

**REPORTABLE**

**IN THE SUPREME COURT OF INDIA  
CIVIL APPELLATE JURISDICTION  
CIVIL APPEAL NO. 5401 OF 2009**

M/s Oriental Kuries Ltd. represented by its  
Chairman P.D. Jose

...Appellant

versus

Lissa & Ors.

...Respondents

**J U D G M E N T**

**INDU MALHOTRA, J.**

1. The issue which has arisen for consideration in the present Civil Appeal is with respect to the jural relationship between a chit fund entity and the subscribers, created by a chitty agreement; and whether it is a debt in *prasenti* or a promise to discharge a contractual obligation.
2. The present Appeal arises out of a Chit Fund conducted by the Appellant, a chit fund entity. The duration of the chit

fund was from 1978 to 1990. The Respondents were subscribers of the chit fund. During the subsistence of the chit fund, the Respondents defaulted in the payment of 12 installments from 24.11.1981 to 24.11.1984.

2.1 The Appellant – chit foreman instituted two Suits against the Respondent – subscribers before the Subordinate Judge, Thrissur, Kerala. The first Suit bearing O.S. No. 323/1984 was filed for recovery of 12 installments for the period 24.11.1981 to 24.11.1984; and, the second Suit bearing O.S. No. 548/1987 was filed for recovery of future subscriptions due under the chit fund after 24.11.1984.

2.2 The Subordinate Judge, Thrissur, Kerala decreed both the Suits in favour of the Appellant – Company on 09.04.1990.

In O.S. No. 323/1984, the Respondents were directed to pay the Appellant – Company a sum of Rs. 40,915/- with Interest @12% on the sum of Rs. 34,800/- from the date of filing the Suit till the date of

decree, and thereafter Interest @6% per annum from the date of the decree till the date of realization.

In O.S. No. 548/1987, the Respondents were directed to pay the Appellant – Company a sum of Rs. 83,820.68/- with Interest @12% on a sum of Rs. 63,800/- from the date of filing of the Suit till the date of decree, and thereafter Interest @6% per annum from the date of the decree till the date of realization.

2.3 Aggrieved by the aforesaid Judgment and Decree dated 09.04.1990 passed by the Subordinate Judge, Thrissur, the Respondents herein filed two Appeals bearing A.S. No. 326/1992 and A.S. No. 346/1992 before the Single Judge of the Kerala High Court.

The learned Single Judge of the High Court dismissed both the Appeals filed by the Respondents *vide* a common Judgment and Order dated 27.06.1994.

The Single Judge held that the Kerala Chitties Act, 1975 does not apply to the Chit Fund in question,

since the same was started from Mangalore, Karnataka. The Appellant being a trading company, was exempted under Section 13(1)(e) of the Companies Act, 1956 from specifying the States to which the objects would extend in the Memorandum and Articles of Association.

Reliance was placed by the Single Judge on the Full Bench decision of the Kerala High Court in *P.K. Achuthan and Anr. v. State Bank of Travancore, Calicut*,<sup>1</sup> wherein it was held that a chit fund is essentially a debt *in praesenti*, but permitted to be paid in installments. The facility of this debt is available to the debtor so long as the installments are regularly paid. The nature of the transactions under a chit fund are essentially that of a debtor-creditor relationship.

It was noted that the judgment in *P.K. Achutan (supra)* had been affirmed by the Supreme Court in

---

<sup>1</sup> AIR 1975 Ker 47.

*K.P. Subbarama Sastri and Ors. v. K.S. Raghavan and Ors.*<sup>2</sup>

- 2.4 Aggrieved by the common Judgment and Order dated 27.06.1994 passed by the learned Single Judge, the Respondent filed two Second Appeals bearing AFA Nos. 84 of 1994 and 85 of 1994 before the Division Bench of the Kerala High Court.

The Division Bench *vide* the impugned Judgment and Order dated 15.01.2009, allowed AFA No. 84 of 1994, and dismissed AFA No. 85 of 1994.

The division bench noted that the decision of the full bench in *P.K. Achutan (supra)* had been over-ruled in *Janardhana Mallan & Ors. v. Gangadharan & Ors.*,<sup>3</sup> wherein a five-judge bench of the Kerala High Court held that future installments payable by a chit subscriber are not a debt owed to the chit foreman, and therefore, could not be recovered in case of default in payment of an installment.

---

<sup>2</sup> (1987) 2 SCC 424.

<sup>3</sup> AIR 1983 Ker 178.

The subsequent larger bench decision of five judges in *Janardhana Mallan (supra)* was evidently not brought to the notice of the Supreme Court in *K.P. Subbarama Sastri (supra)*. The decision in *Achutan's* case would no longer hold the field, since it had been over-ruled by the larger bench in *Janardhana Mallan's* case.

The Division Bench held that by entering into a chitty agreement, a debt is not created at once by the subscriber in respect of payment of all future installments, as the chitty variola only contains a promise to pay, which is not a promise to repay an existing debt, but only to pay and discharge a contractual obligation. The execution of the security bond is to ensure fulfillment of the terms of the contract by the parties. If the subscriber fails to pay future installments in terms of the contractual obligations, then the subscriber would become a defaulter, he would incur a debt to the foreman, and

would not be a liability to pay in future of an existing liability.

On the facts of the case, the division bench held that the Appellant – Company was entitled to recover 12 installments from the Respondents for the period from 24.11.1981 to 24.11.1984. However, future installments could not be recovered.

2.5 Aggrieved by the judgment of the Division Bench, the Appellant – chit fund company filed the present Special Leave Petition. This Hon'ble Court *vide* Order dated 10.08.2009 granted special leave to appeal. The dispute between the parties got resolved during the pendency of the present appeal.

This Court *vide* Order dated 13.11.2009 noted the submission made by the Counsel for the Appellant that several suits had been filed by the Appellant – Company against the subscribers, which had been dismissed on the basis of the impugned judgment. In

these circumstances, the present Appeal was pressed for determination.

### 3. DISCUSSION AND ANALYSIS

At the time when modern banking was not fully developed in small towns and rural areas, chit fund institutions emerged to cater to the financial needs of low-income households. A conventional chit fund is an old indigenous financial institution involving periodic subscriptions by a group of persons. It is, in law, a contract between the subscribers and the foreman, which provides that the subscribers shall subscribe a certain sum by way of regular installments for a specified period of time. Each subscriber in his turn, as determined by lot, or auction, or in any other manner specified, is entitled to the prize amount. The number of subscribers in a chit fund would constitute the number of installments, so that every subscriber is assured of receiving the prize amount. As there is a mutuality of interest amongst



the subscribers to each chit fund, it constitutes a convenient instrument which combines savings and borrowings.

The duties of the foreman of the chit fund include enrolling subscribers, and drawing up the terms and conditions of the scheme in the form of an agreement. For these services, the foreman charges a commission, on which a ceiling is fixed.

Each prized subscriber must furnish acceptable security against the remaining installments, so as to be eligible to receive the lumpsum payment. The security is to be furnished by the subscriber directly to the foreman. In the event of default by a subscriber to pay his installments on the due date, the chit fund scheme may provide for forfeiture of dividend, or levy of penal interest.

4. A full bench of the Kerala High Court in *P.K. Achutan (supra)*, held that it is manifest that what actually transpires when a prized subscriber is allowed to draw the *kuri* amount is the grant of loan to him from the common fund in the hands of

the foreman with the concessional facility of effecting repayment in installments, which is subject to the stipulation that the said concession is liable to be withdrawn in the event of default being committed in payment of any of the installments. It is a debt in *praesenti*, but permitted to be paid in installments, for the benefit of the debtor so long as the installments are regularly paid. This being the true nature of the, the stipulation for furnishing a security bond which would enable the foreman to recover from the prized subscriber, the whole of the balance amount due from him in a lump sum when default occurs in payment of any of the installments. Such a stipulation cannot be regarded as a penalty clause. It is necessary for the foreman of a chit who occupies a special relationship with all the subscribers of the chit fund, which would justify stringent provisions being incorporated in the agreement for safeguarding the interest of all the subscribers. Without punctual payments by the individual subscribers, the foreman will not be in a position to discharge his obligations to the other subscribers. It is

therefore necessary that the foreman should reserve to himself the power to recover in a lump sum, the entire balance amount due in respect of future installments, on a default being committed by a prized subscriber. In the context of the special features and incidents of chit fund transactions, the incorporation of a stipulation in the chitty hypothecation bond, cannot be regarded to be unconscionable or penal in nature.

5. In *Janardhana Mallan* (supra), a five-judge bench of the Kerala High Court overruled the decision in *P.K. Achutan* (supra), and held that it would not be possible to say that on entering into the chitty agreement a debt is incurred by the subscriber for the amount of all the future installments, and in respect of such amount there is a debtor – creditor relationship. The chitty variola embodies a promise to pay on future dates. It is not a promise to repay an existing debt, but in discharge of a contractual obligation. The prize

amount is not received as a loan, but by virtue of the terms of the contract between the parties.

6. The Chits Funds Act, 1982 (hereinafter referred to as “the 1982 Act”) was enacted by Parliament, and came into force on 19.08.1982. The issue of the applicability of the 1982 Act to the State of Kerala was considered by a Constitution Bench of this Court in *State of Kerala and Ors. v. Mar Appraem Kuri Company Ltd. and Ors.*<sup>4</sup> The Constitution Bench held that on the enactment of the Chit Funds Act, 1982 which covered the entire field of “chits” under Entry 7 of List III of the Constitution, the Kerala Chitties Act, 1975 stood impliedly repealed. As a consequence, the Central Act became applicable forthwith in the State of Kerala, even though the Kerala legislature notified the 1982 Act on 30.04.2012.

---

4 (2012) 7 SCC 106.

7. The constitutional validity of the Chit Funds Act, 1982 was challenged before this Court in *Shriram Chits & Investment (P.) Ltd. v. Union of India & Ors.*<sup>5</sup> The challenge to the vires of the various provisions under the 1982 Act was repelled. This Court held that all the provisions under the 1982 Act are relevant and material to protect the interest of the subscribers. The three-judge bench held that :

*“15. We were referred to the decision of this Court in K.P. Subbarama Sastri and Ors. v. K.S. Raghavan and Ors. : [1987]2SCR767 wherein a contract providing for payment of money in installments and stipulating that on default in payment of any of the installments all the future installments shall be payable at a time with interest was held not penal in nature in the case of kuri transaction under the Kerala Chitties Act, 1975. While upholding the transaction a Bench of this Court approved the decision of the earlier Full Bench decision of the Kerala High Court in the case P.K. Achuthan (supra) wherein the Kerala High Court had upheld such a transaction and held it, to be of not a penal nature. In this context Eradi, J. (as His Lordship then was) speaking for the Full Bench observed that a subscriber truly and really becomes a debtor for the prized amount paid to him. It will be noticed that the later Full Bench decision of the Kerala High Court in Janardhana Mallan and Ors. (supra) was not brought to the notice of this Court and the Court was referred to the over-ruled decision of the Kerala High Court. The fact remains that the question involved before us as to the true nature of transaction for the purpose of*

---

<sup>5</sup> AIR 1993 SC 2063.

*finding out the relevant entry in the Constitution into which it may fall, was not involved in that case.*

16. It appears to us, but for the discordant note struck by the other Full Bench of the Kerala High Court in the aforesaid case of P.K. Achuthan (Supra), the consistent view of all the High Courts has been that it is not a moneylending transaction and that there is no relationship of debtor and creditor for the purpose of it being treated as a money lending transaction.”

(emphasis supplied)

The reference made to the judgment in *P.K. Achutan* (supra) and *Janardhana Mallan* (supra) was in passing, and this Court did not either affirm, or reject the ratio laid down in either of these cases.

8. Where a contract provides for payment of money in installments, and contains a stipulation that on default being committed in paying any of the installments, the whole sum shall become payable at once, such a stipulation would not be in the nature of a penalty.
9. The division bench in the impugned Judgment dated 15.01.2009, held that by entering into a chitty agreement, a

debt is not created at once by the subscriber with respect to the amount of all the future installments. The chitty agreement embodies a promise to pay and discharge a contractual obligation, and not a promise to repay an existing debt.

10. We do not agree with the view expressed by the division bench. When a prized subscriber is allowed to draw the chit amount, which is in the nature of a grant of a loan to him from the common fund in the hands of the foreman, with the concessional facility of effecting re-payment in installments; this is subject to the stipulation that the concession is liable to be withdrawn in the event of default being committed in payment of any of the installments.

The chit subscriber at the time of subscription, incurs a debt which is payable in installments. If a subscriber is permitted to withdraw the collected sum on his turn, without being bound to pay the future installments, it would

jeopardize the interest of all other subscribers, and the entire mechanism of the chit fund system would collapse.

11. A perusal of the provisions of Chapter V of the 1982 Act makes it clear that if a prized subscriber defaults in making payment of an installment, the chit foreman has the right to recover the amount covering all future subscriptions from the defaulting subscriber as a consolidated amount.

Section 32 of the 1982 Act empowers the foreman to recover the consolidated payment of all future subscriptions forthwith in the case of a default.

Chapter V of the Chit Funds Act, 1982 prescribes the rights and duties of prized subscribers. Section 31 to 33 in Chapter V read as follows :

*“31. Prized subscriber to furnish security.— Every prized subscriber shall, if he has not offered to deduct the amount of all future subscriptions from the prize amount due to him, furnish, and a foreman shall take, sufficient security for the due payment of all future subscriptions and, if the foreman is a prized subscriber, he shall give security for the due payment of all the future subscriptions to the satisfaction of the Registrar.*



32. Prized subscriber to pay subscriptions regularly.  
— Every prized subscriber shall pay his subscriptions regularly on the dates and times and at the place mentioned in the chit agreement and, on his failure to do so, he shall be liable to make a consolidated payment of all the future subscriptions forthwith.

33. Foreman to demand future subscriptions by written notice.— A foreman shall not be entitled to claim a consolidated payment from a defaulting prized subscriber under Section 32 unless he makes a demand to that effect in writing.

(2) Where a dispute is raised under this Act by a foreman for a consolidated payment of future subscriptions from a defaulting prized subscriber and if the subscriber pays to the foreman on or before the date to which the dispute is posted for hearing the arrears of subscriptions till that date together with the interest thereon at the rate provided for in the chit agreement and the cost of adjudication of the dispute, the Registrar or his nominee hearing the dispute shall, notwithstanding any contract to the contrary, make an order directing the subscriber to pay to the foreman the future subscriptions on or before the dates on which they fall due, and that, in case of any default of such payments by the subscriber, the foreman shall be at liberty to realise, in execution of that order, all future subscriptions and interest together with the costs, if any, less the amount, if any, already paid by the subscriber in respect thereof:

Provided that if any such dispute is on a promissory note, no order shall be passed under this sub-section unless such promissory note expressly states that the amount due under the promissory note is towards the payment of subscriptions to the chit.

(3) Any person who holds any interest in the property furnished as security or part thereof, shall be entitled to make the payment under sub-section (2).

(4) All consolidated payments of future subscriptions realised by a foreman shall be deposited by him in an approved bank mentioned in the chit agreement

*before the date of the succeeding instalment and the amount so deposited shall not be withdrawn except for payment of future subscriptions.*

*(5) Where any property is obtained as security in lieu of the consolidated payment of future subscriptions, it shall remain as security for the due payment of future subscriptions.”*

(emphasis supplied)

12. The object is to empower the foreman to recover the amount in a lump sum from a defaulting subscriber, so as to secure the interest of the other subscribers, and ensure smooth functioning of the Chit Fund. Such a provision would not amount to a penalty.
13. The relationship between the foreman and the subscribers in a chit fund transaction is of such a nature that there is a necessity and justification for making stringent provisions to safeguard the interest of the other subscribers, and the foreman. If a prized subscriber defaults in payment of his subscriptions, the foreman will be obliged to obtain the equivalent amount from other sources, to meet the obligations for payment of the chit amount to the other

members, who prize the chit on subsequent draws. For raising such an amount, the foreman may be required to pay high rates of interest.

14. The stipulation of empowering the foreman to recover the entire balance amount in a lump sum, in the event of default being committed by a prized subscriber, is to ensure punctual payment by each of the individual subscribers of the chit fund. Without punctual payments, the system would become unworkable, and the foreman would not be in a position to discharge his obligations to the other members of the chit fund.

15. In view of the aforesaid discussion, the relationship between a chit subscriber and the chit foreman is a contractual obligation, which creates a debt on the day of subscription. On default taking place, the foreman is entitled to recover the consolidated amount of future subscriptions from the defaulting subscriber in a lump sum.

16. The impugned judgment dated 15.01.2009 passed by the Division Bench of the High Court in AFA No. 85 of 1994 is set aside. The Civil Appeal is allowed in the aforesaid terms. All pending Applications, if any, are accordingly disposed of.  
Ordered accordingly.

.....J.  
(INDU MALHOTRA)

.....J.  
(SANJIV KHANNA)

**New Delhi,  
November 6, 2019.**