The Legality of Usurious Interest Rates in the Indian Financial Sector

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I. Introduction

The issue of usurious or exorbitant interest rates has occupied a central position in banking jurisprudence across jurisdictions. Interest is the consideration paid by a borrower for the use of money and serves as the foundation of modern banking and credit markets. Commercial banks and Non-Banking Financial Companies (NBFCs) depend heavily upon interest income as a primary source of revenue.[1] Consequently, financial institutions require flexibility in pricing credit according to factors such as market conditions, risk assessment, liquidity requirements, cost of funds, operational expenses, and borrower creditworthiness.

However, unrestricted discretion in fixing interest rates raises concerns regarding exploitation of borrowers, particularly where there exists a significant imbalance in bargaining power. Excessive interest rates may trap borrowers in cycles of debt, undermine consumer welfare, and conflict with principles of fairness and equity.[2] Historically, legal systems responded to such concerns through usury laws that imposed ceilings on interest rates and empowered courts to reopen unfair transactions.

In India, the legal position has evolved from judicial scrutiny under the Usurious Loans Act, 1918 to a largely deregulated regime supervised by the Reserve Bank of India (RBI). The enactment of Section 21A of the Banking Regulation Act, 1949[3] significantly restricted the power of courts to interfere in banking transactions solely on the ground that the interest charged was excessive. At the same time, RBI regulations, consumer protection principles, and judicial doctrines concerning transparency and fairness continue to impose meaningful limitations upon lenders.

This paper seeks to examine whether commercial banks and NBFCs can legally charge usurious rates of interest and to identify the legal, regulatory, and judicial safeguards that govern the exercise of such power.

II. Concept of Usurious Interest

The term "usury" originates from the Latin word usura, meaning compensation for the use of money. Traditionally, usury referred to the charging of interest at a rate considered excessive,

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[1] Reserve Bank of India Act, No. 2 of 1934, pmbl.; Banking Regulation Act, No. 10 of 1949.

[2] Reserve Bank of India, *Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023*, ch. IX (updated periodically).

[3] Banking Regulation Act, 1949, § 21A.

unconscionable, or morally unacceptable. Ancient legal systems, religious doctrines, and common law traditions often prohibited or strictly regulated usurious transactions.

In India, the concept found statutory recognition through the Usurious Loans Act, 1918.[4] Under the Act, courts were empowered to reopen loan transactions where two conditions were satisfied:

1. The interest charged was excessive; and
2. The transaction was substantially unfair.

The legislation reflected the belief that borrowers frequently occupied a weaker bargaining position and required judicial protection against oppressive lending practices.[5]

The concept of usurious interest is not confined to a particular percentage. Rather, it involves an examination of the circumstances surrounding the transaction, including the bargaining power of the parties, prevailing market conditions, risk factors, transparency of terms, and the overall fairness of the arrangement.

Modern financial systems have increasingly shifted away from fixed statutory ceilings and towards market-based determination of lending rates. Consequently, contemporary concerns focus less on numerical rates and more on issues such as informed consent, disclosure, transparency, unfair contractual practices, and compliance with regulatory standards.

The question in modern banking law is therefore not simply whether an interest rate is high, but whether it has been imposed lawfully, transparently, and consistently with applicable regulatory norms.

III. Statutory Framework

A. Usurious Loans Act, 1918

The Usurious Loans Act represented the earliest statutory mechanism for controlling excessive interest. It empowered courts to reopen transactions where interest was excessive and the transaction was substantially unfair. The Act reflected the protective approach adopted by legislatures during periods when borrowers were vulnerable to exploitation by moneylenders.

However, with the development of institutional banking and RBI regulation, Parliament gradually moved away from judicial determination of appropriate interest rates.

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[4] Usurious Loans Act, No. 10 of 1918, §§ 3–4.
[5] Banking Regulation Act, 1949, § 21A.

B. Section 21 of the Banking Regulation Act, 1949

Section 21 empowers the Reserve Bank of India to determine banking policy relating to advances made by banking companies. RBI may issue directions regarding lending practices, margins, purposes of advances, and interest-related matters in the public interest.

This provision establishes the RBI as the principal authority responsible for regulating banking credit and lending policy.

C. Section 21A of the Banking Regulation Act, 1949

Section 21A provides:

"No court shall reopen any transaction between a banking company and its debtor on the ground that the rate of interest charged by the banking company is excessive."

The legislative purpose behind this provision was to prevent courts from substituting their judgment for that of banking regulators and financial institutions regarding appropriate interest rates. The provision effectively excludes the application of traditional usury principles to banking transactions and recognizes that lending decisions involve economic and policy considerations best left to expert regulators.

The result is that courts generally cannot invalidate a banking transaction merely because the agreed rate of interest appears high or unreasonable.

IV. RBI Act, 1934 and Regulatory Powers

The Reserve Bank of India occupies a unique position within India's financial architecture. Established under the RBI Act, 1934, it functions as the central bank responsible for monetary stability, financial regulation, and supervision of banks and NBFCs.[6]

In *Peerless General Finance & Investment Co. Ltd. v. RBI*[7], the Supreme Court recognized the broad regulatory authority of the RBI and emphasized that its directions are designed to protect depositors, maintain confidence in the financial system, and ensure orderly economic development.

Similarly, in *Internet and Mobile Association of India v. RBI*[8], the Supreme Court observed that RBI is not an ordinary statutory regulator but a specialized institution possessing considerable

[6] Reserve Bank of India Act, 1934, §§ 21, 35A, 45JA, 45L.
[7] *Peerless General Finance & Investment Co. Ltd. v. Reserve Bank of India*, MANU/SC/0685/1992.
[8] *Internet & Mobile Association of India v. Reserve Bank of India*, MANU/SC/0264/2020.

expertise in economic and financial matters. The Court stressed that significant judicial deference must be accorded to RBI decisions concerning financial regulation.

The RBI therefore serves as the primary institution responsible for balancing market freedom with borrower protection.

V. RBI's Regulatory Approach Towards Excessive Interest

Unlike many jurisdictions that impose statutory ceilings on lending rates, India follows a largely deregulated interest-rate regime.[9]

The RBI generally permits banks and NBFCs to determine lending rates based upon:

- Cost of funds
- Risk premium
- Credit profile of borrowers;
- Operational costs
- Market competition
- Liquidity conditions.

However, deregulation does not imply absence of regulation.

The RBI requires NBFCs to adopt board-approved interest rate policies that clearly specify the methodology used for determining lending rates. Borrowers must be informed of all charges, penalties, and interest obligations at the time of sanction and throughout the tenure of the loan.[10]

The RBI's Fair Practices Code further requires transparency, non-discrimination, proper disclosure, and fair treatment of customers.[11]

Thus, the RBI's regulatory philosophy is not to impose numerical ceilings but to ensure that interest rates are determined through transparent, rational, and non-arbitrary mechanisms.

VI. Judicial Approach Towards Excessive Interest Charged by Banks

The Indian judiciary has consistently adopted a cautious approach while examining allegations of excessive interest charged by banks. Courts have recognized that determination of lending rates is primarily an economic and regulatory function entrusted to the Reserve Bank of India.

[9] Reserve Bank of India, *Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023*, ¶¶ 85–89.
[10] Reserve Bank of India, *Fair Practices Code for NBFCs*, RBI/2023-24.
[11] Reserve Bank of India, *Guidelines on Digital Lending*, RBI/2022-23/111 (Sept. 2, 2022).

Nevertheless, judicial intervention remains available where banks violate statutory provisions, RBI directives, principles of natural justice, or contractual obligations.

A review of judicial precedents reveals that courts generally refrain from interfering with the commercial wisdom of banks regarding interest rates, while simultaneously ensuring that borrowers are protected against arbitrary, non-transparent, and unfair practices.

A. Central Bank of India v. Ravindra (2001)

The Constitution Bench decision in *Central Bank of India v. Ravindra*[12] is the most authoritative pronouncement on the law relating to interest in India.

The case arose from conflicting judicial opinions regarding the legality of compound interest, capitalization of interest, and the interpretation of Section 34 of the Code of Civil Procedure. The Supreme Court undertook an extensive examination of banking practices, RBI directives, and principles governing interest.[13]

The Court held that interest is essentially compensation paid by a borrower for the use or retention of money belonging to another. Banking institutions are entitled to capitalize interest at periodic intervals where such capitalization is permitted by contract and consistent with established banking practice. Once interest is capitalized, it forms part of the principal for future calculations.

However, the Court drew an important distinction between ordinary interest and penal interest. Penal interest serves a punitive function and therefore cannot itself be capitalized. The Court observed that allowing penal interest to generate further interest would result in unjust enrichment and would impose an unreasonable burden upon borrowers.[14]

The judgment established several important principles:

1. Compound interest is permissible where authorized by contract and banking usage.
2. Penal interest cannot be capitalized.
3. Courts may examine whether interest calculations comply with RBI directions.
4. Banking transactions enjoy a degree of judicial deference due to their economic nature.

The significance of *Ravindra* lies in its recognition that while banks possess commercial freedom, such freedom remains subject to legal and regulatory constraints.

B. State Bank of India v. Yasangi Venkateswara Rao (1999)

[12] *Central Bank of India v. Ravindra*, MANU/SC/0663/2001.
[13] *Id.* ¶¶ 42–57.
[14] *Id.* ¶¶ 55–63.

In this case, borrowers challenged the charging of interest on the ground that the rates were excessive and oppressive.

The Supreme Court rejected the challenge and emphasized that after the enactment of Section 21A of the Banking Regulation Act, courts cannot reopen transactions merely because the interest charged appears excessive.

The Court observed that banking is a specialized field governed by RBI policy and economic considerations. Judicial review cannot be exercised on the basis of subjective notions regarding what constitutes a reasonable interest rate.

The judgment reinforced the legislative intention underlying Section 21A and affirmed that courts are not competent to determine appropriate commercial lending rates.[15]

C. Corporation Bank v. D.S. Gowda (1994)

The Supreme Court in this case considered whether courts could interfere with interest rates charged by banks after the enactment of Section 21A.

The Court held that Section 21A was introduced specifically to prevent courts from applying traditional usury principles to banking transactions. Parliament consciously intended to transfer regulatory authority over interest rates from courts to the RBI.

However, the Court clarified that Section 21A does not grant banks unlimited power. Judicial scrutiny remains available where banks act contrary to statutory provisions or RBI directives.

This decision established that Section 21A bars challenges based solely on excessive interest but does not immunize illegal or arbitrary conduct.[16]

D. Bank of Baroda v. Perchem Industries (1992)

The Bombay High Court examined whether the Usurious Loans Act continued to apply to banking transactions following the insertion of Section 21A.

The Court held that Section 21A had retrospective effect and applied even to pending proceedings. It further observed that the legislative objective was to exclude banking transactions from judicial scrutiny under usury laws.

[15] *State Bank of India v. Yasangi Venkateswara Rao*, MANU/SC/0027/1999.
[16] *Corporation Bank v. D.S. Gowda*, MANU/SC/0788/1994.

The judgment recognized that determination of interest rates falls within the domain of banking policy and economic regulation rather than traditional equitable principles.

This case remains an important authority for the proposition that borrowers cannot challenge banking transactions merely because interest appears high.[17]

E. Manmeet Singh v. Union of India (2024)

This recent decision of the Allahabad High Court illustrates the modern judicial emphasis upon transparency and informed consent.

The petitioner obtained a housing loan at an agreed floating rate of 12.5%. Subsequently, the bank increased the rate to between 16% and 18% without establishing that adequate notice had been provided to the borrower.

The Court held that RBI guidelines require banks to adopt transparent procedures while revising floating interest rates. Any increase in rates must be properly communicated and must comply with contractual and regulatory requirements.

The Court concluded that unilateral enhancement of interest without notice and consent amounted to an unfair banking practice.

This decision demonstrates that judicial intervention is still available where banks disregard procedural fairness and transparency obligations.[18]

VII. Judicial Approach Towards Excessive Interest Charged by NBFCs

The position of NBFCs differs significantly from that of scheduled commercial banks.

Unlike banks, NBFCs do not directly benefit from the statutory protection contained in Section 21A of the Banking Regulation Act. Nevertheless, courts generally recognize that NBFCs operate in a higher-risk lending environment and therefore may legitimately charge higher rates of interest.

The judicial approach toward NBFCs has largely focused upon regulatory compliance rather than numerical interest ceilings.

A. Peerless General Finance & Investment Co. Ltd. v. RBI (1992)

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[17] *Bank of Baroda v. Perchem Industries*, MANU/MH/0498/1992.
[18] *Manmeet Singh v. Union of India*, 2024:AHC:8624-DB; MANU/UP/0167/2024.

The Supreme Court emphasized the RBI's broad regulatory authority over non-banking financial institutions.

The Court observed that financial institutions often deal with vulnerable investors and borrowers who require protection from exploitative practices. Consequently, RBI possesses extensive powers to regulate NBFC operations in the public interest.

The judgment underscores that RBI supervision constitutes the primary safeguard against abusive financial practices.[19]

B. Regulatory Scrutiny of NBFC Lending Practices

Courts have consistently recognized that NBFCs operate under different business models and risk structures compared to traditional banks and unlike Scheduled Commercial Banks, NBFCs generally do not have access to low-cost deposits and Liquidity Adjustment Facilities of RBI, and largely rely on bank & market borrowings, resulting in increased cost of funds for NBFCs. The interest rate offered by NBFCs seem to be in alignment considering their cost of borrowings, risk premium based on the risk category of the borrower and a mark up for operational expenses and their margin. However, courts have also stressed that NBFCs must comply with RBI Fair Practices Codes and disclosure requirements.[20]

Failure to disclose the basis of interest calculations, hidden charges, processing fees, or penalty clauses may expose NBFCs to regulatory action and judicial scrutiny.

C. Digital Lending and Emerging Concerns

Recent concerns regarding digital lending platforms have intensified scrutiny of NBFC practices.

Borrowers have increasingly complained of annualized rates exceeding conventional banking norms, hidden fees, and aggressive recovery mechanisms. In response, RBI has strengthened disclosure requirements and emphasized transparency in digital lending arrangements.

Thus, the legality of NBFC interest rates increasingly depends upon compliance with disclosure obligations rather than adherence to a fixed statutory ceiling.[21]

[19] *Peerless General Finance & Investment Co. Ltd. v. Reserve Bank of India*, MANU/SC/0685/1992.
[20] Reserve Bank of India, *Master Direction – NBFC Scale Based Regulation Directions, 2023*, ch. IX.
[21] Reserve Bank of India, *Guidelines on Digital Lending*, RBI/2022-23/111.

VIII. Credit Card Interest and the Supreme Court's Decision in HSBC v. Awaz

The decision of the Supreme Court in *Hongkong and Shanghai Banking Corporation Ltd. v. Awaz*[22] represents the most important recent authority on allegations of usurious interest in the context of credit cards.

The dispute originated before the National Consumer Disputes Redressal Commission, which held that charging interest beyond 30% per annum on credit card defaults constituted an unfair trade practice. The Commission attempted to impose a ceiling on credit card interest rates and restrict capitalization of penal charges.

The banks challenged the decision before the Supreme Court.

The Supreme Court overturned the Commission's ruling and held that the National Commission had exceeded its jurisdiction.

The Court emphasized several principles:

1. RBI is the specialized regulator responsible for determining banking policy.
2. Consumer forums cannot assume the role of economic regulators.[23]
3. Section 21A prevents courts and tribunals from reopening banking transactions merely because interest appears excessive.[24]
4. Credit card holders were informed of the applicable rates and terms.
5. No evidence established that the banks had violated RBI directives.

The Court further observed that fixing maximum or minimum interest rates is a matter involving economic policy, market conditions, risk assessment, and banking expertise. Such decisions cannot be undertaken by consumer adjudicatory bodies.

The significance of *HSBC v. Awaz* lies in its strong affirmation of RBI's regulatory supremacy and judicial restraint in matters involving interest-rate determination.

IX. Transparency, Fairness and Unfair Trade Practices

Modern banking jurisprudence increasingly focuses upon procedural fairness rather than numerical regulation of interest rates.

Courts now examine whether borrowers were adequately informed regarding:

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[22] *Hongkong & Shanghai Banking Corp. Ltd. v. Awaz*, MANU/SC/1383/2024.
[23] *Id.* ¶¶ 42–61.
[24] *Id.* ¶¶ 50–61.

1. Applicable interest rates
2. Penal charges
3. Methodology of calculation;
4. Changes in lending rates
5. Consequences of default

The shift reflects recognition that informed consent is a more effective safeguard than rigid interest-rate ceilings.

A. Texco Marketing Pvt. Ltd. v. Tata AIG General Insurance Co. Ltd. (2022)

The Supreme Court held that a party cannot rely upon contractual provisions that were not properly disclosed or that undermine the legitimate expectations of the counterparty.

Although the case arose in the insurance context, the principles regarding disclosure and fairness have wider implications for financial contracts.

The Court emphasized that hidden clauses and undisclosed conditions may be disregarded where they operate unfairly against consumers.[25]

B. Godfrey Phillips India Ltd. v. Ajay Kumar (2008)

The Supreme Court stressed that findings of unfair trade practice require clear evidence of deception, misrepresentation, or unfair conduct.

The decision reinforces the principle that allegations of unfairness must be supported by objective evidence rather than subjective dissatisfaction.

Applied to banking transactions, the case suggests that interest rates cannot be condemned merely because they are high. There must be evidence of unfairness, concealment, deception, or regulatory violation.[26]

X. Economic Regulation and Judicial Deference

Indian courts have repeatedly acknowledged the limits of judicial competence in matters involving economic policy.

In *Shri Sitaram Sugar Co. Ltd. v. Union of India*[27], the Supreme Court observed that economic decisions often involve complex considerations of policy, expertise, and public interest. Courts

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[25] *Texco Marketing Pvt. Ltd. v. Tata AIG General Insurance Co. Ltd.*, MANU/SC/1466/2022.
[26] *Godfrey Phillips India Ltd. v. Ajay Kumar*, MANU/SC/1765/2008.
[27] *Shri Sitaram Sugar Co. Ltd. v. Union of India*, MANU/SC/0249/1990.

should therefore exercise restraint and avoid substituting their judgment for that of specialized regulators.

The principle was reaffirmed in *Internet and Mobile Association of India v. RBI*[28], where the Supreme Court described RBI as a uniquely placed institution possessing specialized expertise in financial regulation.

The doctrine of judicial deference rests upon several considerations:

1. Financial regulation involves technical expertise.
2. Economic decisions require balancing competing interests.
3. Courts lack institutional capacity to determine optimal lending rates.
4. Regulatory agencies possess access to market data and economic analysis.

Consequently, courts generally defer to RBI decisions unless they are arbitrary, unconstitutional, disproportionate, or contrary to statutory authority.

XI. Analysis

The contemporary legal framework governing interest rates demonstrates a significant shift from judicial regulation to regulatory supervision.

Historically, courts actively protected borrowers through usury laws that permitted reopening of oppressive transactions. The enactment of Section 21A[29] fundamentally altered this approach by restricting judicial interference in banking transactions.

The first major theme emerging from the jurisprudence is the primacy of RBI regulation. Decisions such as *Peerless*, *Internet and Mobile Association of India*, and *HSBC v. Awaz* consistently recognize the RBI as the institution best equipped to regulate lending practices. Courts increasingly view interest-rate determination as an economic issue rather than a purely legal question.

The second theme is the distinction between substantive and procedural fairness. Modern courts rarely question the substantive level of interest charged. Instead, they examine whether the rate was properly disclosed, transparently calculated, and contractually agreed upon. Cases such as *Manmeet Singh* demonstrate that judicial intervention is more likely where lenders fail to provide notice, conceal material terms, or act arbitrarily.

The third theme concerns the evolving role of consumer protection principles. Although courts cannot ordinarily invalidate banking transactions for excessive interest, they remain willing to

[28] *Internet & Mobile Association of India v. Reserve Bank of India*, MANU/SC/0264/2020.
[29] Banking Regulation Act, 1949, § 21A.

intervene where borrowers are misled or deprived of meaningful consent. Transparency has emerged as the primary safeguard against exploitation.

The fourth theme relates to NBFC regulation. Unlike banks, NBFCs operate in higher-risk sectors and often cater to underserved borrowers. Higher rates may therefore be economically justified. Nevertheless, RBI's increasing emphasis on disclosure, digital lending regulation, and fair practices indicates growing concern regarding predatory lending models.

A critical evaluation of the current framework suggests that India has moved from a "rate-control model" to a "transparency-and-regulation model." Instead of imposing statutory caps, the law relies upon disclosure obligations, RBI supervision, market competition, and targeted judicial intervention to protect borrowers.

While this approach preserves credit availability and financial innovation, it also places significant responsibility upon regulators to ensure that market-based pricing does not become a vehicle for exploitation. The effectiveness of the framework therefore depends largely upon robust RBI supervision and strict enforcement of disclosure standards.

Accordingly, the legality of an interest rate today depends less upon its numerical magnitude and more upon whether it is transparent, contractually justified, risk-based, and consistent with applicable regulatory requirements.

XII. Conclusion

The issue of whether commercial banks and NBFCs can charge usurious interest rates reflects the broader tension between contractual freedom, financial stability, and borrower protection. Historically, Indian law empowered courts under the Usurious Loans Act, 1918 to reopen transactions involving excessive and unfair interest rates. However, the emergence of a sophisticated banking system and the increasing role of the Reserve Bank of India as the central financial regulator led to a significant transformation in the legal framework governing lending practices.

The enactment of Section 21A of the Banking Regulation Act, 1949 marked a decisive legislative shift away from judicial determination of reasonable interest rates. The provision expressly bars courts from reopening banking transactions merely on the ground that the interest charged is excessive. Judicial decisions such as *State Bank of India v. Yasangi Venkateswara Rao*, *Corporation Bank v. D.S. Gowda*, and *Bank of Baroda v. Perchem Industries* have consistently affirmed this position and recognized that lending rates are primarily matters of banking policy and economic regulation.

At the same time, the statutory protection available to banks does not create absolute immunity. The judiciary has repeatedly emphasized that banks remain subject to RBI directions, contractual obligations, and principles of transparency and fairness. Decisions such as *Central Bank of India v. Ravindra* and *Manmeet Singh v. Union of India* demonstrate that courts are willing to intervene where interest calculations violate RBI norms, where penal interest is improperly capitalized, or where interest rates are altered without adequate disclosure and borrower consent.

The position of NBFCs presents additional complexities. While they enjoy substantial freedom in determining lending rates, they operate under the regulatory supervision of the RBI and are required to comply with Fair Practices Codes, disclosure obligations, and consumer protection standards. The RBI has increasingly emphasized transparency in digital lending, microfinance, and retail lending sectors, indicating growing concern regarding predatory lending practices and excessive charges imposed upon vulnerable borrowers.

The Supreme Court's decision in *Hongkong and Shanghai Banking Corporation Ltd. v. Awaz* further clarifies that courts and consumer forums cannot assume the role of economic regulators by fixing interest-rate ceilings. The judgment reinforces the principle that RBI is the expert body entrusted with balancing competing considerations of borrower welfare, market efficiency, credit availability, and financial stability.

An examination of the statutory framework, RBI regulations, and judicial precedents reveals that contemporary Indian law does not prohibit high interest rates per se. Instead, the legality of an interest rate depends upon whether it is imposed through a transparent, non-arbitrary, and regulatorily compliant process. The focus has shifted from controlling the numerical rate of interest to ensuring fairness in the manner in which such rates are determined and communicated.

Therefore, commercial banks and NBFCs may charge market-driven and risk-based rates of interest, even where such rates are significantly higher than conventional lending rates. However, they cannot impose arbitrary, hidden, unconscionable, or non-disclosed charges that violate RBI directives or undermine informed borrower consent. The modern legal framework thus rejects both unrestricted lender discretion and rigid judicial price control, relying instead upon regulatory supervision, transparency obligations, and targeted judicial intervention to safeguard borrower interests.

In conclusion, the answer to the research question is that commercial banks and NBFCs can charge high rates of interest, but they cannot lawfully charge usurious interest in a manner that is arbitrary, deceptive, unfair, or inconsistent with the regulatory standards prescribed by the Reserve Bank of India. The contemporary approach of Indian law is therefore best understood as a system of regulated market freedom rather than one of absolute contractual liberty or strict statutory control.