole country.

16) With regard to legislative competency of the State Legislature to enact the impugned Act, it is stated that as per Entry 30 of List-II, money lending is the State subject. The impugned Act regulates only money lending activities of the MFIs and the subject matter including measures of regulation of this activity are not occupied by any Central legislation. In pith and substance, the impugned Act seeks to regulate the activity of money lending, which does not in any manner deal with the matters enumerated under Entries 43 and 45 of List-I. It is further stated that the provisions of Chapter IIIB of the RBI Act do not in any manner regulate the activity of money lending by non-banking financial companies (NBFCs) and they are limited to regulating the activity of acceptance of deposits by the NBFCs. After undertaking a detailed exercise of consultations with all the stakeholders and after considering the consequences on un-regulated activity of the MFIs, the State was satisfied that there is need for a regulatory law and accordingly, the impugned Act was enacted. It is further stated that the challenge of the petitioner to Section 2(d) of the Act on the basis of inclusion of a NBFC within the definition of MFI vis-à-vis Chapter IIIB of the RBI Act is untenable. There is no repugnancy between the operation of the provisions of Chapter IIIB of the RBI Act and the provisions of the impugned Act.

17) Reserve Bank of India, respondent No.3 in Writ Petition No.3823 of 2012, has filed a counter affidavit through its Assistant General

Manager in the Department of Non-Banking Supervision. It is stated that Chapter IIIB of the RBI Act contains provisions relating to non-banking institutions receiving deposits and financial institutions, and in exercise of the powers conferred under Sections 45JA, 45K, 45L, 45M, it is open to the RBI to issue directions to NBFCs with respect to prudential norms, manner of functioning, conduct of business etc. including the rate of interest that may be charged by NBFCs on loans and advances granted by them. MFIs fall under the category of NBFCs as their principal business is financing by way of loans and advances and are under the regulatory purview of the RBI for all purposes, and Chapters IIIB and V of the RBI Act and directions issued thereunder are applicable to MFIs which are NBFCs. NBFCs which are engaged in micro-financing activities and have been licensed under Section 25 of the Companies Act and not accepting public deposits are exempted from Sections 45-IA, 45-IB and 45-IC of the RBI Act.

18) It is further stated in the counter affidavit filed by the RBI that they have prescribed broad guidelines on fair practices for NBFCs vide Circular dated 28.9.2006, according to which, a Fair Practices Code has to be framed and approved by the Board of Directors of respective NBFCs, outlining mode of processing the applications, terms and conditions, interest rates etc. Likewise, the RBI advised the NBFCs to lay out appropriate internal principles and procedures in determining interest rates and processing and other charges. The directions issued by the RBI from time to time have been consolidated and updated vide Master Circular – Fair Practices Code dated 13.7.2012 and the same is placed on record. It is further stated that on 15.10.2010, the RBI formed a sub-committee under the Chairmanship of Y.H. Malegam to study issues and concerns in the micro finance sector insofar as they relate to entities regulated by the RBI. The said committee examined the prevalent practices of MFIs with respect to interest rates, lending and recovery practices etc., and recommended

for a separate category of NBFCs to be created for those operating in micro finance sector, to be known as Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI). The said committee also recommended that a NBFC classified as NBFC-MFI should satisfy certain conditions and that a NBFC which does not qualify as NBFC-MFI should not be permitted to give loans to the micro finance sector, which, in the aggregate exceed 10% of its total assets. The report of the sub-committee was accepted by the RBI, and with a view to implement the said recommendations, the RBI issued directions on 2.12.2011 in exercise of its powers under Sections 45JA, 45K, 45L and 45M of the RBI Act, known as Non-Banking Financial Company-Micro Finance Institutions (Reserve Bank) Directions, 2011 for regulating the NBFC-MFIs. Thus, the RBI has been regulating the micro finance institutions, which are companies, as a separate category viz., NBFC-MFIs under the provisions of Chapter-III B of the RBI Act. In paragraphs 22 and 23 of the counter affidavit, the RBI has described in detail the directions issued by it, fair practices in lending, transparency in interest rates, multiple lending, over-borrowing, non-coercive methods of recovery etc., and stated that NBFC-MFIs are under the regulatory purview of RBI and the regulatory framework formulated by it are binding on the NBFC-MFIs and all the NBFCs.

19) As regards legislative competence in respect of money lending, it is stated that the State Legislature is competent to enact any law under Entry 30 of List-II in the Seventh Schedule of the Constitution of India, but regulation of financial institutions such as NBFCs is with Parliament under Entry 43 of List-I. The regulation of financial institutions such as NBFCs or NBFC-MFIs would include regulation of rate of interest charged by them. The State Legislature is competent to enact any law with respect to money lending under Entry 30 of List-II, however, regulation and winding up of trading corporations including banking, insurance and financial corporations is covered by Entry 43 of List-I, and to the extent the impugned Act deals with

NBFCs, the same is outside the legislative competence of the State Legislature. Therefore, the impugned Act can deal only with MFIs which are not NBFCs. However, according to Section 2(d) of the impugned Act, MFI includes a NBFC as defined under the RBI Act, and the other provisions relate to registration of MFIs before the registering authority, power of the registering authority to suspend/cancel registration, maximum amount of interest recoverable on loans, penalty for contravention of the provisions of the Act etc. It is stated that the power to determine the policy with respect to rates of interest and to prescribe rates of interest for loans and advances granted by financial institutions vests with RBI. As per Section 45Q of the RBI Act, the provisions of Chapter IIIB have an overriding effect on other laws and in case the provisions of the impugned Act, especially the provisions relating to registration, renewal of registration, interest rates, penalty for contravention of the provisions of the Act etc. are applied to NBFC-MFIs, it will result in dual regulation causing confusion to regulated NBFCs. The RBI has taken necessary steps to protect the interest of the borrowers of NBFC-MFIs and the public. It is further submitted that if the provisions of the impugned Act are made applicable to NBFC-MFIs, it would result in conflict and dual regulation by the RBI and the State Government.

20) A rejoinder affidavit is filed on behalf of the writ petitioner in Writ Petition No.25891 of 2010 reiterating the petition averments.

21) 'The Forum For Better Living Society, Hanumakonda', which was impleaded as a party respondent in Writ Petition Nos.25891 of 2010 and 25894 of 2010 filed separate counter affidavits supporting the impugned Act. Some individuals claiming to be victims of atrocities committed by different MFIs and Manjeera Women's Medak District Mutually Aided Thrift & Credit Cooperative Societies Federation Ltd., who were impleaded as party respondents to Writ Petition Nos.25891 and 25894 of 2010, also filed affidavits supporting the impugned Act.

22) S/Sri K. Ramakrishna Reddy, E. Manohar, V. Venkataramana, learned Senior Counsel appearing for the petitioners submitted that the impugned Act is violative of Articles 14, 19, 20, 21 and 246 of the Constitution of India as the same encroaches upon the occupied field of legislation conferred upon the Parliament under Entry Nos.43, 44, 45 and 93 of List-I in the Seventh Schedule, and it is not within the legislative competence of the State of Andhra Pradesh. They submitted that the impugned Act is violative of Article 14 of the Constitution because when the Parliament has created an exclusive class of entities which are subjected to the rigors of Companies Act and Chapter IIIB of the RBI Act, the State Legislature cannot club and treat those entities to be also within its field of legislation. The State of Andhra Pradesh is not competent to prescribe books of account, statistical returns, penalties and punishments under the impugned Ordinance in respect of the companies and entities governed under the Union List. The companies or the entities like the petitioners cannot be penalized under the impugned Act for playing complementary and supplementary role to assist the State in the fulfillment of the directive principles of State policy. The petitioners have got a fundamental right to carry on any business, occupation or profession, upon which any supervision can be only by law made by the Parliament and any law made by an incompetent legislature cannot satisfy the test of reasonable restriction under Article 19(6) of the Constitution. They further submitted that the petitioner companies are already under comprehensive regulations made by the Parliament by Article 246(1) read with Entries 43 and 44 of List I of the Constitution and the State Legislature is not competent to enact any law which will be in direct conflict with the substantive or subordinate legislation made by the Union of India. The expression “micro finance institutions” in Section 2(d) of the impugned Act covers even non-banking financial companies which fall within the purview of the Banking Regulation Act, 1949. They further submitted that as per

Section 45Q of the RBI Act, the provisions of Chapter IIIB of the said Act have overriding effect and it is a clog on the legislative competence of the State of Andhra Pradesh.

23) The learned Senior Counsel further submitted that the scope of Entry 30 under List II dealing with money lending does not extend to regulation of NBFCs registered under the RBI Act. The State justified the passing of the impugned Act under Entry 30 of List II, which provides for money lending and money lenders. However, the Supreme Court held that the scope of Entry 30 of List II does not extend to regulation of entities which fall within the scope of Entries 43 and 44 of List I. It is further submitted that the lack of legislative competence of the State to regulate NBFCs registered with RBI is also evident from Entry 32 of List II. The NBFCs registered with RBI are financial corporations and fall within the ambit of Entries 43 and 44 of List I and consequently, the impugned Act is ultra vires the Constitution to the extent it seeks to regulate the affairs of NBFCs registered with RBI under the RBI Act. On the principle of federal supremacy, the exclusive power of the Parliament to make laws with respect to matters enumerated in List I overrides the legislative competence of the State to make laws with respect to List II, and this is evident from the non-obstante clause used in Article 246(1) of the Constitution. Since the regulation of NBFCs falls under Entries 43 and 44 of List I, the legislative competence of the State Legislature under Entry 30 of List II does not extend to regulation of the said entities. The learned Senior Counsel placed reliance on the following judgments of the Supreme Court in **Indu Bhusan Bose v. Rama Sundari Debi**, **K. Ramanathan v. State of Tamil Nadu** (supra), **Delhi Cloth and General Mills Co. Ltd. v. Union of India**^[3], **K.K. Baskaran v. State of Tamil Nadu**^[4], **Associated Timber Industries v. Central Bank of India**^[5], **T. Velayudhan Achari v. Union of India**^[6], **State of Kerala v. Mar Appraem Kuri Co. Ltd.**^[7], **Government of Andhra Pradesh v. J.B.**

Educational Society^[8], K.C. Gajapati Narayan Deo v. State of Orissa^[9], Dharam Dutt v. Union of India^[10], Board of Trustees, Ayurvedic and Unani Tibia College v. State of Delhi^[11] and Bhanumati v. State of Uttar Pradesh^[12] Kartar Singh v. State of Punjab^[13], State of Tamil Nadu v. K. Shyam Sunder^[14] A.P. Dairy Development Corpn. Federation v. B. Narasimha Reddy^[15], Krishi Upaj Mandi Samiti v. Shiv Shakti Khansari Udyog^[16] and two unreported judgments of the Gujarat High Court in **Sundaram Finance Ltd. v. State of Gujarat (delivered on 6.9.2012) and **Radhe Estate Developers v. Mehta Integrated Finance Co. Ltd.** (delivered on 26.4.2011) and a judgment of the Delhi High Court in **Kanta Mehta v. Union of India^[17]** and a judgment of the Calcutta High Court in **Tata Motors Ltd. v. State of West Bengal^[18]**.**

24) Per contra, the learned Advocate General, while reiterating the contentions urged in the counter affidavit, submitted that the impugned Act is referable to Entry 30 of List II and the principal aim and objective of the legislation is to regulate the activity of money lending by various organizations and that no part of the Act seeks to deal with the aspects of incorporation, regulation and winding up of trading companies or it is connected with Banking referable to Entries 43 and 45 of List I of the Seventh Schedule. He submitted that money lending is the State subject and the Constitution enables the State Government to regulate the money lending activities and protect people from exploitation. The impugned Act regulates only money lending activities of the MFIs and the subject matter is not occupied by any central legislation. The provisions of Chapter IIIB of the RBI Act do not regulate the activity of money lending by the NBFCs and all the provisions referred to therein are limited to regulating the activity of acceptance of deposits by

NBFCs. These provisions govern certain aspects of the functioning of NBFCs and there is no provision to protect the interests of the borrower. The MFIs are evading action under Chapter IIIB of the RBI Act, as they are not allowed to collect deposits. Therefore, the contention of the petitioner companies that they are regulated by the RBI insofar as their lending practices are concerned, is not correct. Similarly, the contention of the RBI that they are regulating the NBFCs and the State Government has no jurisdiction is false. The RBI has never exercised any authority in examining the lending practices and in protecting the borrowers nor did they have the machinery to examine the lending practices at the village level. There is a regulatory deficit in regulating the lending activities of the MFIs in the existing scheme prior to the impugned Act. The contention of the petitioner companies that it amounts to dual regulation is false because Chapter IIIB of the RBI Act pertains to corporate governance and capital adequacy, whereas the impugned Act deals with the lending practices and protection of borrowers. The petitioners have no other activity except micro lending. All the field level officers of the petitioner companies are loan officers and their operations pertain to lending and recovery. As the MFIs are solely engaged in money lending operations and recovery of the same from vulnerable sections, they should follow the regulations of money lending. As regards the legislative competence of the State to enact the impugned Act, the learned Advocate General submitted that the activities of MFIs are purely in the nature of money lending, which is the State subject as per Entry 30 of List II of the Seventh Schedule of the Constitution and it is the responsibility of the State Government to regulate the money lending activities and protect people from exploitation. The impugned Act regulates only the money lending activities of the MFIs which are not regulated by any agency. Therefore, the impugned Act is within the legislative competence of the State Government. In support of the contentions, the learned Advocate General placed reliance on the

judgments of the Supreme Court in **Fatehchand Himmatlal v. State of Maharashtra**^[19], **Union of India v. Shah Goverdhan Lal Kabra**^[20], **Krishna Bhimrao Deshpande v. Land Tribunal, Dharwad**^[21], **South Indian Film Chamber of Commerce, Madras v. Entertaining Enterprises, Madras**^[22], **Polaki Motors v. State of Orissa**^[23], **Indian Aluminum Co. Ltd. v. Karnataka Electricity Board**^[24], **P.N. Krishna Lal v. Government of Kerala**^[25], **Kartar Singh v. State of Punjab** (supra), **Delhi Cloth and General Mills Co. Ltd. v. Union of India** (supra), **Express Hotels Pvt. Ltd. v. State of Gujarat**^[26], **K.K. Baskaran v. State of Tamil Nadu** (supra), **State of West Bengal v. Kesoram Industries Ltd.**^[27] and **New Horizon Sugar Mills Ltd. v. Govt. of Pondicherry**^[28].

25) Sri D. Prakash Reddy, learned Senior Counsel appearing for the RBI reiterated the contentions urged in the counter affidavit filed on behalf of the RBI and submitted that the directions issued by the RBI to NBFCs on 2.12.2011 as modified on 3.8.2012 are binding on them and in case the provisions of the impugned Act relating to registration, renewal of registration, interest rates, penalty for contravention of the provisions of the impugned Act are applied to NBFC-MFIs, it will result in dual regulation causing confusion to regulated entities.

26) It is the contention of the petitioner companies that the RBI issued the Non-Banking Financial Company Micro Finance Institutions (Reserve Bank) Directions, 2011 (NBFC-MFI Directions) on 2.12.2011, as modified on 3.8.2012, and the same comprehensively regulate the micro finance institutions, therefore, the impugned Act will not survive.

It is their further contention that the State of Andhra Pradesh does not have the legislative competence to enact the impugned Act. Our attention has also been drawn by the learned Senior Counsel appearing for the petitioners to the Micro Finance Institutions

(Development and Regulation) Bill, 2012 introduced by the Finance Minister in the Lok Sabha in March, 2012 to contend that the regulation of MFIs falls within the exclusive domain of Union of India and not the State Government. Whereas, it has been urged on behalf of the State that the provisions of Chapter IIIB of the RBI Act govern certain aspects of the functioning of non-banking financial institutions and there is no provision to protect the interests of the borrower and that the activities of MFIs are in the nature of money lending, therefore, as per Entry 30 of List II in the Seventh Schedule of the Constitution, it is the responsibility of the State Government to regulate the money lending activities and protect people from exploitation and thus, the State Legislature is competent to enact the impugned Act.

27) The preamble of the impugned Act says that it is an Act to protect the Women Self Help Groups from exploitation by the Micro Finance Institutions in the State of Andhra Pradesh and for the matters connected therewith or incidental thereto. The statement of objects and reasons of the impugned Act reads thus:

“Whereas, Government of Andhra Pradesh has facilitated organization of the below poverty line households into Self Help Groups (SHG) for the purpose of their economic advancement by achieving financial inclusion through linking with the banking network;

And whereas the endeavor of the State is to protect the interest of SHGs and relieve them from undue hardship by regulating money lending transactions by the money lending MFIs, who are providing loans to SHGs with usurious interest rates and resorting to coercive means of recovery resulting in impoverishment and at times leading to suicides of the borrowers.”

A perusal of the statement of objects and reasons of the impugned Act shows that it is an Act to protect the interests of Self Help Groups and relieve them from the undue hardship by regulating money lending transactions by the money lending MFIs who are providing loans with usurious interest rates and resorting to coercive

means of recovery.

28) Chapter IIIB of the RBI Act contains the provisions relating to non-banking institutions receiving deposits and financial institutions. The provisions relate to registration of the company, maintenance of percentage of assets, reserve fund, power of the RBI to collect information from non-banking institutions as to deposits and to give directions, etc. In addition to this, in exercise of the powers conferred by Sections 45JA, 45K, 45L and 45M of the RBI Act, the RBI issued directions known as the Non-Banking Financial Company-Micro Finance Institutions (Reserve Bank) Directions, 2011 on 2.12.2011. These directions shall apply to every non-banking financial company-MFI as defined therein. An NBFC-MFI is defined as a non-deposit taking NBFC other than a company licensed under Section 25 of the Indian Companies Act, 1956, that fulfils the condition of minimum net owned funds of Rs.5 Crore (Rs.2 Crore for the NBFC-MFIs registered in the north eastern region) and not less than 85% of the net assets are in the nature of qualifying assets. The Directions also deal with pricing of credit, fair practices in lending, transparency in interest rates, multiple-lending, over-borrowing and ghost-borrowers, non-coercive methods of recovery etc. It is also stated that the Master Circular dated 1.7.2011 shall be applicable to NBFC-MFIs also and non-compliance with these Directions shall invite penal provisions under the RBI Act. These directions were issued pursuant to the recommendations made by a sub-committee of the Central Board of RBI constituted to study issues and concerns in the MFI sector. A perusal of these Directions reveals that the RBI issued the same in the public interest to enable the Bank to regulate the credit system to the advantage of the country.

29) Apart from the above, as noticed above, the Union of India introduced the Micro Finance Institutions (Development and Regulation) Bill, 2012 in the Lok Sabha. The object of the proposed enactment is to provide for development of regulation of the micro

finance institutions for the purpose of facilitating access to credit, thrift and other micro finance services to the rural and urban poor and certain disadvantaged sections of the people and promoting financial inclusion through such institutions and for matters connected therewith or incidental thereto. The said Act provides for constitution of Micro Finance Development Council at the national level, State Micro Finance Councils and District Micro Finance Committees. Chapter V deals with registration of micro finance institutions with RBI. Chapter VII relates to the functions and powers of RBI. Redressal Mechanism is provided under Chapter IX and Offences and Penalties are provided in Chapter X. The Act is very exhaustive and deals with every aspect of the micro finance sector.

30) Though Chapter IIIB of the RBI Act deals with non-banking institutions receiving deposits, the provisions contained therein do not deal in extenso with the micro finance institutions, with particular reference to irregularities committed by MFIs and the penalties that may be imposed. This prompted the State Government to request the RBI to regulate the MFIs in the State which are charging usurious interest rates and resorting to coercive means of recovery. On the letter addressed by the Chief Minister of the State, it appears that the Governor of RBI, through his letter dated 19.7.2010, while intimating that the RBI had written to all banks to take suitable corrective action, stated that the role of the RBI is limited to the regulation of only those MFIs that are registered as NBFCs with the RBI, with regard to which there is already a fair practice code in place, and opined that the State Government may be the most effective agency in controlling irregularities in regard to coercive interest rates. This is the background for enacting the impugned Act which received the assent of the Governor of Andhra Pradesh on 31.12.2010 and it was published in the Andhra Pradesh Gazette on 1.1.2011. As noticed above, the object of the impugned Act is to protect the interests of self help groups from the MFIs who are providing loans to them with

usurious interest rates and resorting to coercive means of recovery resulting in impoverishment and at times leading to suicides of the borrowers.

31) From the letter dated 19.7.2010 of the Governor, RBI, it is clear that the role of the RBI is limited to regulation of only those MFIs that are registered as NBFCs with the RBI, in respect of which Chapter IIIB of the RBI Act applies. However, subsequently, on 2.12.2011, the RBI issued Non-Banking Financial Company-Micro Finance Institutions (Reserve Bank) Directions, 2011, as modified on 3.8.2012, basing on the report of a sub-committee of the Central Board of RBI constituted to study issues and concerns in the MFI sector. The Union of India also introduced the Micro Finance Institutions (Development and Regulation) Bill, 2012 in the Lok Sabha and is likely to take the shape of an enactment.

32) Having perused the material on record, we are of the view that the Directions issued by the RBI on 2.12.2011, as modified on 3.8.2012, coupled with the provisions of Chapter IIIB of the RBI Act will protect the interests of the self help groups from usurious interest rates and coercive means of recovery with which object the impugned Act was enacted. Apart from this, the Micro Finance Institutions (Development and Regulation) Bill, 2012 introduced by the Central Government in the Lok Sabha is a complete code in itself as regards the micro finance institutions. Once that Bill takes the shape of an enactment, we are of the opinion that it will govern every aspect of the micro finance institutions at all levels and in all respects and all the issues raised by the petitioners herein. In such circumstances, it would be a futile exercise for this Court to examine the legislative competence or otherwise of the State to legislate the impugned enactment, therefore, we have not gone into the same. The Government of Andhra Pradesh may, therefore, examine the matter, whether, in the wake of introduction of Micro Finance Institutions (Development and Regulation) Bill, 2012 in the Lok Sabha by the

Union of India, which is more comprehensive than the impugned Act, dealing every activity of the micro finance institutions, and, which is likely to be passed by the Parliament, is it necessary to have the impugned enactment also on the statute book and a decision may accordingly be taken after the Central enactment comes into operation.

The writ petitions are disposed of accordingly. However, the interim orders, dated 22.10.2010, as modified by order, dated 29.10.2010, shall continue to operate for a period of six weeks and no coercive steps against the petitioners be taken during the said period.

PINAKI CHANDRA GHOSE, CJ

11th February, 2013.

VILAS V. AFZULPURKAR, J.

ARS

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- [\[1\]](#) (1969) 2 SCC 289
 - [\[2\]](#) (1985) 2 SCC 116
 - [\[3\]](#) AIR 1983 SC 937
 - [\[4\]](#) (2011) 3 SCC 793
 - [\[5\]](#) (2000) 7 SCC 93
 - [\[6\]](#) (1993) 2 SCC 582
 - [\[7\]](#) (2012) 7 SCC 106
 - [\[8\]](#) (2005) 3 SCC 212
 - [\[9\]](#) AIR 1953 SC 375
 - [\[10\]](#) (2004) 1 SCC 712
 - [\[11\]](#) AIR 1962 SC 458
 - [\[12\]](#) (2010) 12 SCC 1
 - [\[13\]](#) (1994) 3 SCC 569
 - [\[14\]](#) (2011) 8 SCC 737
 - [\[15\]](#) (2011) 9 SCC 286

- [\[16\]](#) 2012 (8) Scale 271
- [\[17\]](#) (1987) 62 Comp Cases 769 (Delhi)
- [\[18\]](#) (2012) 3 Cal LT 1
- [\[19\]](#) (1977) 2 SCC 670
- [\[20\]](#) (2002) 8 SCC 228
- [\[21\]](#) (1993) 1 SCC 287
- [\[22\]](#) (1995) 2 SCC 462
- [\[23\]](#) 1993 Supp (2) SCC 674
- [\[24\]](#) (1992) 3 SCC 580
- [\[25\]](#) 1995 Supp (2) SCC 187
- [\[26\]](#) (1989) 3 SCC 677
- [\[27\]](#) (2004) 10 SCC 201
- [\[28\]](#) 2012 (9) Scale 524