
GOVERNMENT BOND HOLDERS AS CREDITORS: NATURE OF RIGHTS AND LIMITS OF REMEDIES IN INDIA

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ABSTRACT:

Every investor looks for an investment that is secure and bears potential for profit. Investments made in one's life play a vital role in shaping their future endeavors and lifestyles. With the rapid development in capitalistic ventures, an ever-increasing rate of inflation and cost of living, the need for investments has become even more crucial; perhaps it has become a need, like all other basic needs. Nowadays, with the increase in financial knowledge and wealth management know-how amongst the public, every individual either invests or considers investments in some form or other. Every investor has a common trait, regardless of him being a newbie or an experienced investor, that he takes a calculated call prior to finalizing the investment decisions. The surety that their investments would give them good returns and return of their capital is what every investor looks for. Amongst the different forms of investments, Government securities and Government bonds are considered the safest modes, as it gives surety of return on investment and return of capital, i.e., there shall be no default risk, hence making it the most sought-after, lucrative form of investment. This article analyses the relationship between the investors and the government, the legal rights and the extent of remedies available to them.

Keywords: Investor, Investments, Government securities, Government bonds, Reserve Bank of India (Bank).

Objective and scope of the study:

The objective of this research is to understand the position of a government bondholder or a government security holder as a creditor to the government. This study shows the actual basis on which the relationship between the Government and the Government bondholder is established. This study further analyses the legal remedies and their limits available to such bondholders and some basic thoughts on what is money and its evolution.

What is money, and how has it evolved?

The term 'Money' holds a significant value in itself; most people associate the term money with wealth and fortune, but that is not the real case. The money that we all adore and want has not been the same in the past. Like the concept of a separate legal entity or any other man-made legal concept, as the case may be, Money too is a man-made concept that works on the principle of trust between two persons.

Over the years, the concept of money has changed; what we consider money today might not have been considered as money in the past, but throughout all these changes, one thing has remained constant: the trust between the parties.

There have been several definitions of the term 'money'; the most common one used by professionals is that money is anything that serves as a medium of exchange, a store of value, and a unit of account (Ragan & Lipsey, 2011, p.609). This definition holds good for almost every situation, and economists will agree to this. But perhaps that was not the case when the concept of banking and money came into existence.

In the early days, the barter system was the most common form of exchange; the problems with the barter system were evident, as there was no consistency or standard, which led to the gold era, where the focus shifted towards gold and silver. Soon after, goldsmiths who used to have large vaults to store gold gained trust from the public, and eventually they started keeping the public's gold safe. Soon after, the Goldsmiths started to lend the same gold for interest, and this became a very lucrative business; eventually, it led them to issue gold bonds, which acted as a symbol of trust between the public and the goldsmith, which eventually led to the concept of banking and money, a system that is based completely on trust between two or more people.

The legal and statutory framework governing government securities in India:

Several legislations in India govern the government borrowings and securities, namely the Constitution of India, the Government Securities Act 2006, and the Reserve Bank of India Act 1935. Here is the overview of these laws and their relevant impact on the Government securities.

The Constitution of India:

Article 292 of the Constitution of India reads as follows:

*The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed.*¹

This gives the Union the ultimate power to borrow, furnishing security for India. The power given to the Union is wide enough to include borrowings from both within and outside India. In other words, the Central government can take a loan that is borrowed from within India or from a foreign country. The union executive shall exercise the power subject only to such limits as may be fixed by Parliament from time to time.²

On the other hand, the power of borrowing by a State has been restricted, and it is enshrined under Article 293 of the Constitution of India. Article 293 reads as:

1) Subject to the provisions of this article, the executive power of a State extends to borrowing within the territory of India upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be fixed by the Legislature of such State by law and to the giving of guarantees within such limits, if any, as may be so fixed.

(2) The Government of India may, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State or, so long as any limits fixed under article 292 are not exceeded, give guarantees in respect of loans raised by any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund

¹ INDIA CONST. art. 292.

² D.D. Basu, *Introduction to the Constitution of India* 391 (26th ed. 2022)

of India.

(3) A State may not without the consent of the Government of India raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government.

*(4) A consent under clause (3) may be granted subject to such conditions, if any, as the Government of India may think fit to impose.*³

Article 293, though it permits the state to borrow funds, is not as wide as the Union's. The state has been restricted from borrowing funds from outside India, but has been given the power to borrow from within the territory of India. Even though the Constitution permits the state to borrow from within the territory of India, it is not absolute; there are some conditions, which are as follows:

- A. The Government of India may itself offer a loan to the State, under a law made by the Parliament. So long as the loan or any part thereof remains outstanding, no fresh loan can be raised by the state without the consent of the Government of India. The Government of India may impose terms on giving such consent.⁴
- B. If the Union has guaranteed an outstanding loan of the state, no fresh loan can be raised by the State Government without the consent of the Union Government.⁵

Therefore, the Constitution grants the basic right to the Central and the State Governments concerning borrowings and also lays down the conditions and limits.

The Government Securities Act 2006:

Government securities are considered the safest form of investment that an individual can make. The reason for it being considered as the safest form of investment is because of the fact that government securities are known to have given returns with interest on time over the span of several years. Now the question arises as to how safe and secure it is to invest in Government

³ INDIA CONST. art. 293.

⁴ D.D. Basu, *Introduction to the Constitution of India* 391 (26th ed. 2022)

⁵ *Ibid* 4.

securities. Safety and security refer to the guaranteed return of capital and regular payment of interest. Perhaps referring to section 11 of the act would give us a hint. Section 11 reads as follows:

11. Issue of duplicate securities and of new securities on conversion, consolidation, sub-division, renewal, stripping or reconstitution.—(1) *If the person entitled to a Government security applies to the Bank alleging that the Government security has been lost, stolen or destroyed, or has been defaced or mutilated, the Bank may, on proof to its satisfaction of the loss, theft, destruction, defacement or mutilation of the Government security, and subject to such conditions and on payment of such fees as may be prescribed, order the issue of a duplicate Government security to the applicant.*

(2) *If the person entitled to a Government security applies to the Bank to have the Government security converted into a Government security of another form, or into a Government security issued in connection with another loan or to have it consolidated with other like Government securities, or to have it sub-divided, or to have it renewed, stripped or reconstituted, the Bank may, subject to such conditions and on payment of such fees as may be prescribed, cancel the Government security and order the issue of a new Government security or Government securities.*

Explanation.—*A Government security may be stripped separately for interest and principal or reconstituted on the application of the holder subject to such terms and conditions as may be specified.*

(3) *The person to whom a duplicate Government security or a new Government security is issued under this section shall be deemed for the purposes of section 18 to have been recognised by the Bank as the holder of the Government security; and a duplicate Government security or new Government security so issued to any person shall be deemed to constitute a new contract between the Government and such person and all persons deriving title thereafter through him:*

*Provided that the issue of new security under this section shall not affect the interest of third parties in whose favour a charge or other interest was lawfully created and was subsisting at the time of issue of the new security.*⁶

⁶ The Government Securities Act, 2006, § 11, No. 38 of 2006, India Code, <https://www.indiacode.nic.in>.

This section gives peace of mind to the investors who have invested in government securities, as they can be sure that no matter what happens, even if the security has been lost or destroyed, the investor will be provided with another duplicate by the Reserve Bank of India, and the investment will not go to waste, as the risk is very high in case of non-government bonds and securities. It also gives the investors immense satisfaction regarding the surety of their investments. Now the question arises, what will happen if the government fails to pay back the loan? What remedy does the investor have?.

The 2006 Act mainly focuses on managing ownership and security rather than being a bankruptcy code, and is mainly focused on the transfer of ownership once the actual owner has died. Referring to section 13 of the act, which deals with the law applicable to government securities, it reads:

Notwithstanding that, as a matter of convenience, the Government may have arranged for payments on a Government security to be made elsewhere than in India, the rights of all persons in relation to Government securities shall be determined in connection with all such questions as are dealt with by this Act by the law and in the Courts of India.⁷

This gives the right to the Security holder to approach the court and claim a remedy. This also includes the payments made outside India. This remedy is not absolute; there is a crucial limitation as mentioned under section 23 of the Act, which reads:

(1) Where no shorter period of limitation is fixed by any law for the time being in force, the liability of the Government in respect of any interest payment due on a Government security shall terminate on the expiry of six years from the date on which the amount due by way of interest became payable:

Provided that the Government may allow a bona fide claim for payment of interest after the expiry of the period of six years in those cases where the holders of securities could not prefer their claims within the said period of six years.

(2) Notwithstanding anything contained in sub-section (1), the Bank may specify the securities in respect of which, the circumstances under which, and the terms and conditions subject to

⁷ The Government Securities Act, 2006, § 13, No. 38 of 2006, India Code, <https://www.indiacode.nic.in>.

*which, interest may be paid even after the expiry of the period specified in the said sub-section.*⁸

Therefore, in an event where the Government fails to pay interest to the investor or the investor fails to claim it, the Government's liability to pay interest will terminate after 6 years. While the Government may allow such claims, it is not legally bound to do so.

Considering the relationship between the Government security holder and the Government, it is clear that they hold a contractual relationship with a promise to pay the sum of money with capital and interest. The Government needs cash for various needs, like infrastructure, Education, research, etc., and for that reason, it approaches its citizens for a loan in return for promises to pay interest; therefore, it becomes the basis of the contractual relationship and it's not a fancy form of contractual, it's the same as that which is entered between two private parties the Supreme Court in the case of *Union of India v. A.L. Rallia Ram*⁹ gave a similar opinion that the government is bound by the obligations to honour the contract as an ordinary citizen.

All these procedures and rules indicate that the operation of the Government securities is based on trust, a trust that there exist rules and regulations that will be followed at all costs. When it comes to contracts, the consequences for non-compliance are very strict, and the same holds true for government securities.

The question may arise, why do securities holders have so much trust?

A major contributing factor can be that the Government can generate its own money anytime, which technically means that the Government can never run out of money.

Then what remedies does the Government Securities Act 2006 provide to those who have not been paid the interest? It could be summarised as follows:

- a. Right to approach the court of law.
- b. Recovery of unpaid interest in a title dispute.
- c. Right to pursue the wrongful Recipient.

⁸ The Government Securities Act, 2006, § 23, No. 38 of 2006, India Code, <https://www.indiacode.nic.in>.

⁹ *Union of India v. A.L. Rallia Ram*, A.I.R. 1963 S.C. 1685 (India)

In addition to this, there is the 'rule of law', hypothetically speaking, even if there is no remedy available, the rule of law will prevail, and the procedure as per the law will also prevail, thereby granting justice. The Rule of law, which remains stable, is backed by the Grundnorm, i.e., the Constitution of India, and the trust so created makes the Government securities so attractive.

The Reserve Bank of India Act 1934:

Referring to the preamble of The Reserve Bank of India Act 1934, which reads as:

The primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth¹⁰

The main goal of this Act is to regulate banknotes to secure monetary stability in the nation. Although this Act does not directly outline any provisions, it provides for indirect protection to the Government securities holder.

To understand how the Reserve Bank of India manages government securities, we need to look into two key sections, which are section 21(2) and section 17(8).

Section 21, which deals with the Reserve Bank's right to Transact government business in India and subclause 2 of section 21 deals with public debt, it says:

(2) The [Central Government] shall entrust the Bank, on such conditions as may be agreed upon, with the management of the public debt and with the issue of any new loans.¹¹

The Reserve Bank of India is the banker to the government, and all its transactions are taken care of by it. The Reserve Bank further advises and lays down guidelines with respect to the management of the public debt. Therefore, the government cannot arbitrarily use the funds collected as a means of Government security, hence this adds on as an additional protection for the investors.

Further Referring to subclause 8 of section 17 of the Reserve Bank of India Act 1934, which pertains to transactions of the Government security and states:

¹⁰ Reserve Bank of India Act, 1934, pmb., No. 2, Acts of Parliament, 1934 (India)

¹¹ The Reserve Bank of India Act, 1934, § 21(2), No. 2 of 1934, India Code, <https://www.indiacode.nic.in>.

*(8) the purchase and sale of securities 1[of the Central 2[Government or a 3[State] Government]] of any maturity or of such securities of a local authority 4*** as may be specified in this behalf by the 5[Central Government] on the recommendation of the Central Board:*

Provided that securities fully guaranteed as to principal and interest by 6 [any such

Government 7[or authority]] shall be deemed for the purposes of this clause to be securities of such Government 7[or authority];¹²

This provision enables the rediscounting of the bonds and securities, thereby enabling the investors to trade in securities.

In other words, the Reserve Bank of India Act 1934 creates a safe and regulated environment in which the government bonds are issued and traded. Which again indicates that this whole system works on trust, so established by law.

The Reserve Bank of India is another means of laying down procedures for the Government bonds and securities that are nonetheless mandatory. Therefore, it ensures that there remains a standard while issuing securities and bonds, which gives faith to the investors.

Conclusion:

Although the Constitution of India, the Government Securities Act 2006, and the Reserve Bank of India Act 1935 provide the investors with remedies and protection through legally laid down principles. The fundamental aspect that makes investments in Government securities so lucrative and instills confidence amongst the investors is the trust between the investors and the Government and the trust in the procedure as laid down by law. The fact that the Government by itself cannot go bankrupt, and it can generate wealth by itself, creates confidence in the minds of the holders of the Government security that their investment will not be at risk and will not falter in payment of interest and return of principal.

¹² The Reserve Bank of India Act, 1934, § 17(8), No. 2 of 1934, India Code, <https://www.indiacode.nic.in>.