

KARNATAKA ACT NO. 30 OF 2005
THE KARNATAKA PROTECTION OF INTEREST OF DEPOSITORS IN FINANCIAL
ESTABLISHMENTS ACT, 2004

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STATEMENT OF OBJECTS AND REASONS

There has been a rapid growth of Financial establishments, not covered by the Reserve Bank of India Act, 1934 (Central Act II of 1934) in the State. These financial establishments are receiving deposits from the public, mostly middle class and poor classes on the promise of high rates of interest and easy gains, Many of the financial establishments have defaulted to return to the public, the deposits on maturity and thereby cheating the depositors of their legitimate due. There have been representations from Depositors Associations and public to have a legal mechanism to protect the interests of depositors. The Reserve Bank of India has also suggested that the State Government should enact a law in order to protect the interests of the depositors. Therefore it was considered necessary to bring a suitable legislation to regulate the activities of such financial establishments, other than those covered by the Reserve Bank of India Act, 1934.

Accordingly, the Karnataka (Protection of Interest of Depositors in Financial Establishments) Bill, 2000 (L. A. Bill No. 36 of 2000) was introduced in the State Legislature and both the Houses approved the same. The Bill was then sent to the Government of India to obtain assent of the President. However, the President of India withheld his assent to the Bill on the ground that the amendments suggested by the Ministry of Finance Company Affairs (Banking Division) could not be carried out as the Bill had already been passed by the State Legislature.

The Bill among other things provides for the following:-

- (i) Defining the term "Default" to include fraudulent failure to return the deposit or pay interest, bonus, and profit or perform service promised.
- (ii) Attachment of property of financial establishment and that of the Promoter, Director, Partner, Manager or Member of the Financial Establishment, in case of default of return of deposit.
- (iii) Attachment of property of malafide transferees where it is transferred by the Financial Establishment otherwise than in good faith and for consideration.
- (iv) Appointment of competent authority to exercise control over the said property and the powers and duties of the competent authority
- (v) Constitution of Special Court for dealing with all the cases
- (vi) Institution of Criminal Proceedings against the Promoter, Partner, Director, Manager or any other person responsible for management of the Financial Establishment for contravention of the provisions of the law which is punishable up to ten years of imprisonment and up to one lakh rupees of fine.

Certain other consequential and incidental provisions are also made.

Hence the Bill.

[L.A. BILL No. 2 OF 2004]

[Entry 64, 65 of list II and entry 2, 11A, 13 and 46 of list III of the Seventh Schedule to the Constitution of India]

KARNATAKA ACT NO. 30 OF 2005

(First Published in the Karnataka Gazette Extra-ordinary on the Twenty Second Day of December, 2005)

THE KARNATAKA PROTECTION OF INTEREST OF DEPOSITORS IN FINANCIAL ESTABLISHMENTS ACT, 2004

(Received the assent of the President of India on the Fourteenth Day of December, 2005)

An Act to provide for protection of Interest of depositors in Financial Establishments and matters relating thereto:

Whereas it is expedient to provide for protection of interest of the depositors in Financial Establishments and the matters relating thereto and for the purposes hereinafter appearing;

Be it enacted by the Karnataka State Legislature in the fifty fourth year of the Republic of India, as follows:-

CHAPTER-1

1. Short title and commencement.- (1) This Act may be called the Karnataka Protection of Interest of Depositors in Financial Establishments Act, 2004.

(2) It shall come into force on such date as the Government may, by notification, appoint and different dates may be appointed for different provisions of the Act.

This Act has come into force w.e.f. 17th day may 2006. by Notification No.FD 44 TAR 2006 Dated:17.05.2006.

(See the text of the notification at the end of the Act)

2. Definitions.- In this Act unless the context otherwise requires,-

- (1) "Competent Authority" means the authority appointed under Section 5;
- (2) "Deposit" includes and shall be deemed always to have included any receipt of money or acceptance of any valuable commodity by any Financial Establishment to be returned after a specified period or otherwise, either in cash or in kind or in the form of a specified service with or without any benefit in the form of interest, bonus, profit or in any other form, but does not include,-
- (i) amount raised by way of share capital or by way of debenture, bond or any other instrument covered under the guidelines given and regulations made, by the Security Board of India, established under the Securities and Exchange Board of India Act, 1992;
 - (ii) amounts contributed as capital by partners of a firm;
 - (iii) amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (Central Act 15 of 1992) ;
 - (iv) any amount received from,-
 - (a) the Industrial Development Bank of India,
 - (b) a State Financial Corporation,

- (c) any financial institution specified in or under section 4A of the Companies Act, 1956(Central Act 1 of 1956) or
- (d) any other institution that may be specified by the Government in this behalf;
- (v) amounts received in the ordinary course of business by way of,-
 - (a) security deposit,
 - (b) dealership deposit,
 - (c) earnest money,
 - (d) advanced against order for goods or services;
- (vi) any amount received from an individual or a firm or an association of individuals, registered under any enactment relating to money lending which is for the time being in force in the State: and
- (vii) any amount received by way of subscriptions in respect of a Chit.

Explanation I.- “Chit” has the meaning as assigned to it in clause (b) of section 2 of the Chit Funds Act, 1982 (Central Act 40 of 1982);

Explanation II.- Any credit given by a seller to a buyer on the sale of any property (whether movable or immovable) shall not be deemed to be deposit for the purposes of this clause;

(3) “Depositor” means a person who has made deposits with Financial Establishment;

(4) “Financial Establishment” means any person *or a group of individuals* accepting deposit under any scheme or arrangement or in any other manner but does not include a corporation or a co-operative society owned or controlled by any State Government or the Central Government or a banking company as defined under clause (c) of section 5 of the Banking Regulation Act, 1949 (Central Act X of 1949);

(5) “Government “ means the State Government;

(6) ‘Special Court’ means court established under section 10.

CHAPTER-II

3. Attachment of properties on default of return of deposits.- (1) The Government or the District Magistrates in their respective jurisdiction, suo moto or on receipt of any complaint may cause investigation of a complaint or fraudulent transaction referred to in this section. The District Magistrate shall forward his report together with the complaint to the Government at the earliest.

(2) Notwithstanding anything contained in any other law for the time being in force,-

(i) where, upon complaint received from any depositors or otherwise, the Government is satisfied that any Financial Establishment has failed -

(a) to return the deposit after maturity or on demand by depositor: or

(b) to pay interest or other assured benefit: or

(c) to provide the service against such deposit; or:

(ii) Where the Government has reason to believe that any Financial Establishment is acting in and detrimental to the interest of the depositors with an intention to defraud them; or

(iii) Where the Government is satisfied that such Financial Establishment is not likely to return the deposits or make payment of interest or other benefits assured or to provide the services against which the deposit is received.

the Government may, in order to protect the interests of the depositors of such Financial Establishments, after recording reasons in writing, issue an order by publishing it in the official gazette, attaching the money or property believed to have been acquired by such financial establishment either in its own name or in the name of any other person from and out of the deposits collected by the financial establishments, and where it transpires that such money or other property is not available for attachment or not sufficient for the repayment of the deposits, such other property of the said financial establishments, or the personal assets of the promoters, partners, directors, managers or members or any other person of the said Financial Establishments.

(3) The Government shall also notify the ad-interim order made under sub-section (2) in the Official Gazette and two newspapers having wide circulation and shall also cause to be affixed a copy of such order on some conspicuous place of the property so attached.

(4) On the publication of the order made under sub-section (2), all the properties and assets of the Financial Establishment and the persons mentioned therein shall forthwith vest in the Competent Authority appointed by the Government, pending further order from the *Special Court*.

4. Power to enter premises and inspect certain documents.- (1) The Competent authority or any other authority authorized by the designated authority in order to carry out the purposes of this Act shall have power to enter and search any premises where it has reason to believe that any register, book, record, paper, application, information in electronic storage and retrieval device or medium, instrument or proceedings are kept and to inspect them and to take such notes and extracts as it may deem necessary.

(2) Every person having in his custody or maintaining such register, book, record, paper, application, instrument or proceedings shall at all reasonable times produce or permit the Designated authority or any other authority authorized by the designated authority to inspect them and to take notes and extracts as it may deem necessary and if necessary seize and impound them:

Provided that no residential accommodation (not being a place of business cum residence) shall be so entered into and searched except on the authority of a search warrant issued by a Magistrate having jurisdiction over the area, and all searches under this section shall, so far as may be made in accordance with the provisions of the Code of Criminal Procedure, 1973 (Central Act II of 1974).

5. Competent Authority.- (1) The Government shall, by notification, appoint an officer not below the rank of an Assistant Commissioner to be the Competent Authority for the purpose of this Act.

(2) The Competent Authority shall within thirty days from the date of receipt of the order made under section 3, apply to the special Court for further order of attachment absolute.

(3) An application made under sub-section (2) shall be accompanied by one or more affidavits, stating the grounds on which the order is made under section 3 and the amount of money or other property believed to have been acquired from out of the deposits and the details, if any, of persons in whose name such property is believed to have been invested or acquired or any property attached under Section 3.

(4) The competent authority may also make an application to any Special Court or Designated Court or any other judicial forum established or constituted or entrusted with the powers by any other State Government under any similar enactment for adjudicating any issue or subject matter pertaining to money or property or assets belonging to or ostensibly belonging to a Financial Establishment or any person notified under this Act situated within the territorial jurisdiction of that Special Court or Designated Court or any judicial forum, as the case may be, for passing appropriate orders to give effect to the provisions of this Act.

6. Duties and powers of Competent Authority.- (1) On receipt of order of appointment, the Competent Authority shall take such necessary actions as it is necessary or expedient for taking physical possession of all the monies and assets of the concerned financial establishment expeditiously and the Competent Authority shall have all the powers which are necessary for the aforesaid purpose.

(2) Without prejudice to the generality of the powers vested under sub-section (1), the Competent Authority may carry out the purposes of this Act and shall be entitled to,-

- (a) require assistance of any police authority or any other authority or person and on such requisition it shall be the duty of the police authority or such other authority or person to extend necessary assistance;
- (b) open bank accounts in any scheduled commercial bank and credit all monies realized and operate the bank accounts while dealing with the money received in his capacity as Competent Authority;
- (c) require any person believed to be in possession of control over any money or assets of the financial establishment, to furnish necessary information, and to hand over possession of such assets to the Competent Authority and such person shall comply with the requisition without any loss of time;
- (d) appoint legal practitioner or chartered accountant or any other person whose services are necessary for taking possession of assets and realization of the assets of the Financial Establishment;

- (e) sell, receive, transfer, endorse, negotiate, or otherwise deal with any marketable security or negotiable instrument belonging to or in the control of the Financial Establishment and give proper discharge for the same;
- (f) *sell, transfer or otherwise realise* any movable or immovable property belonging to or in the control of the Financial Establishment or sell the property belonging to or in the control of the Financial Establishment, by public auction or with the prior approval of the Special Court by private arrangements;

Provided that the perishable items of assets shall be sold by public auction as soon as the Competent Authority deems fit.

- (g) make payment as per the orders passed by the Special Court from out of the bank accounts, and
- (h) do all and every acts which would be necessary for the speedy realization of the assets of the Financial Establishment.

Explanation.- For the purpose of this section the expression "Financial Establishment" includes the directors, partners, promoters, managers or member of said establishment or any other person whose property or assets have been attached under section 3.

7. Assessment of assets and deposit liabilities:- (1) Within thirty days from the date of appointment, the Competent Authority shall assess the deposit liabilities and the assets of the Financial Establishment and submit a report thereof to the Special Court.

(2) The Competent Authority thereafter shall issue notice either individually or by means of effective media publication, inviting the claims by secured creditors, if any, and also the depositors of the Financial Establishments to submit their claims with proper proof to establish the same

(3) Every notice under sub section (2) sent to or deemed to have been effected to claimants shall state that if the statement or claim is not sent to the Competent Authority before the expiry of the period of one month from the date of notice, the claims shall not be treated as claim entitled to be paid under the provision of this Act.

(4) Every notice sent to a secured creditor shall require him to value the security before the expiry of the period of one month from the date of the notice and such notice shall also state that if the statement of the claim together with the valuation of the security is not sent to the Competent Authority, the Competent Authority itself shall value the security and its valuation shall be binding on such secured creditors.

(5) If the claimant fails to comply with the notice as per sub section (4), such security shall be valued by the Competent Authority to the best of its judgment.

8. Report by the Competent Authority.- After making a report under section 7, the Competent Authority shall make an application to the Special Court seeking permission to make payment to the depositors from out of the money realized. While making such application, the

Competent Authority shall assess the liability to the depositors and other liabilities and in case the money realized or realizable is not sufficient to meet the entire liability, seek permission of the Special Court for making payment to the depositors and disburse the money as per the orders of the Special Court.

CHAPTER-III

9. Fraudulent default by Financial Establishment.- Any Financial Establishment, which fraudulently defaults any repayment of deposit on maturity along with any benefit in the form of interest, bonus, profit or in any other form as promised or fraudulently fails to render service as assured against the deposit, every person including the promoter, director, partner manager or any other person or an employee responsible for the management or conducting of the business or affairs of such Financial Establishment, shall on conviction, be punished with imprisonment for a term which may extend to six years and with fine which may extend to one lakh of rupees and such Financial Establishment also shall be liable for a fine which may extend to an amount equivalent to five lakhs of rupees. or where such deposits is quantifiable in terms of money twice the amount involved in such default whichever is more;

Provided that in the absence of special and adequate reasons recorded by the Special Court)in the judgment of the Court, the imprisonment shall not be less than three years and the fine shall not be less than twenty thousand rupees as against each individual and not less than one lakh of rupees against such Financial Establishment.

Explanation.- For the purpose of this section a Financial Establishment, which commits default in repayment of such deposit with such benefits in form of interest, bonus, profit or in any other form as promised or fails to render any specific service promised against such deposit, or fails to render any specific service agreed against the deposit with an intention of causing wrongful gain to one person or wrongful loss to another person or commits such defaults due to its inability arising out of impracticable or commercially not viable promises made while accepting such deposit or arising out of deployment of money or assets acquired out of the deposits in such manner as it involves inherent risk in recovering the same when needed shall, be deemed to have committed a default or failed to render the specific service, fraudulently.

CHAPTER-IV

10. Special Court.- (1) For the purposes of this Act, the Government may, with the concurrence of the Chief Justice of the High Court of Karnataka, by notification, constitute one or more Special Court consisting of a single judge not below the rank of a District and Sessions Judge for such area or areas or for such class or classes of cases.

(2) No Court including the Court constituted under the Presidency Towns Insolvency Act, 1909 [Act 3 of 1909] and the Provincial Insolvency Act, 1920,[Act 5 of 1920] other than the Special Court shall have jurisdiction in respect of any matter to which the provisions of this Act is invoked.

(3) Any pending case in any other court in respect of which the provisions of this Act is invoked, shall stand transferred to the Designated Courts from the date of notification issued under sub-section (1).

11. Powers of the Special Court regarding realization of assets and payment to depositors.- (1) The Special Court shall have all the powers for giving effect to the provisions of this Act.

- (2) Without prejudice to the generality of sub section (1), the Special Court may
- (a) give any direction to the Competent Authority as it deems fit, for effective implementation of the provisions of this Act.
 - (b) approve the statement of dues of the Financial Establishment due from various debtors, assessment of the value of the assets of the Financial Establishment, finalise the list of the depositors and their respective dues;
 - (c) direct the Competent Authority to take possession of any assets belonging to or in the control of the Financial Establishment and transfer or realize the attached assets or sell the attached assets by public auction or by private sale as it deems fit or depending upon the nature of assets and credit the sale proceeds thereof to the bank accounts;
 - (d) approve the necessary expenditure to be incurred by the Competent Authority for taking possession and realization of the assets of the financial establishment;
 - (e) on receipt of an application under section 8, order for payment to the depositors by the Competent Authority or order for proportionate payment to the depositors in the events of the money so realized is not sufficient to meet the entire deposit liability; and
 - (f) pass any order which the Special Court deems fit for realization of the assets of the company and repayment to the depositors of the Financial Establishment or on any matter or issue incidental thereto.

Explanation.- For the purpose of this section, the expression “Financial Establishment” includes the directors, partners, Promoters, managers or member of said establishment or any other person whose property or assets have been attached under section 3.

12. Powers of Special Court regarding attachment.- (1) Upon receipt of an application under section 5, the Special Court shall issue to the Financial Establishment and to any other person if any, whose property is attached by the designated authority under section 3, a notice accompanied by the copies of the application and affidavits and of the record of evidence, if any, calling upon them to show cause on *or before* a date to be specified in the notice why the order of attachment should not be made absolute.

(2) The Special Court shall also issue such notice, to all other persons represented to it as having or being likely to claim, any interest or title in the property of the Financial Establishment or the person to whom the notice is issued under sub section (1), calling upon all such persons to appear on the same date as that specified in the notice and make objection if they so desire to the attachment of the property or any portion thereof on the ground that they have interest in such property or portion thereof.

(3) Any person claiming an interest in the property attached or any portion thereof may, notwithstanding that no notice has been served upon him under this section, make an objection as aforesaid to the Special Court at any time before an order is passed under sub-section (4) or sub-section (6).

(4) The Special Court shall if no cause is shown and no objections are made on or before the specified date, forthwith pass an order making the order of attachment absolute, and issue such direction as may be necessary for realization of the assets attached and for the equitable distribution among the depositors of the money realized from out of the property attached..

(5) If cause is shown or any objection is made as aforesaid, the Special court shall proceed to investigate the same and in so doing, as regards the examination of parties and in all other respects, the Special Court shall subject to the provisions of this Act, follow the summary procedure as contemplated under Order 37 of the Civil Procedure Code, 1908 and exercise all the powers of a court in hearing a suit under the said Code and any person making an objection shall be required to adduce evidence to show that on the date of attachment he had some interest in the property attached.

(6) After investigation under sub-section (5), the Special Court shall pass an order as far as may be within one year from the date of receipt of application under sub-section (1), either making the ad-interim order of attachment absolute or varying it by releasing a portion of the property from attachment or cancelling the ad-interim order of attachment.

Provided that Special Court shall not release from attachment any interest which it is satisfied that the Financial Establishment or the person referred to in sub-section (1) has in the property, unless it is also satisfied that there will remain under attachment an amount or property of value not less than the value that is required for repayment to the depositors of such Financial Establishment.

(7) Where the Special Court passes an order under sub-section (6), making the order of attachment absolute or varying the order of attachment by releasing a portion of the property from attachment it may, issue such direction as may be necessary for realisation of the assets attached and for the equitable distribution amongst the depositors of the money realised from and out of the assets so attached.

(8) Where an application is made by any person duly authorised or constituted or specified by any other State Government under similar enactment empowering him to exercise

control over any money or property or assets attached by that State Government, the Special Court shall exercise all its powers, as if, such an application were made under this Act and pass appropriate order or direction on such application so as to give effect to the provisions of such enactment.

13. Attachment of property of malafide transferees.- (1) Where the assets available for attachment of a Financial Establishment or other person referred to in section 3 are found to be less than the amount or value which such Financial establishment is required to repay to the depositors and where the Special Court is satisfied, by affidavit or otherwise, that there is reasonable cause for believing that the said Financial Establishment has transferred (whether before or after the commencement of this Act) any of the property otherwise than in good faith or for proper consideration, the Special Court may, by notice, require any transferee of such property (whether or not he received the property directly from the said Financial Establishment) to appear on a date to be specified in the notice and show cause why so much of the transferee's property as is equivalent to the proper value of the property transferred should not be attached.

(2) Where the said transferee does not appear and show cause on the specified date, or where after investigation in the manner provided in sub-section (5) of section 12 the Special Court is satisfied that the transfer of the property to the said transferee was not in good faith or for proper consideration, the Special court shall order attachment of so much of the said transferee's property as is in the opinion of the Special Court equivalent to the proper value of the property transferred.

14. Security in lieu of attachment.- Any Financial Establishment or person whose property has been or is about to be attached under this Act may, at any time, apply to the Special Court for permission to give security in lieu of such attachment and where the security offered and given is, in the opinion of the Special court, satisfactory and sufficient, it may cancel the ad-interim order of attachment or, as the case may be, refrain from passing the order of attachment.

15. Administration of property attached.- The Special Court may, on the application of any person interested in any property attached and vested in the competent authority under this Act, and after giving the competent authority an opportunity of being heard, make such orders as the special Court considers just and reasonable for;

- (a) providing from such of the property attached and vested in the competent authority as the applicant claims an interest, in such sums as may be reasonably necessary for the maintenance of the applicant and of his family, and for expenses connected with the defence of the applicant where criminal proceedings have been instituted against him in the Special Court.
- (b) safeguarding so far as may be practicable the interest of any business affected by the attachment and in particular, the interest of any partners in such business.

(c) discharging in the prescribed manner, out of the property so attached, any liability, statutory or otherwise, accruing to a financial establishment or a person emanating out of the proceeding before the Special Court,

16. Appeal.- Any person including the competent authority, if aggrieved by an order of the Special Court, may appeal to the High Court within thirty days from the date of the order.

17. Special Public Prosecutor.- The Government shall, by notification, appoint an Advocate of not less than fifteen years standing as a Special Public Prosecutor for the purpose of conducting the cases in the Special Court.

18. Procedure and powers of Special Court regarding offences.- (1) The Special Court may take cognizance of the offence without the accused being committed to it for trial and in trying the accused person, shall follow the procedure specified in the Code of Criminal Procedure, 1973 (Central Act II of 1974) for the trial of warrant cases by Magistrates.

(2) The provisions of the Code of Criminal Procedure, 1973 (Central Act II of 1974) except the provisions of section 438 shall, so far as may be, apply to the proceedings before a Special Court and for the purpose of the said provisions, Special Court shall be deemed to be a Court of Judicial Magistrate, First class or Metropolitan Magistrate as the case may be.

CHAPTER-V

19. Act to override other laws.- Save as otherwise provided in this Act, the provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any custom or usage or any instrument having effect by virtue of any such law.

20. Protection of action taken in good faith.- No suit or other proceedings shall lie against the Government or the Competent Authority or an officer or employee of the Government for anything which is in good faith done or intended to be done under this Act.

21. Power to make rules.- (1) The Government may, by notification after previous publication make rules for carrying out the purposes of this Act.

(2) Every rule made under this Act, shall be laid as soon as may be after it is made before each House of the State Legislature while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions and if before the expiry of session in which it is so laid or the session immediately following both Houses agree in making any modification in any such rule or both Houses agrees that the rule should not be made, the rule shall, thereafter have effect only in such modified form or be of no effect, as the case may be, so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

22. Power to remove difficulties.- If any difficulty arises in giving effect to the provisions of this Act, the Government may, as occasion arise, by order, do anything, not inconsistent with the provisions of this Act, which appears to it to be necessary to remove the difficulty.

The above translation ಕರ್ನಾಟಕ ಹಣಕಾಸು ಸಂಸ್ಥೆಗಳಲ್ಲಿ ಠೇವಣಿದಾರರ ಹಿತಾಸಕ್ತಿ ಸಂರಕ್ಷಣೆ ಅಧಿನಿಯಮ, 2004 (2005 ರ ಕರ್ನಾಟಕ ಅಧಿನಿಯಮ ಸಂಖ್ಯೆ 30) be published in the Official Gazette under Clause (3) of Article 348 of the Constitution of India.

T.N. Chaturvedi

Governor of Karnataka

By Order and in the name of the Governor of Karnataka

G.K. BOREGOWDA

Secretary to Government

Department of Parliamentary Affairs and Legislation

GOVERNMENT OF KARNATAKA

No. FD 44 TAR 2006

Karnataka Government Secretariat
Finance Department
Bangalore, Dated: 17.05.2006.

NOTIFICATION

In exercise of the power conferred by sub – section (2) of section 1 of the Karnataka Protection of Interest of Depositors in Financial Establishments Act, 2004 (Karnataka Act.30 of 2005), the Government of Karnataka hereby appoints the 17th day of may, 2006 as the date on which all provisions of the said Act shall come in to force.

By order and in the name of the
Government of Karnataka

(C. SHAMARAO)
Under Secretary to Government
(FR & BCC).
Finance Department