

Contemporary Developments in Corporate and Commercial Laws in India

A COLLECTION OF ARTICLES

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NLIU - TRILEGAL SUMMIT ON
CORPORATE AND COMMERCIAL LAWS,
2024



Centre for
**Business &
Commercial Laws**
NATIONAL LAW INSTITUTE UNIVERSITY, BHOPAL

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Foreword

It gives me immense pride and pleasure to pen this note on the publication of the Summit Book for the 9th edition of the NLIU-Trilegal Summit on Corporate and Commercial Laws, 2024. In the dynamic landscape of legal education and research, it is through rigorous exploration, critical analysis, and intellectual engagement that the foundations of academic discourse are laid. Research centers, embedded within the precincts of law schools, play a pivotal role in nurturing and cultivating this quest for knowledge. The Centre for Business and Commercial Laws, ably guided by Prof. (Dr.) Ghayur Alam, with its constant efforts in igniting a quest for research and enquiry, stands resolute in upholding this commitment.

In the last eight years, the summit has evolved into a distinguished platform, fostering intellectual discourse, and promoting scholarly endeavors in the ever-evolving realm of commercial laws and it has made the legal fraternity notice its commendable progress. It is a pleasure to witness the collaborative spirit embodied in our partnership with Trilegal as such collaborations are essential in bridging the gap between academia and the industry and in ensuring that meaningful contributions are made to the contemporary legal landscape.

The importance of analyzing corporate and commercial laws has never been more pronounced than the current times. The challenges posed by cross-border transactions, multinational corporations, and the harmonization of disparate legal systems underscore the need for scholarly engagement and dialogue. There is a need to delve into these challenges for seeking innovative solutions which are both contextually relevant and globally informed. This summit precisely serves this purpose by providing a critical forum to students, professionals, practitioners, and

policymakers for exploring and unraveling these intricate legal issues that arise in the wake of the current legal paradigm.

The 9th edition of this summit has adeptly addressed an expansive array of subjects characterized by their contemporary significance. Encompassing topics such as the integration of Artificial Intelligence within corporate boardrooms, copyright challenges precipitated by generative AI, amendments to the Listing Obligations and Disclosure Requirements (LODR) framework, and the elaborate analysis of the implications of the Digital Personal Data Protection Act, the articles comprehensively discuss the nuances surrounding these developments. Furthermore, the discussions extend to encompass significant research inquiries within the domain of antitrust law, Alternate Investment Funds, tax implications on online gaming, and lending guidelines pertinent to Non-Banking Financial Companies (NBFCs), among other salient subjects.

The Summit Book is a testament to the authors' commitment and dedication. Their investment of time and intellect is evident in the rigorous research and thoughtful analysis presented in these pages, making it a valuable resource for scholars, practitioners, and students alike. I must also extend my heartfelt appreciation to the team at CBCL, whose unwavering efforts and commitment have been instrumental in bringing this publication to fruition. Their dedication to the academic mission of the center, coupled with their meticulous attention to detail while managing stringent deadlines has been instrumental in taking this endeavor to new heights.

I would like to place on record my sincere appreciation for the efforts taken by the Editorial Board at the Centre for Business and Commercial Laws towards organizing this Summit and congratulate Trilegal, Eastern Book Company and SCC Online for extending their support in this endeavor. It is only through their combined efforts that the Summit has continued to be a resounding success over the years. I am confident that the Centre will continue to uphold the legacy of the Summit and thrive in the years to come.

PROF. (DR.) S. SURYA PRAKASH
Vice Chancellor, National Law Institute University, Bhopal

Preface

It is a matter of immense pleasure to write the preface to this collection of articles and essays on diverse themes in Corporate and Commercial Laws. We, at the National Law Institute University (NLIU) have, over the years, continuously endeavored to promote legal research on contemporary legal issues in the field of corporate, commercial, and business laws. In pursuance of this aim, the Centre for Business and Commercial Laws (CBCL), in collaboration with one of India's leading law firms, Trilegal, is proud to organise the 9th edition of the NLIU-Trilegal Summit on Corporate and Commercial Laws, 2024.

The previous editions of the Summit focused on key issues pertaining to, *inter alia*, mergers and acquisitions, securities, and insolvency and bankruptcy laws, and witnessed participation by students from various law universities across the country. This Summit, in continuation of its successful legacy, expands upon the development of all areas of corporate and commercial laws, particularly key developments in the field of AI and Data Protection. With a record number of submissions, this year, the Summit seeks to provide an accessible platform to law students across the country to discuss, debate and learn various dimensions of Corporate and Commercial Laws.

Building on the above narrative, this Summit book begins with the article *Absorbing Sustainability in Antitrust Frameworks: A Proposal for the Introduction of a 'Consumer Welfare' Model*. In this article, the author advocates for integrating sustainability into antitrust frameworks to address the global environmental crisis. Traditional economic models, like the consumer welfare standard, fall short in considering environmental impacts. The author proposes a threshold to prevent 'greenwashing' and argues for a multi-goal approach in antitrust, with sustainability

as a legitimate objective. Different standards of intervention, such as the modified total welfare and citizen welfare standards, are discussed, emphasizing the need for an economic membrane to channel sustainability considerations. International examples from Australia, New Zealand, and the Netherlands are examined, and the discussion extends to Indian competition law, suggesting the Competition Commission of India adopt standards like the modified total welfare or citizen welfare standards in specific cases. While concluding, the author stresses the urgency of including sustainability in antitrust enforcement for effective environmental protection.

In *Greening the Insolvency Regime: Sustainability as the Ideological and Substantive Backbone of the Insolvency and Bankruptcy Code, 2016* builds upon the suggestions made by the Insolvency and Bankruptcy Board of India concerning the incorporation of India's climate change agenda into the IBC. The paper delves into the viability of the proposal and explores similar endeavors undertaken in foreign jurisdictions to delineate the means to achieve the same. It concludes with three suggestions to bring the idea advanced by the IBBI to life. The paper aims to reconcile the ostensibly juxtaposed interests of the Indian corporations and the environment.

In the article *Dark Patterns and Antitrust: Can India Afford the Cost of Privacy?*, the author analyses the impact of India's Digital Personal Data Protection Act, 2023 that imposes a blanket ban on targeted advertising and behavioral monitoring for children, leaving advertisers to face the economic repercussions of this seemingly promising and crucial measure. The author conducts a comprehensive discussion of 'dark patterns', and its juxtaposition with antitrust laws. It then deliberates to provide a balance between addressing the data-driven economic interests of big tech giants and securing children's privacy. The author ultimately argues that the cost of children's privacy runs beyond economic considerations, observing its potential to jeopardize the mental and emotional well-being of an entire generation.

The article *Trade reform: A Comprehensive Look at the Settlement Period and the T+0 Implementation in India* seeks to scrutinize the

complicated world of settlement processes by navigating through its operational aspects, evolutionary journey, key stakeholders, prevailing constraints, and imminent transformations. The article undertakes an analysis of the process of settlement by specifically discussing SEBI's recent 'T+0 regime' and instant settlement mechanism. The author analyses the T+0 regime, discussing the benefits of the same and further concludes that the successful implementation of this recent settlement regime would enhance India's capital market by promoting greater involvement, openness, and economic expansion.

The article *The IBC's Real Estate Conundrum: Why it's not the Right Fit for Homebuyers' Woes* critically examines the inclusion of homebuyers as financial creditors under India's Insolvency and Bankruptcy Code, emphasizing conflicts with the Code's objectives. It questions the commercial wisdom of involving homebuyers in the Committee of Creditors, suggesting potential stagnation in decision-making. The author advocates prioritizing sector-specific remedies like RERA and CPA, proposing a nuanced approach to prevent clashes with the IBC. The piece underscores the need for synergy between bankruptcy law and consumer protection, suggesting amendments to protect homebuyer interests in case of liquidation. Ultimately, it calls for a reconsideration of the policy decision, urging a balance between insolvency law and sector-specific legislation for effective resolution.

Guilty Until Proven Innocent? – Analysing SEBI's Prohibition of Unexplained Suspicious Trading Activities seeks to analyse the draft SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023 and throws light on how their enforcement in their present form can be counterproductive. The article undertakes an analysis of presumption in Indian securities jurisprudence, and in securities law across jurisdictions to present how an alternative solution could have been taken up. Furthermore, the article explores the impact of the draft regulations on genuine traders due to the reverse burden of proof, vaguely used terminologies and low threshold for raising presumption. The authors make suggestions for amending the draft regulations by clearly stipulating the terminologies used, mandating the

establishment of foundational facts with evidence as a pre-requisite, considering motive as an element and using artificial intelligence and algorithm to improve the prediction of fraudulent activities.

The article titled *Harmonizing Expediency and Commercial Wisdom: Proposing AI Integration in the Insolvency and Bankruptcy Code to Enhance Efficiency and Preserve the Mandate of Expediency in the IBC Ecosystem* highlights a pertinent issue in the current insolvency regime that is, the frequent breach of the statutory period prescribed for the Corporate Insolvency Resolution Process. It first highlights the current legal scenario grappling with inordinate delays and then proposes a solution by suggesting the integration of Artificial Intelligence in the insolvency regime to aid the Resolution Professional in the CIRP. The author has analysed its practicality and feasibility with the help of case studies of the same in various jurisdictions such as the European Union, Australia, and Colombia. They have then recommended its application at the different stages of insolvency.

The article *Navigating the Turbulent Waters: Unravelling the Controversial Role of Taxation Authorities within the Insolvency and Bankruptcy Code's Waterfall Mechanism* aims to address the tussle between the Insolvency and Bankruptcy Code, 2016 and the tax authorities for their status in the waterfall mechanism while drawing parallels across jurisdictions globally. The author suggests the conflict between legislations can be resolved by legislative amendments proposed to explicitly clarify creditor prioritization, incorporate taxation authorities in Committees of Creditors, and establishment of a comprehensive framework for creditor hierarchy. The recommendations made emphasise the need to avoid potential disruptions and ensure the IBC's original objectives are upheld, particularly safeguarding the rights of financial creditors.

The article *Sailing Through SEBI's Symphony of The LODR (Second Amendment Regulations) 2023: How to Combat the Hidden Agreements Shaping India's Boardroom Overture?* navigates the intricacies of countering hostile takeovers and undisclosed agreements in corporate acquisitions. In addition to spotlighting key changes like Regulation 30A and

materiality thresholds under Regulation 30(4), the paper also traces evolution of LODR Regulations, contemporary corporate governance trends, and the imperative for regulatory adaptability in dynamic business environments. The research gains depth through analysis of recent cases, including the NDTV-Adani Hostile Takeover and the intricate Amazon-Future Group Dispute, revealing the nuanced complexities of undisclosed agreements and regulatory strategies.

Bridging the Murky Chasm: A Proffered Legal Blueprint to resolve the Copyright Quandary and Data Privacy Dilemma of Generative AI Training endeavors to address the legal challenges surrounding generative AI within Indian Jurisprudence, drawing parallels with jurisprudences in the UK, USA, Japan and the EU. The article delves into the potential copyrights and privacy rights infringement stemming from the use of large databases in training Generative AI models. Recognizing the startup ecosystem in the country, the author critically appraises the need of Generative AI while advocating for a judicious approach by recommending a revenue-sharing mechanism with rights-holder and a consent-based paradigm to mitigate the risk of infringement of rights and ensure ethical utilization of Generative AI.

The article *Taxing Times: Assessing the Burden of Recent Tax Amendments on Online Skill Gaming* warns an impending amendment could cripple online games like rummy and poker. By drawing a comparative analysis with successful models employing Gross Gaming Revenue taxes in the United Kingdom and France, the paper highlights the proposed amendment's shortcomings and potential pitfalls. In conclusion, the authors advocate for a comprehensive re-evaluation of the amendment, urging policymakers to prioritize a balanced and informed approach that ensures both regulatory compliance and the sustainability of the online skill gaming industry.

Sugarcane Farmers in Limbo: Analysing their Position as Bajaj Hindusthan Sugar's Operational Creditors aims at providing a legal context to the protests by the farmers supplying sugarcanes to the Bajaj Hindusthan Sugar Ltd. The paper begins with noting the need for clearing the dues of the farmers as they belong to the unorganised sector,

and they require payments to sustain themselves for the next season. The paper analyses the petition filed by the farmers under Section 7 of the Insolvency and Bankruptcy Code, 2016. It considers precedents on this matter to argue that farmers should be considered as operational creditors, bypassing the claims of other creditors.

Corporate Raiders or Do-Gooders? Analysis of Activist Investors in An Indian Context at its very outset throws light on hedge funds moving on to analyse the case of eBay. The article also delves into the rule of majority and the fault with it whilst bringing forth a detailed case study of the Adani Group. Through the means of the case study, the author identifies intervention points and lays down a detailed analysis of the astronomical growth of the Adani Group and the lapses identified in corporate governance owing to its practices. The author also brings forth ethical and environmental concerns that have recently come into the legal landscape. The author concludes by making recommendations for reforms in Alternate Investment Funds and Institutional Investors.

The article *Opening the Doors of Private Enforcement: Analyzing False Advertisement Claims from an Antitrust Lens* critically examines the intersection of false advertising claims and antitrust laws. The paper challenges the prevailing belief that false advertising has a minimal effect on competition. It presents arguments based on the potential adverse impacts on competitors and consumers. Using examples, such as the ‘market of lemons’ analogy, the paper proposes a framework for injured competitors to seek total compensation inclusive of lost profits caused due to false advertisements.

The article titled *Sailing the Ship of Liabilities: Redefining Limited Liabilities for NBFCs in India* explores the lacunae in the current regulatory mechanism deployed for the NBFCs and the limited liability partnership model usually followed for these entities, with a brief discussion of two major NBFCs crises that occurred in India. The author further pitches for changes in the current model of governance and recommends increasing liability on the senior management officials. Further, it compares the feasibility of civil and criminal liability. The author’s main goal throughout the manuscript is to strike a harmonious balance between

PREFACE

increasing liability to manage systemic risk and ensuring that investors remain interested in these firms. By minimizing the costs associated with monitoring multiple investors, this redesign aims to make the process more efficient.

It is our sincere hope that this book makes a significant contribution to the literature on business and commercial laws. Each author whose work has been chosen for publication deserves our most heartfelt gratitude and congratulations. We express our sincere gratitude to our Chancellor, Hon'ble Shri Justice Ravi Malimath, the Chief Justice of the High Court of Madhya Pradesh for encouraging, guiding, and supporting us in our academic pursuit. We express our thanks and gratitude to our Vice-Chancellor, Prof. (Dr.) S. Surya Prakash for his encouragement, guidance, and support. We would also like to express our immense gratitude to Trilegal, our equal partner in supporting this endeavour. We extend our sincere thanks to our publishing partner, the Eastern Book Company (EBC).

As Chairperson of CBCL, I would like to extend my appreciation to the General Body of CBCL that has put forth their most sincere efforts in the conduct of the Summit and the publication of the Summit Book. I convey my best wishes to the General Body of CBCL, led by Ms. Samavi Srivastava, Mr. Vachas Chaturvedi, Mr. Amitabh Abhijit, Ms. Anjali Catherine, and Ms. Mahak Saxena, who made this Summit a success and helped the University deliver this publication. The NLIU—Trilegal Summit on Corporate and Commercial Laws has become a legacy which ought to be upheld by generations to come with ever-growing enthusiasm and dedication.

PROF. (DR.) GHAYUR ALAM

Senior Professor and Dean, Undergraduate Studies
Chairperson, Centre for Business and Commercial Laws

Message from Trilegal's Desk

The corporate legal world as we know it, spanning across a multitude of practice areas, carries an inevitable dynamic nature. As the world chases technological advancements, innovation, and improvement, so do the regulations and laws that govern them, making it imperative for us as responsible members of the legal fraternity to expand and contribute to legal discourse. This is where the annual NLIU-Trilegal Summit comes in as an innovative exercise aimed at orienting our future lawyers to the constantly burgeoning landscape of corporate and commercial laws.

In recent years, the legal world is witnessing simultaneous developments in the form of the steady recovery from the economic impacts of the pandemic, increasing regulation, and interesting developments such as the involvement of Artificial Intelligence in law gaining unprecedented relevance. As lawyers of this generation, keeping up with constant commercial and economic growth of the legal landscape is far-fetched in the absence of a pursuit for knowledge on our end. Our roles extend far beyond merely providing legal advice. We are also expected to anticipate and protect against potential risks on behalf of stakeholders in all commercial enterprises. This makes it our imperative duty to maintain a learning curve, regardless of the years of experience we may carry with us. It comes from a fundamental understanding that in world of today, change is the only constant – making lawyers who predict such changes indispensable.

The Trilegal Summit is the culmination of nearly a decade long collaboration with NLIU with the aim to bolster the sense of academic exploration in students across law schools in India. We encourage students to take up research on topics within a large spectrum of practice areas including but not limited to Capital Markets, Insolvency and Bankruptcy

Laws, Technology, Media and Telecommunication, and Private Equity. Preparing the lawyers of tomorrow goes beyond training that comes from the four walls of a classroom. The format of the Trilegal Summit gives the participants the opportunity to test their research, writing and speaking skills, all of which are important for one to become a reliable and successful lawyer.

This Summit Book is the culmination of the hard work of the editors of the CBCL as well as the dedication with which authors across this country have put forth their best efforts to present before us legal analysis and novel solutions to the contemporary lacunae in the corporate field. It consists of the 15 finest articles chosen from a grand total of over 170+ submissions through a combined review process conducted by CBCL and Trilegal in accordance with the practise followed during previous editions of the Summit. These articles and essays cover a wide range of topics which are extremely relevant to issues faced by market practitioners today and will also be of great help in the coming days, with further evolution of deal structures. We congratulate all the participants in their sincere efforts and enthusiastic participation during the Summit.

Every new edition gives us renewed hope for the future of the Indian legal field and this 9th edition is no exception. Trilegal's long standing commitment to contributing towards the growth and development of the legal landscape in India has been matched by NLIU's focus on research and excellence. This perseverance has allowed this Summit to grow into one of the most competitive and rewarding events in the country, and an essential for every law student desirous of a career in the corporate laws.

On behalf of Trilegal, we are honoured to partner with an esteemed institution such as NLIU, Bhopal. We are grateful to the Hon'ble Vice Chancellor, faculty members and students of NLIU, the Hon'ble Chairperson and members of the CBCL, for their continued support towards the Summit and their hard work in ensuring yet another successful edition of the Summit.

YOGESH SINGH
Partner & Head
Corporate Practise, Trilegal

Message from the Centre for Business and Commercial Laws (CBCL)

The Centre for Business and Commercial Laws (CBCL) at NLIU was established in 2008 to promote research and analysis in the field of corporate and commercial laws. Since then, it has continued with its upward trajectory, constantly finding new means of expanding the contours of scholarly research in the field. In furtherance of its core ideals and objectives, it is an honour to present before you the 9th NLIU-Trilegal Summit Book- a curated collection of articles on the contemporary developments in corporate and commercial laws in India.

The Summit Book, showcased at the 9th NLIU-Trilegal Summit on Corporate and Commercial Laws, seeks to articulate the constantly evolving nature of corporate and commercial laws as they gracefully adapt to the ever-shifting landscape of domestic and global commercial transactions. Over the preceding years, the field has witnessed remarkable developments and transformative changes, profoundly shaping its practice. Through this publication, we aim to encapsulate the vibrancy inherent in commercial and corporate laws, shedding light on their continuous evolution in response to the dynamic contours of the business world.

The Summit book is the result of a meticulous three-tiered review process, conducted by the adept editorial teams of CBCL and Trilegal in collaboration, based on which fifteen outstanding submissions are selected for publication and presentation. These articles traverse a rich spectrum of themes, *inter alia*, exploring security laws, banking and finance regulations, laws governing mergers and acquisitions, and the intricate facets of competition law. We extend our heartfelt congratulations to the

authors, whose relentless efforts and dedication have taken shape in the form of the Summit Book.

We are honoured to carry forth the legacy of the previous leadership of the Centre, whose unwavering efforts have played a pivotal role in elevating the Summit to new heights with each successive edition. We express our deepest gratitude to Trilegal for their indispensable guidance and support, contributing significantly to the success of the Summit and the resulting publication. Their commitment to fostering an environment of analytical thinking and result-oriented research is inspiring. We are forever indebted to the Hon'ble Vice Chancellor Prof. (Dr.) S. Surya Prakash and our esteemed Chairperson Prof. (Dr.) Ghayur Alam for their unwavering support and guidance, always inspiring us to do better. A heartfelt expression of gratitude is reserved for our publishers, Eastern Book Company, for their unwavering support throughout the publication process. Their relentless dedication has been instrumental in the triumph of this Summit and the subsequent publication of this book.

Finally, we express our warmest gratitude to the dedicated general body of CBCL, whose persistent hard work ensures proficiency and expertise, ensuring the calibre of the articles selected. Their unwavering commitment to the flawless organization of the Summit is heart-warming, and more importantly, indispensable for the resounding success of this edition. With great pride, we present to you the compilation of articles from the 9th NLIU-Trilegal Summit on Corporate and Commercial Laws, 2024, eagerly anticipating insightful feedback from our esteemed readers.

SAMAVI SRIVASTAVA

Convenor
Centre for Business and Commercial Laws

VACHAS CHATURVEDI

Co-Convenor
Centre for Business and Commercial Laws

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Absorbing Sustainability in Antitrust Frameworks: A Proposal for the Introduction of a ‘Consumer Welfare’ Model

—Archita Satish and Ishika Garg*

ABSTRACT

The thrust of the paper is to propose how sustainability considerations can be incorporated as a goal of antitrust law, particularly in India, through the introduction of alternative models to the price-based “consumer welfare” standard. It lays out the basis for the inclusion of sustainability as a goal of antitrust by relying on a multi-goal perspective of this regime. In order to do so, it borrows from Ariel Ezrachi’s ‘Sponge and Membrane’ framework to conclude that sustainability as a goal can be ‘absorbed’ into antitrust law. The paper observes this absorption of sustainability in antitrust frameworks from across the world. Such analysis reveals that there is a lacuna in the underlying principle informing the threshold at which antitrust enforcement agencies can regulate agreements towards sustainability. This paper proposes an alternative to the traditional threshold of the “consumer welfare” model. Instead of focusing only on the direct impact on consumers of the product, it advocates for a model that takes an all-inclusive approach in including citizens as stakeholders since the environment is a community resource. This is as opposed to the “public interest” model which would allow any sustainable arrangement and possibly defeat the purpose of antitrust law. Such a threshold would filter out any attempts at ‘greenwashing’ which is the biggest concern in

* The authors are students at the National Academy of Legal Studies and Research, Hyderabad (NALSAR).

introducing sustainability into antitrust. The paper then analyses how Indian competition law can absorb sustainability as a goal and introduce this favourable threshold. For this purpose, reliance is placed on the preamble of the Competition Act 2002, the pro-environment thrust of the Constitution of India, India's international obligations and the structure of the Competition Commission of India.

I. INTRODUCTION

The world is facing an environmental crisis. The need for sustainability, defined as economic development that meets present needs without compromising on future generation's ability to meet their own,¹ has been felt now more than ever. While governments have responded to the crisis through national level environmental laws and regulations as well as have collaborated internationally to deal with the task, the initiatives of non-state actors are equally relevant to this fight. Classical economics has failed to account for environmental impact through a price-based model, resulting in what Pigou termed a negative externality.² Further, game theory has shown that in a market where maximising profits is the short-term goal of rational producers, any firm which goes out of its way to incur expenses for the sake of the environment would be deterred by a "first mover disadvantage" and effectively wiped out of the market unless supported by consumers through demand, or by the government through out of market measures.³

Antitrust law today is the regime that regulates how private entities operate within a market.⁴ Traditionally, antitrust enforcement agencies have applied the standard of "consumer welfare" as shorthand for justified interference within the market. Thus, cartels are prohibited, abuse of dominance checked, and mergers authorised on whether consumer welfare would triumph. However, whether such a standard can equally justify agencies intervening for sustainability is a matter of debate. In other

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1. United Nations, Report of the World Commission on Environment and Development: Our Common Future A/42/427 (1987).
 2. Arthur Cecil Pigou, *The Economics of Welfare* (4th ed., Macmillan, 1932).
 3. Johannes Paha, 'Sustainability Agreements and First Mover Disadvantages', (2023) 19(3) *Journal of Competition Law & Economics* 357.
 4. OECD, Sustainability and Competition, OECD Competition Committee Discussion Paper (2020) 7 <<http://www.oecd.org/daf/competition/sustainability-and-competition-2020.pdf>> accessed on 1 December 2023.

words, whether an agency can intervene to check market players colluding to prevent sustainable options from coming to market,⁵ or allow the adoption of voluntary standards to commit to lowering emission standards is unclear. This leads to a preliminary enquiry of whether sustainability as such can be a goal of antitrust law. On a secondary level, is how, if included, it can be actualised.

A major concern that arises from incorporating sustainability as a goal of antitrust is ‘greenwashing’. Greenwashing is the phenomenon of companies giving a false impression of the environmental impact or benefits of their products or conduct.⁶ This issue of greenwashing in antitrust would arise only if a blanket exemption is granted on the grounds of achieving sustainability. For instance, the Dutch Competition Law Authority granted an exemption to an agreement between soft drink suppliers to remove the extra plastic handle on the packaging of their products. However, it has been contested whether this initiative positively impacts the environment considering that the packaging largely continues to consist of plastic.⁷ In this light, this paper attempts to formulate a threshold to create a membrane to allow genuine sustainability to enter the antitrust regime.

By tracing the evolution of schools of economic thought that have informed antitrust enforcement this paper argues the first level question by using a multiple goals approach and answers that sustainability should be one of the goals of antitrust law. However, instead of adding sustainability as another goal of antitrust, this paper mediates its introduction through an “economic membrane” model, as proposed by Ariel Ezrachi and instead looks at different standards based on which antitrust agencies can intervene in the market. Such analysis helps answer the secondary level question of which standard of intervention would enable sustainability to be taken into consideration by competition authorities.

5. Case AT. 40178 Car Emissions (2021).

6. Pauline Kuipers, Tialda Beestra and Joost van Roosmalen, ‘A risk of “greenwashing” by competition authorities’ (Kluwer Competition Law Blog, 13 September 2022) <<https://competitionlawblog.kluwercompetitionlaw.com/2022/09/13/a-risk-of-greenwashing-by-competition-authorities/>> accessed on 4 January 2024.

7. *ibid*; Authorities for Consumers and Markets, ‘ACM is favorable to joint agreement between soft-drink suppliers about discontinuation of plastic handles’ (ACM) <<https://www.acm.nl/en/publications/acm-favorable-joint-agreement-between-soft-drink-suppliers-about-discontinuation-plastic-handles?n>> accessed on 4 January 2024.

While Part I of the paper presents an overview of how sustainability and antitrust interact, Part II covers the evolution of schools of thought and makes the case for the inclusion of sustainability. By exploring how different schools propose different standards for intervention and analysing how these have been adopted to factor in sustainability by different jurisdictions in Part III, the paper in Part IV finally argues what standards India can adopt to join the global cohort of antitrust enforcement bodies that are joining the fight for sustainable development.

A. Understanding Sustainability

This section briefly outlines how this paper understands the sustainability question as well as presents a brief overview of its interaction with antitrust laws. Far from being an abstract notion of environmental protection, sustainable development is rooted in economic growth and its reimagination. The climate and environmental crisis have made resources that much scarcer, requiring that we be more careful in meeting present needs to ensure enough for the future. Therefore, at its core sustainability is an argument for new ways to produce and consume such that the scarce resources that help fulfil human wants can continue to be met.

The introduction referred to the first ever definition of sustainable development (used alternatively with sustainability in this paper). While this definition is broad enough to incorporate concerns for human rights, governance, and other social goals, otherwise broadly termed ESG today,⁸ the present paper restricts the understanding of sustainability to its environmental context, in line with how antitrust agencies have defined sustainability. For instance, the Dutch agency, *Autoreit Consumer & Markt (ACM)*, has considered factors related to climate change, biodiversity, and interaction with the environment.⁹

8. Mark S Bergman et al, 'Introduction to ESG', (Harvard Law School Forum on Corporate Governance, 1 August 2020), <<https://corpgov.law.harvard.edu/2020/08/01/introduction-to-esg/>> accessed 2 December 2023.

9. Dutch ACM, 'Guidelines Sustainability agreements Opportunities within competition law' [7] <<https://www.acm.nl/sites/default/files/documents/second-draft-version-guidelines-on-sustainability-agreements-oppurtunities-within-competition-law.pdf>> accessed 2 December 2023.

A. Sustainability and Antitrust: Walking a Tightrope?

The extent of environmental degradation seen today is arguably the result of a market failure that has failed to factor in its cost.¹⁰ Why then do we turn to markets again? The answer lies in both the forces of competition and cooperation which could bring out private solutions to the issue. From a competition perspective, competitive markets foster efficiency and innovation, which could produce more sustainable solutions to human wants.¹¹ Furthermore, consumers have been shown to prefer a more sustainable product over a normal alternative available at the same price.¹² This indicates that sustainability could be seen as a quality desired by consumers, and relevant for a consumer welfare approach.¹³ From the angle of cooperation, antitrust presents more of an obstacle since prohibitions on cartels, agreements and information sharing often prevent the adoption of agreements aimed at sustainable objectives.¹⁴ The Nobel winning research of Elinor Ostrom has shown how collaborative efforts to protect common resources like the environment can be successful, if given sufficient legal legroom, overcoming the “tragedy of the commons” and first mover disadvantage in taking eco-friendly action.¹⁵ Therefore, the argument is to modify antitrust laws to create a defence for sustainable collaboration.

Schinkel et al have argued that a competitive market should be preferred over collaborative horizontal agreements since it produces better sustainable outputs. By drawing a comparison between production agreements, sustainability agreements and a competitive market, their economic models show that intrinsically motivated green investments in a competitive market have much more environmental and profit benefits

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10. Nicholas Stern, *Climate Change, Ethics and the Economics of the Global Deal* (Economist’s View, 29 November 2007) <<https://economistsview.typepad.com/economistsview/2007/11/nicholas-stern.html>> accessed 2 December 2024.
 11. OECD, *Sustainability and Competition – Note by Australia and New Zealand* (2020) 3 <[https://one.oecd.org/document/DAF/COMP/WD\(2020\)62/en/pdf](https://one.oecd.org/document/DAF/COMP/WD(2020)62/en/pdf)> accessed 4 December 2023.
 12. M. Kitzmueller and J. Shimshack ‘Economic perspectives on corporate social responsibility’ (2012) 50(1) *Journal of Economic Literature* 51.
 13. OECD (n 4).
 14. Denise Hearn et al (Columbia Center on Sustainable Investment) ‘Antitrust and Sustainability: A Landscape of Analysis’ (2023) <<https://ccsi.columbia.edu/content/antitrust-and-sustainability-landscape-analysis>> accessed 5 December 2023.
 15. Justus Enninga, ‘Environmentalism, a flirt with eco-authoritarianism and the robustness of ordoliberalism’ *Const Polit Econ* (2023).

than coordinated ones where the output may be capped.¹⁶ This view essentially stems from an anxiety about greenwashing, where a facade of environmentalism is used to dilute the primary goal of competition enforcement. Yet, as argued by Maurits Dolmans, while this may be true in markets where consumers are aware of and willing to pay for the benefit of sustainable choices, in the absence of the same, a cycle of lack of consumer demand and first-mover disadvantage would leave sustainability in the rut of market failure.¹⁷ Therefore, this paper proceeds with a view that allows for sustainability to be considered within both prongs of antitrust, through competition enforcement and relaxations for private collaborations. Having explained the model of sustainability and its interaction with antitrust adopted by this paper, Part II explores the normative arguments for the inclusion of sustainability as a goal of antitrust law.

II. GOALS AND STANDARDS OF ANTITRUST LAW

B. Tracing History and Schools of Thought

Antitrust laws across the world have developed on the premise of consumer welfare and market efficiency. The regimes have been influenced by the various economic schools of thought regarding the basis and objectives of antitrust laws. One of them is the Harvard School founded on market structuralism, as was the first objective of the Sherman Act, enacted in response to the rise of trusts formed between entities after the Civil War.¹⁸ It argued that few large firms are more powerful to indulge in anti-competitive practices than multiple small firms. Thus, it developed a per se rule where certain conducts are presumed to be unreasonable and categorised as anti-competitive on the face of it without further inquiries. Such conduct includes price fixing, group boycotts, and tying

16. Martin Schinkel, Yossi Spiegel & Leonard Treuren, 'Production agreements, sustainability investments, and consumer welfare' 216 *Economics Letters* (2022).

17. Maurits Dolmans, 'Sustainability agreements and antitrust – three criteria to distinguish beneficial cooperation from greenwashing' (Chillin' Competition, 9 September 2021) <<https://chillingcompetition.com/2021/09/09/sustainability-agreements-and-antitrust-three-criteria-to-distinguish-beneficial-cooperation-from-greenwashing-by-maurits-dolmans/>> accessed 7 December 2023.

18. Wayne D. Collins, 'Trusts and the Origins of Antitrust legislation' (2013) 81 *Fordham L. R.* 2279.

arrangements because they adversely affect efficiency and thereafter consumer welfare.

The Chicago School of thought, dominated by scholars like Robert Bork and Richard Posner who entrench the objective of antitrust laws in consumer welfare, rejected the Harvard School. They premise the necessity of protection of consumer welfare in price theory and profit maximisation by entities.¹⁹ The limitation of this theory lies in the characterization of consumer welfare as purely economic welfare in terms of allocative and productive efficiency and pushes against government intervention in the market. It is the wide adoption of the Chicago School of thought by the US courts that led to the evolution of the rule of reason, the counter to the *per se* rule, which analyses the impact of challenged conduct on other factors mentioned above by undertaking a cost-benefit analysis.²⁰

Taking an opposite stance, the Freiburg School of thought, famously ‘ordoliberalism’, argued that the government should intervene in the market to the extent of setting its framework or the “rules of the game” to disallow contracts from empowering private parties to adversely affect the stakeholders of a competitive economy. This approach developed from a need to regulate looming private power, as was seen during the Nazi regime, thereby protecting the individual equally from the tyranny of private oppression and democracy.²¹ They were also aware of the necessity for constitutionally embedded restraint on this government power from becoming ‘excess’ and overarching in the quest to counter private power.²² From this brief history arises the expansive basket of goals that new-age scholars claim antitrust laws are meant to achieve. These include freedom of choice, reasonable prices, opportunity to freely undertake business, mitigating coercion, qualitative standards, innovation, socio-political goals of democracy, privacy, data ownership, and so on.

19. Gioliano Amato, *Antitrust and the Bounds of Power: The dilemma of liberal democracy in the history of the market*, (Oxford, 1997), pp. 20-23.

20. *Continental T.V., Inc. v GTE Sylvania Inc.* [1977] 433 U.S. 36.

21. Gioliano Amato (n 19), pp. 39-43.

22. *Ibid* 41.

A. A Multi-Goal Approach to Antitrust

Various schools have brought forward several goals of antitrust as the flagship objectives. However, there is immense literature critiquing the same and expanding the goals antitrust actually set out to achieve since the beginning. Efficiency as a goal is said to be beneficial if it is dynamic, wherein the firm experiences economic as well as systemic advancement through innovation.²³ Distribution of resources is as important as their allocation because the former attempts to resolve problems of inequality and poverty which are said to be the initial legislative goals behind antitrust laws in the form of safeguarding public interest.²⁴ While it makes economic efficiency analysis clear,²⁵ the Borkian claim of consumer welfare being the core of antitrust has been challenged as based on false history, false market, and false conduct, not benefitting any stakeholders, besides producers, in the long run.²⁶ The critics argue that ‘the freedom of economic opportunity’ and ‘prevention of concentration of power’ should be considered the main theme in the legislative history of antitrust laws.²⁷ The legislative intent was not just consumer-facing but producer-facing such that it wished to ensure fair competition by protecting small producers from larger private powers.²⁸ This essentially leads us to the political dimension of antitrust laws which has been dismissed by the Chicago School.

The choice of a school of thought is inherently a political choice with respect to market structure, distribution of resources and wealth through antitrust mechanisms.²⁹ Political context adds another nuance to the eco-

23. Gundlach and Moss, ‘The Role of Efficiencies in Antitrust Law: Introduction and Overview’ (2015) 60(2) *The Antitrust Bulletin* 91.

24. Dina I. Waked, ‘Antitrust as Public Interest Law: Redistribution, Equity, and Social Justice’ (2020) 65(1) *The Antitrust Bulletin* 87.

25. Joe Kennedy, ‘Why the Consumer Welfare Standard Should Remain the Bedrock of Antitrust Policy’ (Innovation Technology & Innovation Foundation, October 2018) <<https://docs.house.gov/meetings/JU/JU05/20181212/108774/HHRG-115-JU05-20181212-SD004.pdf>> accessed 7 December 2023.

26. Sandeep Vaheesan, ‘The Profound Nonsense of Consumer Welfare Antitrust’ (2019) 64(4) *The Antitrust Bulletin* 1.

27. Eleanor M. Fox, ‘Modernization of Antitrust: A New Equilibrium’ (1981) 66 *Cornell L. R.* 1140, 1149, 1153.

28. Christopher Grandy, ‘Original Intent and the Sherman Antitrust Act: A Re-examination of the Consumer-Welfare Hypothesis’ (1993) 53(2) *The Journal of Economic History* 359.

29. Ariel Katz, ‘The Chicago School and the Forgotten Political Dimension of Antitrust Law’ (2020) 87(2) *The University of Chicago Law Review* 413.

conomic analysis of efficiency and consumer welfare by increasing transparency, providing certainty and legitimacy to antitrust laws. Further, economic analysis alone does not inform us of the political powers that private corporations can gain and exercise in the market and in democracy, thus impacting the freedom of not only other producers but also the bureaucrats in charting the course of the market and its regulation.

From this derives the argument of protection of competition itself. Here, the consumer welfare and efficiency goals would become the means to the end of protecting the competition as a process.³⁰ Rejecting the utilitarian approach for a deontological one, a democracy protects competition in the political, cultural and economic dimensions, thereby yielding holistic results.³¹ Basically, antitrust laws have multiple goals to fulfil - political as well as economic- because the markets want efficiency, the government wants consumer welfare and the society wants growth. There is no doubt that multiple goals can be messy. However, economics cannot be a purely technical science, it has to mingle with political and social aspects of competition.³² This also necessarily means that each jurisdiction's own politics and socio-economic context can influence the goals of its antitrust laws.³³

This discussion implies that sustainability can equally be a goal of antitrust law. It is an extension of the argument for equity, by balancing the needs of the present for resources with that of the future. Furthermore, by taking into account non-market players such as non-consuming classes, animals, and the broader environment, it accounts for broader stakeholder welfare than the traditional approach to antitrust. Lastly, considering that the climate crisis presents an existential risk to society at large, there is a strong argument for its consideration. Although the extent to which it may be seen as a threat has clear political implications,³⁴ from

30. Tim Wu, 'After Consumer Welfare, Now What? The "Protection of Competition" Standard In Practice' (2018) Competition Policy International; Columbia Public Law Research Paper No. 14-608.

31. Oles Andriychuk, 'Rediscovering the Spirit of Competition: On the Normative Value of the Competitive Process' (2010) 6(3) European Competition Journal 575.

32. Foer and Durst, 'The Multiple Goals of Antitrust' (2018) 63(4) The Antitrust Bulletin 494.

33. OECD, Sustainability and Competition, OECD Competition Committee Discussion Paper 15 (2020) <<http://www.oecd.org/daf/competition/sustainability-and-competition-2020.pdf>> accessed 10 December 2023.

34. See Denise Hearn et al (n 12), pp. 36-38.

the above discussion it is clear that antitrust can never be set apart from politics.

III. STANDARDS OF ANTITRUST INTERVENTION

C. Containing the Sponge: A Case for Standards

In Part II, we made the normative argument for the inclusion of sustainability as a goal of antitrust. Ariel Ezrachi describes the ability of antitrust laws to absorb a wide range of goals as characteristic of a sponge.³⁵ While this is a useful analogy, such an open-ended multi-goal approach faces several disadvantages. Firstly, it makes the certainty of the law difficult, with abstract notions of goals being invoked in adjudication.³⁶ Secondly, such a balancing act leaves the predictability of antitrust law at stake, since any one value could be considered more pressing at different points of time.³⁷ Both of these effects lead to the third and final blow to this approach, in that it affects the legitimacy of antitrust law with it seeming to be governed by the political choice of enforcement agencies at their whim.³⁸ This is in fact the danger that Chicago scholars seem to hark against in avoiding the inclusion of “political” goals into antitrust law. Therefore, a technically feasible solution must be proposed for the effective inclusion of sustainability into the antitrust framework.

Ezrachi proposes that a “sponge” of antitrust be contained by an “economic membrane”, rooting a goal of antitrust within an economic frame of analysis.³⁹ Thus, for instance, sustainability would not be equated to broad environmentalism or ecocentrism but rather channelled through an economic understanding. Here, we posit standards of intervention as the relevant criterion. Standards of intervention are exactly such an economic membrane because firstly, they focus on the criterion that triggers the applications of antitrust laws and, secondly, they specify to what extent a cost-benefit analysis must be conducted amongst competing values. Moreover, as argued by Inderst and Thomas, such an approach

35. Ariel Ezrachi (n 27).

36. *Ibid.*

37. *Ibid.*

38. *Ibid*; Roman Inderst & Stefan Thomas, ‘Legal Design in Sustainable Antitrust’ (SSRN, 2022) 3 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4058367> accessed 10 December 2023.

39. Ariel Ezrachi (n 27), pp. 15-20.

avoids the possible consequence of a multi-goal approach in that it can never allow sustainability, in its naked form, to supersede competition enforcement and other values. Significantly, this approach avoids choosing between various goals from the perspective of the agency and instead places the consumer at the heart of the analysis, as will be seen in the following section.⁴⁰

A. Comparing the Standards of Intervention

In this section, we will examine the prevalent standards of intervention as well as look at examples of how foreign jurisdictions have used them to include sustainability. This section largely borrows from the glossary of standards laid out by the OECD in its report on the consumer welfare standard.⁴¹ The first is the “consumer welfare standard” which seeks to maximise the benefit available to the end user of goods and services as a priority. Thus, efficient consumer solutions that increase output and reduce prices are the only concern of this standard. Since sustainability often increases the price of products, at least in the short run, this prevalent standard has failed to account for it. This can be contrasted with the “protection of competition standard”, where competition as a process is deemed an end in itself. Thus, efforts which favour more competition will be preferred over ones that do not, implying that sustainable collaborations, as described in Part I would be hit under this standard. The consumer welfare standard must also not be confused with the “total welfare standard”, which forms the basis of the Borkian school. This standard allows any private conduct so long as the overall welfare of producers and consumers is maximised or at least maintained. While arguably, a total welfare standard must take into account “total stakeholders”, it fails to account for non-market players and their interests, hence again failing to look at sustainability. This is where new standards have been developed to accommodate the same. The “modified total welfare standard” takes

40. Roman Inderst & Stefan Thomas, ‘Reflective Willingness to Pay: Preference for Sustainable Consumption in Consumer Welfare Analysis’ (2021) LawFin Working paper No. 14, Centre for Advanced Studies on the Foundations of Law and Finance 24.

41. OECD, The Consumer Welfare Standard - Advantages and Disadvantages Compared to Alternative Standards, OECD Competition Policy Roundtable Background Note (2023) 7-18 <www.oecd.org/daf/competition/consumer-welfare-standard-advantages-and-disadvantages-to-alternative-standards-2023.pdf> accessed 12 December 2023.

into consideration a wider range of stakeholders and considers the distributional impact of the benefits accrued or harm caused by private action.

For instance, The Australian Competition and Consumer Commission (ACCC) and the New Zealand Commerce Commission (NZCC) follow a broad “public benefit” test grounded in a modified total welfare standard. Their jurisprudence defines public benefit as “anything of value to the community generally, any contribution to the aims pursued by the society...including the achievement of economic goals of efficiency and progress”. The NZCC allows mergers under the Commerce Act 1986 on this basis where it is satisfied that the public benefits would outweigh the detriment to competition. This assessment is undertaken within the framework laid down in the New Zealand Treasury’s Cost/Benefit Analysis Guidelines.⁴² It also accounts for increased compliance with existing environmental protection laws and actual impact while granting authorization.⁴³ Similarly, the ACCC has issued draft guidelines for making trustworthy environmental claims consisting of requirements of empirical evidence, full disclosure, narrowing down targets and making achievable claims, transparency, et cetera.⁴⁴ This model also allows the ACCC to revoke the authorization upon evidence of misrepresentation or material change in circumstances, thus ensuring flexibility.⁴⁵

A connected model is the “citizen welfare standard”. This approach weighs the impact of antitrust outcomes on all citizens as a whole. This can be seen as even wider than the modified approach, because it also considers civil political goals of a citizen, apart from social-welfare ones. It essentially means that if the environmental benefits, on a citizen level, arising out of per se anti-competitive conduct outweigh the detriment to competition, then such conduct would not be prohibited even though the consumers of that product market might be facing adverse consequences

42. New Zealand Government, ‘Cost Benefit Analysis including Public Sector Discount Rates’ (The Treasury, 27 July 2015) <<https://www.treasury.govt.nz/information-and-services/state-sector-leadership/investment-management/plan-investment-choices/cost-benefit-analysis-including-public-sector-discount-rates>> accessed 10 December 2023.

43. Refrigerant License Trust Board (Commerce Commission Decision 735, 25 November 2011).

44. Australian Competition and Consumer Commission, ‘Draft guidance for business, Environmental and sustainability claims’ (ACCC, July 2023) <https://www.accc.gov.au/system/files/Environmental%20and%20sustainability%20claims%20-%20draft%20guidance%20for%20business_web.pdf> accessed on 9 December 2023.

45. OECD (n 11).

of higher prices, et cetera. This can be rationalised by the fact that sustainability efforts take time to fructify, and consumers today are paying to ensure a greener tomorrow. The Netherlands Authority for Consumers and Markets (ACM) has adopted this standard through the acknowledgment of other legislations juxtaposed with the Dutch Competition Act such that its application does not render ineffective the application of other laws (such as the Environmental Management Act).⁴⁶ Therefore, agreements allowed under its new draft guidelines incentivize firms to make positive contributions to sustainability, those which are based on non-discriminatory codes of conduct like standards and certifications, or deals to fund the acquisition of sustainable means of production.⁴⁷

The two standards - the citizen welfare standard and the modified total welfare standard - can be argued to be theoretically different in the sense that they have varying scopes. The citizen welfare standard is concerned with the broader values of sustainability whose benefits could accrue to anybody based on which anti-competitive conduct might be allowed. It is a low threshold for entities to meet and thus prone to misuse. The modified total welfare standard is rightly more conservative in its approach insofar as it counts the accrual of benefits or harm to stakeholders in that particular instance as evidence for sustainability instead of the lower threshold of benefits to anybody. In reality, however, the enforcement of these two standards might be the same given that in the citizen welfare standard, the Dutch ACM requires evidence of accrual of fair share of benefits to the consumers as well.

Last but not the least is the idea of ‘public interest considerations’. Admittedly, this is not a standard, but rather commonly found in the language of statutes or other national legal documents to allow for goals like sustainability to be considered. This paper contends that far from being a standard, public interest is as vague as the multi-goal approach and therefore, must be abandoned for the same reasons unless it specifically lays down what these interests are. The Anti-Monopoly Law of

46. OECD, Horizontal Agreements in the Environmental Context (2010) <<https://www.oecd.org/competition/cartels/49139867.pdf>> accessed 9 December 2023.

47. Dutch ACM, ‘Guidelines Sustainability agreements Opportunities within competition law’ (Dutch ACM, 2021) <<https://www.acm.nl/sites/default/files/documents/second-draft-version-guidelines-on-sustainability-agreements-opportunities-within-competition-law.pdf>> accessed 12 December 2023.

China, for instance, accounts for broader public interest in Article 15 by providing a specific exemption to anti-competitive conduct if they can be proved to be “serving public interests in energy conservation, environmental protection and disaster relief.”⁴⁸ Likewise, the Russian law grants state preferences to certain anti-competitive conduct or agreements if they are undertaken for ‘environmental protection’.⁴⁹

This paper therefore advocates that the modified total welfare standard and the citizen welfare standard provide viable alternatives through which sustainability can become an anvil for antitrust enforcement. Some countries like New Zealand for instance have adopted a mixed regime of standards where, save for the route of authorisation where a modified total welfare standard would be applicable, the consumer welfare approach remains the norm. It can also be inferred from the above discussion that sustainability as a factor of the antitrust regime can be rooted either directly in the law or through the interpretation of vague and ambiguous phrases in the antitrust laws to include sustainability goals in their ambit. Part IV will now analyse how Indian competition law can consider sustainability.

IV. ABSORBING SUSTAINABILITY INTO INDIAN COMPETITION LAW

Competition Law in India is currently governed by the Competition Act 2002 (*Act*). The Act in its current form does not allow for any explicit or implicit environmental considerations. The preamble of the enactment might suggest a standard consumer welfare approach, considering that it provides for the creation of a Commission “to protect the interests of consumers”. However, this is one among other objectives spelled out, including promoting and sustaining competition in the markets and ensuring the freedom of trade to other market participants. From this, it can be argued that the Act espouses at least a multi-goal orientation to competition law. Further, Indian courts have taken a broad interpretation of consumer interest to mean well-being.⁵⁰

48. Anti-monopoly Law of the People’s Republic of China 2007, art 15.

49. Federal Law No.135-FZ of July 16th, 2006 ‘On Protection of Competition’, art 19.

50. Excel Crop Care Ltd. v Competition Commission of India, AIR 2017 SC 2734.

Notably, the structure of the Competition Commission of India (CCI) under Section 8 requires its members to be persons of special knowledge in various fields including finance, international trade, industry, and most importantly ‘competition law and policy’ that the Central government might consider useful. Thus, it can be argued that the structure of CCI allows it to consider multiple arenas affecting markets and competition policy and invite expertise for the same, which leaves room for sustainability as a factor to be incorporated into it. On a national principled level, the Constitution of India espouses the importance of environmental protection in the fundamental duties and Directive Principles of State Policy under Articles 51A and 48A. Here, it is not only the duty of the citizens to safeguard the environment and natural resources but also the responsibility of the State to “protect and improve the environment”. The right to a healthy, pollution-free environment has also been located in the right to life under Article 21.⁵¹

Section 54 of the Act also provides another window through which sustainability can be addressed. Clause (b) gives the Central Government the power to exempt “any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries”. India is a signatory to multiple international instruments whereunder she has pledged to achieve certain sustainability goals. Among others,⁵² the first and foremost is the United Nations Conference on the Human Environment (*Stockholm Convention of 1972*) which India was a part of. This resulted in the Stockholm Declaration laying down principles for cooperation across the world to link economic growth, environmental pollution, and the well-being of people around the world and mitigate any more adverse impacts. The United Nations Framework Convention on Climate Change

51. Press Information Bureau, Government of India, ‘Environment Protection under Constitutional Framework of India’ (Press Information Bureau, June 2014) <<https://pib.gov.in/newsite/printrelease.aspx?relid=105411>> accessed 12 December 2023.

52. The Convention on Biological Diversity of 5 June 1992 (adopted 29 January 2000, entered into force 11 September 2003) 1760 UNTS 69; Cartagena Protocol on Biosafety (adopted 29 January 2000, entered into force 11 September 2003) UNTS 208, 39 ILM 1027, Nagoya Protocol on Access and Benefit Sharing (adopted 29 October 2010, entered into force 12 October 2014) 3008 UNTS 3; Ramsar Convention on Wetlands (adopted 2 February 1971, entered into force 21 December 1975) 996 UNTS 245; Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal (adopted 21 March 1989, entered into force 5 May 1992) 1673 UNTS 57.

(UNFCCC) has been ratified by India and aims to stabilise the concentration levels of Greenhouse Gases (GHGs) to reduce climate change impacts. The Montreal Protocol on Substances that Deplete the Ozone Layer was signed by India in 1992 wherein it promised to reduce the emission of ozone-depleting substances. India is also part of the Kyoto Protocol and the Paris Agreement which are target-based agreements to reduce the emission of GHGs and limit the global temperature increase to control climate change. Since these sustainability goals form a part of India's obligations, the CCI must account for such considerations in assessing anti-competitive conduct.

Now that it is apparent that sustainability ought to be considered by the CCI, we move to how this must be done, using the approach of standards from Part III. Arguably, the current Competition Act finds itself somewhere between the Chicago consumer welfare standard and the Harvard Protection of Competition standard.⁵³ Reliance on the latter can especially be seen to factor in non-price considerations, as was observed with the Google Android cases.⁵⁴ Emphatically, it is argued that this standard approach should be chosen as opposed to bringing in sustainability through Section 54(a) as has been argued elsewhere.⁵⁵ The sub-section authorises the Central Government to exempt certain categories of enterprises from antitrust scrutiny in the "public interest." However, as argued earlier, a broad public interest exemption falls foul of eroding competition itself in the process of assimilating more goals. As such, the adoption of a modified total welfare or a citizen welfare standard would be a logical shift. Whether India should adopt such a standard as a complete replacement of the current model, or as a mixed regime where this would only apply to cases where questions of sustainability are at issue, is beyond the scope of this paper. That being said, considering these alternative standards can also help tackle concerns of privacy and other goals

53. See Chintan Bharadwaj & Sakshi Agarwal, 'Goals of Competition law in India' (SSRN, 2021) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3789536> accessed 13 December 2023.

54. Mr. Umar Javeed and Others v Google LLC and Another, CCI 39/2018.

55. Ismail Siddiqui, 'Competition Policy and Sustainability: A Difficult Path to Tread?' (SSRN, 2022), <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4056805> accessed 13 December 2023; Pallavi Mishra, 'Locating the Contours of Sustainability and Environmental Protection within Competition Law in India: Swinging in Tandem or Isolation?' (SSRN, 2023) 14-15 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4461327> accessed 13 December 2023.

that are increasingly knocking at the doors of the CCI, a holistic adoption would not be misplaced.

V. CONCLUDING REMARKS

A historical analysis of antitrust laws shows us that a multi-goal approach to antitrust can be taken, thus allowing for the inclusion of sustainability, a goal which is crucial to the 21st century economy. At the same time, to prevent the dilution of competition in the process of including sustainability, this paper uses the economic membrane model to advocate for the adoption of standards of intervention by antitrust enforcement agencies as opposed to a broad “public interest” inclusion. By looking at the standards used by foreign jurisdictions, the paper argues for the adoption of a modified total welfare or a citizen welfare standard, in addition or as an alternative to the price-based consumer welfare model that prevails. It extends this argument to the Indian context, by showing how in light of the objects of the enactment, constitutional considerations and international obligations, the Competition Commission of India must consider sustainability and do so by adopting a comprehensive standard.

With limited time to act for environmental protection, no stone can be left unturned. Therefore, through an economic membrane, antitrust laws must factor in sustainability to ensure that non-state actors are also enabled to meet this existential challenge.

Greening The Insolvency Regime: Sustainability as The Ideological and Substantive Backbone of The Insolvency and Bankruptcy Code, 2016

—Aditya H. and Ishwaryah Manikandan*

ABSTRACT

Much discussion surrounding the viability, logic, and success of the Insolvency Bankruptcy Code (the Code) has taken place since its relatively recent passing in 2016. As a consolidated piece of legislation with the burden of balancing the interests of corporations, creditors, and the larger ecosystem in which the former two operate, it has inevitably gathered a cloud of expectations with respect to its success. Recently, the rule-making body, the Insolvency and Bankruptcy Board of India (IBBI) floated an interesting suggestion of including the larger climate change agenda in the manifestation of the Code. Climate change is undeniably a pressing global concern that the Indian government has promised to combat at several international fora such as the recent COP28 that ripened consensus over a fossil fuel phase-out. However, notwithstanding other means of doing so, the authors of this paper find much value in IBBI's suggestion. Through the course of this paper, the authors wish to further build upon this thought and suggest a comprehensive framework to integrate climate change mitigating measures into the Code. In doing so, the appropriateness of insolvency legislation as an arena for the implementation of climate change mitigating norms, alongside an appraisal of similar endeavours abroad is explored. A three-pronged reform of the current insolvency regime is suggested to undertake the exercise of 'greening' the insolvency regime. In essence, the paper hopes to contextualize this novel

* The authors are students at the Hidayatullah National Law University, Raipur (HNLU).

suggestion as a mere offshoot of the idea of sustainability that lies at the fulcrum of the legislative intent behind the passing of the Code.

I. INTRODUCTION

“The Insolvency and Bankruptcy Code is about resolution, not recovery.”

For several years after the passing of the Insolvency and Bankruptcy Code of 2016 (the Code), the above line remains so intrinsically linked with the Code that it has appeared in every conversation,¹ judgment,² and opinion editorial aimed at an appraisal of the legislation.³ The fact that the Code is resolution-oriented is telling of the innate motive of encouraging the sustenance of businesses rather than picking them apart to quickly finance their recovery process.⁴ The Insolvency and Bankruptcy Board of India (IBBI), established by the Code itself, recently expressed its intent to ensure that climate change conscious norms are inculcated within the Code.⁵ While this proposal remains at the stage of ideation, the authors of this paper believe that such an endeavour can be met with success if done with the armour of sound policymaking. The focal point of this paper is to trace the elements of sustainability in the Code and how this conditions a conducive framework for the implementation of climate change mitigating measures through the enforcement of the Code.⁶

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1. ‘Falling Recovery Rates and Increase in Resolution Time Dent IBC’s Success, Says CRISIL’ (The Hindu, 4 November 2023) <<https://www.thehindu.com/business/falling-recovery-rates-and-increase-in-resolution-time-dent-ibcs-success-says-crisil/article67570542.ece>> accessed 25 December 2023.
 2. Seshnath Singh and Anr v Baidyabati Sheerophuli Cooperative Bank Ltd and Anr Civil Appeal No. 9198/ 2019.
 3. Bikash Narayan Mishra, ‘IBC: From Perceived Recovery Tool to Resolution Mechanism - Challenges and Opportunities Ahead’ (ETBFSI, 21 October 2023) <<https://bfsi.economictimes.indiatimes.com/blog/ibc-from-perceived-recovery-tool-to-resolution-mechanism-challenges-and-opportunities-ahead/104579161>> (ETBFSI) accessed 25 December 2023.
 4. Mahima Yadav, ‘Green Insolvency: Analysing the Role of the IBC in Promoting Sustainable and Environmentally Responsible Restructuring and Resolution’ (KnowledgeSteez, 15 July 2023) <<https://knowledgesteez.com/2023/07/article-green-insolvency-analysing-the-role-of-the-ibc-in-promoting-sustainable-and-environmentally-responsible-restructuring-and-resolution/>> accessed 17 December 2023.
 5. Gireesh Chandra Prasad, ‘Climate Change: Distressed Firms to Be Judged on Green Plans’ (Mint, 3 December 2023) <<https://www.livemint.com/news/india/ibc-climate-strategy-to-be-made-key-to-debt-resolution-11701617740527.html>> accessed 27 December 2023.
 6. Tuula Linna, ‘Insolvency Proceedings from a Sustainability Perspective’ (2019) 28(2) International Insolvency Review <<https://onlinelibrary.wiley.com/doi/abs/10.1002/>

In essence, this paper is divided into three parts- of which, the first section sets out to prove a simple truism- that private law can validly and effectively be used to cater to public policy ends. In this pursuit, a cross-jurisdictional analysis of similar endeavours is undertaken to gauge the effectiveness of the same. Having done so, it further places the Code specifically in this paradigm and analyses the appropriateness of the Code as a legislation that can effectively bring about positive change with respect to the imposed climate change mitigating measures. The second section deals with the overarching theme of sustainability as a cornerstone throughout the Code and differentiates between ideological and substantive sustainability. In recognizing the ample presence of ideological sustainability in the legislative intent behind the Code, the authors strongly advocate for substantive sustainability by way of adopting a fourfold definition of the same. Finally, the third section lays bare the suggested framework of implementation that does justice not only from a social, political, and economic efficiency standpoint but from an environmental aspect too.

II. RESOLVING THE DICHOTOMY OF PUBLIC VS PRIVATE LAW IN LOCATING THE JURISPRUDENTIAL BASIS OF INSOLVENCY

The classification of laws has never been an airtight compartmentalization of legislation or principles.⁷ Yet, certain fundamental rights stipulate the concept of ‘negative liberty’ to keep some aspects of the law largely divorced from the burden of public policy considerations.⁸ One such right is that of the right to trade and profession that protects the overarching

iir.1345> (Linna) accessed 24 December 2023.economic, social/culture, and political dimensions. Currently, sustainability research is a rich scientific discipline producing a significant number of research papers. However, sustainability in the context of insolvency proceedings has attracted little research compared with, for example, how much attention corporate social responsibility has received in company law research. This article studies sustainability in the context of liquidation and restructuring proceedings and the preservation of different kinds of resources (natural, manufactured, human, and social capital

7. Keith Crawford, ‘The Law and Economics of Orderly and Effective Insolvency’ (University of Nottingham, 8 August 2013) <<http://eprints.nottingham.ac.uk/13372>> accessed 29 December 2023.

8. Jonathan R Hay and Andrei Shleifer, ‘Private Enforcement of Public Laws: A Theory of Legal Reform’ (1998) 88(2) *The American Economic Review* <https://scholar.harvard.edu/shleifer/files/priv_enforce.pdf> accessed 24 December 2023.

negative liberty principle of a free market.⁹ Now, to contextualize this jurisprudential debate with respect to insolvency law in India, it can be reduced to an academic binary of opinions.¹⁰

One set of scholars contends that bankruptcy law is innately of ‘economic account’,¹¹ so as to say that the fulcrum of such law to exist derives from promising the creditor due return of his money invested into the failing undertaking – either by prompt restructuring,¹² or by the last resort measure of liquidation.¹³ It follows this understanding of insolvency that it is an innately private right (of the creditor and the debtor to the extent of the possibility of a viable restructuring plan) and therefore falls within the ambit of ‘negative liberty’ of not having to bear the impress of proactive political endeavours.¹⁴ However, another set of scholars dismiss the ‘economic account’ as a theory that overshadows the importance of other nuanced aspects,¹⁵ there are, to the law of insolvency.¹⁶ These aspects range from the health of the economy,¹⁷ to the subjectivity of the industries undergoing such a process of insolvency,¹⁸ making this area of law wider in scope as against the private concept of it simply being for the benefit or detriment of the creditors and debtors alone.¹⁹ This approach is more holistic to the extent of two ends;²⁰ one, it considers the externalities that the relative ease or difficulty of the insolvency process produces

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9. Manfred E Streit, ‘Economic Order, Private Law and Public Policy The Freiburg School of Law and Economics in Perspective’ (1992) 148 *Journal of Institutional and Theoretical Economics*.
 10. Donald R Korobkin, ‘Rehabilitating Values: A Jurisprudence of Bankruptcy’ (1991) 91(4) *Columbia Law Review*.
 11. Thomas Jackson, *Logic and the Limits of Bankruptcy Law* (Harvard University Press, 1986).
 12. Daniel Hayek, Christina Meyer and Chantal Joris, ‘Restructuring over Liquidation’ (Mondaq, 22 June 2015) <<https://www.mondaq.com/insolvencybankruptcy/406226/restructuring-over-liquidation>> accessed 27 December 2023.
 13. Ashmika Agrawal, ‘Liquidation as Going Concern Under Insolvency and Bankruptcy Law’ (2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3527389> (Agrawal) accessed 27 December 2023.
 14. Steven L Schwarcz, ‘Rethinking Freedom of Contract: A Bankruptcy Paradigm’ (1998) 77 *Texas Law Review*.
 15. David Carlson, ‘Philosophy in Bankruptcy’ (1987) 85 *Michigan Law Review* (Carlson).
 16. Elizabeth Warren, ‘Bankruptcy Policy’ (1987) 54 *The University of Chicago Law Review* 775.
 17. *Ibid.*
 18. Agrawal (n 13).
 19. Daphna Lewinsohn-Zamir, ‘In Defense of Redistribution through Private Law’ (2006) 91 *Minnesota Law Review*.
 20. Carlson (n 15).

in the economy, and two, it recognizes the potential of this area of law in incentivising policy-motivated effects in the economy.²¹

It is against this backdrop that the authors of this paper locate the position of insolvency law as a creator of substantive rights and liabilities,²² within the larger legal framework by positing three claims. One, is that by a lack of a constitutionally guaranteed fundamental right to bankruptcy, this area of law cannot be said to fall within the ambit of negative liberty.²³ Insofar as constitutional recognition is concerned, the realm of bankruptcy law only rises to the extent of a socio-economic right of welfare. Two, that the very intent behind insolvency legislations across the world and specifically the Code in India, is telling of the multitude of factors that were weighed in consideration of the larger ecosystem as against the private rights of individuals,²⁴ further cementing the viability of policy motivated norms to be included in the same.²⁵ Third, that the inclusion of such norms and their prolonged functioning explains the potential of this piece of legislation to bring about substantial change in the sphere of climate change mitigation too.²⁶ It is upon these three claims that the authors build their case for a greener insolvency regime in India, not only recognising the merit in the recent suggestion by the IBBI but going a step ahead in evolving a holistic framework.

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21. Alexander Gouzoules, 'Going Concerns and Environmental Concerns: Mitigating Climate Change Through Bankruptcy Reform' (2022) 63 BCL Rev. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4028203> (Gouzoules) accessed 27 December 2023.
 22. Jasper Vikas, 'Judicial Pragmatism by the Supreme Court of India in Adjudicating Insolvency and Bankruptcy Issues' (2023) <<https://papers.ssrn.com/abstract=4666530>> accessed 27 December 2023.
 23. Robert K Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (1994) University of Illinois Law Review.
 24. Kevin A Kordana and David H Tabachnick, 'Taxation, The Private Law, And Distributive Justice' (2006) 23 Social Philosophy And Policy <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1091729> accessed 27 December 2023.
 25. Gouzoules (n 21).
 26. Linna (n 6); Gouzoules (n 21).

III. CROSS-JURISDICTIONAL INQUIRY INTO THE CONVERGENCE OF INSOLVENCY CLAIMS AND ENVIRONMENTAL LEGISLATION

The viability of instrumentalizing insolvency legislation to achieve public policy ends is evidenced by several countries,²⁷ that have adopted measures of varying degrees of intensity in moving towards a greener economy.²⁸ They do so by seeking to reconcile public policy (especially environmental) interests with that of corporate interests. In this section, the authors attempt a cross-jurisdictional inquiry into the convergence of insolvency and environmental legislation, exploring how certain countries have sought to resolve the dilemma with respect to the discharging of environmental liabilities during insolvency proceedings.

A. The United States of America

1. *The Nature of Environmental Claims*

In the U.S., most environmental claims in bankruptcy proceedings are carried out using the Comprehensive Environmental Response, Conservation and Liability Act, 1980 (*CERCLA*)²⁹ and the Resource Conservation and Recovery Act (*RCRA*).³⁰ Apart from the *CERCLA*, there exist various state-specific legislation akin to the *CERCLA* but differing in certain aspects.³¹ It is important to understand that the legislative intent behind the U.S. Bankruptcy Code (focused on fairly distributing a bankrupt person's assets with the aim of balancing the creditors' chance of recovery and the debtor's opportunity for a new beginning) and that of the *CERCLA* (ensuring environmental preservation by sharing the expenses

27. Saqib Aziz and others, 'Does Corporate Environmentalism Affect Corporate Insolvency Risk? The Role of Market Power and Competitive Intensity' (2021) 189 *Ecological Economics* <<https://www.sciencedirect.com/science/article/abs/pii/S0921800921002408>> accessed 27 December 2023.

28. Tuula Linna, 'Company Purpose in the Context of Business Sustainability and Insolvency Proceedings' (2021) 18 *European Company Law* <<https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\EUCL\EUCL2021021.pdf>> accessed 27 December 2023; Susan Cantlie, 'When Words Collide: Environmental Regulation in Conflict with Bankruptcy Legislation' (1992) 21 *Canadian Business Law Journal*; Jeffrey C Carhart, 'Environmental Issues in Corporate Insolvencies and Reorganizations Forum: Environmental Law' (2002) 51 *University of New Brunswick Law Journal*.

29. 42 U.S.C. 9601.

30. 40 CFR, s 30.16.

31. David Bledsoe and Jessica Hamilton, 'Discharging Environmental Claims in Bankruptcy: What do you mean that I have to still clean that up?' (2010) 29(3) *LJ*.

linked to the remediation of sites holding hazardous substances) are fundamentally different and may be at odds with each other.³²

In *Ohio v. Kovacs*,³³ the court held that an obligation to clean up for environmental damage caused before the suit for action was dischargeable since it was in the nature of a “claim” as a “right of payment” under the Bankruptcy Code.³⁴ This was because the obligation had turned monetary in nature. This decision was reaffirmed in *United States v. Whizco*.³⁵ While it may be argued that the modern Bankruptcy Code gives individual debtors an opportunity to start afresh without the burden of past unmanageable debts,³⁶ the case of Apex Oil company points to the imposition of duties of overwhelmingly expensive environmental clean-up operations (costing about \$150 million) long after a restructuring involving sale of polluting assets.³⁷ An action for the same was brought under the RCRA to demand clean-up operations,³⁸ though the RCRA is a tool that only allows the plaintiff to demand a clean-up and not monetary compensation.³⁹ This is an example of how the courts sought to address the issue of environmental liabilities without having to engage in a direct conflict with existent insolvency law by instituting a claim under an Act that would not be in the form of a monetary compensation (liable to be discharged) but rather in the form of an obligation to clean up.

2. *Clean-up Costs as Administrative Expenses*

Since administrative expenses are given a higher priority with respect to the distribution of assets of the debtor’s estate, environmental clean-up expenses may be treated as “administrative expenses”.⁴⁰ In *Midlantic National Bank v. New Jersey Department of Environmental Protection*,⁴¹

32. Blanca Mamutse and V. Fogleman, ‘Environmental Claims And Insolvent Companies: The Contrasting Approaches Of The United Kingdom And The United States’ (2013) 2(2) *British Journal of Legal Studies* (Mamutse and Fogleman).

33. *Ohio v Kovacs* [1985] 469 U.S. 274.

34. 11 U.S.C. s 101(5)(A).

35. *United States v Whizco, Inc.*, 841 F.2d 147, 148 (6th Cir. 1988).

36. *LocalLoan Co.*, 292 U.S. at 244.

37. *U.S. v Apex Oil Co.* 579 F.3d 734.

38. *Ibid.*

39. 42 U.S.C. s 6973(a) (2012).

40. 11 U.S.C. s 507(a)(1); *Re Smith - Douglas, Inc.*, 856 F.2d 12, 17 (4th Cir. 1988).

41. *Midlantic National Bank v New Jersey Dept. of Environmental Protection* 474 U.S. 494, 106 S. Ct. 755 [1986] ct. at 762, 88 L.Ed.2d.

the Supreme Court had confirmed that “environmental clean-up claims were entitled to administrative expenses priority.” It also had the effect of stating that contaminated locations cannot be abandoned by companies going through insolvency.⁴²

1. *The “Imminent Danger” Criterion*

However, certain decisions since the *Midlantic* case have affirmed that the debtor may abandon contaminated locations in certain instances,⁴³ such as when there is no “imminent danger or damage within the plant” and when there exist no adequate “unencumbered assets” to bear the cost of clean-up.⁴⁴ In *Re Mahoney-Troast Construction Co.*, the court held that since the site did not pose an “imminent danger to public health”, such environmental clean-up costs could not be treated as administrative expenses.⁴⁵ However, the “imminent danger” criterion is not defined by any U.S. legislation and is hence, a matter to be decided by the courts.⁴⁶ The “imminent danger” criterion has logical backing and may be transplanted into the Indian scenario by requiring that the same be determined by the Resolution Professional upon adequate consideration of prevailing circumstances during the Corporate Insolvency Resolution Process (*CIRP*).

The conclusion that may be drawn is that any environmental claims that may arise prior to insolvency proceedings (pre-petition liabilities) may be discharged in the American context but not those that arise after insolvency proceedings have been initiated.⁴⁷ When environmental law clashes with bankruptcy law in real-life situations, the courts cannot guarantee consistent support for environmental regulations in every instance. However, the courts must assess a variety of factors such as the extent and type of environmental harm, alongside other relevant considerations

42. *Mamutse and Fogleman* (n 32).

43. *Ibid.*

44. *Re Smith Douglas, Inc.*, 856 F.2d 12, 17 (4th Cir. 1988).

45. *Re Mahoney-Troast Construction Co.*, 189 B.R. 57, 62.

46. Lawrence P. Schnapf, *Environmental Issues in Business Transactions* (ABA book Publishing 2011) 353.

47. 11 U.S.C. s 727 (b).

that need to be weighed in contextualising such environmental claims against the backdrop of insolvency proceedings.⁴⁸

B. The United Kingdom and Scotland

Much like the Indian context, the UK's Insolvency Act, 1986 seeks to promote restructuring of distressed businesses over liquidation.⁴⁹ The UK's Companies Act mandates directors of companies to take into account the "impact of company operations on the community and the environment" whilst working towards the welfare of the company.⁵⁰ With respect to insolvency, the Cork Report by the Review Committee on Insolvency Law and Practice states that community interests have always been important to insolvency matters.⁵¹ However, there exist practical difficulties in achieving a balance between survival or profitability of companies and community interests. Section 178 of the Insolvency Act allows for disclaiming "onerous property" which may be described as property that is incapable of being sold for value or giving rise to financial obligations.⁵²

Weakening the case for public policy intervention through insolvency legislation, the court in *R (People and Planet) v. HM Treasury* held that government intervention in internal company policy decisions could not be prioritised over the interests of the shareholders.⁵³ Later, in *Re Celtic Extraction*, the court ruled that the liquidator could disclaim a waste management license.⁵⁴ In effect, the ruling affirmed that compliance costs associated with such a license could not be prioritised over external debts owed by the company to, say, secured creditors. It held that the 'polluter pays' principle could not be applied to situations wherein the polluter was incapable of paying. Similarly, in *Re Rhonda Waste Disposal Ltd*, it was stated that assets of the company could not be allocated towards meeting future terms of compliance with a waste management license.⁵⁵

48. *Re Smith - Douglas, Inc.*, 856 F.2d 12, 17 (4th Cir. 1988); *Re Mahoney-Troast Construction Co.*, 189 B.R. 57, 62.

49. *Powdrill v Watson* [1995] 2 AC 394.

50. The Companies Act, 2013, s 172.

51. Cmnd 8558, [1982], para 1734.

52. Insolvency Act, 1986, s 178(6).

53. [2009] EWHC 3020.

54. *Re Celtic Extraction* [2001] Ch. 475, [42].

55. *Re Rhondda Waste Disposal Ltd* [2001], ch. 57, paras 43-44.

These decisions have had the effect of dangerously ignoring environmental considerations.

The provision of administration in insolvency proceedings allows stressed companies to appoint an administrator to undertake a swift restructuring of the business to maximize value to creditors during insolvency or to salvage the business with the hope of becoming profitable in the future.⁵⁶ In the case of *Re UK Coal Operations Ltd*, the concerned company went through administration involving a restructuring before going through liquidation by liquidators who also played the role of administrators in the case - to enable the disclaimer of onerous liabilities.⁵⁷ A dysfunctional colliery was disclaimed – which would have otherwise costed a hefty sum in excess of £100,000 per week for maintenance.⁵⁸ This serves to show how a company utilised administration proceedings to defeat the ‘polluter pays’ principle.

The Scottish Environment Protection Agency case⁵⁹ had the effect of reversing the decision in *Re Celtic Extraction* by ruling that the liquidator could not disclaim land and statutory licenses.⁶⁰ Similarly, in *Nimmo and Friar* as the joint liquidators of *Doonin Plant Ltd*,⁶¹ it was held that prioritising fulfilment of environmental obligations when distributing assets of an insolvent company “does not violate the statutory distribution scheme or the *pari passu* principle”. However, these decisions seem to have been driven by statutory interpretation of existent environmental statutory claims rather than public policy considerations aimed at proactive environmental conservation.⁶² Reliance on resolution of the conflict between environmental claims and insolvency law through judicial decisions has

56. Gary Haywood ‘Part 1 – What Is Administration?’ (Serena Collage Content Management System, 19 June 2013) <<https://www.insolvencydirect.bis.gov.uk/freedomofinformationtechnical/manual/ch49-60/chapter%2056-1/Part%201/Part%201.htm>> accessed 26 December 2023.

57. *Re UK Coal Operations Ltd* [2013] EWHC 2581.

58. Statement by PwC, ‘Ocanti Opco Limited – in Liquidation (formerly UK Coal Operations Limited)’ (PwC, 10 September 2014) <https://www.pwc.co.uk/assets/pdf/ocanti_opco_progress_report_sept14.pdf> accessed 24 December 2023.

59. *Scottish Environment Protection Agency v Joint Liquidators of the Scottish Coal Company Ltd* [2013] CSIH 108.

60. *Re Celtic Extraction* [2001] Ch. 475, [42].

61. [2018] CSOH 89.

62. Blanca Mamutse, ‘Lessons from Scotland: environmental regulators’ claims as contingent debts or liquidation expenses in insolvency proceedings (and the future toppling of a Celtic giant?)’ (2020) 33(2) *Insolvency Intelligence* <<http://researchonline.ljmu.ac.uk/id/eprint/11713/>> accessed 25 December 2023.

created a cloud of ambiguity with respect to the status of environmental claims and how and by whom they are to be discharged.⁶³

C. Canada

In Canada, the Companies' Creditors' Arrangement Act (CCAA) seeks to promote the restructuring of distressed companies and provides for a stay of proceedings against the debtor by the creditors. However, proceedings by a regulator which do not seek monetary payment or the fulfilment of its claims as a creditor, are not subject to such a stay. The question of determining whether and what environmental liabilities are subject to a stay for the CCAA has been the area of concern with respect to judicial decisions.

In the case of Newfoundland and Labrador, the Canadian Supreme Court provided for a three-part test to determine whether a regulatory order could be a claim.⁶⁴ Firstly, there must be some form of liability, debt, or obligation owed to a creditor. Secondly, such an obligation or liability must have been incurred prior to the insolvency/bankruptcy. Finally, it must be possible to quantify such a claim. The decision had the effect of backing the stay of proceedings related to environmental remediation orders (subject to the three-part test) during insolvency. While critics did say that this decision would violate the principle of 'polluter pays', the Court argued that refusal of such a stay would have the effect of unfairly penalising secured creditors by leaving them lesser assets to be distributed to fulfil their claims.⁶⁵ Moreover, should the entity emerge a restructured entity, it would be liable to fulfil such remediation orders and so there was no 'free license to pollute' granted to companies.

The 2019 decision of *Orphan Well Association v Grant Thornton Ltd* witnessed the Canadian Supreme Court provide some clarity on the issue by sub-classifying such environmental liabilities into 'public duties' and 'debts'.⁶⁶ Whilst the former was said to be subject to discharge/compro-

63. *Ibid.*

64. *Newfoundland and Labrador v AbitibiBowater Inc* [2012] SCC 67.

65. Steven J. Weisz, Catherine (I) Powell & Jenna Willis, 'The Untidy Intersection between Environmental and Insolvency Law in Canada' (2013) 7 *Insolvency & Restructuring Int'l* <<https://heinonline.org/HOL/LandingPage?handle=hein.journals/iri7&div=22&id=&page=> 24> December 2023.

66. *Orphan Well Association v Grant Thornton Limited* [2019] SCC OnLine Can SC 7.

mise or a stay, the latter was not. The rationale behind according such priority to public duty claims is that such duties involve imminent danger to the public – requiring immediate intervention to prevent potential or further economic and environmental damage to communities.

IV. SUSTAINABILITY AT THE CRUX OF IBC: AN APPROPRIATE ARENA FOR CLIMATE CHANGE MITIGATING REFORMS

The chief objective of any legal argument positing an amendment of an existing piece of legislation or critiquing a certain inadequacy within it is to prove that such a suggestion conforms to the larger legislative intent behind the passing of the legislation.⁶⁷ Any such suggestion that proves conformity to the ‘spirit’ of the legislation while experimenting with the contours of its text is well within the reasonable bounds of statutory interpretation.⁶⁸ Now, through the first and second sections, the authors of this paper first proposed a principle-based public policy inroad into the domain of bankruptcy law and justified the same with evidence of this experiment’s success from abroad. In this section, the Code is placed under specific scrutiny in the context of the changes so suggested in the rest of the paper.

D. Legislative Intent Behind Passing of IBC

As established earlier in the paper, the Code functions to streamline the process of restructuring and encourages the sustenance of businesses. Additionally, an important objective sought to be achieved through the passing of the IBC, was to improve India’s ranking on the World Bank’s ‘Ease of Doing Business Index’. This Index has since been replaced by the Business Enabling Environment Report. One of the key considerations of this report has been with respect to the capacity of debtors to meet environmental obligations. Additionally, the insolvency resolution indicator takes into consideration the viability of the reorganization or liquidation plan as a tool to effectively address environmental concerns and

67. McNollgast, ‘Legislative Intent: The Use of Positive Political Theory in Statutory Interpretation’ (1994) 57 *Law & Contemp. Probs.* <<https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4216&context=lcp>> accessed 28 December 2023.

68. Daniel A Farber and Philip P Frickey, ‘Legislative Intent and Public Choice’ (1988) 74(2) *Va. L. Rev.* <<https://www.jstor.org/stable/1073149>> accessed 28 December 2023.

ensure compliance with environmental law.⁶⁹ While India prides itself on its actions for compliance with its Paris Agreement goals on the world stage to pursue its ongoing battle against the existential threat of climate change, conscious political will on all fronts of governance is essential to materialise the same.⁷⁰

Ideological and Substantive Sustainability

The crux of sustainability as a concept itself is a mammoth one to comprehend. The Brundtland Report,⁷¹ provides a starting point by defining sustainable development to be ‘overall progress today without endangering the possibility of such progress in the future’ but the essential idea of sustainability remains tied to its name itself: to sustain unabated.⁷² From a legislative perspective, this sustainability can be understood from two angles: ideological and substantive sustainability. Ideological sustainability refers to such legislation that hopes to perpetuate the longevity of an existing element.⁷³ This is present in the Code by way of its emphasis on resolution over recovery and it does so for three reasons. One, to provide corporations with the last resort option of a restructuring over premature liquidation.⁷⁴ Two, to safeguard the interests of the creditor by way of an elaborate codification of the procedure of such resolution in the Code itself to ensure the creditor’s interests are not compromised.⁷⁵ Three, the aspect that is the most important for the scope of ideological sustainability, it is in the interest of the public and the general economic landscape of the country.⁷⁶ It is well-known that the Code actively encourages the sustainability of corporations by creating conditions conducive for their

69. Ibid.

70. Anand Singha, ‘India Only G20 Member to Meet Commitments of Paris Agreement on Environment, Says Modi’ (CNBCTV18, 23 June 2023) <<https://www.cnbctv18.com/environment/india-only-g20-country-to-uphold-paris-agreement-on-environment-modi-usa-17016351.htm>> accessed 2 January 2024.

71. Jan Thomas Frecè and Deane L Harder, ‘Organisations beyond Brundtland: A Definition of Corporate Sustainability Based on Corporate Values’ (2018) 11 *Journal of Sustainable Development*..

72. ETBFSI (n 3).

73. Linna (n 6).

74. Elizabeth Klee and Lewis Kornhauser, 36 *The Journal of Legal Studies* ‘Comparisons of the Incentive for Insolvency under Different Legal Regimes’ (2007) <<https://www.journals.uchicago.edu/doi/abs/10.1086/509273>> accessed 2 January 2024.

75. Crawford (n 7).

76. Nimit Gupta, Nishma Desai and Evanshi Garg, ‘Impact of Insolvency and Bankruptcy Code on India’s Macro Economy Focusing on Indian Commercial Banks’ (2020) 22 *Supremo Amicus* 174 <https://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/supami22§ion=20&casa_token=Yv71R4GuVKEAAAAA:pmoS-Z9spRocEoX-

revival rather than liquidation but another important angle that is often overlooked is that of substantive sustainability.⁷⁷

Substantive sustainability, in the context of the Code, can be understood under four pillars: economic, social, political, and environmental. Several provisions of the Code explicitly cater to the first three pillars; these may be embedded in provisions enabling corporations to resort to the Corporate Insolvency Resolution Process (*CIRP*) or those that enumerate the rules of fair conduct of the resolution professionals and corporate debtors. But the Code is rather lacking with respect to the fourth pillar.⁷⁸ This is the inadequacy the authors of this paper hope to fix by way of suggestions in the latter half. Climate change has become a global concern and is rapidly wreaking unprecedented levels of havoc. The externality of climate change has very real consequences for the economy,⁷⁹ as it hosts both victims,⁸⁰ and perpetrators of environmental degradation.⁸¹ Prudent policymakers have voiced their concerns regarding the repeated failure of a global consensus with respect to a collective commitment to combat climate change.⁸² This necessitates unconventional rationales to achieve a viable path to sustainable growth— one such rationale being that of incentivising corporations to adopt climate change mitigating measures voluntarily by way of the legislators using the provisions of the Code as a bargaining chip.

TzLpuovVaejWE1InoS2TFYR71DyNPMgoamWHqu4dCd4eDU6doxtLENpdCUG> accessed 2 January 2024.

77. Agrawal (n 13).

78. Abhiman Das and others, 'Insolvency and Bankruptcy Reforms: The Way Forward' (2020) 45 *Vikalpa: The Journal for Decision Makers* 115 <<https://journals.sagepub.com/doi/full/10.1177/0256090920953988>> accessed 2 January 2024.

79. Brian Andrew, 'Market Failure, Government Failure and Externalities in Climate Change Mitigation: The Case for a Carbon Tax' (2008) 28 *Public Administration and Development* 393 <<https://onlinelibrary.wiley.com/doi/abs/10.1002/pad.517>> accessed 2 January 2024.

80. Jean Chateau Thube Geetika Dang, Margaux MacDonald, John A Spray, Sneha D, 'A Framework for Climate Change Mitigation in India' (*IMF*) <<https://www.imf.org/en/Publications/WP/Issues/2023/10/20/A-Framework-for-Climate-Change-Mitigation-in-India-535854>> accessed 25 December 2023.

81. Gouzoules (n 21).

82. Paul G Harris, 'Collective Action on Climate Change: The Logic of Regime Failure' (2007) 47 *Nat. Resources J.* 195 <https://heinonline.org/hol/cgi-bin/get_pdf.cgi?handle=hein.journals/narj47§ion=11&casa_token=nkJhwf1D4moAAAAA:hjtyVLiRx-j5k1H-qMgJfakcZU_VJsqcWG1qSOTZEsjHHvlqxnbxwDiyx_NrSDVgQPnfzoltQ> accessed 2 January 2024.

A. India's Tryst with Sustainability

In essence, the authors recognize three issues that are fundamentally environmental in nature. One, that of unabated greenhouse gas (*GHG*) emissions by a class of corporations involved in the production of power and industry. These two sectors contribute to 62% of India's *GHG* emissions.⁸³ To this effect, the government has already taken several steps such as the Renewable Purchase Obligations (*RPOs*) that mandate a certain ration of renewable power to be supplied by power distribution companies (*DISCOMs*) alongside fossil fuel derived electricity. This ratio is expected to go up to 43% by 2029-30.⁸⁴ Though this a welcome reform, its impact has been dulled by several roadblocks inherent in the sector such as the debt stress of *DISCOMs* amid limitations of political economy not allowing the required level of 'greening' of energy sources.⁸⁵ Similarly, with respect to the industry sector, the government has come up with the Perform Achieve Trade (*PAT*) mechanism where corporations that are categorised as large energy consumers are allotted 'energy saving certificates' when they consume lesser than the government mandated target. These certificates can then be traded on power exchanges. This again, despite being a robust mechanism, has failed to abate emissions due to the ever-increasing need for heavy industries and their structural difficulties in switching to renewable energy sources.

Current efforts by the government, with due respect to the legislative creativity that goes into these schemes, ultimately boils down to a top-down framework of either incentivising or penalising by use of the authority of the State itself. The problem that these traditional instruments of climate change mitigation present is that they are subject to the prevailing macroeconomic structure and how elastic it is to facilitate an energy transition. In the absence of conditions conducive to such a pace of transition, the excise and subsidy system does not satisfactorily bring about substantial change. An alternative approach is to focus on

83. *Ibid.*

84. Sheoli Pargal and Sudeshna Ghosh Banerjee, *More Power to India: The Challenge of Electricity Distribution* (Washington, DC: World Bank 2014) <<https://openknowledge.worldbank.org/bitstream/10986/18726/1/889060PUB0978100Box385252BooPUBLICo.pdf>> accessed 29 December 2023.

85. Brijesh Bhatt and Anoop Singh, 'Power Sector Reforms and Technology Adoption in the Indian Electricity Distribution Sector' (2021) 215 *Energy* 118797 <<https://www.sciencedirect.com/science/article/pii/S0360544220319046>> accessed 2 January 2024.

microeconomic enforcement of these norms instead;⁸⁶ private climate governance ends can be incentivised by way of top-down measures.

Three, the underwhelming nature of global climate policy consensus.⁸⁷ Despite robust academic and activist involvement in the realm of global climate change policy, the decision-making forums are innately political and often end up in a deadlock.⁸⁸ The political argument of developed nations dodging their historical responsibilities and the global south unionising against such a travesty is in and of itself an unsustainable approach.⁸⁹ Several Conferences of Parties or COPs have gone by without substantial progress towards achieving the Common but Differentiated Responsibilities (CBDRs) and by virtue of countries of the global south such as India itself lacking the infrastructure to deal with climate change induced calamities, there is a greater domestic and global need to combat the same irrespective of the larger political blame game.⁹⁰

Three-Pronged Reforms

The idea of climate change mitigating norms being embedded into insolvency legislations is a classic offshoot of legal pragmatic approaches such as that of the carrot and the stick.⁹¹ Herein, the carrot is the benefit of flexibility that a rights-based progressive piece of legislation such as the Code offers to financially distressed corporations whereas the stick lies in the simple denial of access to such relief. A categorical denial of such a benefit to two classes of corporations, that is, the ones that are involved in an industry that profits from the degradation of the envi-

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86. Jonathan M Gilligan, 'Carrots and Sticks in Private Climate Governance' (2018) 6 *Texas A&M Law Review* 179 <https://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/twlr2018§ion=11&casa_token=ZiFOO2X5ArcAAAAA:VtVtggLW-5FL9wPnE3lxGcOP8U4XJkvwNHEcRXeYytbyYwcA6q_WznLcZpmXsKhTHtG_KI6SeQ> accessed 2 January 2024.
87. Cinnamon P Carlarne, 'Rethinking a Failing Framework: Adaptation and Institutional Rebirth for the Global Climate Change Regime' (2012) 25 *Geo. Int'l Env'tl. L. Rev.* 1.
88. Hayley Stevenson, 'Institutionalizing Unsustainability: The Paradox of Global Climate Governance' (2013) <<https://escholarship.org/uc/item/4z9pf66p>> accessed 29 December 2023.
89. Andrew Hurrell and Sandeep Sengupta, 'Emerging Powers, North-South Relations and Global Climate Politics' (2012) <<https://www.jstor.org/stable/23255546>> accessed 29 December 2023.
90. Sk Mustak, 'Climate Change and Disaster-Induced Displacement in the Global South: A Review' in Azizur Rahman Siddiqui and Avijit Sahay (eds), *Climate Change, Disaster and Adaptations* (Springer International Publishing 2022).
91. Jaka Cepec and Mitja Kovac, 'Carrots and Sticks as Incentive Mechanisms for the Optimal Initiation of Insolvency Proceedings' (2016) 7(2) *DANUBE* <<https://www.econstor.eu/bitstream/10419/184508/1/danb-2016-0005.pdf>> accessed 29 December 2023.

ronment (such as fossil fuel companies) and the ones that fail to meet a certain benchmark of environmental, social and governance indicators of sustainability is a step towards bringing about radical ‘greening’ of the insolvency regime in India. This simple game theoretical approach is propounded in the first and second solutions in this section. The third solution addresses the larger concern of sidelining environmental claims under the Indian insolvency framework, suggesting changes along the lines of a recent Canadian judgment enforcing the same by way of a division into public duties and money claims.

E. Addressing the Problematic Chunk: Special Treatment of Top Polluters

A report released by the International Monetary Fund caps India’s GHG emissions sector-wise and concludes that the top 5 polluting sectors are (in descending order): power, industry, transport, residential and agriculture.⁹² Out of these sectors, power and industry alone contribute to 62% of the national GHG emissions. The authors pick these two sectors as those of specific significance in combating climate change for two reasons: one, the composition of the power sector is such that it is overwhelmingly dominated by the State government-run DISCOMs alongside a nascent private sector presence,⁹³ and two, these sectors face a structural difficulty in the process of energy transition that traditional incentives by way of subsidies and excise duties are unable to help bridge.⁹⁴

1. *Specific Denial of the Benefit of CIRP to Top Polluting Corporations*

Enterprises stand to gain much from the provisions of the Code; a bargaining chip, that the authors propose, can be used to incentivise environment-conscious behaviour. At the outset, the top polluting corporations need to be mapped out alongside their contributions to the national GHG emissions. After having done this, the Code is to be amended to

92. Thube (n 82).

93. Bhatt and Singh (n 87); CMA Dr KINNARRY THAKKAR and PANKAJ DAYANAND PANDAGALE, ‘A Comparative Analysis Of Performance Of Power Supply Companies In The Duopoly Market Of Mumbai Region’ (2021) 27(4) *Journal of Contemporary Issues in Business and Government*.

94. Carlarne (n 90).

incorporate a definition for ‘fossil fuel companies’ that includes those ‘corporations involved in the generation of energy by way of their dependence on fossil fuels such as coal, oil and natural gas’. Such a definition can be included within the scope of the Act itself to operationalize a categorical denial of the benefit of CIRP under the Code to these corporations. The legal basis for such a denial arises from the fact that the benefit of restructuring that is given to corporations under the Code is at the discretion of the legislators and does not cater to a constitutionally guaranteed right of the debtor or the creditor for that matter.⁹⁵

In essence, the solution proposed by the authors under this head is threefold. It begins by way of a statutory definitional clause for ‘fossil fuel companies’ within the Code itself. Later, these corporations, by way of their special distinguishing features, are excluded from the scope of the CIRP process. The Code, in its current form, prescribes a consequential treatment of all corporations indiscriminately to provide them with an opportunity of restructuring to resuscitate the business before ultimate liquidation.⁹⁶ However, for reasons argued above, it is imperative that the benefit of restructuring is denied to corporations that exploit the environment. The second leg of the solution is to incorporate an express element of public interest.⁹⁷ Though the Code itself is relatively new and has only begun to churn out an insolvency law jurisprudence in India about less than a decade ago, it is a well-established principle in countries such as the US that insolvency must compulsorily cater to some aspects of public interest.⁹⁸ This understanding has diverged into several different classes of corporations being defined and guided differently with respect to insolvency proceedings with the express intent to protect public interest. These include railroad corporations,⁹⁹ stockbrokers,¹⁰⁰ and mass tort

95. Cepec and Kovac (n 94).

96. Shakti Deb and Indrajit Dube, ‘Insolvency and Bankruptcy Code 2016: Revisiting with Market Reality’ (2021) 63 *International Journal of Law and Management*.

97. Sara Jain, ‘Analysing the Overriding Effect of the Insolvency and Bankruptcy Code, 2016’ (2020) 13(1) *NUJS L. Rev.* <<http://nujlawreview.org/2020/05/26/analysing-the-overriding-effect-of-the-insolvency-and-bankruptcy-code-2016/>> accessed 29 December 2023.

98. David A Beck, ‘Public Interest Must Be Considered’ (2020) 39(4) *American Bankruptcy Institute Journal* <<https://www.proquest.com/openview/1099b0e294abfa21cd-05f2e960a73b1e/1?pqorigsite=gscholar&cbl=33486>> accessed 31 December 2023.

99. Julie A Veach, ‘On Considering the Public Interest in Bankruptcy: Looking to the Railroads for Answers’ (1996) 72(4) *Ind. LJ*.

100. Michael E Don and Josephine Wang, ‘Stockbroker Liquidations Under the Securities Investor Protection Act and Their Impact on Securities Transfers’ (1990) 12 *Cardozo L.*

bankruptcies which are made specific exemptions to the general scheme of the US Bankruptcy Code as applicable to all.¹⁰¹

Along the same lines, the authors of this paper believe that the Indian context too must recognise specific exemptions to the general scheme of the US Bankruptcy Code as applicable to all. Though it is an acknowledged truth that the Code impliedly takes such an element into consideration, the same must be operationalised within the statute itself to provide a concrete framework for the furtherance of the same.¹⁰² The final leg of the solution is that of an overseeing body- an environmental trustee. It is a valid concern that simply taking away the option of restructuring from these corporations and initiating their liquidation alone does not do away with the fact that they have been polluters till the point of insolvency. In this period, such a corporation may hold several assets such as oil rigs and drilling equipment, assets that would inevitably be sold off to conclude the liquidation process. The potential buyers of these equipment would inevitably be horizontal competitors, in which case, the entire point of fast-tracking the liquidation of the former corporation falls flat.

To counter this, an environmental trustee is necessitated. Borrowing from the provisions of the US and Canada, where a class of corporations such as stockbrokers are dealt with within the Bankruptcy Code itself as in the case of the US or ancillary legislations mandating certain requirements as in the case of Canada, a similar arrangement is to be worked out in the Indian context. This office can be a sobering voice in balancing the interests of the larger public vis-à-vis that of the creditors and the debtor. If a fossil fuel company, upon liquidation, is left with ‘polluting assets’ such as coal mines at its disposal, it is in the public’s best interest to not sell these to a competitor as that would only perpetuate the cycle and completely evade the very purpose of its early liquidation. But at the same time, it is in the competing interests of the creditor to sell these assets at maximum value to recover from the debtor. In such an instance,

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101. Edward J Janger, ‘Aggregation and Abuse: Mass Torts in Bankruptcy’ (2022) 91(2) *Fordham L. Rev.* <<https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=5961&context=flr>> accessed 31 December 2023.
102. ABLJ editor, ‘IBC Resolution within Regulated Sectors in the Public Interest’ (*Law.asia*, 4 January 2021) <<https://law.asia/ibc-regulated-sectors-public-interest/>> accessed 31 December 2023.

the environmental trustee can regulate to whom such assets are sold.¹⁰³ For instance, if a corporation in the renewable energy sector is to buy from this debtor, the ‘polluting asset’ can be repurposed along the lines of facilitating a smooth energy transition.¹⁰⁴ The government can play a proactive role in encouraging such repurposing, as such an approach has been validated by several studies by way of providing benefits to the up-and-coming renewable energy generation market in terms of subsidies and tax exemptions.¹⁰⁵

2. *Mandating Compulsory Environmental Insurance for Fossil Fuel Companies*

To supplement the solution proposed in Part A, particularly with respect to environmental liabilities caused by accident, adequate consideration must be given to legislation such as the Public Liability Insurance Act, 1991 (*PLIA*) which mandates owners of “hazardous substances” to acquire insurance policies for the period during which the handling of such substances is undertaken.¹⁰⁶ The ambit of insurance envisioned under the *PLIA* must be widened to mandate that all owners of hazardous substances take up environmental insurance irrespective of the volume of such substances handled. In going about such an exercise, it is pertinent to acknowledge the limitations of compulsory environmental insurance - it would have the effect of covering for unintended environmental liabilities and not those caused through wilful means.¹⁰⁷ The upside to

103. Chr Lamnatou, C Cristofari and D Chemisana, ‘Renewable Energy Sources as a Catalyst for Energy Transition: Technological Innovations and an Example of the Energy Transition in France’ (2023) 221(5) *Renewable Energy* <https://www.researchgate.net/publication/375562478_Renewable_energy_sources_as_a_catalyst_for_energy_transition_Technological_innovations_and_an_example_of_the_energy_transition_in_France> accessed 31 December 2023.

104. Elena Shao, ‘In a Twist, Old Coal Plants Help Deliver Renewable Power. Here’s How.’ (The New York Times, 15 July 2022) <<https://www.nytimes.com/2022/07/15/climate/coal-plants-renewable-energy.html>> accessed 31 December 2023.

105. Alaize Dall-Orsoletta, Fernando Romero and Paula Ferreira, ‘Open and Collaborative Innovation for the Energy Transition: An Exploratory Study’ (2022) 69 *Technology in Society* <<https://www.sciencedirect.com/science/article/pii/S0160791X22000963>> accessed 27 December 2023.

106. Public Liability Insurance Act, 1991, s 4.

107. Minga Negash and Tesfaye T Lemma, ‘Institutional Pressures and the Accounting and Reporting of Environmental Liabilities’ (2020) 29 (5) *Business Strategy and the Environment* <https://www.researchgate.net/publication/339092133_Institutional_pressures_and_the_accounting_and_reporting_of_environmental_liabilities> accessed 27 December 2023.

this measure would be the effect of ensuring that a certain degree of financial risk is absorbed by private sector insurers, thereby ensuring that the burden on the government is lessened. Another matter that deserves adequate attention is the fact that the PLIA has not been amended since its enactment in 1991; the relief amounts mentioned in the Schedule to the Act are meagre sums that may not even be close to sufficient to meet environmental damage obligations.¹⁰⁸ The authors suggest that the Act be amended to increase the relief amounts suiting prevailing conditions.

3. *Mandating the Creation of an Environmental Public Duty Fund*

The costs associated with clean-up operations at a single site can be massive. A single contaminated plant in Madhya Pradesh required clean-up operations amounting to over 165 crores in costs (according to 2010 estimates).¹⁰⁹ It comes as no surprise that at times, the insolvent estate may not be adequate to meet these expenses even when it is to be prioritised to meet ‘environmental public duties’. As explained earlier, ‘fossil fuel companies’ owe a special duty of care to the environment. In recognising that the Environment Relief Fund only caters to ‘post-damage’ claims, the authors locate a need for corporations to equip themselves in dealing with environmental liabilities incurred while conducting business as usual (BAU). Firstly, the definition of a ‘fossil fuel company’ must be inserted into the definitions clause of the Companies Act along the same lines as proposed in the Code in Part A.¹¹⁰ Secondly, a provision to the effect of creating an ‘Environmental Public Duty Fund’ as a “fund created for fulfilling environmental public duties as determined during the Corporate Insolvency Resolution Process” must be inserted into the Act. Finally, a provision must be inserted into the Act requiring ‘fossil fuel companies’ to contribute 1% of their net profits over three preceding years to this Environmental Public Duty Fund in addition to the Corporate Social Responsibility quantum of 2% under Section 135.¹¹¹ In effect, this would ensure that a ready corpus of funds is available to be put to quick use to remediate such duties.

108. Public Liability Insurance Act, 1991, s 3 (1).

109. ‘Operation Clean-Up’ (DowntoEarth, 15 July 2010) <<https://www.downtoearth.org.in/coverage/operation-cleanup-1460>> accessed 1 January 2024.

110. The Companies Act, 2013, s 2.

111. *Ibid*, s 135.

F. ESG-Related Parameters in Ensuring Holistic Sustainability Through the IBC

While Part A presents a viable solution for fossil fuel corporations and those that are involved in potentially environment-degrading industries, this Part intends to address the general need for making corporations more sustainable. Upon recognising that the insolvency procedure can be a platform for bringing about substantial change, the next question is how. The IBBI, in its recent publication titled, ‘IBC-Evolution, Learnings and Innovation’, featured an article titled ‘The Intersection of ESG and Insolvency: An Exploration of Responsible Restructuring Practices in India’ (the article) with a valuable suggestion to this end.¹¹² It juxtaposed the idea of environmental, social and governance aspects of company law to fulfil the agenda of sustainability through the Code. The authors find much merit in this suggestion and trace that this very paper was inspired by a need to critique such a suggestion.

It is long established that corporations with higher ESG compliance are less likely to have deteriorating financial health leading to insolvency.¹¹³ In fact, academic analysis of the relation between ESG and insolvency has always limited itself to dealing with the two as independent concepts that are mutually exclusive of each other. Though there have been ample studies on the efficacy of ESG,¹¹⁴ and several of which even establish a positive relation between higher sustainability rating and a lower risk of insolvency,¹¹⁵ the juxtaposition of these two has been rather recent, an innovation brought about by the ‘ESG wave’ globally.¹¹⁶ It is against this context that the suggestion in the article must be situated. In essence, it

112. Sudhaker Shukla and Asit Behera, ‘The Intersection of ESG and Insolvency: An Exploration of Responsible Restructuring Practices in India’ (2023) IBC-Evolution, Learnings, and Innovation <<https://ibbi.gov.in/uploads/publication/c9800578f99e42c11b-5573b4686fb545.pdf>> accessed 29 December 2023.

113. Saqib Aziz, Mahabubur Rahman, Dildar Hussain and Duc K. Nguyen, ‘Does Corporate Environmentalism Affect Corporate Insolvency Risk? The Role of Market Power and Competitive Intensity’ (2021) <<https://www.sciencedirect.com/science/article/abs/pii/S0921800921002408>> accessed 29 December 2023.

114. Jin-Ho Jung and Hyeon-Suk Park, ‘A Study on the Effect of Corporate ESG Activities on Business Performance: Focusing on the Moderating Effect of Corporate Values Perception’ (2022) 7 Industry Promotion Research.

115. Joel F Houston and Hongyu Shan, ‘Corporate ESG Profiles and Banking Relationships’ (2022) 35 The Review of Financial Studies.

116. ‘The Investor Revolution’ (Harvard Business Review, 2019) <<https://hbr.org/2019/05/the-investor-revolution>> accessed 1 January 2024.

identifies a basic premise that is best captured by way of an analogy- the article equates the corporate ecosystem to a mixed bag of greenfield and brownfield plots. It goes on to underscore that the mushrooming of the greenfield plots and their development is limited but the brownfield plots, a metaphor for corporations having opted for CIRP under the Code, offer much potential in terms of moulding a trajectory of sustainable growth.

It is made clear that the article proposes the integration of ESG factors with respect to corporations that have entered CIRP by way of operationalising several discretionary elements such as the parameters on which resolution plans are gauged or by creating artificial restraints and incentives in the bidding system for resolution plans. Out of the six possible ways of ESG integration into the Code that the article ponders, two are of special significance. The first of which is to amend the statute itself by way of including ESG factors in the evaluation of resolution plans under Section 30(2) of the Code.¹¹⁷ Whereas, the second means set out to do the same by incentivising the powers, that regulatory guidelines issued by the IBBI hold in CIRP, by way of including elements of ESG in the Evaluation Matrix (*EM*) as is being currently issued under the Regulations of the Code.

While the authors are in full agreement with respect to the need for ESG integration into the insolvency regime of the country and even as far as the methods suggested in the article go, there is an alternative suggestion about the bounds of where it stops. Corporations that opt for a CIRP process are to be mandated to submit a Comprehensive Environmental Risk Report (*CERR*) that details their ESG practices alongside a holistic disclosure of the entity's 'relationship with nature' to bring into its ambit every detail of its ongoing, past, and future operations that may be polluting or creating a risk of an environmental liability - including details relating to previously undertaken clean-up efforts.¹¹⁸ This report is to be given due weightage by the Resolution Professional in deciding the most appropriate Resolution Plan in the bidding process. It would also support the identification of 'top polluters'.

117. The Insolvency and Bankruptcy Code, 2016, s 30(2).

118. Linna (n 6).

B. Overhaul of Existing Scheme of Dealing with Environmental Liabilities

While Parts A and B of the solutions dealt with proactive ways of imbuing an element of substantive sustainability within the provisions of the Code, this Part identifies an existing issue and hopes to remedy it. The issue is the widespread sidelining of environmental liabilities under the current scheme of the Code. The authors recognize that the disbursal of environmental liabilities is certainly not a *sine qua non* of the Code when seen from a legislative intent angle, and on the heels of this realisation, a more nuanced approach is advocated. One that ensures environmental liabilities are not entirely sidelined to the detriment of public interest while balancing such concerns against the immediate stakeholders.

G. Creation of a ‘Public Duty’ Obligation Upon Corporations

The Canadian Supreme Court in *Orphan Well Association v. Grant Thornton Limited* explained that environmental liabilities are of two kinds: debts and public duties.¹¹⁹ While debts may be subject to discharge, public duties are to be carried out notwithstanding the insolvency proceedings. It comes as no surprise that the actions of the insolvent involving harmful pollution, could significantly harm the environment and pose a direct or indirect risk to public health. Allowing such entities to dodge their responsibility to remedy the destruction they cause by retaining such environmental liabilities as unsecured creditors would be disastrous because environmental contamination may have the effect of detrimentally affecting the lives of innumerable people and businesses.

It is more important that the “polluter fixes” rather than “polluter pays”. The fine amount associated with environmental violations has the jurisprudential purpose of acting as a sanction against undesirable behaviour. It may not necessarily be used by the government to absorb the costs of environmental clean-up. However, imposing the responsibility on insolvent companies to clean up after themselves would have the effect of ensuring that larger community considerations are addressed as a matter of priority. This is particularly important because India is one of the most vulnerable nations with respect to climate change; a statistical truth

119. *Orphan Well Association v Grant Thornton Limited*, 2019 SCC OnLine Can SC 7.

reflected by several studies.¹²⁰ This is also the reason why such environmental duties to clean up must be treated as “public duties”.

The authors propose that an amendment be made to Section 3 of the Code,¹²¹ to define “environmental public duty” as “a duty to remediate the risk of causing imminent harm to the public at large, as determined upon submission of the Comprehensive Environmental Risk Report during the Corporate Insolvency Resolution Process”. Additionally, Section 53 (a) concerning the prioritisation of the distribution of assets be amended by listing environmental public duties alongside the insolvency resolution process and liquidation costs.¹²² Evidence of such an approach may be found in Scottish and American judicial decisions which have provided that environmental liabilities be treated as insolvency costs.¹²³ Taking a lesson from such an approach, the Indian insolvency regime must ensure that the determination of what constitutes an ‘environmental public duty’ must be done during the CIRP, utilising the Comprehensive Environmental Risk Report submitted by the debtor. Any fine amounts associated with environmental duties may be relegated to the status of debts owed to unsecured creditors.¹²⁴ This would have the effect of ensuring that the most pressing needs associated with environmental clean-up operations, affecting the public at large, would be addressed as a matter of priority.

V. CONCLUSION

The importance of environmental considerations in law-making has grown considerably in the wake of the existential threat of climate change. While it is a common belief that the insolvency law and environmental legislation seek to achieve entirely different goals, the authors explain that multi-dimensional sustainability (of which, environmental sustainability forms a part) has always been a key purpose behind the enactment

120. Simrin Sirur, ‘What the Latest IPCC Report on Climate Vulnerability & Adaptation Means for India’ (*ThePrint*, 1 March 2022) <<https://theprint.in/environment/what-the-latest-ipcc-report-on-climate-vulnerability-adaptation-means-for-india/852967/>> accessed 29 December 2023.

121. The Insolvency and Bankruptcy Code, 2016, s 3.

122. The Insolvency and Bankruptcy Code, 2016, s 53(a).

123. Joint liquidators of Doonin Plant Limited [2018] CSOH 89; *Midlantic National Bank v New Jersey Dept. of Environmental Protection* 474 U.S. 494, 106 S. Ct. 755 [1986] at 762, 88 L.Ed.2d.

124. The Insolvency and Bankruptcy Code, 2016, s 53(d).

of the Code of 2016. The parochial understanding of the insolvency legislation as a private right granted to ensure better sustenance of businesses must be expanded to include substantive sustainability considerations, mindful of the fact that insolvency is a socio-economic right of welfare and not a fundamental right.

The three-pronged solution framework is composed firstly of a specific denial of CIRP to ‘top polluters’. Since it is likely that such top polluters would have a larger volume of environmental liabilities, ensuring the prioritisation of fulfilment of the same during liquidation is advisable. Secondly, mandating compulsory environmental insurance and the creation of an environmental public duty fund would have the effect of ensuring efficiency in the absorption of clean-up costs associated with accidental damage and the availability of adequate funds to remediate liabilities posing imminent danger to the public at large respectively.

Thirdly, applying ESG norms in the CIRP with respect to the identification of bidders and mandating the submission of the Comprehensive Environmental Risk Report (*CERR*) by the debtor would help identify the nature of environmental liabilities and greatly aid the prioritisation of such norms in the CIRP. Finally, an approach to sub-classify environmental liabilities into ‘environmental public duties’ and ‘debts’ through the implementation of the ‘imminent danger’ criterion in the CIRP – ably supported by the *CERR* would ensure a rational prioritisation of the fulfilment of those liabilities that are of the greatest importance to people and the economy at large. With the right framework and efficient implementation, the ‘greening’ of the Indian insolvency regime would serve to adequately reconcile corporate and environmental interests in the critical battle against climate change.

Dark Patterns and Antitrust: Can India Afford the Cost of Privacy?

—Tejaswini Kaushal and Mayank Bhandari*

ABSTRACT

With India's Digital Personal Data Protection Act, 2023 imposing a blanket ban on targeted advertising and behavioral monitoring for children, a critical question arises: can India afford to prioritize children's privacy over the data-driven economic considerations of big tech giants like Meta and Amazon? This paper examines the impact of dark patterns on children's privacy in the digital age, focusing on the interplay between data protection and competition law in India. Dark patterns manipulate user behavior and extract more data than required, particularly from vulnerable children. 60% of children spend 3 hours daily on social media, immersed in platforms riddled with these manipulative tactics. The new regulations may challenge Meta's business model, forcing them to consider non-personalized ads or subscription-based models. This shift raises concerns for both advertisers (ineffectiveness of non-personalized Ads) and users (hesitance towards subscriptions). Dark patterns give dominant players like WhatsApp an unfair advantage by enabling vast data collection and hindering fair competition by restricting market entry for smaller competitors. Prioritizing children's privacy carries economic challenges, but the long-term costs of inaction are far more significant. Exploiting their data manipulates behavior, impedes development, and creates lasting ethical and privacy concerns. Will Meta implement ad-free subscriptions, bar young users, or find alternative data collection methods? Can regulators effectively balance the right to privacy with the economic realities of data-driven businesses? The paper argues that the question

* The authors are students at Dr. Ram Manohar Lohia National Law University, Lucknow (RMLNLU).

“Can India afford the cost of privacy?” is not just an economic question, but an ethical one. Choosing children’s well-being and data security necessitates creative solutions, regulatory vigilance, and a collective commitment to building a safer digital landscape. The path forward may be complex, but the cost of inaction on data protection may be too high for both children and society as a whole.

I. INTRODUCTION

The advent of digital transformation has ushered in consumption and production patterns never seen before.¹ This has necessitated innovative business models for effective competition in the digital market.² New technologies and associated knowledge have empowered market players to devise modern solutions for enhanced customer service.³ Data, regarded as the key to success in the digital realm, blurs the lines between production factors and products themselves, subsequently making information both a product and a raw material.⁴ With data possession and proper utilization emerging as indicators of market power, traditional economic measurement tools take a backseat.⁵

The Fourth Revolution has ushered in an environment fostering new models of interactions among market players and diverse consumption and production styles and facilitated the interplay between competition law and data protection law.⁶ The potency of data introduces challenges not only to competition law but also to personal data protection. The evolving digital economy makes it challenging to consider these regimes

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1. A. JB and others, ‘Innovation in a crisis: Why it is more critical than ever’ (McKinsey & Company, 17 June 2020) <www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/innovation-in-a-crisis-why-it-is-more-critical-than-ever> accessed 5 January 2024.
 2. David Deller and others, ‘Competition and Innovation in Digital Markets’ (2021) 40 BEIS Research Paper Number <https://assets.publishing.service.gov.uk/media/60f5b6d8e90e0764d4c68c10/uae-ccp-report__1_.pdf> accessed 4 January 2024.
 3. Leah Leachman and Don Scheibenreif, ‘Using Technology to Create a Better Customer Experience’ (Harvard Business Review, 17 March 2023) <<https://hbr.org/2023/03/using-technology-to-create-a-better-customer-experience>> accessed 2 January 2024.
 4. The Economist, ‘The world’s most valuable resource is no longer oil, but data’ (The Economist, 6 May 2017) <www.economist.com/leaders/2017/05/06/the-worlds-most-valuable-resource-is-no-longer-oil-but-data> accessed 1 January 2024.
 5. Ibid.
 6. WEF, ‘Leading through the Fourth Industrial Revolution Putting People at the Centre’ (WEF 2019) <www3.weforum.org/docs/WEF_Leading_through_the_Fourth_Industrial_Revolution.pdf> accessed 20 December 2023.

separately, yet the delineation of responsibilities between these systems remains unclear.⁷

Safeguarding children's privacy comes out as a paramount consideration in this deliberation, given the ubiquity of smartphones, tablets, and computers in the contemporary digital landscape.⁸ The phenomena of dark patterns are widespread in the day-to-day digital experiences of children.⁹ They pose a range of potential harms, including threats to privacy, economic exploitation, and adverse effects on mental health and overall development.¹⁰ There is a pressing need to reassess ethical frameworks and protective strategies in the digital era, with a renewed emphasis on prioritizing the well-being of children over commercial interests. Human rights instruments, especially the United Nations Convention on the Rights of the Child (*UNCRC*)¹¹ and the right to freedom of thought,¹² emphasize the importance of governments directing initiatives to create a safer online environment for children. Governments worldwide, including those in India,¹³ the United States,¹⁴ and the European Union,¹⁵ have acknowledged this concern and enacted laws to ensure responsible treatment of children's information by companies and websites. The Indian data protection law has now imposed a blanket ban on target advertising and behavioral monitoring for children. However, let us take the example

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7. Arletta Górecka, 'Competition Law And Privacy: An Opinion on The Future of a Complicated Relationship - Kluwer Competition Law Blog' (Kluwer Competition Law Blog, 8 June 2022) <<https://competitionlawblog.kluwercompetitionlaw.com/2022/06/08/competition-law-and-privacy-an-opinion-on-the-future-of-a-complicated-relationship/>> accessed 5 January 2024.
 8. Brooke Auxier and others, 'Children's engagement with digital devices, screen time' (Pew Research Center: Internet, Science & Tech, 28 July 2020) <www.pewresearch.org/internet/2020/07/28/childrens-engagement-with-digital-devices-screen-time/> accessed 5 December 2023.
 9. Jenny Radesky and others, 'Prevalence and Characteristics of Manipulative Design in Mobile Applications Used by Children' (PubMed Central, June 2022) <www.ncbi.nlm.nih.gov/pmc/articles/PMC9206186/> accessed 1 January 2024.
 10. Janna Anderson and Lee Rainie, 'Themes: The most harmful or menacing changes in digital life that are likely by 2035' (Pew Research Center: Internet, Science & Tech, 21 June 2023) <www.pewresearch.org/internet/2023/06/21/themes-the-most-harmful-or-menacing-changes-in-digital-life-that-are-likely-by-2035/> accessed 2 January 2024.
 11. Convention on the Rights of the Child (adopted 20 November 1989, entered into force 2 September 1990) 1989.
 12. UN General Assembly, Universal Declaration of Human Rights, 10 December 1948, 217 A (III), art 18.
 13. The Digital Personal Data Protection Act (DPDA), 2023, ss 3(8), 9.
 14. The Children's Online Privacy Protection Rule, 2013.
 15. The European Union, General Data Protection Regulation 2016, art 8.

of most digital platforms, for instance, Meta, giving out services for free. It works on a business model of taking data as a consideration instead of money. Advertisers would not be willing to pay what they are paying right now for running non-personalized Ads. The bargain would be either to increase the frequency of non-personalized Ads like in television or the premium subscription-based models. So, the question arises: “Can India Afford the Cost of Privacy?”

Intending to address this dilemma, the paper focuses on digital platforms and applications, which are considered the primary actors in the digital economy. This paper has a threefold scope of research: Firstly, understanding the presence of dark patterns in the user interface (*UI*) and user experience (*UX*) of applications, websites, and software in the digital era; secondly, examination of the competition dynamics in such patterns; thirdly, exploration of the intersections between competition law and data protection law with emphasis on children privacy by dissecting the regulatory frameworks in India, the United States, and the European Union, and assessing their practical implications through real-life case studies.

This paper conducts the above analysis in four parts. Part II addresses the concept of dark patterns in platform characteristics, analyzes its intense impact on children’s privacy and well-being, and discusses the domestic and international statutory framework for addressing them. Part III analyzes the intersection of dark patterns and the Competition Act, 2002¹⁶ to highlight the antitrust implications of these dark patterns in the digital era due to excessive data collection and subsequent misuse. Part IV provides case studies to expound on the concepts in discussion with real-world scenarios. Part V scrutinizes a way ahead for India, tackles the question of whether India is ready for a subscription-based model for applications to safeguard its privacy, and tries to determine the cost of privacy for the Indian public.

16. The Competition Act, 2002.

II. DIGITAL DECEIT: WHAT ARE DARK PATTERNS?

The term ‘dark patterns,’ also called ‘deceptive patterns,’ was initially coined by the UX expert Harry Brignull in 2010.¹⁷ These patterns encompass strategies employed in websites or App to manipulate and mislead users into actions they did not intend, such as making purchases or signing up for services. The act of ‘misleading’ involves undermining or impairing consumer autonomy and decision-making, constituting a form of misleading advertisement, unfair trade practice, or a violation of consumer rights.¹⁸ The 2022 reports from the Federal Trade Commission (*FTC*) highlight a noticeable increase in sophisticated dark patterns, which are design tactics aimed to deceive consumers into opting for subscriptions, making payments, or compromising their privacy.¹⁹

One concerning aspect of dark patterns involves the manipulation of users by Advertisers and companies to obtain their data.²⁰ The online environment now sees an unprecedented aggregation of personal information, providing a rich resource for more assertive marketing strategies.²¹ Dark patterns deceive users by creating an illusion of choice in data-sharing options while subtly steering them away from privacy settings, such as pre-checked boxes or automatic opt-ins, cleverly concealed within obscure sections of settings menus.²²

A. Dark Patters or Black Hole?

A group of researchers at Princeton University conducted a study that resulted in the definition of taxonomy for dark patterns, characterized

17. Brignull H, ‘Bringing Dark Patterns to Light’ (Medium, 7 July 2021) <<https://harrybr.medium.com/bringing-dark-patterns-to-light-d86f24224ebf>> accessed 3 January 2024.

18. Ibid.

19. ‘FTC Report Shows Rise in Sophisticated Dark Patterns Designed to Trick and Trap Consumers’ (Federal Trade Commission, 15 December 2022) <www.ftc.gov/news-events/news/press-releases/2022/09/ftc-report-shows-rise-sophisticated-dark-patterns-designed-trick-trap-consumers> accessed 6 January 2024.

20. ‘How Much is Your Data Worth? The Complete Breakdown for 2024’ (Invisibly, 13 July 2021) <www.invisibly.com/learn-blog/how-much-is-data-worth> accessed 6 January 2024.

21. ‘Data is the new gold - How & why data is collected & sold’ (Consent Management Platform (CMP) Usercentrics, 21 October 2021) <<https://usercentrics.com/knowledge-hub/data-is-the-new-gold-how-and-why-it-is-collected-and-sold/>> (Data is the new gold) accessed 4 January 2024.

22. ‘Privacy Dark Patterns: A Case for Regulatory Reform in Canada’ (Canadian Bar Association, 8 September 2022) <www.cba.org/Sections/Privacy-and-Access/Resources/Resources/2022/EssayWinner2022Privacy> accessed 6 January 2024.

by dimensions including asymmetry, covert tactics, deception, obscuring crucial information, and restrictiveness.²³ Dark patterns permeate our digital landscape and significantly influence typical digital user behaviors. For instance, several online platforms reveal users' online statuses and 'read' receipts, creating an environment where prompt responses are anticipated once a message is seen or a user is identified as online.²⁴ Popular instant messaging services like WhatsApp contribute to the pressure by publicly displaying a user's online status, compelling individuals to reply promptly.²⁵ While this can be coped with by disabling read receipts, their online presence status remains evident regardless.²⁶ Less opacity in using these services makes navigating social expectations within digital communication platforms difficult.

The major conflict area emerges here regarding its impact on children. Children here are particularly vulnerable to the influence of dark patterns on social media and other sites, often falling into the traps of compulsive digital usage.²⁷ These dark patterns can significantly affect a child's cognitive and emotional learning trajectory.²⁸ A 2023 study reveals that 60% of children spend 3 hours a day on social media, and it can be reasonably anticipated that a major cause of this addiction stems from their victimization to dark patterns prevalent on these platforms.²⁹

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23. 'Dark Patterns at Scale: Findings from a Crawl of 11K Shopping Websites' (Princeton University) <<https://webtransparency.cs.princeton.edu/dark-patterns/>> accessed 17 December 2023.
 24. Westin F, 'Fomo-Centricity: How Social Media's Dark Designs Cause Users to Reluctantly Give Up Their Data' (Thesis, Carleton University 2020) <<https://chorus.scs.carleton.ca/wp-content/papercite-data/pdf/westin2020thesis-carleton.pdf>> accessed 4 January 2024.
 25. Sanja Kelly and others, 'Silencing the Messenger: Communication App Under Pressure' (Freedom House) <<https://freedomhouse.org/report/freedom-net/2016/silencing-messenger-communication-apps-under-pressure>> accessed 19 December 2023.
 26. Ibid.
 27. Disrupted Childhood: The cost of persuasive design (Version 2, 5Rights Foundation 2023) <<https://5rightsfoundation.com/uploads/Disrupted-Childhood-2023-v2.pdf>> accessed 2 January 2024.
 28. Ying T, 'Effects of using mobile instant messaging on student behavioral, emotional, and cognitive engagement: a quasi-experimental study - International Journal of Educational Technology in Higher Education' (Springer Open, 11 January 2022).
 29. TOI, '60% Children Spend 3 Hours A Day on Social Media: Study' (The Times of India, 23 September 2023) <http://timesofindia.indiatimes.com/articleshow/103878956.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> (TOI, 3 hours a day on social media) accessed 6 January 2024.

This begs the question of how children are allowed unrestricted on a majority of the most popular sites, including social media,³⁰ gaming,³¹ and other services,³² in the first place. This situation is slightly better in certain countries. In the EU, for instance, the Meta-owned social messaging platform WhatsApp adjusted its age requirements to raise the minimum age to 16 for users residing in Europe to align with the General Data Protection Regulation (*GDPR*) requirements.³³ Meta also revisited Facebook's privacy policy to comply with Europe's *GDPR* policy.³⁴ The social media giant is now requesting teenagers aged between 13 and 15 years to designate a parent or guardian who would grant permission for them to share information on the platform.³⁵ Failing to do so would result in these users being unable to access a fully personalized view of the platform. However, most such platforms have not specified how they intend to verify the age limit of their users.³⁶

Furthermore, individuals living outside Europe will still be held to the existing standard, which mandates users to be at least 13 years old.³⁷ The old Data Protection mandate in India did not punish companies to collect and process data of children as per their whims and fancies as long as it

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30. Nitish Chandan, 'Minimum age to use Social Networks in India' (The Cyber Blog India, 4 January 2015) <<https://cyberblogindia.in/minimum-age-use-social-networks-india/>> accessed 6 January 2024.
 31. 'Child's Play in Digital India: Handling Teen Data with Kid Gloves?' (S&R Associates, 7 June 2023) <www.snrlaw.in/childs-play-in-digital-india-handling-teen-data-with-kid-gloves/> accessed 4 January 2024.
 32. 'More Indian children visiting 'inappropriate' websites: McAfee survey - ET BrandEquity' (ETBrandEquity.com, 27 April 2017) <<https://brandequity.economicstimes.indiatimes.com/news/digital/more-indian-children-visiting-inappropriate-websites-mcafee-survey/58392009>> accessed 6 January 2024.
 33. Gibbs S, 'WhatsApp raises minimum age to 16 for Europeans ahead of *GDPR*' (The Guardian, 25 April 2018) <www.theguardian.com/technology/2018/apr/25/whatsapp-raises-minimum-age-16-europeans-facebook-gdpr-eu#:~:text=WhatsApp%20is%20raising%20the%20minimum,EU's%20new%20data%20protection%20rules> accessed 2 January 2024
 34. Steve Ranger, 'Facebook makes *GDPR* push with new data privacy settings' (ZDNET, 18 April 2018) <www.zdnet.com/article/facebook-makes-gdpr-push-with-new-data-privacy-settings/> accessed 16 December 2023.
 35. *Ibid.*
 36. Gold A, 'Tech platforms struggle to verify their users' age' (Axios, 6 March 2023) <www.axios.com/2023/03/06/age-checks-online-children-social-media-privacy> accessed 30 December 2023.
 37. Kumar A, 'WhatsApp's separate privacy policies for Europe and India raise concerns' (India Today, 14 January 2021) <www.indiatoday.in/technology/news/story/whatsapp-s-separate-privacy-policies-for-europe-and-india-raises-concerns-1758888-2021-01-14> accessed 26 December 2023.

is consent based. Companies just mentioned in their privacy policies that consent provider is an adult. This led to a lot of abuse such as complaints were filed against Byju's to NCPDR for children's database buying and selling.³⁸ But with the recent changes in the Indian data privacy domain and the passing of the Digital Personal Data Protection Act (*DPDPA*), 2023, there is potential for Meta to adjust its policies accordingly. The DPDPA mandates 'verifiable parental consent' for users below 18,³⁹ with penalties reaching up to ₹200 crore for non-compliance.⁴⁰ However, no immediate developments have occurred in this regard, and the term 'verifiable parental consent' also remains undefined in the act, with no specified methods outlined for its implementation. Despite this, it is worth noting that the government now has the authority, and action may be imminent. This shift in regulations may also pave the way for similar adjustments in the treatment of Indian child users under upcoming data protection rules under the DPDPA.⁴¹

B. The American Outlook

Various laws have been enacted to counteract the prevalence of dark patterns globally and one of the most proactive nations is the USA. A recent development is the introduction of the Deceptive Experiences To Online Users Reduction (*DETOUR*) Act, which was passed fairly recently in July 2023.⁴² Before this, the Bureau of Consumer Protection used to enforce several policies to shield consumers from being ensnared in subscription services with convoluted opt-out procedures or deceptive offers. Additional pieces of legislation, including the Consumer Financial Protection Act (*CFPA*),⁴³ the FTC Act,⁴⁴ the Restore Online Shoppers' Confidence Act (*ROSCA*),⁴⁵ the Electronic Fund Transfer Act (*EFTA*),⁴⁶

38. DHNS, 'NCPDR summons BYJU'S CEO over database buying claims' (Deccan Herald, 22 December 2022) <<https://www.deccanherald.com/india/ncpcr-summons-byjus-ceo-over-database-buying-claims-1173895.html>> accessed 26 December 2023.

39. DPDPA (n 13), s 9.

40. DPDPA (n 13), schedule pt 3.

41. 'Indian government preparing to release draft DPDPA rules' (International Association of Privacy Professionals) <<https://iapp.org/news/a/indian-government-preparing-to-release-draft-dpdpa-rules/>> accessed 6 January 2024.

42. H.R.6083 - 117th Congress (2021-2022).

43. Consumer Financial Protection Act (CFPA), 2010.

44. Federal Trade Commission Act 1914, s 5.

45. Restore Online Shoppers' Confidence Act (ROSCA), 2010.

46. Electronic Fund Transfer Act (EFTA) 1978.

and the Telemarketing Sales Rule (*TSR*),⁴⁷ serve to safeguard users against unfair, abusive, or deceptive marketing practices.

The CFPA, in particular, focuses on addressing the use of “negative options,” where a consumer’s failure to take action is treated as consent.⁴⁸ For example, if a consumer neglects to submit a cancellation request, they may continue to be charged for a company’s services due to the application of “negative options.” While negative options, such as offering a free trial period followed by a paid subscription, are not inherently illegal, the incorporation of dark patterns can obstruct users from canceling a service reasonably, leading to recurring payments and intricate refund processes.

Furthermore, the state of California explicitly prohibits using dark patterns under the California Privacy Rights and Enforcement Act.⁴⁹ This state law unequivocally states that an “agreement obtained through the use of dark patterns does not constitute consent.”⁵⁰

C. What is the Indian Strategy to Tackle Dark Patterns?

On November 30, 2023, the Central Consumer Protection Authority officially issued the Guidelines for Prevention and Regulation of Dark Patterns, 2023, which became effective on the same date.⁵¹ A crucial aspect outlined in these guidelines is the definition of Dark Patterns, encompassing any practices or deceptive design patterns within UIs or UXs on any platform.

These guidelines are applicable to all platforms providing systematic goods/services in India, as well as to advertisers and sellers. Individuals associated with any platform are prohibited from engaging in dark practices. In instances of ambiguity or disputes regarding interpretation, the decision of the Central Consumer Protection Authority holds final authority. Additionally, if any dark practice is already regulated under

47. Telemarketing Sales Rule (*TSR*) 2015.

48. Brown A, ‘CFPB issues circular on unlawful “negative option” marketing practices’ (DLA Piper, 24 January 2023) <www.dlapiper.com/en/insights/publications/2023/01/cfpb-issues-circular-on-unlawful-negative-option-marketing-practices> accessed 6 January 2024.

49. The California Privacy Rights and Enforcement Act 2020.

50. Cal. Civ. Code, s 1798.140(h).

51. Guidelines for Prevention and Regulation of Dark Patterns, 2023.

another law, these guidelines serve as an additional measure and do not derogate from existing legal provisions. Specified dark patterns for India include false urgency, basket sneaking, confirm shaming, forced action, subscription trap, interface interference, bait and switch, drip pricing, disguised advertisement, nagging, trick questions, and rogue malwares.⁵² The Indian jurisdiction unlike US and EU does not provide for data protection related to dark pattern which is designed to obtain more data than required. Indian companies usually seek the consent along with acceptance of terms and conditions leaving users with little or no choice to disagree with market analytics. These kinds of patterns are identified by EU regulators as Forced Data Collection or Forced to Get Marketing Material.⁵³

III. INTERSECTING LINES: DARK PATTERNS' IMPACT ON ANTITRUST

A. When Data is Money

Shoshana Zuboff, an American scholar and writer, highlights the rise of a new form of economic power that capitalizes on tracking and monetizing every online interaction.⁵⁴ Privacy becomes a commodity traded for access to digital services in this landscape.⁵⁵ Google's introduction of 'Behavioral Surplus' was a turning point, enabling companies to customize Ads according to actual behavioral patterns and optimize their marketing budgets.⁵⁶ This evolution gave rise to Big Data, a crucial asset for online economic activities. Data-driven companies gain a competitive

52. *Ibid*, annexure A.

53. Behavioural study on Unfair Commercial Practices: Dark patterns and Manipulative Personalization in the Digital Environment: (Final Report, EU 2022) <<https://op.europa.eu/en/publication-detail/-/publication/606365bc-d58b-11ec-a95f-01aa75ed71a1/language-en/format-PDF/source-257599418>><https://op.europa.eu/en/publication-detail/-/publication/606365bc-d58b-11ec-a95f-01aa75ed71a1/language-en/format-PDF/source-257599418>> accessed 25 December 2023.

54. Kavenna J, 'Shoshana Zuboff: Surveillance capitalism is an assault on human autonomy' (The Guardian, 4 October 2019) <www.theguardian.com/books/2019/oct/04/shoshana-zuboff-surveillance-capitalism-assault-human-autonomy-digital-privacy> accessed 24 December 2023.

55. Akshat Verma and Dr. Ila Malhotra Anand, 'Data Capitalism: The Ultimate Tsukuyomi' (2023) 11(4) *Quest Journals: Journal of Research in Business and Management* 74.

56. S Zuboff, *Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power* (PublicAffairs, 2019).

edge by relying on constant and up-to-date information.⁵⁷ Big tech giants leverage user data, initially using it to enhance services and later transforming it into a lucrative revenue stream through targeted advertising.⁵⁸ The phenomenon of network effects further amplifies this advantage, making it challenging for competitors without strong databases to enter or expand in the market.⁵⁹

The growing economic importance of big data prompts a reevaluation of consumer harm and competition criteria. This demands equal emphasis not only on traditional antitrust parameters based solely on price but also on non-price factors such as privacy and data protection. However, a question arises: Should transgressions involving exclusionary conduct and data privacy violations by dominant data-rich companies be addressed under competition laws or through the enactment of specific data protection laws? The following section addresses this dilemma.

B. N. The Competition Act Juxtaposed with Dark Patterns: No Light Ahead?

1. Demanding More Than What Is Required

Dark patterns create an intersection with competition law when companies employ tactics that go beyond the necessary data requirements. One such dark UX pattern involves soliciting more personal information from users than they initially intended to provide, often justified under the guise of “knowing your users.”⁶⁰ This technique is employed by websites or App aiming to induce users into offering additional information or taking actions beyond their original intent.⁶¹ For instance, a website may initially prompt users to sign up for a newsletter but then proceed to request their full name, phone number, and address.

57. Andrei Hagiu and Julian Wright, ‘When Data Creates Competitive Advantage’ (Harvard Business Review, January 2020) <<https://hbr.org/2020/01/when-data-creates-competitive-advantage>> (Hagui and Wright) accessed 2 January 2024.

58. Ibid.

59. James Currier, ‘What Makes Data Valuable: The Truth About Data Network Effects’ (NfX, February 2020) <www.nfx.com/post/truth-about-data-network-effects> accessed 14 December 2023.

60. Timothy Morey and others, ‘Customer Data: Designing for Transparency and Trust’ (Harvard Business Review, May 2015) <<https://hbr.org/2015/05/customer-data-designing-for-transparency-and-trust>> accessed 6 January 2024.

61. Ibid.

The exposure of children to complex digital environments and manipulative design tactics, i.e. dark patterns, exploit the vulnerability of children, who lack the full cognitive abilities to discern or resist such manipulations.⁶² The systematic ‘datafication’ and profiling of children’s online behavior fuel child-centric digital analytics, leading to economic exploitation and infringements on children’s rights.⁶³

Another significant dimension of deceptive design includes direct monetization via in-app purchases and employing data-driven strategies to monetize children’s personal information.⁶⁴ The changing revenue models of games influence user behavior through game design, particularly in the realm of behavioral design within games.⁶⁵ The implementation of such a monetization model in children’s apps is carefully designed to enhance engagement and encourage purchases.⁶⁶

Another aspect involves the collection of sensitive document data, such as Aadhar numbers in games and sites, where the collection of such information is excessive and disproportionate to the needs of the platform.⁶⁷ The platforms may sometimes, by law, be required to collect such details as part of ‘Know Your Customer’ (KYC). Such collection of data shall adhere to the principle of data minimization.⁶⁸ The upcoming data protection rules may provide more clarity on modes of verification and KYC.⁶⁹

As per EU guidance, if controllers request a higher level of verification than required to access the service, they must justify this in relation to

62. Data is the new gold (n 21).

63. Hagui and Wright (n 57).

64. M.R. Leiser, ‘Protecting Children from Dark Patterns and Deceptive Design’ [2023] SSRN <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4660222> accessed 3 January 2024.

65. Simone van der Hof and others, “‘Don’t Gamble With Children’s Rights’—How Behavioral Design Impacts the Right of Children to a Playful and Healthy Game Environment’ (Frontiers, 2 May 2022) <www.frontiersin.org/articles/10.3389/fdgth.2022.822933> accessed 5 January 2024.

66. ‘The Kids Don’t Stand A Chance: Unfair And Deceptive Advertising In Children’s Apps’ (2020) 66 Loyola Law Review <<https://space.loyno.edu/jspui/bitstream/123456789/188/1/Fernandez%20-%20LLR%20-%2066.1.pdf>> accessed 7 January 2024

67. Pierre Laperdrix and others, ‘The Price to Play: a Privacy Analysis of Free and Paid Games in the Android Ecosystem’, ACM Web Conference 2022 (HAL Science 2022) <<https://hal.science/hal-03559973/document>> accessed 3 January 2024.

68. Guidelines 2/2019 on the processing of personal data under Article 6(1)(b) GDPR in the context of the provision of online services to data subjects, art 5(1)(c).

69. DPDA (n 40).

the accountability and fairness principles and minimize both the burden on the user (in line with ‘efficient and timely protection’) and personal data processed (in line with data minimization) in the process.⁷⁰ The authors understand that the collection of data is part of the consideration in exchange for services provided by the website. However, dark patterns employed to collect more of such data are analogous to violating consensus-ad idem where the consumer is not aware of the cost he is paying while using the website. After the implementation of DPDPA, such data collection may not only contravene the data minimization principle but also violate the Competition Act, 2002, concerning the abuse of a dominant position through the usage of such data.⁷¹

2. *Having a Non-monetary Impact on the User*

Traditionally, antitrust regulators intervened when dominant enterprises limited output, increased prices, or engaged in predatory pricing.⁷² Pricing was considered a pivotal competition parameter, yet this saw a shift in perspective due to increased digitization.⁷³ Dark patterns now lie under the category of anti-competitive practices that influence the market without an explicit monetary impact. In present times, they are employed more often than an average user can anticipate. A Northeastern University study in October 2021 uncovered widespread use of dark patterns, revealing that 95% of the top 240 Android Apps employed deceptive tactics, and over 50% of major websites implemented such patterns.⁷⁴ A separate 2021 Advertising Standards Council of India (ASCI) study focused on social media influencer Ads found that 29% of these Ads featured misleading dark patterns.⁷⁵ Additionally, a 2020 MIT study demonstrated that when popular websites used dark patterns in data col-

70. Coline Boniface and others, ‘Security Analysis of Subject Access Request Procedures How to Authenticate Data Subjects Safely When They Request for Their Data’ [2019].

71. The Competition Act, 2002, s 4.

72. Predatory Pricing (OECD 1989) <www.oecd.org/competition/abuse/2375661.pdf> accessed 3 January 2024.

73. Ibid.

74. Johanna Gunawan and others, ‘A Comparative Study of Dark Patterns Across Mobile and Web Modalities’ (2021) 5 Proc. ACM Hum-Comput. Interact, CSCW2 377 <<https://darkpatterns.ccs.neu.edu/pdf/gunawan-2021-cscw.pdf>> accessed 15 December 2023.

75. Dark Patterns: New Threat to Consumer Protection (Discussion Document, ASCI 2022) <www.ascionline.in/wp-content/uploAds/2022/11/dark-patterns.pdf> accessed 4 January 2024.

lection pop-ups, participants were 8-23% more likely to consent to tracking.⁷⁶ These findings collectively underscore the prevalence and impact of dark patterns in shaping user behavior across various digital platforms.

Furthermore, Meta (formerly Facebook Inc.) and Google have employed dark patterns, including pre-selected checkboxes and confirm shaming, compromising user privacy, more than once over several years of their existence and use.⁷⁷ These tactics often default to disabling privacy-protecting options, exploiting users' cognitive inertia.⁷⁸ For instance, Facebook used to warn users that disabling facial recognition means they will not be notified if someone impersonates them, omitting information about the potential risks of enabling facial recognition technology. This was an explicit example for confirm shaming, a practice of inducing users not to select privacy-protecting options by framing them as alarming or shameful. Facebook recently took down the facial recognition feature in view of privacy concerns raised by many.⁷⁹

Another example is of pre-ticked boxes to consent to cookies or privacy guidelines on a website, propelling rash acceptance of the terms of use amongst visitors. Users, not paying close attention, may fail to choose more private options or opt out of privacy-threatening ones. The overwhelming exposure to online consent banners has also led to "consent fatigue," causing most to mechanically click 'accept' without delving into the specifics.⁸⁰ Such tactics enable social media companies to obtain user consent for the most privacy-intrusive options, expanding access to valuable big data sold to advertisers. To address this, one strategy can be to keep the checkboxes empty initially, encouraging users to read all options for an informed choice or prioritize the most private options

76. Midas Nouwens and others, 'Dark Patterns after the GDPR: Scraping Consent Pop-ups and Demonstrating their Influence' [2020] CHI 13 <<https://people.csail.mit.edu/ilaria/papers/Midas-MITCHI2020.pdf>> accessed 29 December 2023.

77. BBC News, 'Facebook and Google use 'dark patterns' around privacy settings, report says' (BBC News, 28 June 2018) <www.bbc.com/news/technology-44642569> accessed 6 January 2024.

78. *Ibid.*

79. 'An Update on Our Use of Face Recognition | Meta' (Meta) <<https://about.fb.com/news/2021/11/update-on-use-of-face-recognition/>> accessed 6 January 2024.

80. Luis Montezuma and Tara Taubman-Bassirian, 'How to avoid consent fatigue' (International Association of Privacy Professionals, 29 January 2019) <<https://iapp.org/news/a/how-to-avoid-consent-fatigue/>> accessed 7 January 2024.

by default. This strategy has been adopted and implemented under the GDPR already.⁸¹

Dark patterns are deemed unfair, exploitative, and exclusionary, creating significant barriers for new entrants lacking access to extensive big data. Recognizing data as a crucial non-price competition parameter, it was long overdue for the Competition Commission of India (CCI) to investigate tech enterprises for the potential abuse of dominance by compromising user data privacy. In the 2018 case of *Bharat Matrimony v. Google Inc.*,⁸² a shift to achieve this end was witnessed when the CCI rebuked Google for abusing its dominance in the Indian market for biased online web searches. CCI also noted that Google did not provide free search services as the data collected from the users on every search contributed to 'big-data' analysis and revenue to Google from targeted advertisements.

3. *Coercion as a Component of Abuse of Dominance*

Daniel Kahneman, a Nobel Prize-winning economist, highlights the dual nature of our brain.⁸³ He demarcates them into two systems, namely 'System 1' and 'System 2,' the former being responsible for quick and spontaneous reactions.⁸⁴ Dark patterns, such as streaks in Snapchat messaging, trigger System 1 of the brain. The dopamine release from dark patterns tricks users into incessantly falling back to its use, leading to user addiction and increased platform usage.⁸⁵ Multiple studies throughout the decades have established higher vulnerability of younger brains to dopamine hits from dark patterns on such websites.⁸⁶ In such scenarios, a game-addict or social media-addict child becomes highly likely to

81. Bateman R, 'GDPR: Don't Use Pre-Ticked Boxes for Cookies TermsFeed' (TermsFeed, 1 July 2023) <www.termsfeed.com/blog/gdpr-no-pre-ticked-boxes-cookies/> accessed 2 January 2024.

82. *Bharat Matrimony v. Google Inc.* [2012] Case Nos. 07/2012.

83. 'Daniel Kahneman Explains the Machinery of Thought' (Farnam Street) <<https://fs.blog/daniel-kahneman-the-two-systems/>> accessed 3 January 2024.

84. *Ibid.*

85. Waters J, 'Constant craving: how digital media turned us all into dopamine addicts' (the Guardian, 22 August 2021) <www.theguardian.com/global/2021/aug/22/how-digital-media-turned-us-all-into-dopamine-addicts-and-what-we-can-do-to-break-the-cycle> accessed 4 January 2024.

86. Zara A, 'Why young brains are especially vulnerable to social media' (APA, 3 February 2022) <www.apa.org/news/apa/2022/social-media-children-teens> accessed 21 December 2023.

consent to sharing any and all information that a website or platform may be seeking from him if refusal results in blocking its access to the child. In the longer run, children keep falling deeper into the trap as extended usage allows tech enterprises to extract more user data, better exploit cognitive biases, and manipulate behavior. While an illusion of consent is created, the reality is that tech platforms coerce users, especially children, into actions detrimental to their interests, clearly falling beyond the notion of free will. Hence, coercion becomes a key element of market dominance abuse under competition law in this scenario.⁸⁷

In 2020, the CCI investigated WhatsApp's proposed privacy update, forcing users to share unnecessary personal data or opt out of the platform.⁸⁸ Such tactics evidently classify as dark patterns. The CCI aptly identified a prima facie case of abuse of dominance, considering WhatsApp's dominance in the relevant market and the coercive nature of the user choices. Similarly, in 2020, Google was found to abuse its dominance by exclusively allowing GPay payments on its Play Store, limiting market access for other payment platforms.⁸⁹ These cases establish the CCI's consistent treatment of coercion as a crucial component in identifying abuse of dominance.

For dark patterns without direct monetary impact, the tactics used to compel users to share data should be viewed as a form of coercive anti-competitive activity, unjustly amplifying the market influence of these platforms. These must be countered just as thoroughly and fiercely by the CCI.

4. *Dark Patterns as a Product of Non-Price Parameters for Competition*

Price competition arises from the equilibrium between supply and demand for specific goods.⁹⁰ Non-price parameters competition, on the other hand, pertains to alterations in the qualitative attributes of

87. Competition Act, (n 16), s 4.

88. Harshita Chawla v WhatsApp Inc. and Facebook Inc, Case No 15/2020.

89. XYZ v Alphabet Inc. and Others, Case No 07/2020.

90. Arrow KJ and Debreu G, 'Existence of an Equilibrium for a Competitive Economy' (Case) (1954) 22(3) *Econometrica* (Arrow KJ and Debreu G).

individual goods and services.⁹¹ Data collection through dark patterns falls within the latter category. Dark patterns create a conflict with competition law when companies employ tactics that go beyond the necessary data requirements. This technique is employed by websites or Apps aiming to induce users into offering additional information or taking actions beyond their original intent.⁹² For instance, a website may initially prompt users to sign up for a newsletter but then proceed to request their full name, phone number, and address. In the subsequent section, this aspect is further explored through the WhatsApp case study.

IV. FOOD FOR THOUGHT: SOME CASE STUDIES OF RELEVANCE

A. WhatsApp: Yes, Or Yes? The Choice is Yours

1. *Flipping through WhatsApp's Case Files*

Meta has been scrutinized for its questionable use of consumer data time and again.⁹³ Its subsidiary, WhatsApp, has faced and continues to face scrutiny across multiple jurisdictions. The 2014 Facebook/WhatsApp merger⁹⁴ in itself raised eyebrows in the US, where the FTC raised concerns for data protection within the competition law ambit due to the anticipated personal data processing and data transfers between Facebook and WhatsApp.⁹⁵

After the merger, WhatsApp lost users due to a privacy policy change allowing data sharing with Facebook, impacting the competitive constraint that privacy represents. In the EU, WhatsApp received a record €225 million fine from Ireland's data watchdog, marking the highest penalty ever imposed by the Irish Data Protection Commission and the

91. 'A Framework to Evaluate Non-Price Factors in Competition Regulation — Esya Centre' (Esya Centre) <www.esyacentre.org/documents/2022/3/29/a-framework-to-evaluate-non-price-factors-in-competition-regulation> accessed 7 January 2024.

92. Ibid.

93. Sanja Kelly and others, 'Silencing the Messenger: Communication Apps Under Pressure' (Freedom House, 2016) <<https://freedomhouse.org/report/freedom-net/2016/silencing-messenger-communication-apps-under-pressure>> accessed 6 January 2024.

94. Case No COMP/M.7217.

95. 'FTC Notifies Facebook, WhatsApp of Privacy Obligations in Light of Proposed Acquisition' (Federal Trade Commission, 10 December 2014) <www.ftc.gov/news-events/news/press-releases/2014/04/ftc-notifies-facebook-whatsapp-privacy-obligations-light-proposed-acquisition> accessed 20 December 2023.

second-highest under the GDPR.⁹⁶ This was done in the 2018 investigation into WhatsApp for transparency issues in data processing and privacy policy clarity, with ongoing objections from eight countries, including Germany, France, and Italy.⁹⁷

Through tactics such as obtaining consent through cookie acceptance and subsequently sharing data with third parties, WhatsApp subtly gains access to unassuming users' data, a dark pattern colloquially termed "privacy Zuckering" after Meta CEO Mark Zuckerberg.⁹⁸ Users, especially children, have unknowingly shared contact lists, photos, metadata, geolocations, messages, and other personal information on this platform that has come back to manipulate them in manners unthought of.⁹⁹ The effectiveness of dark patterns and other online manipulation techniques lies in making a user's behaviors seem natural through the creation of an illusion of free will, invading internal decision-making, and hampering 'decisional privacy.'

2. *WhatsApp's Position as a Dominant Entity*

In India, WhatsApp boasts over two billion monthly active users globally and a significant presence with an estimated 400 million users and revenues close to USD 1 billion. It is widely used by children for communication with families and friends. CCI, in *In Re Harshita Chawla and WhatsApp Inc. (2020)*,¹⁰⁰ has held WhatsApp as a dominant entity in India's smartphone over-the-top messaging app market, emphasizing direct network effects and the absence of messaging platform interoperability, making it difficult for users to switch App easily. A similar recognition of WhatsApp as a dominant entity is present for markets internationally as well, like recently in the European case of Meta

96. WhatsApp issued second-largest GDPR fine of of225m' (BBC News, 2 September 2021) <www.bbc.com/news/technology-58422465> accessed 2 January 2024.

97. *Ibid.*

98. Stuti Mazumdar and Symran Bhue, 'Responsible Design Part 10 of 14: Privacy Zuckering' (Think Design, May 2022) <<https://think.design/blog/responsible-design-part-10-of-14-privacy-zuckering/>> accessed 4 January 2024.

99. Elkind and others P, 'How Facebook Undermines Privacy Protections for Its 2 Billion WhatsApp Users' (ProPublica, 7 September 2021) <www.propublica.org/article/how-facebook-undermines-privacy-protections-for-its-2-billion-whatsapp-users> accessed 5 January 2024.

100. Farnam Street (n 83).

Platforms Inc v Bundeskartellamt.¹⁰¹ This implies that similar to a dominant firm manipulating prices in a traditional market, a dominant firm in a data-driven market can manipulate data collection, raising anti-competitive concerns. Hence, WhatsApp is more than capable of exploiting its dominance to impose unfair terms on users.

3. *Privacy as a Non-Price Factor of Competition*

“WhatsApp conjures the image of an unlicensed lorry driver, who, having loaded up his truck with a hazardous substance has now begun to careen recklessly down a highway, eager to beat all other traffic. Already, the truck has begun to spill, hurting those that it passes, heading inexorably towards a collision which could destroy the lives of many. While it picks up speed, policemen remain silent, or worse, look away.” was the court’s commentary in *Karmanya Singh Sareen v. Union of India*,¹⁰² heard on 01 February 2023, reflecting a stronger endorsement by the CCI in favor of preserving privacy over fostering commerce.

The aspect of privacy as a critical non-price factor in competition also emerges in the context of WhatsApp, as held in *In Re: Updated Terms of Service and Privacy Policy for WhatsApp Users (2021)*.¹⁰³ Under the Competition Act, CCI highlighted that compromised consumer data protection and privacy diminishes quality that not only harms consumer welfare but also creates exclusionary effects, reinforcing the dominant player’s market position and manipulating entry barriers in other markets. A similar approach was present in the merger case of *Facebook/WhatsApp (2014)*,¹⁰⁴ where the EC acknowledged privacy as a valuable aspect of quality for consumers. Despite both jurisdictions recognizing privacy as a non-price parameter, the integration of privacy concerns and competition law has occurred more prominently in India than in other jurisdictions.

101. *Meta Platforms Inc v Bundeskartellamt*, Case no. 238/05.

102. *Karmanya Singh Sareen v. Union of India* [2016] W.P.(C) 7663/2016.

103. *In Re: Updated Terms of Service and Privacy Policy for WhatsApp Users* [2021] Suo Moto Case No. 01/2021.

104. Case (n 90).

4. *The Antitrust-Privacy Conflict*

In the 2020 case, CCI found no competition law concerns in WhatsApp's 2016 privacy update on the reasoning that any violation of the Information Technology (IT) Act, 2000,¹⁰⁵ did not fall under the purview of the Competition Act.¹⁰⁶ This case subsequently reached the Delhi High Court (DHC) when CCI refused to take up the matter on the lack of jurisdiction.¹⁰⁷ The DHC upheld the 2016 Privacy Policy, which has been appealed against and remains pending with the Supreme Court.¹⁰⁸ However, in the 2021 case, the CCI deviated from its prior self-restraint in initiating an investigation. Instead, it employed strategic oversight regarding overlapping jurisdictions in the privacy domain between the IT Act, 2000, and DPDPA, 2023, with the Competition Act. The CCI's approach seems to align with those of Germany and Turkey, but without fully appreciating the differences in the legal system and the complex interplay between competition laws and privacy laws in those jurisdictions.

While the step is in the general interest, such overlapping regulatory frameworks have been seen to introduce uncertainty for involved parties due to conflicting decisions and add to regulatory compliance challenges. In India, the persisting stance is that the CCI will scrutinize conduct for anti-competitive implications.¹⁰⁹ The influence of privacy issues is subject to the provisions of the DPDPA, which alters the CCI's role in privacy matters. Anticipating that India has now enacted a separate data privacy law, it is likely to aggravate potential conflicts between these domains unless they two consolidate and mold themselves to suit a combined application in certain matters concerning privacy.

For instance, in the EU, judicial bodies have been cautious about integrating privacy into antitrust scrutiny without a detailed assessment. During the EU's Facebook/WhatsApp merger, it was asserted that privacy concerns due to data concentration are beyond the scope of EU competition law and are addressed by the GDPR, indicating a deliberate

105. Information Technology Act, 2000 (21 of 2000).

106. (n 84).

107. *Karmanya Singh Sareen & Anr. v. Union of India & Ors* [2016] DHC W.P.(C) 7663/2016.

108. *Whatsapp LLC, Facebook v CCI* [2022] LiveLaw (Del) 799.

109. *Competition* (n 13), s 7.

separation of competition law and privacy concerns to avoid collisions between these domains.¹¹⁰

However, the shift in approach is ongoing even in the EU. For instance, the EU Court of Justice in *Meta Platforms Inc v Bundeskartellamt* (2023) departed from the *Asnef-Equifax* ratio,¹¹¹ to hold that a national competition authority has the authority to assess compliance with data protection law to ascertain whether a breach of competition law resulted from a violation of data protection law. The FCO concluded that Meta’s amalgamation of data from sources outside Facebook for personalized advertising, done without users’ consent, not only violated data protection laws but also amounted to an abuse of Meta’s dominant market position. This case implies a potential acceptance of the integration by acknowledging that dominant entities can manipulate data or privacy standards to influence user choices.

5. *The 2021 Prima Facie Order*

The CCI took suo-motu cognizance of WhatsApp’s new Privacy policy on March 24, 2021. The CCI’s Order pertaining to WhatsApp’s 2021 privacy policy update specifically addressed the sharing of user data on WhatsApp with Facebook within the competition law domain. Here, WhatsApp had implemented the updated policy by prompting users to provide consent by a specified date, after which access to WhatsApp services would be denied. Interestingly, unlike previous updates, the 2021 privacy policy did not offer users an “opt-out” option, i.e., withdrawal of consent, which used to restrict usage of those features in the App, which the rest functioned as before. This time it left users in a “take-it-or-leave-it” scenario, where the App would function solely on acceptance of all privacy updates, like it or not. CCI determined that, due to WhatsApp’s dominant position, user consent could not be considered voluntary, and its unreasonable data practices, coupled with market dominance, constituted an exploitative violation of Section 4 of the Competition Act, 2002.¹¹²

110. *Arrow KJ and Debreu G* (n 90).

111. *Asnef-Equifax et al v Asociación de Usuarios de ServiciosBancarios* EU:C: 2006:734.

112. Competition Act (n 13), s 4.

6. *Future Course for Meta in India*

The DHC, in its order above,¹¹³ observed that “accumulation and processing of personal data from Whatsapp, in addition to its own direct data collection, can be done by Facebook for the purposes of consumer profiling that allows for targeted Ads.” From this observation, it is a fair assumption that WhatsApp may start to show Ads on its app, and based on the user’s reaction to those Ads, the user profile may be created, which may then be shared with Facebook. Now, parents usually provide gadgets to children at a young age for reasons including safety, education or entertainment, and such devices may not have Instagram or Snapchat, but they would most likely have WhatsApp pre-installed.

The DPDPA 2023 explicitly prohibits behavioral monitoring and targeted advertising for children under 18 years. Therefore, WhatsApp faces a critical decision: either bar users below 18 from the platform or refrain from showing them personalized Ads based on their data. A blanket ban on young users seems unlikely, as Meta would not risk losing such a significant portion of its user base. Instead, an EU-inspired approach, offering a subscription-based ad-free model, appears more probable.¹¹⁴ Non-personalized Ads would not sit well with advertisers who do not want to reach users outside their target demographics. Imagine the absurdity of showcasing bathroom fittings advertisements to a pre-teen audience! However, the Indian user base would be less likely to be on board with the subscription model. It would be interesting to see what Meta comes up with after the implementation of the DPDPA and the upcoming data protection rules, anticipated to be out by January 2024, with big tech expected to be compliant within six months.¹¹⁵

B. Amazon Echo Dot: ‘Alexa, Are You Violating My Privacy?’

1. *Alexa is Always Listening*

In the Amazon Echo Dot for Kids case, the US Department of Justice (*DOJ*) held that Amazon’s data collection and retention practices regarding

113. *Ibid.*

114. Foo Yun Chee and Chavi Mehta, ‘EU set to bar Meta from ads based on personal data’ (Thomson Reuters, 7 December 2022) <www.reuters.com/technology/eu-raises-concerns-over-metas-targeted-ad-model-wsj-2022-12-06/> accessed 4 January 2024.

115. DPDPA (n 13).

children’s voice recordings on Alexa devices violate the Children’s Online Privacy Protection Act (COPPA)¹¹⁶ and the FTC Act’s prohibition on unfair or deceptive acts and practices.¹¹⁷ COPPA requires operators of websites directed towards children to notify parents about the information they collect from children under 13 years, obtain parental consent, and allow deletion of the data at any time. In addition, such a service is prohibited from retaining the information collected from children under 13 for longer than is reasonably necessary to provide the service. However, when users requested the deletion of their voice recordings, or when parents used the Alexa Privacy Hub or the Alexa App to delete their children’s voice recordings, Alexa deleted the voice recordings but retained written transcripts of those recordings in residual data stores.

As per the data minimization principle, the processing of data may only be done if such processing is necessary for the fulfillment of the contract. The necessity of the processing may be analyzed by “the objective pursued and of whether it is less intrusive compared to other options for achieving the same goal.”¹¹⁸ If there are realistic, less intrusive alternatives, the processing is not ‘necessary’ even if it is necessary for the controller’s other business purposes.

For Alexa to recognize and process a child’s voice request, it is not reasonably necessary to retain that child’s voice recordings forever. Amazon only needs to retain a voice recording for a few seconds to respond to the request that the child has just made.¹¹⁹ While parents may wish to review and supervise their child’s interactions with Alexa by accessing the stored recordings, storing those recordings forever is not reasonably necessary for that purpose either. Nor is the indefinite retention of children’s voice recordings reasonably necessary for Amazon to continue improving Alexa’s speech recognition and processing capabilities.

The FTC, in its complaint, held that the company failed to put in place an effective system to ensure that it honored users’ data deletion requests. Even when Amazon discovered its failures to delete geolocation data, the FTC held that Amazon repeatedly failed to fix the problems. Amazon

116. Children’s Online Privacy Protection Act (COPPA), 2000, ss 6501–6506.

117. Federal (n 43).

118. Guidelines (n 66).

119. Federal Trade Commission v. Amazon.com Inc [2023].

settled with FTC on conditions such as data deletion, and Amazon will be required to pay a \$25 million civil penalty.¹²⁰

2. *Amazon's Defense Analysis*

According to the complaint, Amazon claimed it retained children's voice recordings in order to help it respond to voice commands, allow parents to review them, and improve Alexa's speech recognition and processing capabilities. Children's speech patterns and accents differ from those of adults, so the unlawfully retained voice recordings provided Amazon with a valuable database for training the Alexa algorithm to understand children, benefitting its bottom line at the expense of children's privacy. This algorithm helps Amazon products such as Echo Dot Kids to deliver better to their targeted audience than their competitive products, creating an exclusionary effect that unjustly amplifies these platforms' market influence. This may be seen as another example of Big tech taking more data than they are supposed to, resulting in a dark pattern affecting competition via non-price competition, making an entry barrier for other entrants. Imagine the ramifications if such data acquired via Alexa is used to profile and target children, manipulating them to buy things that they otherwise would not buy. The children are most susceptible to these kinds of manipulations. This may be done by selling such transcripts of Alexa's voice requests to platforms like YouTube for Kids to show targeted Ads. First violation as held by FTC in the complaint was that Amazon misled the parents by assuring that the children's voice recordings and geolocation data may be deleted as per their instructions. The second violation as held by FTC was the privacy policy of Amazon with respect to children's data to be unfair. Policy mentioned the recording shall be retained until requested to be deleted which is against the data minimization principle. Failing to notify the request for deletion of recordings and geolocation data has not been honored. FTC moved this complaint under Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits "unfair or deceptive acts or practices in or affecting commerce."

120. 'Amazon Agrees to Injunctive Relief and \$25 Million Civil Penalty for Alleged Violations of Children's Privacy Law Relating to Alexa' (Department of Justice, United States Department of Justice) <www.justice.gov/opa/pr/amazon-agrees-injunctive-relief-and-25-million-civil-penalty-alleged-violations-childrens> accessed 3 January 2024.

V. IS THERE LIGHT AT THE END OF THIS TUNNEL?: PONDERINGS AND SUGGESTIONS FOR A BRIGHTER FUTURE

Companies that recognize a significant portion of their user base comprises children must design their websites with this vulnerability in mind. As observed worldwide, the penalty was huge in data protection cases where children were the victims. It is crucial to note that the dark patterns are subjective depending upon the vulnerability of the user in question. In the well-publicized incident involving TikTok in Italy, a 13-year-old girl tragically took her own life after participating in a TikTok challenge.¹²¹ In response, TikTok adjusted its default settings for users under 16 to be private.¹²² Companies like WhatsApp and Amazon, when catering to child users, should not only introduce versions of their privacy policies tailored for the understanding of children but also ensure that they do not incorporate dark patterns that exploit the vulnerabilities of young users. What may not be a dark pattern for an adult user may be for a child user. In India, while companies may still be allowed to handle children's data and refine their algorithms, they are legally obligated under the DPDPA 2023 to refrain from engaging in tracking, behavioral monitoring, targeted advertising, and the use of dark patterns. If companies like Meta or gaming platforms experience financial setbacks due to these data restrictions on their young users, they are anticipated to introduce a subscription-based model for app usage. Such subscription services may encompass a 15-30% commission for Google Play or the App Store, along with other applicable taxes.¹²³

This research paper has delved into the intricate ecosystem of dark patterns, their impact on children's privacy in the digital age, and the complex interplay between data protection and competition law. DPDPA's law with respect to children's privacy has led us to a singular yet profound

121. Deutsche Welle, 'Italy targets TikTok after death of child – DW – 01/23/2021' (dw.com, 23 January 2021) <www.dw.com/en/italy-targets-tiktok-after-death-of-child-in-black-out-challenge/a-56322643> accessed 8 January 2024.

122. Guardian staff reporter, 'Italy blocks TikTok for certain users after death of girl allegedly playing 'choking' game' (The Guardian, 23 January 2021) <www.theguardian.com/world/2021/jan/23/italy-blocks-tiktok-for-certain-users-after-death-of-girl-allegedly-playing-choking-game> accessed 6 January 2024.

123. '15% for the first \$1M (USD) revenue earned by the developer each year 30% for earnings in excess of \$1M (USD) revenue earned by the developer each year' <<https://support.google.com/googleplay/android-developer/answer/112622?hl=en>>.

question: Can India afford the cost of prioritizing children's privacy by restricting data collection and personalized advertising in a market dominated by giants like Meta?

A. Key Findings

Dark patterns are pervasive across digital platforms, manipulating user behavior and extracting excessive data, particularly from vulnerable children. A staggering percentage of children spend an eighth of their day on social media, immersed in platforms where dark patterns are like hidden predators.¹²⁴ These manipulative tactics, prevalent in 95% of top Android App¹²⁵ and 29% of social media influencer Ads,¹²⁶ resultantly developing cognitive biases and emotional vulnerabilities. The consequences are alarming, potentially hindering healthy development and self-perception and creating lifelong digital footprints fraught with ethical and privacy concerns.

Imagine the chilling reality: A child, ensnared by dark patterns, unknowingly surrenders his personal data with each click and scroll. Given that these tactics increase consent to data tracking by 8-23%,¹²⁷ manipulation of children can be done with insidious ease. This data, then, becomes the lifeblood of dominant players like WhatsApp and Amazon, allowing them to refine algorithms, personalize experiences, and gain an unfair competitive advantage.

The ramifications ripple beyond immediate economic concerns. Every targeted advertisement, every manipulative nudge, chips away at a child's autonomy and agency. Imagine the exploitation if Alexa voice recordings, capturing innocent speech patterns, are used to profile and target children, subtly influencing their purchase decisions. The cost of inaction on data protection, then, extends far beyond mere financial loss. It jeopardizes the mental and emotional well-being of an entire generation.

Dark patterns also create competition concerns, as dominant players like Amazon and Meta leverage vast data profiles to gain an unfair advantage, hindering fair market entry for smaller competitors.

124. TOI 3 hours on social media (n 29).

125. Johanna (n 71).

126. Dark (n 72).

127. Midas (n 73).

B. Future Uncertainties

How will Meta adapt to the new regulations? Will they implement ad-free subscriptions, bar young users, or find alternative data collection methods? Can regulators effectively balance the right to privacy with the economic realities of data-driven businesses?

C. The Cost of Privacy

While prioritizing children's privacy carries economic challenges, the long-term costs of neglecting it are potentially far greater. Exploiting children's data can manipulate behavior, impede cognitive development, and create lasting digital footprints with ethical and privacy concerns. Ultimately, the question of "Can India afford the cost of privacy?" is not merely an economic one. It is a critical ethical dilemma. Choosing children's well-being and data security necessitates creative solutions, regulatory vigilance, and a collective commitment to building a safer, more responsible digital landscape. The path forward may be complex, but the cost of inaction on data protection may prove far too high for children and society as a whole.

Trade Reform: A Comprehensive Look at the Settlement Period and The T+0 Implementation in India

—Sahil Sachin Salve and Sanjeev Rajepandhare*

ABSTRACT

In the intricate web of India's economic growth, the stock market stands as a key player, orchestrating the exchange of capital and ownership. At the heart of this financial ballet lies the settlement process, a crucial juncture where tangible assets and currency change hands. Witnessing a transformative journey from delayed settlements to the current T+1 model, the Securities and Exchange Board of India (SEBI) emerges as a linchpin in this evolution. SEBI, with its multifaceted role in market regulation, anomaly detection, and investor protection, has garnered international acclaim. However, its most noteworthy contribution is molding the settlement process into a streamlined and efficient mechanism. A recent milestone in this journey is marked by the release of a SEBI consultation paper, charting the course for an instantaneous settlement process, poised further to accelerate the gears of the stock market machinery.

This research paper delves into the complex world of settlement processes, navigating through its operational aspects, evolutionary journey, key stakeholders, prevailing constraints, and imminent transformations. A focal point of this exploration is the recent consultation paper released by SEBI, outlining a roadmap for substantial changes in the settlement landscape. The study conducts a nuanced analysis, projecting the potential impacts of the proposed Instant Settlement process. While acknowledging SEBI's commendable reforms that have positively

* The authors are students at the Maharashtra National Law University (MNLU).

influenced various entities, including investors, exchanges, and the government, the research also uncovers certain limitations in the proposed mechanism that could reverberate in the market dynamics.

In its entirety, seeks to contribute to the existing body of knowledge by offering a comprehensive examination of the new reform. It not only sheds light on the benefits but also underscores the demerits, providing a balanced understanding essential for informed decision-making in the financial landscape.

I. INTRODUCTION

A free-market economy depends heavily on the stock market because it gives businesses access to capital in return for giving investors a portion of the company's ownership. The stock market plays a vital role in the growth of the economic well-being of the country. The basic function of the stock market is to assist the listed companies with investments by investors in return for stocks (ownership rights). Such stocks are traded on stock exchanges. The stock exchange is a market where financial instruments like stocks, bonds, and commodities are traded.¹ The Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) are the two major stock exchanges in the Indian stock market. Buying a company's stock comes with rights to a company like ownership, voting rights into the company's decisions, etc.

The Indian stock market has witnessed rapid growth which has been beneficial to domestic as well as to foreign investors. In India, the Stock Market has seen significant growth after the implementation of the LPG reforms that were introduced to attract foreign investments. SEBI is a statutory body that regulates the securities markets in India. It regulates, directs, investigates, and also has the power to make rules (given to it by the parliament) for stock market regulation.² It seeks to safeguard the interests of the investors. Recently, this year in September, Nifty crossed 20000 points for the first time which was a historic moment for the

1. Corporate Finance Institute, 'Stock Exchange' <<https://corporatefinanceinstitute.com/resources/equities/stock-exchange/>> accessed 5 December 2023.

2. James Chen, 'What Is the Securities and Exchange Board of India (SEBI)?' (Investopedia, 27 May 2022) <<https://www.investopedia.com/terms/s/sebi.asp>> accessed 5 December 2023.

Indian stock market. This underscored the healthy growth trajectory of the Indian Stock Market.³

In the Stock Market, the settlement period is a very important aspect which is a two-way process that involves the transfer of funds and securities on the settlement date. The Indian stock market underwent a watershed moment on January 27, 2023, as the T+1 settlement period was implemented, (where T stands for trade day when a buyer/seller gets his order executed and T+1 day i.e. is the day, when the actual shares will get transferred from the seller's Demat account to buyer's demat account and subsequently money, gets transferred from buyer's to seller's trading account) to settle trade due to which India has now surpassed developed nations like the US and the UK to become the second country, after China, to reach this milestone. T+1 settlement period simply entails that if a trade is carried out on the 21st of Oct it will get settled by the 22nd Oct.

This tremendous change becomes even more remarkable considering that the Indian stock market has undergone a transition from a week-long settlement period (in the physical share transfer era) to the current T+1 settlement cycle. After accomplishing the T+1 cycle, the attempt was to further shorten this process. In furtherance of this, SEBI has released a consultation paper on 'Optional T+0 Settlement period or instant settlement', sparking the discussion about its implementation, merits and demerits.⁴ This article is purported to explain trade mechanisms and the evolution of complex settlement processes. Thus highlighting how pivotal it is to have a holistic understanding of the current setup. In addition to these objectives, special emphasis is placed on the analysis of possible changes in the settlement times in the Indian stock market in the future.

3. Kousta v Das, 'Nifty Tops 20,000 for First Time since September: What's Driving the Rally' (India Today, 29 November 2023) <<https://www.indiatoday.in/business/story/stock-market-update-nifty-crosses-20000-key-factors-driving-strong-rally-2468865-2023-11-29>> accessed 6 December 2023.

4. Securities and Exchange Board of India (SEBI), 'Introduction of Optional T+0 and Optional Instant Settlement of Trades in Addition to T+1 Settlement Cycle in Indian Securities Markets' (2023).

II. TRADE MECHANISM AND THE CONCEPT OF TRADE SETTLEMENT

Let us understand with the help of an illustration how this system works, for example, A, a buyer who wants to buy a share of Company 'X' at Rs.1000, places an order to his broker (a stockbroker is a financial professional who executes orders in the market on behalf of clients, also known as a Registered Representative) to buy stock.⁵ On the other hand, B, a Seller who wants to sell the stock of the same company 'X' for the same price i.e. Rs.1000, asks his broker to find a buyer at the same price. Now when the price matches at the stock exchange, the trade is executed. Now on the surface, this looks like an easy process but many entities and processes are involved here to facilitate this process of execution of the trade.

After the trade is executed and the market is closed, the clearing corporation initiates the clearing process. The clearing corporation has the responsibility to match the orders executed on that trading day and decide the liability that the buyer/seller has against each other. The clearing phase is the process of matching buy and sell orders and determining the net amount of money that needs to be transferred and the net number of shares that need to be delivered. This process is carried out by a clearing house, which is an independent entity that is not involved in the actual trading of shares.

When the clearing corporation is done with their estimation, it is transferred to the clearing members and the process of settlement starts. The period from the seller agreeing to sell stocks to the buyer, to stocks deposited into the buyer's demat account is called the settlement period. In this whole process of settlement, there are several bodies involved such as Brokers, Depositories, Clearing houses, Clearing Members, Clearing Banks, etc.—which play crucial roles in the exchange; these will all be covered in detail later in this article.

III. PROCESS OF SETTLEMENT AND THE IMPACT OF DEMATERIALIZATION ON IT

The settlement period is the time required for the trade between the buyer and seller where the shares are transferred into the buyer's account and

5. Corporate Finance Institute, 'Stockbroker' <<https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/stockbroker/>> accessed 9 December 2023.

the seller will get money in exchange for shares sold by him.⁶ The role of the Depository, Clearing Houses, and Depository Participant becomes vital as they are key players in executing this transaction. The current regime followed by the Indian stock market is a T+1 settlement period. The T+1 settlement period has been a boon to the Indian capital market as with the help of a quick settlement process market is achieving new heights in every aspect but the way towards this was not easy. Thus, it becomes immensely important to delve into the evolution and significance of the settlement period. The evolution of this settlement period has its roots in the concept of Dematerialization.

Dematerialization:

In the 1990s, unlike today, shares were in the physical form. This paper form of trading in the stock market was always hectic for all genuine market players and beneficial to those with a guilty conscience. These physical shares were the epicentre of problems like the circulation of false or fake stocks, mismanagement of physical stock, and delivery delays. On account of these mis-happenings, investors suffered losses like receiving duplicate securities and delays in transfer.⁷ This in turn led to a rampant increase in disputes and arbitration matters arising between investors. These multi-folded issues caused severe curtailment in the market growth. Major Regulation and banking institutions realized that paper trading was now an unpragmatic form of trading and that there was a dire need for a solution to secure market efficiency and growth.

In view of tackling all the abovementioned problems, Parliament enacted the Depositors Act, 1996 which came into force on 20th Sept 1995.⁸ The underlying purpose of this act was to offer a solution for the slew of problems arising due to physical form and increase the efficiency of the clearing and settlement process. A Depository is an organization where the securities of shareholders are held in electronic format at the request of the shareholder through the medium of a Depository

6. Corporate Finance Institute, 'Settlement Period' <<https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/settlement-period/>> accessed 10 December 2023.

7. Preeti Goyal and Raj S. Dhankar, 'Antecedents of Clearance and Settlement Process Redesign: A Case of Indian Capital Markets' (2010) VI Asia-Pacific Business Review 15 (Goyal and Dhankar), pg. 17.

8. The Depositories Act 1996.

Participant (*DP*).⁹ Depository doesn't directly deal with its customers, it interfaces with its customers through another agent called Depository Participants. The primary function of a depository is to reduce settlement risk by cutting down the paperwork involved in trading, settlement, and transfer of securities. In short, depositories are one kind of bank that holds the shares on behalf of its customer securely. Another feature of the Depository Act was that it granted permission for the establishment of a multiple depository system which creates healthy competition among the depositories leading to mutual growth. At present, there are two Depository Organisations that are working in India - National Securities Depository Limited (*NSDL*) and Central Depository Services (India) Limited (*CDSL*) and the interconnectivity between NSDL and CDSL was operationalized on 14 December 2002, which enables the instantaneous transfer of securities that are dematerialized on both depositories.¹⁰

IV. EVOLUTION OF SETTLEMENT PERIOD IN INDIA

The evolution of the settlement period can be categorized into two parts:

1) Pre-rolling settlement and 2) Post-rolling settlement.

A. Pre-rolling settlement

The Account period of settling transactions was used during the pre-rolling settlement period in India. In this process, transactions for an entire week were to be settled on a pre-specified date that would be in the next week. The trade used to settle after two weeks under the account period settlement, but it was shortened to one week in November 1994 when the NSE's capital markets segment started to trade. These transactions did not mature for settlement right away; instead, the investors had to wait for seven to fourteen days (a period that was not always followed) after the trading period ended to receive their sale proceeds.¹¹ The authorities were compelled to implement rolling settlement reforms as a result of the emergence of a crisis concerning account period settlement that

9. 'What Is a Depository? | IIFL Knowledge Center' <<https://www.indiainfo.com/knowledge-center/demat-account/what-is-a-depository>> accessed 12 December 2023.

10. Mr. B. Hari Babu, Prof. B.K. Surya Prakasha Rao, and Dr. B. Srinivasa Rao, 'Role of Depositories in Indian Capital Market – A Comparative Study between NSDL and CDSL' (2016) 6(12) International Journal of Scientific and Research Publications, pg. 135.

11. Goyal and Dhankar (n 7).

included the collapse of highly leveraged positions, accusations of market manipulation, payments crisis at the Calcutta Exchange, and unethical practices at the BSE and the equity market.¹²

B. Post-rolling settlement

The G-30 meeting held in 1989 was the first instance where the idea of replacing the current regime with a rolling settlement system in the T+5 mode of settlement was envisaged.¹³ The anticipation of rolling settlement led to a decline in stock exchange turnover, driven by SEBI's decision to prohibit naked short sales, this pre-implementation move resulted in a significant drop in turnover even before the formal introduction of the rolling settlement. In addition to this, the fact that the Market was not used to such reforms resulted in a short-term downfall of market turnover. Subsequently, in a couple of months, turnover increased as the market got tuned into the new settlement procedure.¹⁴

On January 15, 1998, trading in demat shares commenced based on a T+5 rolling settlement cycle. SEBI selected 10 scrips for rolling settlement on a T+5 basis which came into effect from January 10, 2000.¹⁵ This was the first move by SEBI towards Compulsory Rolling Settlement (CRS). CRS completely banned arbitrage and traders were prohibited from carrying forward their positions. On December 31, 2001, every category of stocks was subjected to rolling settlement in all stock exchanges. This move was one of the most far-reaching reforms in the history of India's capital market wherein the shares were getting settled in just 5 days.¹⁶

A remarkable feature of rolling settlement was that in the pre-rolling settlement period, if buyer A placed an order on Monday and buyer B on Friday, they both would get their respective shares on the same

12. Sarika Mahajan, and Balwinder Singh, 'Return, Volume and Volatility Relationship in Indian Stock Market: Pre and Post Rolling Settlement Analysis' (2013) 14(3) Sage Global Business Review 413, (Sarika and Balwinder), pg. 414.

13. Saurabh Kumar, 'Rolling Settlement in Stock Exchange' Indian Bar Association <<https://www.indianbarassociation.org/wp-content/uploads/2013/02/Rolling-Settlement-in-Stock-Exchange.pdf>> (Kumar) accessed 18 December 2023.

14. Sarika and Balwinder (n 12).

15. Securities and Exchange Board of India, 'Circular of SEBI Market Department on Rolling Settlement' Circular-39/99 (1999).

16. Securities and Exchange Board of India, 'SEBI Monthly Bulletin' (2000) 9 vol. II <https://www.sebi.gov.in/reports/sebi-bulletin/dec-2000/december-2000-download-in-pdf-file-_13537.html> accessed 22 December 2023.

date of the next week. There were more advantages to opting for Rolling Settlement instead of continuing with account settlement like Priority-Based Transaction Handling, Market Classification for Fair Price Discovery, Mitigation of Market Volatility, Risk Reduction through Fixed Settlement Periods, Prevention of Arbitrary Exchange Shifting, etc.¹⁷

Later, on 2nd January 2002 stocks that were not included under compulsory rolling settlement as of July 02, 2001, were brought under a compulsory rolling settlement (CRS).¹⁸ After the successful implication of the T+5, the market was ready to shorten this cycle even further to mitigate the risk of the long waiting period. Thus, on 1st April 2002, the cycle was shortened to the T+3 period.¹⁹ Later on, the settlement cycle was further shortened from the existing T+3 settlement cycle to the T+2 settlement cycle which came into effect from April 1, 2003.²⁰

After accomplishing the T+2 mark now the goal was towards T+1 settlement. During the late 2000s, the discussion regarding the T+1 settlement was raised. At that time market was efficient and ready to implement the T+1 process due to the digitalized mechanism of trade execution, and efficient participants like depositories, clearing houses, DP, etc. However, a structural barrier was yet to be countered. The contemporary banking sector was insufficient and under-prepared to carry out the T+1 settlement. For quick settlement, Electronic Funds Transfer (EFT) must be operational on a wider scale, and during that time RTGS was not available in every corner of the nation, and banking transactions involving cheques or other instruments were still executed in physical form.²¹ Thus, it was understood that to implement T+1, India will need a strong banking sector.

This turned out to be a time-consuming and patience testing process for the Banking Sector. It took the country nearly two decades of refining and preparing to overcome this structural deficiency. India's domestic

17. Kumar (n 13).

18. Securities and Exchange Board of India, 'Circular of Deputy General Manager Depositories and Custodial Cell on Compulsory Dematerialisation in Rolling Settlement' Policy-Cir-01/2001 (2001).

19. Securities And Exchange Board of India, 'Press Release by Secondary Market Department of Meeting of the Group on Risk Management Systems for The Equity Markets' PR 221/2001 (2001).

20. Sarika and Balwinder (n 12).

21. Goyal and Dhankar (n 7).

equity market was finally able to take the quantum leap of shifting to the T+1 settlement cycle on January 27, 2023. Subsequently, from October 1, 2023, the T+1 settlement cycle for all scrips, was implemented, making India one of the first major economies in the world to make this shift.²² This step taken by SEBI was applauded worldwide as India became the second country after China to achieve this mark. However, one thing to note here is that even China is operating in T+1 settlement for a few segments only whereas since January 2023, India's implication of T+1 is applied to all securities and segments.

Now that it is clear about the evolution of the settlement period in India, the further approach encapsulates the implementation of a T+0 settlement period. India is looking forward to quicker settlement and the article will further analyze this aspect of it.

V. SEBI INTRODUCING NEW MECHANISM

The Indian banking sector strategically employed UPI as a means to achieve the objective of achieving instantaneous money transfers. Similarly, SEBI envisions realizing this goal by establishing real-time transfer systems for securities trading. For this, SEBI has undertaken multiple commendable initiatives which include the transition of the settlement period from T+5 to T+1 and finally, in the phase of deciding to switch to T+0 after consulting with the market participants (stock exchange, depositories, clearing houses, etc...).

In the furtherance of the same, the Securities and Exchange Board of India (*SEBI*), through a Consultation paper titled "Introduction of optional T+0 and optional Instant Settlement of Trades in addition to T+1 Settlement Cycle in Indian Securities Markets" released on 22 December 2023, proposed a reform in the settlement regime of the market. In its paper, SEBI has proposed to introduce the T+0 (same-day) and instant settlement on an optional basis.

This additional feature will complement the prevailing T+1 settlement cycle in the secondary market for the equity cash segment, offering

22. 'Stock Market Settlement Cycles: India's Shift from T+2 to T+1 Explained' (Business Standard, 1 August 2023) <https://www.business-standard.com/markets/news/stock-market-settlement-cycles-india-s-shift-from-t-2-to-t-1-explained-123080100560_1.html> accessed 24 December 2023.

stakeholders substantial flexibility and ensuring the protection of diverse interests.²³ While SEBI's proposal, aimed at enhancing Stock Market efficiency in the Indian market, marks a positive development for both the investors and the overall equity market, certain structural and implementational aspects must be deliberated upon to bring about an effective and meaningful impact.

VI. PROPOSED MECHANISM

SEBI has introduced an innovative mechanism, stipulating the simultaneous implementation of a shorter settlement cycle alongside the existing T+1 settlement, to be executed in two distinct phases.

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Phase 1 will comprise T+0 where the settlement will be completed within a time frame of 1 day whereas, in phase 2, the settlement will be in an instant or immediate settlement cycle. Phase 1 will be applicable for trades executed till 1:30 pm for which the settlement period will be completed on the same day till 4:30 pm. Phase 2 will be applicable for all trades till 3:30 pm which will be settled immediately on a trade-by-trade basis. The leeway to opt for the implementation of T+0 will only be given to the top 500 listed shares that merit the criteria of market capitalization. The implementation of T+0 will be made available for the top 500 listed shares as per their market capitalization. The distribution of the 500 companies will be conducted in a set format of 200, 200, and 100 in order from lowest to highest market cap. Successful implementation of Phase 2 will translate into an automatic discontinuation of Phase 1.

In the T+0 settlement, investors managing their trades through custodians would be excluded. Generally, these investors are institutional investors, primarily foreign funds. However, in Instant settlement, all types of investors will be included, including those who handle their trade through custodians. This decision is taken considering the limited

23. Hitesh Vyas, 'T+0, Instant Settlement Cycle: What Is the New SEBI Proposal and Its Potential Benefits for Investors?' (The Indian Express, 26 December 2023) <<https://indianexpress.com/article/explained/explained-economics/to-instant-settlement-cycle-sebi-markets-explained-9083167/>> accessed 2 January 2024.

availability of time custodial trades get, so they would be temporarily exempted in T+0 and subsequently be added in Instant settlement.²⁴

A positive aspect of this reform is its phased implementation, aligning with the smooth execution observed in the introduction of T+3, T+2, and T+1 settlement cycles. Due to this approach, the implementation of these reforms took place without any hindrance and without affecting the investors and market regulators.

VII. ANALYSIS

It is quite evident from the past reforms of the SEBI in lowering settlement that SEBI has always sought to bring them in a phase-by-phase manner which delivers remarkable results without disrupting the market. The initiative of the T+0 regime will significantly impact the market which benefits from its pros and suffers from its cons.

One of the major reasons India is successful in implementing T+1 or planning for T+0 settlement as compared to other major economies in the world is the size of the market. The market turnover of the USA and China is humongous as compared to India which precludes them from implementing the shorter settlement cycle. The current scenario indicates that as of now the implementation of the T+0 in the USA and China is nearly impossible, however in India, the market turnover is relatively lower making it a great opportunity for the Indian market to implement this regime. It would be difficult for India to implement it in the future if it is delayed. The reason is that the Indian economy is growing steadily. Implementing quicker settlement in an economy undergoing steady and mild growth is comparatively easier than doing so with an economy having rapid growth and massive turnovers (like the USA). Thus India must grab this opportunity to implement the system before the market turnover increases drastically.

The implication of implementing the T+0 can result in greater availability of margin for the investor as compared to the old regime. In the latter,

24. 'SEBI Proposes Implementation: SEBI Proposes Option of T+0, Instantaneous Settlement for Equity Cash Segment' (The Economic Times, 23 December 2023) <https://m.economictimes.com/markets/stocks/news/sebi-proposes-option-of-to-instantaneous-settlement-for-equity-cash-segment/amp_articleshow/106226255.cms> accessed 3 January 2024.

the investor had to wait for one day to utilize the money received after selling the shares, but after T+0, he could utilize his money efficiently. Now due to the availability of this cash with investors, there are high chance of investors re-investing their amount leading to greater liquidity and cash flow in the market. Another effect of the T+0 settlement regime will have been a reduction in the counter-party risk. It means that shortening the duration of settlement would allow the business to be conducted more efficiently and ensure that the risks posed by non-payment and non-delivery of shares are reduced significantly. It would also speed up the process of settlement due to which more transactions will take place. Last but not least, owing to quicker and more convenient transactions, there would be increased profits, at least theoretically and allow all the participants in the market—stock exchanges, depositories, depository participants, and even the government to reap the benefits in the form of an increase in taxes, fees, etc.

As Newton said, “Every action has an equal and opposite reaction”. The same are the consequences of the new law. The strata that will be largely affected by the T+0 regime are foreign portfolio investors (*FPI*). This new regime will put an ample amount of pressure on foreign portfolio investors, who have been very reluctant to participate in the T+1 cycle and now issues will increase due to quicker settlement (T+0 cycle). FPI operates from different geographies with different time zones through their custodian in India. So, a settlement on an hourly basis will put their custodians under heavy stress.

Apart from this FPI issue, there are also many constraints within India’s corporate working framework. After the implementation of T+0 instant settlement, possible areas of concern could be corporate actions such as bonuses, dividends, mergers, demergers, etc., where the record date is important and is based on the settlement cycle. This would unnecessarily increase the trading in the last cycle of the day, creating an overload on the whole system. The Mutual funds may also face some issues, concerning the calculation of the applicable NAV (the reference price for purchase and sale). The cut-off time for equity and debt funds is 3 pm. If an application is submitted before 3 pm, you are allotted units at NAV prevailing on the same day. If it is after 3 pm, you get units at NAV of the next day. With six settlement cycles on a single day, computing NAV

on an hourly basis will be a Herculean task and that may lead to unnecessary disputes.

VIII. CONCLUSION

Significant reforms and technological advancements shaped the transformative journey of the Indian stock market's settlement period evolution. The market has come a long way from the days of physical share trading to the present T+1 settlement cycle. The latest proposal from SEBI to implement instant settlement and optional T+0 is a proactive measure to improve market efficiency. Considering the size and dynamics of the market, SEBI's commitment to seamless transitions can be seen by the phased implementation of the T+3, T+2, and T+1 settlement periods. Moving towards T+0 settlement now offers opportunities as well as difficulties. Improved capital utilization efficiency, decreased counter-party risk, and higher liquidity are some of the possible advantages. Nonetheless, issues like the effects on foreign portfolio investors (*FPIs*), business decisions, and mutual fund operations must be taken seriously.

As India positions itself as one of the first major economies to explore T+0 settlement, its focus on a phased approach and involvement of stakeholders is crucial. This development is consistent with the worldwide tendency towards quicker and more effective settlement cycles. Achieving harmony between utilizing the benefits of quicker settlements and dealing with the challenges presented by this transformation is important.

The cooperative efforts of market players, regulators, and the larger financial ecosystem will be essential in navigating this shift. The successful implementation of the T+0 settlement can enhance India's capital market by promoting greater involvement, openness, and economic expansion.

The IBC's Real Estate Conundrum: Why It's Not the Right Fit for Homebuyers' woes

—Rohan Srivastava*

ABSTRACT

The IBC ever since its enactment has had various tweaks being made to it for the Real Estate sector such as the grant of the status of financial creditors, project-wise CIRPs, reverse CIRPs etc. These have mostly been justified out of reasons of necessity and the need to protect homebuyers who provide advances to builders and promoters. This is despite the existence of the RERA which is the sector-specific beneficial legislation for the protection of homebuyers.

Hence, these tweaks have sought to promote the IBC as an alternative means of redressal for homebuyers and allottees who are aggrieved by defaults committed by builders. This is unlike most jurisdictions which have not provided such remedies in their bankruptcy laws. Recently this approach was questioned by an Expert Committee on Legacy Stalled Real Estate projects which has recommended that the IBC shall be used as the last resort for homebuyer disputes.

In this light, this paper shall take a step back and question whether the IBC should be seen as the appropriate forum for the protection of homebuyers by looking at case laws and employing policy analysis. To this end, this paper shall start by briefly laying out the existing remedies and recourses available to homebuyers outside of the IBC. Part II of the paper shall then trace the development of homebuyer-friendly jurisprudence within the IBC. Part III shall then evaluate the efficacy of the remedies

* The author is a student at the National Law School of India University, Bangalore (NLSIU).

created under the IBC from the perspective of all stakeholders and also evaluate its compatibility with the scheme of the IBC. Part IV shall then propose the way forward which entails synergizing the remedies available under both the acts.

I. INTRODUCTION

Recently, an Expert Committee on Legacy Stalled Real Estate projects was convened, which has recommended that the Insolvency and Bankruptcy Code (IBC) should be used as a “last resort” in disputes that arise in the real estate sector between the allottees and the promoters.¹ The said recommendations can certainly be said to be a break from the broader Indian policy approach to the real estate sector, which has previously sought to promote the IBC as a redressal forum for the consumer woes of homebuyers in addition to other existing legislations such as the Real Estate (Regulation and Development) Act (RERA) and the Consumer Protection Act (CPA).

The IBC, ever since its enactment, has seen tumultuous amendments, particularly in the sector of Real Estate. Starting with the 2018 Amendment Ordinance,² the IBC has time and time again encountered practical difficulties arising out of the Real Estate industry which has led to various judicial innovations and legislative amendments.³ These difficulties are mostly attributable to the peculiar financing structure of the Real Estate industry which relies substantially on advance payments received from allottees of the real estate project.⁴ There is an undisputed asymmetry that exists between the Real Estate firms and the consumers, in terms of not only bargaining power and information but also in terms

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1. Ministry of Housing and Urban Affairs, Report of the Expert Committee on Legacy Stalled Real Estate Projects (2023), (Ministry of Housing and Urban Affairs Report) para 7.
 2. The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.
 3. The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019; The Insolvency and Bankruptcy Code (Amendment) Act, 2020; Srideepa Bhattacharyya and Aishwarya Gupta, ‘Proposed Amendments to the Insolvency and Bankruptcy Code- A Real Solution for Real Estate Insolvencies?’ (Cyril Amarchand Mangaldas Blog, 2023) <<https://corporate.cyrilamarchandblogs.com/2023/03/proposed-amendments-to-the-insolvency-and-bankruptcy-code-a-real-solution-for-real-estate-insolvencies/>> accessed 21 December 2023.
 4. Gausia Shaikh and Anjali Sharma, *Real Estate Insolvencies and the Status of Home Buyers* in Susan Thomas (Springer, 2022) (Gausia Shaikh).

of the entitlements and claims enjoyed by each other upon entering into a contract.⁵

While the existing body of literature on this area has already analysed and commented upon these practical difficulties⁶ and also noted how the numerous real-estate-specific tweaks made to the IBC have weak legal standing,⁷ there is a lack of literature which questions India's policy choice of promoting the IBC as a direct recourse to homebuyers in cases of defaults in light of other existing remedies under RERA and CPA. This paper shall seek to fill this existing gap, which has assumed greater relevance in light of the recent expert committee report. This paper demonstrates that the Indian policy response to the homebuyer problem is misguided because it focuses on shaping IBC as a remedial recourse for aggrieved allottees, despite the existence of other legislations for this purpose. Moreover, despite granting homebuyers the status of financial creditors, homebuyers' interests are still not adequately protected under the IBC.

To this end, this paper shall start by briefly laying out the existing remedies and recourses available to homebuyers outside of the IBC. Part II of the paper shall then trace the development of homebuyer-friendly jurisprudence within the IBC. Part III shall then evaluate the efficacy of the remedies created under the IBC from the perspective of all stakeholders and also evaluate its compatibility with the scheme of the IBC. Part IV shall then propose the way forward which entails synergizing the remedies available under both the acts.

II. CONSUMER PROTECTION IN THE REAL ESTATE SECTOR

The Real Estate sector plays a crucial role not only because of its socio-economic significance in providing housing to the urban masses but also in capital formation, increasing a nation's productive infrastructural

5. *Ibid.*

6. Rachita Shah and Arundhati Diljit, 'Real Estate Developers and Homebuyers: Finding a Harmony Under the IBC' (2020) 6(1) NLS BLR.79 (Rachita and Arundhati).

7. MP Ram Mohan and Vishaka Raj, "Allottees" as Financial Creditors: Pushing the Conceptual Limits of the Indian Insolvency Regime' IIMA W. P. No. 2019-11-01 (IIMA Working Paper) (2019).

capacities and bringing more foreign investment inflows.⁸ The sector contributes to around 15% of the GDP and is the second largest employer in the country.⁹

Pre-2016 there existed no regulations to monitor conditions of sales, completion of projects etc. in this sector even though the average Indian household holds around ninety percent of its wealth in real estate and gold.¹⁰ The government's role was restricted to licensing allocations and granting approvals.¹¹ The CPA remained the only recourse available to customers in the real estate sector for the longest period. However, the CPA failed to provide an adequate remedy to consumers because it is limited to curative remedies and did not do anything to remedy the information and bargaining power asymmetry that existed between the two parties. Moreover, under the CPA, the real estate sector was primarily governed as a 'service' and thus the remedies available were significantly less.¹² The promoters often escaped their liabilities through cleverly drafted contracts and skewed arbitration agreements.¹³ Some of these concerns have been addressed in the newest iteration of the CPA. For instance, a provision of "unfair contract" has been incorporated which can deal with substantive unconscionability in lopsided purchase agreements.¹⁴ In certain cases, the consumer forums have utilized these provisions to strike down unconscionable terms in contracts in the real estate sector.¹⁵ However, by and large, the CPA is inadequate in addressing many of the consumer concerns specific to the Real Estate sector due to its peculiar nature.

In light of these limitations, and growing concerns about consumer exploitation in the Real Estate sector, the parliament, in 2016, decided to enact the RERA which is the first sector-specific regulation to address

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8. Neelam Chawla and Basanta Kumar, 'Does Indian Real Estate Regulation Protect Urban Homebuyers? Policy Implications' (Cogent Business & Management, 2022) (Neelam Chawla) <<https://www.tandfonline.com/doi/pdf/10.1080/23311975.2022.2117164>> accessed 21 December 2023.
 9. A Swathi, 'Analysis of Allottee's Status in the Real Estate Sector' (2021) 1 Indian Journal of Legal Review.
 10. The Household Finance Committee, 2023.
 11. Neelam Chawla (n 8), pg. 3.
 12. The Consumer Protection Act 2019, s 2(42).
 13. Ajar Rab, 'Redressal Mechanism Under the Real Estate (Regulation and Development) Act 2016: Ouster of the Arbitration Tribunal?' (2017) 10 NUJS L Rev. 1.
 14. The Consumer Protection Act 2019, s 2(46).
 15. NBCC (India) Ltd. v Shri Ram Trivedi, [2021] 5 SCC 273.

the concerns highlighted above. The Act establishes the Real Estate Regulatory Authority (*Authority*) and vests significant adjudicatory and regulatory powers with it.¹⁶ The authority is given all the powers exercisable by a civil court and also provides greater flexibility in terms of procedural rules binding it. The Act also requires all real estate developers and agents to mandatorily register themselves with the Authority,¹⁷ and the Authority is tasked with updating all information regarding these registered developers and agents on their website.¹⁸ This is aimed at remedying the wide information asymmetry that exists between the customers and developers in the real estate sector.

Moreover, the RERA also has some sector-specific regulations which account for the sector's peculiar financing structure. The act mandates that no developer can accept payment in advances before entering into a valid registered agreement to sell with the allottees.¹⁹ Further, seventy percent of the total amount raised from advances is required to be kept in a separate escrow account which is to ensure that the amounts raised for one project are utilized only for that particular project.²⁰

An interesting and often ignored provision of the RERA is Section 8 of the Act which allows for taking over the completion of a project in case the registration of the developer is revoked or lapsed under Section 7 of the Act.²¹ Under Section 7 of the RERA, default by the Promoter is an adequate ground for revocation of the registration, and the same can be taken up suo moto by the authority or upon complaints from the allottees.²² This provision essentially allows for the authority to ensure that the possession of the flats is delivered to the allottees even if the said developers are not able to deliver. In the case of *Bikram Chatterji v. Union of India*,²³ the Supreme Court utilized these powers by directing the cancellation of the Amrapali group's registration and directing the NBCC (a government of India entity) to carry on the remaining work and deliver the flats to the allottees. This is similar in principle to the

16. The Real Estate (Regulation and Development) Act of 2016, ss. 32, 34-40.

17. *Ibid* s 3.

18. *Ibid* s 34.

19. *Ibid* s 13.

20. *Ibid* s 4.

21. The Real Estate (Regulation and Development) Act 2016, s 7.

22. *Ibid* s 7.

23. [2019] 19 SCC 161.

operation of the Corporate Insolvency Resolution Process (*CIRP*) under the IBC wherein a resolution plan is invited, and the management of the company is transferred to the applicant who is to then discharge the existing liabilities of the defaulter.²⁴

In the case of *Bank of Maharashtra v. Newtech Promoters & Developers (P) Ltd.*²⁵ the court directly addressed the clash between these two similar remedies by noting that in case the Authority has operationalised Section 8 and the project is under the Authority's supervision, a CIRP cannot be initiated against the project as it will be against the best interests of the homebuyers. The court therefore clearly recognized that the remedy available under the RERA is superior to the benefits accruing from initiation of the CIRP under the IBC.

However, this is not the general norm in cases where there has been a clash between various remedies. In *Ireo Grace Pvt. Ltd. v. Abhishek Khanna and Others*,²⁶ relying on Section 79 of the RERA, the Apex Court held that the remedies under the RERA are in addition to existing remedies and do not preclude the homebuyers from approaching other forums in cases of defaults.²⁷

III. DEVELOPMENT OF REAL ESTATE SPECIFIC PROVISIONS IN THE CODE

Despite the existence of dedicated sector-specific legislation catering to disputes between homebuyers and developers, India has made considerable tweaks in its insolvency law to provide adequate remedies to homebuyers in cases of default. India is peculiar in this respect as other jurisdictions such as the UK, USA and Australia have maintained a separation between consumer-centric laws and insolvency laws, unlike India.²⁸

Initially, the homebuyers could not approach the NCLT directly as they did not usually fall under the definition of 'financial creditors' under the IBC. There were, however, some cases in which homebuyers were classified as financial creditors but these were fact-specific determinations,

24. The Insolvency and Bankruptcy Code, 2016, ss.17, 20.

25. [2022] SCC Online NCLT 326.

26. [2021] 3 SCC 241; *Emaar MGF Land Limited v Aftab Singh* [2018] SCC Online SC 2945.

27. *Ibid* at para 38.

28. IIMA Working Paper (n 7), pg. 5; Gausia Shaikh (n 4) 49-56.

which hinged on the existence of an ‘assured returns’ provision in the purchaser agreement.²⁹ This was in tune with the conceptual definition of ‘financial debt’ provided under the IBC which is a debt disbursed against the ‘time value of money’ and has the commercial effect of borrowing.³⁰ However, in a large number of contracts, there was no such provision, and hence, homebuyers as a category were largely not considered as Financial creditors. Homebuyers eventually sought to be classified as ‘other creditors’ under the scheme of the IBC under a Regulation released in 2016 which added a Form F allowing for creditors not falling in the definition of either operational or financial creditors to file their claims.³¹ However, no rights were vested in favour of the homebuyers by being classified as ‘other creditors’, as neither could they initiate the CIRP or be assured of the liquidation value of the money advanced by them.

These concerns regarding homebuyers’ rights in the insolvency process came to the fore for the first time in the insolvency of Jaypee Infratech Ltd (*JIL*),³² whereupon initiation of CIRP against JIL, a batch of writ petitions were filed in the Supreme Court raising two concerns, firstly, that by virtue of initiation of the CIRP and the consequent moratorium being imposed, the homebuyers were precluded from filing consumer claims at either the Consumer Forums or RERA by virtue of Section 14 read with Section 238.³³ Secondly, if the outcome of the CIRP is liquidation, then the homebuyers would not get possession of the homes they have paid for, and neither will they be assured of any refund as they are not given the status of financial creditors who are assured of receiving the liquidation value of their debt. Upon hearing the writ petition, the court issued some radical directions to the Interim Resolution Professional (*IRP*) to protect the interests of the homebuyers by creating an “interim resolution plan” which is something that does not find mention in the IBC.³⁴ However, before the final disposal of the case, the entire CIRP process was directed

29. *Nikhil Mehta & Sons (HUF) v AMR Infrastructures Limited* (2017) SCC OnLine NCLT 219; *Anubhuti Aggarwal v DPL Builders Pvt. Ltd* (2017) SCC Online NCLT 12672; *Neelam Singh v Megasoft Infrastructure* (2017) SCC Online NCLT 10612.

30. *The Insolvency and Bankruptcy Code of 2016*, s 5(8)(f).

31. *Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016*, Form F.

32. *Chitra Sharma v Union of India*, (2018) 18 SCC 575 (*Chitra Sharma v UOI*).

33. *Gausia Shaikh* (n 4), para 43.

34. *Chitra Sharma v UOI* (n 32) at 10.1.

to be started afresh in light of the 2018 amendment being enacted during the pendency of the case.³⁵

The 2018 amendment, which was prompted by the JIL decision and the Insolvency Law Committee report,³⁶ introduced an explanation to Section 5(8)(f) allowing for the inclusion of allottees as a class under the definition of the financial creditor. This had the effect of eliminating any fact-specific considerations which was the trend hitherto. It was believed that this would address the concerns raised in the JIL case as the allottees will not be able to initiate CIRP proceedings on their own and be a part of the committee of creditors.

Such a move, however, was met with opposition from a large number of builders. It was claimed that the amendment allows for a single disgruntled consumer to push the entire firm into insolvency upon an insignificant default.³⁷ Such an apprehension was well founded given that the existing law envisions a limited role for the NCLT in admitting applications against Section 7 which is only limited to ascertaining the existence of a default on the part of the Corporate Debtor.³⁸ In light of these apprehensions, the legislature brought a Second Amendment in 2019 which imposed a threshold requirement of 10% of the total number of allottees or 100 allottees whichever is less, to file an application under Section 7 upon default by a promoter.³⁹

This subsequent amendment, coupled with the increase in the threshold of default for triggering insolvencies from 1 lakh to 1 crore during the pandemic,⁴⁰ led to a decline in the number of pending cases with the NCLT which had skyrocketed after the 2018 Amendment.⁴¹ Of the large number of complaints filed, Real Estate disputes comprised a substantial portion of the same, with consumers often approaching the NCLT

35. *Ibid* at 50.2.

36. Ministry of Corporate Affairs, 'Report of The Insolvency Law Committee Report' (2018).

37. Ashwini Kumar Sharma, 'Developers Resent Buyers Filing Cases Under IBC' (Live Mint, 25 November 2019) <<https://www.livemint.com/money/personal-finance/will-homebuyers-remain-creditors-under-ibc-11574661744701.html>> accessed 17 December 2023.

38. Guruprasad Hishobkar v Shree Aashraya Souhard Credit Society Ltd., [2023] SCC OnLine NCLAT 299.

39. The Insolvency and Bankruptcy Code (Amendment) Act 2020.

40. The Insolvency and Bankruptcy Code (Amendment) Ordinance 2020.

41. 'RERA and IBC: The Real Solution for Real Estate' (Financial Express, January 1 2020). <<https://www.financialexpress.com/opinion/rera-and-ibc-the-real-solutions-for-real-estate/1808937/>> accessed 17 December 2023.

directly without approaching other remedial mechanisms. As per government estimates, 1821 cases had been filed by homebuyers against builders as of September 30, 2019.⁴²

Despite these sector-specific tweaks made in the IBC to cater to the interests of the consumers, the courts have still encountered practical difficulties in carrying out Real Estate insolvencies owing to the conflicting interests of the allottees in securing possession of the flats and the objectives of the code to ensure asset maximization and maintaining the debtor as a ‘going concern’. This has led to the courts closely monitoring the CIRP of such developers and issuing directions which deviate from the regular resolution process under the IBC. One of the earliest cases where such a trend was seen, was the insolvency of Umang Realtech, where instead of allowing for resolution plans from third parties, the IRP allowed the promoter himself to infuse more funds and act as a lender just so that the flat can be completed and possession be passed on to the homebuyers.⁴³ This said deviation from the regular process has further been upheld in the cases of Anand Murti v. Soni Infratech Pvt. Ltd.⁴⁴ and Amit Katyal v. Meera Ahuja⁴⁵ and is now commonly referred to as ‘Reverse-CIRP’.

Another peculiar deviation that has evolved in real estate insolvency cases is that of ‘project-wise CIRP’, where instead of treating the corporate debtor as the insolvent entity, the process is viewed project-wise and the CIRP is limited to the project in which the default has occurred. The recent expert committee has also recommended this practice, legitimizing it by noting that even RERA has project-wise registrations and also mandates the promoters to keep seventy per cent of the amounts raised from advance payments in a separate escrow account.⁴⁶ Such a modification was also seen in the Umang Reatech case.⁴⁷ In Ram Kishor Arora v. Union Bank of India, the court adopted a peculiar approach by limiting the CIRP to the specific defaulting project but extending the

42. *Ibid.*

43. Flat Buyers Assn. Winter Hills-77 v Umang Realtech (P) Ltd. [2021] SCC OnLine NCLAT 1344 (Flat Buyers v Umang Realtech).

44. Anand Murti v Soni Infratech Pvt. Ltd. [2021] Civil Appeal Nos. 7534 Of 2021.

45. Amit Katyal v Meera Ahuja [2020] Civil Appeal No. 3778 of 2020 (Order dated 03.03.2022).

46. Ministry of Housing and Urban Affairs Report (n 1) para VII (d)(i).

47. Flat Buyers Assn v Umang Realtech (n 43).

IRP's overall supervision to all the projects of the corporate debtor.⁴⁸ In *Whispering Tower Flat Owner Welfare Association*, the NCLT allowed for project-wise CIRP noting that the Committee of Creditors had chosen to proceed with an eight-way project-wise division of the debtor's assets and upheld the commercial wisdom of the Committee.⁴⁹

IV. EVALUATING THE IBC AS A SOLUTION TO HOMEBUYER CONCERNS

Having noted the existing consumer jurisprudence in the real-estate sector and also having briefly looked at real estate sector-specific tweaks made in the IBC, this section shall now demonstrate how the IBC is ineffective as a cure to the woes of the real estate sector. The amendments made have hurt the interests of the homebuyers and the promoters, and also conflict with the scheme of the IBC.

A. The Homebuyer Perspective

As previously noted, unlike other Financial Creditors, the primary interest that homebuyers have in a real estate project is acquiring possession of the homes they have paid for. This is evidenced by the fact that in the *Jaypee Infratech Limited* case, which led to the genesis of homebuyer-specific provisions in the IBC, only 8 per cent of the homebuyers wanted refunds of their advances, while the rest wanted possession of their flats.⁵⁰ This is significant because real estate, as a sector, has one of the lowest resolution rates,⁵¹ allegedly, only 4% of the cases received resolution plans.⁵² This fails to align with their primary interest of securing possession of the flats. Even though in various cases, the courts have instructed

48. *Ram Kishor Arora Suspended Director of M/s. Supertech Ltd. v Union Bank of India & Anr* [2022] Company Appeal (AT) (Insolvency) No. 406 of 2022.

49. *Whispering Tower Flat Owner Welfare Association v Mr Abhay Narayan Manudhane* [2022] Company Appeal (AT) (Insolvency) No. 896 of 2021 (*Whispering Tower v Abhay*).

50. MP Ram Mohan and Vishaka Raj (n 7) 20.

51. 'IBC: Fresh Hope for India's Real Estate' (Khaitan and Anarock 2022) <https://www.khaitanco.com/sites/default/files/newsdocument/Khaitan%20ANAROCK_IBC%20Report_Dec%202022.pdf> accessed 17 December 2023.

52. Sanjeev Sinha, 'Insolvency process of Realty Projects Needs to Undergo a Sea-Change to Provide Relief to Homebuyers: Santosh Pandey' (The Financial Express, May 25, 2023) <<https://www.financialexpress.com/money/insolvency-process-of-realty-projects-needs-to-undergo-a-sea-change-to-provide-relief-to-homebuyers-santosh-pandey-3101397/>> accessed 17 December 2023.

the IRPs to ensure that possession is advanced to the homebuyers,⁵³ such directions cannot be traced to any provisions in the IBC. This raises concerns regarding the scope of the effectiveness of such directions. Contrast this with Section 8 of the RERA which allows for the authority to take up the management of the real estate developer or assign some third party to take up the task of ensuring that possession is delivered to the homebuyers. If this provision is properly operationalized, it clearly provides a better shot for the homebuyers to receive possession of their homes instead of relying on the CIRP to yield a resolution plan that allows for the completion of the stalled projects. The recent expert committee report also seems to concede to this fact.⁵⁴

In the Jaypee Infratech case, the second major concern of the homebuyers was related to securing refunds of the advances they had paid to the promoters. Despite the inclusion of allottees as financial creditors, when a firm is pushed to liquidation, which happens in most cases, the homebuyers will be forced to take major haircuts in the amount they can recover through the liquidation process. This is because, in most cases, they are classified as unsecured financial creditors, who will rank lower in the waterfall mechanism under the IBC. In Pioneer Urban, even when upholding the status of allottees as financial creditors, the apex court conceded that allottees do not have a secured interest in the insolvency proceedings and would therefore rank low in the liquidation waterfall mechanism.⁵⁵

Moreover, the concern about the sidelining of other existing remedies under RERA and CPA due to the operation of the CIRP moratorium under Section 14 of the IBC, is an issue that is still not resolved despite their inclusion as financial creditors. In the case of Pioneer, the Apex Court conceded to the possibility that speculative investors may just want to retrieve their investments and may use Section 7 of the IBC as a route to achieve this upon a slight default on the part of the developer, yet the court did not address this concern properly.⁵⁶ Even the subsequent amendment requiring 10% of the allottees might not be able to guard against such a use of the CIRP process, as the majority of the homebuyers

53. Chitra Sharma (n 32).

54. Ministry of Housing and Urban Affairs (n 1) para 5.

55. Pioneer Urban Land and Infrastructure Ltd. v Union of India [2019] 8 SCC 416, para 61.

56. *Ibid* at para 56.

lack the information and specialisation to make an informed choice regarding what remedy to pursue and may end up deciding against their interests. Even if a RERA proceeding is undergoing, the moratorium will have the effect of staying the proceedings. Only in one case where the RERA authorities have undertaken the task of finishing an ongoing project, has the NCLT held that no CIRP can be initiated to sideline the process.⁵⁷

The current state of affairs raises questions regarding the utility of having allottees considered as financial creditors, as both of the concerns raised in the Jaypee Infratech case regarding the exclusion of alternate remedies upon enforcement of moratorium and the inability to recover the advances still subsist despite their inclusion as financial creditors.

B. The Promoter Perspective

As previously noted, the decision to include homebuyers as financial creditors under the IBC was consistently met with strong opposition by developers who contended that it is prejudicial to their interests and that alternate remedies are available in cases of default.

These concerns hold some water, as the Amendment in 2018 has left open various unresolved issues relating to how it is to be operationalized. One such major issue which has a high mischief potential is the question of what constitutes 'default' as understood under Section 7 of the IBC. Can homebuyers approach the NCLT upon a slight delay in handing over possession of the flat? In the case of *Shilpa Jain v. Raheja Developers*, the NCLT held that upon the expiration of the stipulated thirty-six-week duration in the purchaser agreement, the amount advanced by the allottees becomes 'due and payable' and hence an allottee can initiate the CIRP.⁵⁸ However, in a similar fact scenario, the tribunal has also held that a delay in construction in and of itself will not constitute a default as understood under Section 7 of the IBC.⁵⁹ The tribunal, in arriving at this conclusion, distinguished with the pre-amendment case of *Nikhil Mehta*, where non-completion of the project was considered as a default

57. *Bank of Maharashtra v Newtech Promoters & Developers (P) Ltd* [2022] SCC Online NCLT 326.

58. *Shilpa Jain v Raheja Developers Ltd.* [2019] SCC OnLine NCLT 36286.

59. *Pawan Dubey v J.B.K. Developers* [2018] SCC Online NCLT 794.

under Section 7. The court took note of the committed returns scheme in that case to differentiate the factual scenario. However, the court failed to clarify if the position would change in light of the 2018 Amendment. Thus, there is a lack of clarity regarding what constitutes ‘default’ under Section 7 of the IBC in the context of the homebuyer purchase agreement. This is expected to add to the litigation costs for both parties and might also be responsible for adding to the existing pendency at the NCLT and NCLAT. Part of this ambiguity exists because homebuyers are conceptually different from other financial creditors, where the lending is usually done on clearly identified terms stipulating when the amount becomes due and payable etc. In the present scenario, where precedents exist which have treated a slight delay from the stipulated time period for delivering possession of the flats as a ‘default’, there is an unfair burden on the promoters who are at risk of having their entire projects compromised due to slight delays. The only exceptions that have been allowed are cases where the corporate debtor is unable to deliver flats in light of force majeure events.⁶⁰

C. Conflict with the objectives of the Code

While the conceptual issues associated with bringing allottees within the definition of financial creditors have been extensively commented upon,⁶¹ certain aspects in the evolved jurisprudence have led to inefficiencies in the resolution procedure envisaged under the IBC and go against certain grounded principles of the code.

As noted, homebuyers have a limited interest in acquiring possession of their houses in the entire CIRP process. Despite being a part of the committee of creditors by virtue of the 2018 Amendment, they do not have any stake in maintaining the insolvent firm as a ‘going concern’, unlike other financial creditors such as banks etc. Allottees do not possess the requisite expertise and specialization in maintaining the financial viability of the insolvent firm, unlike financial institutions which are a part of the committee of creditors. This is pertinent because one of the cardinal principles of the IBC is deference to the decision of the committee of

60. *Parvesh Magoo v Ireo Grace Realtech* [2019] Company Appeal (AT) (Insolvency) No. 1141 of 2019.

61. IIMA Working Paper (n 7); Rachita Shah and Arundhati Diljit ‘Real Estate Developers and Homebuyers: Finding a Harmony Under the IBC’ (2020) 6(1) NLS BLR 79, 92-94.

creditors in accepting or rejecting the resolution plan. In *K Sashidhar v. Indian Overseas Bank*, the Apex Court remarked that the legislature has shown deference to the “commercial wisdom” of the CoC in approving or rejecting a resolution plan and their decision is thus beyond the scope of judicial review and cannot be questioned in front of the Adjudicating Authority.⁶² The same view has been affirmed in the landmark case of *Essar Steel India Limited v. Satish Kumar Gupta and Ors.*⁶³ Allowing for an uninformed and unspecialized class of creditors on the CoC which has a limited interest in ensuring that possession of the flats is delivered is likely to impact the legitimacy of the ‘commercial wisdom’ of the CoC. Moreover, since the allottees are not interested in asset maximization and revival of the insolvent firm, is likely to lead to stagnation in CoC decision-making and further decrease the possibility of successful resolutions. The fact that the real estate sector currently has one of the lowest resolution rates under the IBC may also be partially attributable to such stagnations.

In addition to this, certain judicial innovations such as the reverse CIRP are in direct conflict with the text of the IBC.⁶⁴ Section 29A(g) of the IBC categorically bars past promoters of the corporate debtor from submitting resolution plans to the committee of creditors. This has been held to serve the legislative purpose of preventing the corporate debtor from a backdoor entry into the CIRP through a resolution plan.⁶⁵ In the *Umang Realtech* case, the actions of the NCLAT in allowing the promoter to infuse funds for reviving the corporate debtor were directly in the teeth of the bar imposed by Section 29A. Moreover, in other cases such as the *Jaypee Infratech* case, through an act of judicial innovation, the NCLAT directed the IRP to propose an “Interim Resolution Plan” which does not find any mention or indication in the IBC.⁶⁶

Given that the ‘commercial wisdom’ of the CoC has taken a hit by the inclusion of homebuyers as a class, they will likely be agreeable to such innovations which are not traceable to the IBC, but best cater to the interests of the financial creditors as a class. This will allow greater legitimacy

62. [2019] 12 SCC 150.

63. [2020] 8 SCC 531.

64. *Rachita and Arundhati* (n 61), pp. 92-94.

65. *Arcelor Mittal India (P) Ltd. v Satish Kumar Gupta* [2019] 2 SCC 1, pg. 27.

66. *Chitra Sharma* (n 32) at 10.1.

and immunity from judicial scrutiny to judicial innovations which deviate from the scheme of the code. In *Whispering Tower Flat Owner welfare association*, the court cited the decision of the CoC to legitimize project-wise CIRPs which is not a part of the scheme of the code.⁶⁷

It is imperative that the stakeholders involved in the CIRP process do not lose sight of the objective of the IBC which is to ensure greater value utilization and revitalization of the corporate debtor. As highlighted above, these judicial innovations end up departing from the objectives and scheme of the code, in light of protecting consumer interests, which is not the purpose for which the code was enacted.

V. COURSE CORRECTION AND THE WAY FORWARD

Having scrutinized the decision to include homebuyers as financial creditors under the IBC from the perspective of various stakeholders and having noted the conceptual incompatibility of this classification, it appears that the policy decision was a knee-jerk reaction to the Jaypee Infratech Ltd insolvency and failed to take note of the scheme of the IBC. The policymakers did not consider the possibility of strengthening existing sector-specific remedies as a means for addressing these issues. The two concerns brought to the court in the JIL case of the sidelining of other remedies and recovery of consumer advances remain unresolved. This is because the policymakers failed to prioritize correctly. Even the Jaypee Infratech case which prompted these amendments was concerned with the rights of homebuyers in a case of CIRP being initiated by a financial institution. The homebuyers were not aggrieved for not having the right to initiate the CIRP process. However, the amendment failed to offer the homebuyers any additional benefits which are not available under other legislations apart from the right to initiate CIRP. Allowing for such a right with the allottees has led to a host of modifications being made in the IBC. As noted in the previous sections, the status of financial creditors does not ensure the homebuyer's possession of their flats due to low-resolution rates, and neither does it protect their rights in liquidation as they are not secured creditors.

67. *Whispering Tower v Abhay* (n 49).

The question of the interplay between rights under substantive law and bankruptcy rights has been the subject of much debate. While some scholars have argued that bankruptcy law should protect community stakeholders and those who do not have strong legal rights,⁶⁸ the other side of the debate claims that there should be parity between the rights under the legal system generally and rights under the IBC, as otherwise it might lead to forum shopping.⁶⁹ The latter school claims that issues such as those faced by homebuyers are better tackled outside of the realm of bankruptcy law.⁷⁰ However, such an approach though justifiable in theory, overlooks the practical realities where creditors like homebuyers' often do not have the consequences or possibilities of bankruptcy under their contemplation when providing advance payments. They are thus differently placed from other financial creditors who will demand liens or other mechanisms upon contemplating the possibility of bankruptcy and also have more information regarding the finances of the company. Thus, a case for their protection is conceded.

However, in India, there are significant protections available to homebuyers under the substantive law through RERA and CPA etc. The tweaks made in the IBC jurisprudence such as Project-wise CIRP are intended to allow for possession of flats by the homebuyers and thereby try to replicate the remedies existing under the substantive law to some extent. This overlooks the fact that the IBC is not a consumer remedial legislation unlike the RERA and the CPA. While it would be a wise policy decision to protect the rights of homebuyers in case of insolvency, it does not justify replicating the remedies already available in the existing substantive law.

Thus, it is proposed in this section that the future course of action should be aimed at synergizing the substantive remedies and protections under Bankruptcy law and other legislations. Instead of stretching the conceptual limits of the IBC by fitting homebuyers under the definition of 'financial creditors' just to give them a right to initiate proceedings in

68. Karen Gross, 'Taking Community Interests into Account in Bankruptcy' (1987) 72 *Washington University Law Quarterly*, pp. 1031-1048; Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review*, pp. 775-814.

69. Douglas G Baird, 'Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren' (1987) 54(3) *University of Chicago Law Review* pp. 815-834.

70. *Ibid.*

cases of default and then tweaking the CIRP to maximise the possibility of homebuyers getting possession, it is important that the post-insolvency liquidation rights of the homebuyers, in cases when CIRP has been initiated by some other creditor, be focussed upon more. This is also the dominant approach adopted by most countries.⁷¹

D. Prioritizing Sector-Specific Remedies

Since the homebuyers have a limited interest in regaining possession of their flats, RERA and CPA remedies, as demonstrated in the second section, are better aligned with the interests of the homebuyers. The policy concern, as noted in the recent report on Legacy Stalled Real Estate projects, should be more towards operationalizing these remedies which are better suited to assure the homebuyer of the possession of their flats. Section 8 of the RERA, which allows for taking over the completion of a project can be made more streamlined, as it currently faces problems of red tapeism etc. due to the involvement of the state government in the process. Moreover, the provision also has the onerous requirement of having the association of allottees on board, which entails securing 2/3rd votes of the allottees.⁷² Greater streamlining of such provisions which have the potential of assuring possession to the allottees is a preferable approach, as has also been conceded by the courts in one instance by holding that once the process under Section 8 of RERA has been initiated, CIRP cannot be initiated against such a project.

E. Preventing clash of remedies

As noted, one of the concerns that was brought to the fore in the JIL case was regarding the ouster of other remedies upon initiation of CIRP. Even existing cases at the RERA will be ousted once the moratorium under Section 14 of the IBC kicks in. For the moratorium under Section 14 to kick in, the only requirement is the admission of the CIRP application filed under Sections 7, 9 or 10 of the IBC.⁷³ Before 2022, it was the posi-

71. Gausia Shaikh (n 4).

72. Stubb King & Kasiva, 'Resolution Process for Real Estate Companies Under IBC: A Comprehensive Guide' (Mondaq, 9 March 2023). <<https://www.mondaq.com/india/real-estate/1291358/resolution-process-for-real-estate-companies-under-ibc-a-comprehensive-guide>> accessed 17 December 2023.

73. The Insolvency and Bankruptcy Code 2016, s 14.

tion of law that once an application is filed under Section 7 by a creditor and it discloses a default on the part of the corporate debtor, the NCLT is mandated to admit the application. The words 'may' used in Section 7 were interpreted to be a mandatory obligation. However, in 2022, the Supreme Court in the case of Vidarbha Industries, interpreted the word 'may' as used in Section 7 to impart discretion upon the NCLT to admit the CIRP application.⁷⁴ While commenting on the overall merits of this judgment is beyond the scope of this paper, the judgment allows for preventing the ouster of RERA and CPA remedies which are more suitable for homebuyers.

In the case of *Bank of Maharashtra v. Newtech Promoters & Developers (P) Ltd.*, the NCLT utilized the discretion vested in it by the Vidarbha ruling to reject a CIRP application on the ground that it will be prejudicial to the interests of the homebuyers to initiate a CIRP as remedies under the RERA under Section 8 had already been taken.⁷⁵ Not only did this ruling affirm that the remedies under RERA are better suited to the woes of the homebuyers, as noted in the second part of this paper, but it also pointed out the way out of the conundrum created by a multiplicity of remedies for homebuyers'. Usually, a builder is likely to default on consumer pre-payments before failing financially and defaulting on loans or other financial borrowings. This allows for RERA remedies to kick in and ensure the delivery of flats before an insolvency proceeding may be initiated by other financial creditors.

Thus, as the Vidarbha judgment is currently under question and may be overturned through a legislative amendment,⁷⁶ some sector-specific provisions or exceptions must be carved out to ensure that homebuyers' remedies are not ousted by the initiation of CIRP. However, in exercising its discretion it would be up to the NCLT to ensure that the interests of the creditors are not unreasonably ignored. In cases where there is little hope for delivery of possession of flats to homebuyers, initiation of CIRP under the IBC may be the way to go.

74. *Vidarbha Industries Power Ltd. v Axis Bank Ltd.* [2022] 8 SCC 352.

75. *Bank of Maharashtra v Newtech Promoters & Developers (P) Ltd* [2022] SCC Online NCLT 326.

76. Ministry of Corporate Affairs, Invitation of Comments from the Public on Changes Being Considered to the Insolvency and Bankruptcy Code (2016).

F. Protecting Homebuyer interests in case of liquidation

In cases where the sector-specific remedies may not be fruitful or the initiation of the CIRP by financial institutions takes place before any remedy is availed elsewhere, protecting the rights of the homebuyers in case of liquidation assumes greater significance. In the UK, the law commission has recommended that consumer prepayments which are above a certain threshold should be given priority in the event of liquidation.⁷⁷

Similarly, an amendment may be considered in the waterfall mechanism of the IBC to grant some extra protections to consumer advances, as has been done for workmen's dues etc.⁷⁸ This can be justified on the ground that by virtue of the RERA, promoters are anyways mandated to keep seventy per cent of the amount collected from consumers in a separate escrow account as working capital. This amount has nothing to do with the long-term finances and borrowing of the firms, and this may justify treating it separately from the pool of assets liquidated under Section 53. MP Ram Mohan in one of his articles, has proposed an interesting response to this problem by utilizing Sections 18 and 36 of the IBC which talk about the exclusion of 'trusts' from the ambit of the assets concerned in the CIRP.⁷⁹ If consumer advances are required to be put in trust in cases of CIRP being initiated by financial creditors other than allottees, it can ensure that the homebuyers are not deprived of their hard-earned investments in the project. Such a provision can easily be operationalized given that the RERA already mandates that seventy per cent of the total amount raised through consumer advances be kept in a separate escrow account.

VI. CONCLUSION

It is clear from the discussion in this paper that the policy decision of categorizing financial creditors and all subsequent innovations does not sit well with the scheme of the IBC which is enacted as insolvency legislation. Even detached from this consideration, the policy decision is not in the interest of either of the stakeholders. The right approach, instead, would

77. Law Commission, 'Consumer Prepayments in Retailer Insolvency' Law Com no. 368 (2016).

78. The Insolvency and Bankruptcy Code of 2016, s.53(1)(b)(i).

79. IIMA Working Paper (n 7).

be to maintain a distinction between insolvency law and sector-specific consumer beneficial legislations such as RERA and CPA as the point of redress for the homebuyers. This would entail preserving some discretion with the NCLT in admitting CIRP applications to ensure that other remedies are not ousted. IBC protections should be limited to ensuring that consumer advances are not used up in discharging the liabilities of the corporate debtor in insolvency cases initiated by lenders or other financial institutions. The recent report of the expert committee, by placing more emphasis on the mechanisms under RERA and advocating for the use of IBC as a last resort, can be seen as a step in the right direction in this regard.

Guilty Until Proven Innocent? – Analysing Sebi’s Prohibition of Unexplained Suspicious Trading Activities

—Vinita Singh and Jeeri Sanjana Reddy*

ABSTRACT

Owing to the use of technology to gain illegally from the securities market, the Securities and Exchange Board of India has recently introduced the SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023. These regulations introduce novel concepts that intersect with established law outlined in the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, and the SEBI (Prohibition of Insider Trading) Regulations, 2015. In their present form, the draft regulations require only a trading pattern suspicious enough for SEBI to conclude it as a fraudulent activity, after which the alleged offenders bear the burden of disproving the case. Once SEBI identifies a Suspicious Trading Activity (STA), it will establish a “rebuttable presumption of guilt” against the individual or group carrying out the unfair trading activity. While the need for a proposal to revise the existing framework to secure convictions could not be emphasized more, the current approach is riddled with apprehensions. This paper analyses the draft Regulations and throws light on the problems that may arise if they are enforced in their present form. An analysis of Indian securities jurisprudence, and presumptions in securities law across jurisdictions shows that an alternative solution could have been taken up. In addition to suggesting amendments to the draft Regulations to reduce subjectivity and vagueness, the paper makes a case for increasing

* The authors are students at the Damodaram Sanjivayya National Law University, Vishakhapatnam (DSNLU).

the threshold for raising a presumption of suspicious trading activity, the importance of motive as an element of the offence, and adapting to modern technology to aid investigation. All-in-all these considerations are crucial to ensure that the conflicting interests of all players in the Indian securities market can be balanced.

I. INTRODUCTION

Due to an increase in the use of technologically encrypted and vanishing modes of private communication, Securities and Exchange Board of India (SEBI) has been facing challenges in obtaining evidence to conclusively prove the existence of fraudulent activity. The utilisation of innovative techniques for sharing information and conducting trades has led to the usage of conventional methods like analysing call data records for obtaining evidence futile.

Resultantly, SEBI came up with a proposed regulation, namely, the SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023¹ (*PUSTA Regulations or draft Regulations*) which altogether eliminates the need to gather evidence and establish the occurrence of a breach prima facie. Under these Regulations, SEBI merely needs to prove the existence of “Material Non-Public Information” (MNPI) and the occurrence of a trade during a particular period. If an individual or connected persons display an Unusual Trading Pattern (UTP) with abnormal gain in securities coinciding with the existence of MNPI, it will be categorised as Suspicious Trading Activity (STA). This constitutes a presumed infringement of securities regulations. If individuals fail to rebut the presumption, they will be held guilty of engaging in Unexplained Suspicious Trading Activity (USTA), potentially leading to the issuance of an official order.

This move by SEBI is in line with its function of protecting the interests of investors² by effective enforcement of securities laws. Investors would surely prefer markets where regulatory agencies are most effective.

1. Securities and Exchange Board of India, ‘Consultation paper on draft SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023’ (SEBI Consultation paper) (18 May 2023).
 2. The Securities and Exchange Board of India Act, 1992 (45 of 1992) s 11; SEBI v Ashok Dayabhai Shah [2020] SCC OnLine SC 82.

Creating trust in the system by guaranteeing the market's fairness and integrity is required to be SEBI's top priority. However, critics have voiced multiple concerns concerning these regulations. The most common concern is that legitimate businesses may be unjustly targeted by "an avalanche of show cause notices." Therefore, the PUSTA Regulations have received mixed responses, with extreme stances taken on both sides.

On one hand, SEBI believes that this is the method for effective enforcement. In contrast, critics believe that SEBI should focus on updating its investigative methodologies and embracing better technological solutions, instead of solely placing the responsibility on traders to demonstrate that their activities comply with the regulations.³ Presuming guilt and consequently shifting the burden to rebut those presumptions is expected to cause inconvenience to parties involved.

II. UNDERSTANDING THE SCHEME PROPOSED BY SEBI

The draft Regulations contains factors like Unusual Trading Pattern, which involves frequent acts of carrying profitable securities transactions exhibiting a significant change in risk while having certain sensitive information in hand.⁴ The combination of UTP and MNPI is an essential pre-requisite to establish a Suspicious Trading Activity.⁵ STA constitutes a violation of securities law unless individuals can provide convincing explanations for their actions.⁶ In case of failure to rebut the presumption of guilt so drawn, SEBI can take action against the concerned person under the draft Regulations.⁷

Material Non-Public Information refers to information not available to the public at large but can have a substantial impact on the value of

3. Souvik Ganguly, Renjith Nair and Krishna Nair, 'Prove your innocence: Insights into the proposed securities trading regulations' (Lexology, 28 July 2023) <<https://www.lexology.com/library/detail.aspx?g=6d3cfo07-35b1-4f4c-8459-006c9c2b861a>> accessed 10 December 2023.

4. The Securities and Exchange Board of India, 'Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations', 2023, reg 2(1)(j) (SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations).

5. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 2(1)(i).

6. SEBI Consultation paper (n 1).

7. Ibid.

a company’s stock once it becomes public.⁸ This is similar to the concept of “Unpublished Price Sensitive Information” (*UPS*) under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (*SEBI PIT Regulations*).⁹ It could include information about upcoming significant orders that could influence stock prices upon execution or details about impending recommendations on a security by a market influencer.¹⁰

For instance, if a trader consistently places large orders and makes profits (this is the UTP) just before a company’s quarterly results are officially announced (this means that the information is MNPI), such behaviour may result in the inference that the entities would have traded on the basis of prior knowledge.¹¹

In order to proceed with cases of civil nature, SEBI requires circumstantial evidence and preponderance of probability for holding persons liable for violation of law.¹² Unlike the standard of proving a fact beyond reasonable doubt, preponderance of probability demands that the probability of an event happening outweighs alternative probabilities when weighed against each other.¹³ Talking of the draft Regulation at hand, the investigating authority needs to provide initial evidence that the person took part in an Unusual Trading Pattern while having access to MNPI, constituting an assumption of involvement in Unexplained Suspicious Trading Activity. Hence, a “reverse burden of proof” is placed on the accused individual based on inference drawn from circumstantial evidence. Although the draft Regulations outline specific defences that the alleged offender can use to challenge this presumption, providing “detailed documentary evidence” is necessary to support such defences.¹⁴

8. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 2(1)(f).

9. The Securities and Exchange Board of India, ‘Prohibition of Insider Trading Regulations’, 2015, reg 5B(1)(f).

10. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 2(1)(f).

11. SEBI Consultation paper (n 1), para 2.7.3.1 – 2.7.3.2.

12. SEBI Consultation paper (n 1), para 2.2; *Samir C Arora v SEBI* [2004] SCC Online SAT 90.

13. *State of UP v Krishna Gopal* [1988] 4 SCC 302.

14. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 5(1)(2).

The primary reason cited by SEBI for the need for the draft Regulations is the increasing difficulty in procuring evidence due to advancements in technology.¹⁵ Methods used by market participants through unfair trading practices in the securities market have evolved into “camouflaging tactics” such as using technology to destroy evidence which could establish communication or funding connections. In many situations despite the trading pattern of entities depicting strong suspicious behaviour, challenges posed in collecting evidence ultimately “make it impossible to establish preponderance of probability” and evasion from SEBI’s surveillance systems. Therefore, if SEBI were to only establish, *prima facie*, that unexplained suspicious trading activity has occurred, and then shift the onus of proof entirely onto the defendant, it believes that effective enforcement can be achieved. Such an approach could reduce the cost of enforcement, ensure that offenders cannot go scot-free because of insufficient evidence, and act as a deterrent to market participants to be extra careful and refrain from engaging in unfair trade practices.

However, the terminology adopted by SEBI and the standards prescribed seem to be subjective and may leave room for arbitrary interpretation due to their vague nature. It is pertinent to note that SEBI relies on a wide construction of the words “unfair trade practices”.¹⁶ Furthermore, SEBI intends to draw a rebuttable presumption for engaging in Suspicious Trading Activity based on “any reasonable ground”.¹⁷ Thereafter, SEBI proposes that it shall be empowered to direct investigation under the SEBI Act, 1992.¹⁸ The accused persons may rebut this presumption in the following circumstances providing supporting “detailed documentary evidence”: (i) Information was not MNPI; (ii) Trading pattern was not repetitive; (iii) Trading pattern did not exhibit “substantial change in risk taken”; (iv) The period for which trading was undertaken was not short; and (v) Trading activity did not deliver abnormal profits or avert abnormal losses.¹⁹

15. SEBI Consultation paper (n 1).

16. SEBI Consultation paper (n 1).

17. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 5(1).

18. The Securities and Exchange Board of India Act 1992.

19. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 5(2).

III. PRESUMPTION UNDER SECURITIES LAWS: TRENDS ACROSS JURISDICTIONS

Presumptions are preliminary probabilistic assessments made by the court regarding a particular fact, in the absence of supporting evidence.²⁰ The manner of operation of presumptions under securities laws across the world is a less-traversed topic. Analysing presumptions across jurisdictions can contextualize the discussion on SEBI’s approach under the draft Regulations.

A. United States of America

The PUSTA consultation paper refers to the system of presumption of guilt in the United States Security laws. The Securities Act, 1933 enforces liability on individuals engaged in securities offerings in case of the registration statement carrying a materially false statement or a significant omission in the United States of America (*USA*).²¹ In addition to the issuer, anyone who creates the registration statement is also susceptible to legal responsibility.²² However, the defendants are provided with a defence to escape liability if they can prove that they exercised due diligence by conducting a thorough and reasonable investigation and acted like a reasonable person.²³

In the USA, the argument of materiality is considered invalid if the transaction in question cannot be proved unlawful.²⁴ Further, another factor that determines the materiality of any information is the importance it holds for the person to whom it was communicated.²⁵ Courts in the USA in various instances have not allowed the application of strict liability on the traders post presumption of guilt under Section 11.²⁶ The court held that a corporate defendant cannot be held absolutely liable for

20. Antonio E Bernardo, Eric Talley and Ivo Welch, ‘A Theory of Legal Presumptions’ (2000) 16(1) *Journal of Law, Economics, & Organization* <<https://www.jstor.org/stable/3555007>> accessed 7 January 2024.

21. *The Securities Act 1933* (US).

22. Andrew F Tuchand Joel Seligman, ‘The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings’ (2022) 108 *Iowa L Rev* 303.

23. *The Securities Act 1933*, s 11(b)(3).

24. *ECA v JP Morgan Chase* [2009] 553 F3d 187, 204-205.

25. *Media Gen, Incv Tomlin* [2004] 387 F3d 865, 870.

26. Allan Horwich, ‘Section 11 of the Securities Act: The Cornerstone Needs Some Tuckpointing’ (2002) 58 *The Business Lawyer*.

not including arguable material information in the prospectus of which he had no knowledge during the time of its preparation.²⁷

Furthermore, the “Basic presumption of reliance rule” is widely applied in class-action securities cases.²⁸ A plaintiff may assert a rebuttable presumption based on a “fraud-on-the-market theory” in accordance with this rule.²⁹ According to this theory, investors place their trust in the market price of a firm’s security, which, in an operating market environment, accounts for every public misrepresentation made by the firm. In contrast, a defendant may refute this presumption by providing evidence that the purported misrepresentation had no impact on the value of the traded security.³⁰ Nevertheless, simply providing some evidence to refute the presumption is insufficient; defendants wishing to overcome this presumption must actually prove that the purported false representation did not influence the price of the stock.³¹

B. China

China has adopted a similar system of “presumption of reliance or causality” (*yinguo guanxi*) as is practiced in the United States of America. Under Article 18 of the Supreme People’s Court (*SPC*) Third Circular, if a set condition is met (such as the investment being directly connected with misrepresentations), an inter-link is assumed.³² The defendants are given the chance to rebut the presumption if they prove one of the following requirements: (i) The plaintiff divested the securities before the correction date;³³ (ii) The plaintiff acquired the securities either on or subsequent to the said date; (iii) Despite being aware of the misrepresentation, the plaintiff still proceeded with the investment; and (iv) The losses incurred by the plaintiff were either fully or partially, influenced by other factors.

27. *In re Ultimate Corp Sec Litig* (1989) 317 SDNY198.

28. Douglas BPaul and Idefonso ‘Dito’ PMas, ‘Supreme Court Clarifies the Presumptions and Burdens of Proof for Class Certification in Securities Fraud Cases’ (Ackerman, 7 July 2021) <<https://www.akerman.com/en/perspectives/supreme-court-clarifies-the-presumptions-and-burdens-of-proof-for-class-certification-in-securities-fraud-cases.html>> accessed 6 January 2024.

29. *Basic Inc v Levinson* [1988] 485 US 224.

30. *Halliburton Co v Erica P John Fund Inc* [2014] 573 US 258.

31. *Goldman Sachs Group, Inc v Arkansas Teacher Retirement System* [2021] US LEXIS 3391.

32. The SPC Third Circular, art 18.

33. A “stock market correction” occurs when the value of a specific stock or index decreases by 10% from its 52-week high.

As is evident, Chinese law has established well-laid down rules regarding presumptions under securities law.³⁴ This simplifies the process of initiating civil claims related to securities, as it is often exceptionally challenging, if not unfeasible, to definitively establish a causal link between the fraud and the behaviour of the defendant.

C. Singapore

In Singapore, the Securities and Futures Act, 2001 established a new regime for the securities market and emphasized on drawing a presumption of *mens rea*.³⁵ It is pertinent to note that this goes a step beyond establishing motive or intent to use MNPI for making profits. Under Section 218(4), a “connected person” is deemed to know that the information in question is non-public and price-sensitive if the investigation establishes that the “connected person had non-public information” about the company with which he is associated and that such knowledge was confidential.³⁶ The presumption is helpful to the prosecution chiefly because it relieves the prosecution from having to prove actual or constructive knowledge that the information in the possession of the accused is non-public and price-sensitive.³⁷

D. Australia

The Griffiths Committee’s proposal to reverse the onus of proof was not supported in Australia.³⁸ The Attorney General’s Office believed that a blanket presumption would be ‘unreasonable’ but that a limited reversal may be desirable as it is difficult to obtain any evidence that is within the exclusive knowledge of the defendant. The Committee had considered a reversal of the onus of proof as “information within the exclusive knowledge of a very limited range of people and other evidence is not obtainable

34. Robin Hui Huang, ‘Private Enforcement of Securities Law in China: A Ten-Year Retrospective and Empirical Assessment’ (2013) 61 *Am J Comp L* 757.

35. The Securities and Futures Act, 2001 s 218.

36. The Securities and Futures Act, 2001 s 218(4).

37. Hse Yu Chiu, ‘Australian Influences on the Insider Trading Laws in Singapore’ (2002) *Singapore Journal of Legal Studies* <<https://www.jstor.org/stable/24868101>> accessed 19 December 2023.

38. Tomasic R, ‘Casino Capitalism? Insider Trading in Australia’ (1991) *Australian Studies in Law, Crime and Justice*: Australian Institute of Criminology <<https://www.aic.gov.au/publications/lcj/lcj-1>> accessed 21 December 2023.

ble for a variety of reasons such as due to its destruction.” However, since the proposal to reverse the onus of proof was not supported, it was not adopted in the Griffiths Committee’s recommendations,³⁹ and the resulting securities legislation.

IV. KEY CHALLENGES POSED BY THE EXISTING DRAFT

The draft Regulations intend to ensure fairness in the securities market. However, the enforcement of the regulations in their present form can be counter-productive. First, the impact of the presumption on legitimate traders needs to be carefully weighed. Second, SEBI’s approach places an onerous burden of proving a negative fact. Third, the draft Regulations contain ambiguity and vagueness which enable SEBI to raise a presumption even without establishing foundational facts. This approach is contrary to existing securities jurisprudence in India. Finally, the element of mens rea and motive have not been considered for securing a conviction for USTA.

A. Impact on Genuine Traders

The first challenge is the impact of the draft Regulations on genuine traders. The standard of evidence placed on the accused to refute the STA presumption is extremely high. Even though many legitimate traders may be able to refute the presumption, it may result in avoidable disruptions and increased legal costs. Furthermore, it is anticipated that traders might re-think taking additional risks to get high rewards because of the scepticism of an automatic presumption being drawn against them. For instance, a genuine trader might hesitate before taking any trading positions before the release of a company’s quarterly results, as recurring positive trades may be considered suspicious.⁴⁰ An algo trader may be hesitant to execute transactions out of concern that they could be unaware of MNPI.⁴¹

39. Parliament of the Commonwealth of Australia, ‘Griffiths Committee Report’ (1989).

40. Sandeep Parekh and Raghuvamsi Meka, ‘India: hunting for Evidence’ (Mondaq, 5 July 2023), <<https://www.mondaq.com/india/securities/1337914/hunting-for-evidence>> accessed 24 December 2023.

41. Ibid.

B. Reverse Burden Of Proof

Regulation 5(2) of the PUSTA Regulations, 2023 prescribes that “detailed documentary evidence” must be submitted to support any claim.⁴² In the securities market, it might not be able to provide a trail of papers to prove that a person did not act on MNPI. The alleged offender may find it difficult to disprove an assumption through the demonstration of specific circumstances that do not exist. This requirement often equates to proving a negative fact, which is usually more challenging to prove through evidence than a positive fact.⁴³ Moreover, while SEBI notifies the alleged offender of what it deems to be MNPI, there is no analysis of whether the alleged offender had an adequate opportunity to be aware of or correlate the information in question. Even in most cases of insider trading, it is difficult to conclude whether something is Unpublished Sensitive Price Information (*USPI*). The defence largely hinges on whether or not the offender knew such information.

C. Vagueness In The Existing Draft

Another challenge is the vague nature of the draft Regulations. Once SEBI establishes an STA based on “any reasonable ground,” it is permitted to establish a presumption against the individual or group participating in the trading activity. The onus lies on the alleged offender to rebut the presumption with a reasonable explanation (reverse onus). It is a well-established legal principle, although, that in situations when the burden of proof is reversed, it is crucial to have precise rules or standards that would cause the accused to bear the burden of proof.

In addition to the arbitrariness associated with the “reasonable ground” standard, the term “substantial change in risk” has been defined vaguely to the extent that it could essentially encompass all trading activities.⁴⁴ Furthermore, “abnormal returns” are not invariably indicative of unethical trading practices. For instance, a trading pattern that does not show an intent to profit illegally—for example, selling shares when good

42. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 5(2).

43. Deepali Gundu Surwase v Kranti Junior Adhyapad Mahavidyalaya [2013] 10 SCC 324; Chief Engineer v Mithla [2011] 4 MP LJ 373.

44. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 2(1)(j).

news is released—does not subject the trader to penalties under securities law.⁴⁵ The actual profit or loss becomes irrelevant when there is no *intent* behind penalising gains.⁴⁶ Therefore, even the criterion of “abnormal profits or abnormal losses”⁴⁷ is subjective, and it would be difficult for the alleged offender to provide a rebuttal for the same.

The Supreme Court also has emphasized on steering away from subjectivity and sought to eschew the element of subjectivity under securities law in *Securities and Exchange Board of India v Abhijit Rajan*.⁴⁸ By maintaining the subjectivity of certain elements of the presumptive deeming provision, SEBI creates an incredibly restrictive net that could entangle genuine traders. Therefore, existing jurisprudence suggests that for regulations and norms to serve as safeguards, they must be precise, unambiguous, and objective.

D. Low Threshold for Raising Presumption

It is undisputedly common for the Indian securities regime to ascribe a presumption of guilt. For instance, Regulation 3(1) of the SEBI PIT Regulations, 2015 imposes “presumptive guilt” on individuals with Unpublished Price Sensitive Information (*UPSI*).⁴⁹ However, the PUSTA Regulations grant SEBI the power to establish a presumption of culpability notwithstanding the lack of evidence connecting the questionable transactions to the trading activity that it seeks to prevent. In the absence of a “cause-and-effect relationship”, mere suspicions arising from the appearance of irregular trade patterns should not suffice for making a presumption. As per the jurisprudence of *Abhijit Rajan*, persuasive circumstantial evidence and motive are essential pre-requisites, meaning that a reasonable connection between UTP and MNPI must be established.⁵⁰

45. Pavan Burugula, ‘Supreme Court ruling in insider trading case may set a precedent’ (*Economic Times*, 21 September 2022) < <https://economictimes.indiatimes.com/markets/stocks/news/supreme-court-ruling-in-insider-trading-case-may-set-a-precedent/article-show/94337895.cms?from=mdr> > accessed 25 December 2023.

46. *Securities and Exchange Board of India v Abhijit Rajan* [2022] SCC OnLine SC 1241.

47. SEBI, *Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations*, reg 5(2)(e).

48. *Securities and Exchange Board of India v Abhijit Rajan* [2022] SCC OnLine SC 1241.

49. *Securities and Exchange Board of India*, ‘*Prohibition of Insider Trading Regulations*’, 2015, reg 3(1).

50. *Securities and Exchange Board of India v Abhijit Rajan* [2022] SCC OnLine SC 1241.

Further, the SEBI Proposal defines “Unexplained Suspicious Trading Activity” (*USTA*) to include suspicious trading activity by a group of connected persons in a security or a group of securities and executed in circumstances for which no reasonable rebuttal is provided. The SEBI PIT Regulations, 2015 defines “connected persons” and spans a wide range of people who are connected to the Company through regular communication with its executives or by being a part of contractual, fiduciary, or employment relationships, or by working for the company as KMPs or employees.⁵¹ A SEBI Committee Report had discussed that even the determination of connected person will depend on the facts of the case.⁵² The Committee stated that in case there is a lack of evidence that shows an actual access to UPSI, the test of reasonable expectation of access to such information will be drawn. The presumption is rebuttable and is a deeming legal fiction. The Committee also underlined the significance of not mandatorily assuming any information to be UPSI, even if it contains price-sensitive information.⁵³

In a SEBI Adjudication case,⁵⁴ a person was accused of trading while possessing UPSI on the basis of being a mutual Facebook friend of a person associated with a listed company. The allegation by SEBI was based merely on a hypothesis formed by the virtue of being added to a social media friend list. The allegation resulted in carrying out of formal investigation proceedings leading to the loss of job of the accused in the matter. Later it was held by the Adjudicating Authority that the investments carried out by the accused were by his own analysis of the Company and the financial details available in the public domain. A mere suspicion due to Facebook connection resulted in holding the accused guilty of Insider Trading. According to the Adjudicating Authority, possession of UPSI cannot be presumed based only on a mutual connection over social media.

51. The Securities and Exchange Board of India, ‘Prohibition of Insider Trading Regulations’, 2015, reg 2(d).

52. SEBI, ‘Report of the High-Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992’.

53. *Ibid.*

54. In the matter of Palred Technologies [2021] SEBI PM/AN/2021- 22/12320.

V. BALANCING THE SCALES: SUGGESTIONS

To ensure that the securities market is effectively regulated, while simultaneously protecting the interests of all players, SEBI may consider amending the draft Regulations, increasing the threshold for raising a presumption, factoring in motive as an essential element of the offence, and upgrading technological resources to aid with the investigation.

A. Amending The draft Regulations

The ambiguity present in the regulations grants SEBI officials an unwarranted authority to impose their own interpretations on the rules. Thus, the governed are brought to their mercy. This cannot be considered a legitimate “rule-based” system that SEBI intends to replace with the previous one, which was established at the administrative authorities’ discretion.⁵⁵ The amended Regulations should clearly stipulate what precisely are the “reasonable grounds” on which SEBI may draw presumption under the PUSTA Regulations, and what constitutes “substantial change in risk”. Furthermore, “abnormal profits or abnormal losses” cannot always be considered to stem from suspicious trading activity. The securities market is highly speculative and the occurrence of abnormal patterns need not necessarily be due to USTA.⁵⁶

B. Establishing Foundational Facts: A Necessary Pre-requisite?

As per the draft Regulations, SEBI is not required to establish a prima facie case of intentional or reckless conduct by the defendant. In addition to amending the draft to be less subjective, it is proposed that as a part of SEBI’s duty to establish a prima facie case, it should be mandatory to provide persuasive evidence supported by fundamental facts in order to establish the transmission or use of such information. As discussed earlier, the draft Regulations establish a presumption based solely on suspicion, without providing any supporting evidence or supporting facts with evidence in the record.

55. L C Gupta, ‘Challenges before Securities and Exchange Board of India’ (1996) 31(12) Economic and Political Weekly.

56. SEBI, Prohibition of Unexplained Suspicious Trading Activities in the Securities Market Regulations, reg 5(2)(e).

This is contrary to the existing Indian securities jurisprudence. The Supreme Court in *Seema Silk & Sarees v Directorate of Enforcement* held that “reverse burden as a statutory presumption is permitted, but it can be raised only when certain foundational facts are established by the prosecution.”⁵⁷ Such ‘foundational facts’ include the establishment of an “attempt by the insider to encash the benefit of the information” as per the *Abhijit Rajan* jurisprudence.⁵⁸ In this case, the Supreme Court cited *SEBI v Kanaiyalal Baldevbhai Patel*,⁵⁹ which was an alleged violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.⁶⁰ The same case has been mentioned in the consultation paper to discuss unfair trade practices,⁶¹ in which it was ruled that, while *mens rea* is not required for the Regulations to apply and the appropriate standard is of the preponderance of probabilities, an offender’s “attempt to encash the benefit of the information is not exactly the same as *mens rea*.” Therefore, it can be determined by the Court whether the alleged offender’s action in trading securities was an attempt to benefit from or cash in on his knowledge.

Furthermore, SEBI acknowledges that “proceedings under civil law progress on the preponderance of probability and circumstantial evidence.”⁶² In *Balram Garg v SEBI*, the Supreme Court asserted that “trading pattern merely in the presence of any non-public material information cannot be considered to be adequate circumstantial evidence.”⁶³ Finally, the very possession of MNPI can result in liability for fraudulent activities. The rationale for this given by SEBI is that:

“This difficulty arises mainly due to the lack of evidence regarding communication of material non-public information or the failure in establishing the connection between the suspected entities that would withstand legal scrutiny.”⁶⁴

57. *Seema Silk & Sarees v Directorate of Enforcement* [2008] 5 SCC 580.

58. *Securities and Exchange Board of India v Abhijit Rajan* [2022] SCC OnLine SC 1241.

59. *SEBI v Kanaiyalal Baldevbhai Patel* [2017] 15 SCC 1.

60. SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003.

61. SEBI Consultation paper (n 1).

62. *Ibid.*

63. *Balram Garg v Securities and Exchange Board of India* [2022] SCC OnLine SC 472.

64. SEBI Consultation paper (n 1).

However, the extreme approach of the draft Regulations cannot justify entirely doing away with the requirement for SEBI to establish foundational facts. In *Chintalapati Srinivasa Raju v Securities and Exchange Board of India*, the Supreme Court has held that “a reasonable expectation to be in the know of things can only be based on reasonable inference drawn from foundational facts”.⁶⁵ It has further been held the mere fact that an individual is related to the connected individual does not, in itself, constitute sufficient evidence to support an inference. This shows the emphasis the apex Court has laid down on some need for some sort of prima facie case to be established by SEBI – based on coherent facts – before it can draw an inference/ presumption.

C. Motive As An Essential Element

The element of guilty mind cannot be ignored in its entirety while deciding any matter. Offences like insider trading are based on the motive of gaining an unfair gain.⁶⁶ As highlighted above, in cases of insider trading, the quantified gain or loss is not as relevant as the presence of the intention to attain profit.⁶⁷ For instance, it is important to check first whether the person in question actually acted in a way that was in his favour. Motive has been mentioned to be an essential element by the Securities Appellate Tribunal itself in *Rakesh Agrawal v SEBI*,⁶⁸ and *Chandrakala v Adjudicating Officer, SEBI*.⁶⁹ Therefore, the insertion of the motive requirement in insider trading cases has now made a fact-based determination crucial in securities law. Consequently, motive ought to be considered under the PUSTA Regulations, especially since SEBI relies on circumstantial evidence.⁷⁰ In *SEBI v Kishore R. Ajmera*,⁷¹ it was established that:

“the totality of the facts and circumstances surrounding the allegations is relevant... a single meeting or phone call by itself is insufficient circumstantial evidence to establish a presumption of guilt.”

65. *Chintalapati Srinivasa Raju v Securities and Exchange Board of India* [2018] 7 SCC 443.

66. *Rakesh Agrawal v Securities and Exchange Board of India* [2004] 1 CompLJ 193 SAT.

67. *Securities and Exchange Board of India v Abhijit Rajan* [2022] SCC OnLine SC 1241.

68. *Rakesh Agrawal v Securities and Exchange Board of India* [2004] 1 CompLJ 193 SAT.

69. *Chandrakala v Adjudicating Officer SEBI* [2019] SCC OnLine SAT 223.

70. SEBI Consultation paper (n 1).

71. *Securities and Exchange Board of India v Kishore R Ajmera* [2016] 6 SCC 368.

It is pertinent to note that courts in general have held that when cases are based on circumstantial evidence, motive assumes significance.⁷² It has been asserted that, “In the absence of a motive, it would be difficult to complete the chain of events in order to prove the guilt of the accused.”⁷³ It is acknowledged that for market regulation and related matters, SEBI has the same authority as a civil court and not a criminal court, as the aforementioned instances. However, *Dilip S Pendse v SEBI* discusses “serious” securities market-related charges.⁷⁴ It asserts that in according to criminal law, the more severe the offence, the higher the burden of proof; and that the same principle is also applicable to cases of civil nature.

Finally, Canada’s approach to motive under securities laws is also worth noting. In *Finkelstein v Ontario (Securities Commission)*,⁷⁵ the court concluded that motives can take various forms, such as obtaining a client’s trust or establishing a professional standing. In agreement with the Supreme Court’s decision in *Salman v United States*,⁷⁶ the court declared, “... there is no requirement that motive must involve a direct personal financial gain.”

SEBI must consider establishing an “attempt to encash the benefit,” or motive as a part of its prima facie case. This is still a lower threshold than establishing mens rea, and SEBI can still rely on the preponderance of the probability threshold.

D. Improving Surveillance: Technological Advancement

SEBI is a regulatory body with extensive investigative power provided by the SEBI Act, 1992 to safeguard the welfare of legitimate investors.⁷⁷ It exercises legislative, executive, and quasi-judicial authority to carry out functions necessary for the smooth working of the securities market. Indian courts allow violation of privacy through different means:

72. *Ramesh Durgappa Hirekerur v State of Maharashtra* [2017] SCC OnLine Bom 9109.

73. *State of J&K v Shailender Singh* [2023] LiveLaw (JKL) 205.

74. *Dilip S Pendse v Securities and Exchange Board of India* [2009] SAT 80.

75. *Finkelstein v Ontario (Securities Commission)* [2016] ONSC 7508.

76. *Salman v United States* [2016] 137 S Ct 420.

77. Securities and Exchange Board of India Act 1992, s 11C.

(i) legislative enactments; (ii) administrative or executive orders; and (iii) judicial orders.⁷⁸

With such wide powers, the privacy of persons suspected are anyway always compromised and at risk of getting violated. To add to it, the new regulatory framework is proposing an increased burden of proof on the traders to rebut a suspicion drawn by the SEBI. All of this is due to the advent of innovative modes of communication among people:

“the use of innovative, vanishing, and encrypted methods of private communication, as well as complex and untraceable funding arrangements, makes it impossible to establish the preponderance of probability.”⁷⁹

Instead, SEBI should find ways to make its investigative techniques compatible with the advancement of technologies. There has been research done on using machine learning algorithms to distinguish between fraudulent and non-fraudulent transactions.⁸⁰ The artificial neural networks connect millions of data points from datasets that appear to be unrelated, containing anything from tax records and real estate holdings to social media posts and internet protocol identifiers used on airport Wi-Fi networks, and spot patterns.

Research on the classification of fraud has made use of algorithms such as support vector machines (*SVM*), ensembles, artificial neural networks (*ANNs*), Bayesian networks, rule-based systems, and *SVM* to improve the prediction of fraudulent activities in various domains and categorise fraud instances.⁸¹ Scholars who used advanced machine learning algorithms like *SVM* concluded that these algorithms perform better than existing approaches when it comes to predicting accounting fraud.⁸²

AI tools have tremendously helped banks to catch suspicious activity of money laundering. This is due to the fact that a lot of banks can now

78. District Registration and Collector, Hyderabad and Another v Canara Bank and Another [2005] 1 SCC 496.

79. SEBI Consultation paper (n 1), para 2.6.

80. C Phua and others, ‘A comprehensive survey of data mining-based fraud detection research’ (2010) *Artificial Intelligence Review*.

81. Sunil Bhatia, Rashmi Bajaj, Santosh Hazari, ‘Analysis of credit card fraud detection techniques’ (2016) 5(3) *International Journal of Science and Research* < <https://www.ijsr.net/archive/v5i3/NOV162099.pdf> > accessed 3 January 2024.

82. Mark Cecchin and others, ‘Detecting management fraud in public companies’ (2010) 56(7) *Management Science* < <https://www.jstor.org/stable/40785248> > accessed 4 January 2024.

automate the tedious human work involved in document review, and as a result, their false warnings have decreased by up to half as a result of AI. Paypal has managed to reduce its false alarms by 50% through its utilisation of artificial intelligence.⁸³ After a year-long trial with payments company Vocalink Analytics, Royal Bank of Scotland was able to prevent losses to customers in excess of \$9 million by using AI to inspect small business transactions for fraudulent invoices.⁸⁴

Taking example of Australia, the Australian Securities and Investments Commission (*ASIC*) employs the Market Analysis and Intelligence (*MAI*) system as a supervisory technology platform for market surveillance. This system collects real-time data feeds on equities and equity derivatives products and transactions from the primary and secondary Australian capital markets “ASX” and “Chi-X.” The post-trade analytics environment is powered by a technology framework that includes R, Python, MS-Excel, and KDB/Q. The real-time alerts generated by this system are seamlessly integrated into daily operations, potentially leading to in-depth investigations and analyses. In the coming time, the ASIC plans to activate machine-learning algorithms across the dataset in order to spot unusual trading behaviours.⁸⁵

The utilization of computational technology provides regulators and other involved parties with significant chances to enhance market monitoring, enabling the identification of fraudulent activities before they occur.⁸⁶

VI. CONCLUSION

A bare reading of the draft PUSTA Regulations framework shows that SEBI does not require a guilty intent for establishing fraudulent activity.

83. Penny Crossman, ‘How PayPal Is Taking a Chance on AI to Fight Fraud’ (American Banker, 1 September 2016) <<https://www.americanbanker.com/news/how-paypal-is-taking-a-chance-on-ai-to-fight-fraud>> accessed on 25 December 2023.

84. Lisa Quest and others, ‘The Risks and Benefits of Using AI to Detect Crime’ (Harvard Business Review, 9 August 2018) <<https://hbr.org/2018/08/the-risks-and-benefits-of-using-ai-to-detect-crime>> accessed on 25 December 2023.

85. Dirk Broeders and Jermy Prenio, ‘Innovative technology in financial supervision (suptech) – the experience of early users’ (Financial Stability Institute, 2018) <<https://www.bis.org/fsi/publ/insights9.htm>> accessed 2 January 2024.

86. Mark Eshwar Lokanan and Kush Sharma, ‘Fraud prediction using machine learning: The case of investment advisors in Canada’ (2002) 8 Machine Learning With Applications <<https://doi.org/10.1016/j.mlwa.2022.100269>> accessed 4 January 2024.

Consequently, a trader may be liable for fraudulent trading even in the case of lack of a motive. The draft regulations also have ambiguously defined terminology. It falls on the defendant to provide a detailed documentary evidence to prove that the trading pattern is considered “unusual” and the information “material” was in compliance with SEBI guidelines, without SEBI having to establish any foundational facts. Therefore, the draft regulations are in contradiction to the evolving jurisprudence of moving away from strict liability and instead, taking into account elements like the nature of Unpublished Price Sensitive Information (*UPSI*), how their trading aligns with the *UPSI*, and their intention behind seeking abnormal profits or evading losses.⁸⁷ Even if *UPSI* has an impact on trading prices, it is important to first consider whether the person(s) involved actually benefited from the sensitive information.

This article consequently proposes that SEBI ought to consider adopting alternative ways of deducing evidence instead of placing pressure on traders via a reverse burden of proof. If the latter is considered necessary, at the least, SEBI ought to establish a *prima facie* case with foundational facts before being able to raise a presumption. One approach towards the prevention of fraudulent trading and improving the existing surveillance system is employing machine learning. Automated systems can monitor different marketing behaviour of traders which are fraudulent in nature and might otherwise go unnoticed through a human-centric approach.⁸⁸ SEBI has cited technological resources as one of the factors resulting in increased illicit trading cases. However, the same technology can be used to address the issue at hand in a manner which is efficient while also making the market participant more open to trading instead of being inhibited by it.

87. *SEBI v Abhijit Rajan* (2022) SCC OnLine SC 1241; *Quantum Securities Pvt Ltd v SEBI* [2021] SAT 49.

88. Larry Wall, ‘Some financial regulatory implications of artificial intelligence’ 100(C) *Journal of Economics and Business* (2018).

Harmonizing Expediency and Commercial Wisdom: Proposing AI Integration in the Insolvency and Bankruptcy Code to Enhance Efficiency and Preserve the Mandate of Expediency in the IBC Ecosystem

—Sarthak Kumar and Aditya Singh*

ABSTRACT

This paper delves into the intricate interplay between artificial intelligence (AI) and insolvency laws, with a focus on the Insolvency and Bankruptcy Code, 2016 (IBC), in India. Acknowledging the persistent challenges posed by the stringent timelines outlined in the IBC, specifically Section 12, we examine recent judicial pronouncements that have addressed the dilemma of adhering to deadlines while accommodating the principles of commercial wisdom. This dichotomy is exemplified by contrasting decisions regarding the condonation of delays by the committee of creditors and the legal validity of resolution plans submitted after the stipulated timeframe. Expanding the scope beyond India, our analysis incorporates the experiences of Canada, Colombia, and the European Union in their interaction with AI and insolvency laws. We explore diverse legal landscapes to identify commonalities and innovative approaches to enhance efficiency and reduce processing times across pre-insolvency, Corporate Insolvency Resolution Process (CIRP), and liquidation phases. By scrutinizing global practices, we aim to distil key insights applicable to the Indian context. Central to our

* The authors are students at the National University of Study and Research in Law, Ranchi (NUSRL).

proposal is the introduction of a self-assessing AI tool to assist resolution professionals in expediting routine tasks. We argue that the incorporation of AI aligns with current technological capabilities and can significantly contribute to streamlining the resolution process without compromising its expeditious nature. The paper concludes by offering objective legislative and regulatory recommendations aimed at safeguarding the essence of the IBC while fostering an environment where commercial wisdom can thrive. The paper concludes that India has the requisite infrastructure to make a shift toward an AI-augmented IBC ecosystem.

I. INTRODUCTION

Modern-day legislature focuses on reducing the judiciary's workload and expediting the litigation process. Therefore, to achieve this the legislature has consistently incorporated deadlines within the ambits of modern law. These time limits serve a higher function than merely protecting the quality and interest of the trial or proceedings. They also bind the parties and the judicial bodies to dispose of matters in an expedited manner. In essence, it aims at abolishing the "next date" culture.

The Insolvency and Bankruptcy Code, 2016¹ (The Act) is one such Act where a strict deadline has been proposed. Section 12 of the Act² stipulates that corporate insolvency resolution should be finished within one hundred eighty days. In a recent case, the same problem was addressed by the Hon'ble Supreme Court wherefore, it held that if the Committee of Creditors (CoC) allows for a delay then it cannot be condoned in the interest of commercial wisdom.³ However, in an alternative tone, it was held by the court in another case that a resolution plan submitted after the deadline would be bad in law.⁴

1. The Insolvency and Bankruptcy Code 2016.

2. The Insolvency and Bankruptcy Code 2016, s 12.

3. Kalpraj Dharamshi v Kotak Investment Advisors Limited [2021] SC Civil Appeal No.S.29432944 OF 2020.

4. Dwarkadhish SakharKarkhana Limited v Pankaj Joshi [2021] NCLT Company Appeal (AT)(Insolvency) No. 233 of 2021.

The questions regarding the inefficiency and the ineptness of the Act have been a highly debated topic in the contemporary legal scenario. Pertinently, the question of “Whether the prescribed periods should be extended in the interest of common parlance by sacrificing the expeditious nature of the Act. Has been raised by multiple luminaries in the field of law and beyond. Even the courts have made it a general practice to grant extensions on the resolution process timelines.⁵ Ultimately, the basic argument is that it goes against the very mandate of the Act to read down the expeditious nature of the proceedings.

Considering the same, this paper seeks to suggest an alternative mode of expediting the current resolution process by way of incorporating AI into the functionaries of IBC. The paper seeks to establish that with the current technology at hand, it is feasible to incorporate a self-assessing AI to assist a resolution professional (*RP*) in expediting the grunt work. The paper further seeks to highlight the relevant provisions within the Act and other commercial laws that would aid the application of the proposed solution. The paper lastly seeks to suggest objective changes that could be made to the legislative and regulatory framework to protect the spirit of the Act and allow for commercial wisdom to prevail.

II. SCOPE OF THE PROBLEM

A. The Legislative Intent

The problem at hand can be best described as a “time crunch”. Ideally, the resolution should be done within the stipulated time. During the deliberations held in the Lok Sabha, the issue of the period to be provided for every single step of the resolution process was discussed in detail.⁶ This was done by suggesting relevant changes to Sections beginning from 61(2). However, Section 12 was never explicitly discussed.⁷

A mere perusal of the report shows that the committee intended to reduce the period further to expedite the process.⁸ The reduced time paired with the patent absence of any deliberations over Section 12 goes

5. In Re: Dharani Sugars and Chemicals Limited [2023] NCLT IA(IBC)/380.

6. Lok Sabha Secretariat, Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015 (LS 2016).

7. Ibid.

8. Ibid.

to show that despite considering changes within the actual time frame for the micro-management of resolution procedures there were no efforts made towards suggesting changes to the parent Section, i.e. Section 12 of the Act.⁹

The same has resulted in the current problem. The reduction of the original time period, paired with the already arduous task of completing a resolution process has led to a systematic breakdown of the Act's intent.¹⁰ The intent here refers to expeditious resolution processes, as has also been expressed in paragraph 3 of the report.¹¹ AI is a prospective solution to this problem.

B. The Current Legal Scenario

Currently, in India, it has become a common practice for the courts to grant an extension of time in favour of the “commercial wisdom” of the CoC.¹² It is argued that judicial wisdom cannot be equated to commercial wisdom.¹³ However, making a rule out of this exception becomes an antithesis to the already established legislative intent behind the Act.

As an effective example, a recent NCLT judgement¹⁴ is one in a long line of judicial orders that allow for an extension of the Corporate Insolvency Resolution Process (*CIRP*). The issue at hand here is that this extension has now become a way to stall the proceedings. Relying solely on the “commercial wisdom” of the CoC indirectly undermines the “judicial wisdom” of the courts and tribunals.

In the case of *Kalpraj Dharamshi v. Kotak Investment Advisors Limited*, it was held that commercial wisdom may not be a free hand to break the

9. *Ibid.*

10. Soham Chakraborty & Aaryan Wasnik, ‘Keeping it Time-Bound: Resolution Plans under IBC’ (NLIU-CBCL) <<https://cbcl.nliu.ac.in/insolvency-law/keeping-it-time-bound-resolution-plans-under-ibc/>> accessed 10 November 2023.

11. Subhadip Choudhuri, ‘Should the Insolvency and Bankruptcy Code be Shadowed by Limitation’ (IBBI) <<https://ibbi.gov.in/uploads/engagement/WinnerSubhadipChoudhuriGNLUGandhinagar.pdf>> accessed 13 November 2013.

12. National Company Law Appellate Tribunal, <https://nclat.nic.in> accessed 24 November 2023.

13. Kartik Singh ‘Commerical Wisdom v Judicial Wisdom: An Ongoing Debate of Primacy’ (Indian Corp Law, 24 September 2021) <<https://indiacorplaw.in/2021/09/commercial-wisdom-vs-judicial-wisdom-an-ongoing-debate-of-primacy.htm>> accessed on 13th November 2023.

14. In Re: Dharani Sugars and Chemicals Limited [2023] IBA 976/2019.

law.¹⁵ However, the very statement is hypocritical when it allows for commercial wisdom to overrule the legislative mandate. NCLT Chennai has already given orders striking down commercial wisdom where it clashed with the tenets of judicial wisdom.¹⁶ However, the grounds for upholding or striking down such decisions are vague and ultimately, commercial wisdom is the antithesis to the expeditious nature of the Act.

Therefore, the current judicial scenario is doing nothing but functioning as an extension of the CIRP process. Extending the time period it is going against the legislative mandate without explicitly declaring it unconstitutional. It is suggested that instead of judicial augmentation the Indian resolution process should consider technological augmentation. Therefore, the subsequent section proposes how AI is a lucrative solution in augmenting the efforts of the Committee of Creditors and the Resolution Professional by streamlining the CIRP.

III. AI AS THE PROSPECTIVE SOLUTION

AI as a replacement is drastically different from AI's augmentation in the insolvency process.¹⁷ The paper aims to address the need for a robust infrastructure that can be used by the resolution professional and help in reducing redundancy, administrative traffic etc., whilst simultaneously increasing efficiency. The same stands in line with the original mandate of the Act which aims to provide a time-bound and efficient process for the transparent resolution of insolvency and bankruptcy.¹⁸

As established in the previous chapter, the “speedy” nature of the Act is always kept on the backseat due to frequent human delays in the process. An AI algorithm maintained by the GOI would inadvertently allow for a smoother process as it will allow the inherent redundancy of the Act. On multiple occasions, the Act requires the Resolution professional

15. Kalpraj Dharamshi & Anr. v Kotak Investment Advisors Ltd. & Anr [2021] Civil Appeal Nos. 2943-2944/2020.

16. ‘NCLT orders liquidation of Sivasankaran’s Siva Industries’ (The Hindu Business Line, 13 August 2021) <<https://www.thehindubusinessline.com/companies/nclt-orders-liquidation-of-siva-industries/article35883010.ece>> accessed 11 November 2023.

17. ‘Responsible AI: A Draft Discussion Paper’ (NITI Aayog, 22 February 2021) <<https://www.niti.gov.in/sites/default/files/2021-02/Responsible-AI-22022021.pdf>> accessed 14 November 2023.

18. Utkarsh Mittal, ‘IBC 2016: Objective of Insolvency Resolution Process, Challenges & Way Forward’ (TaxGuru) <<https://taxguru.in/corporate-law/ibc-2016-objective-insolvency-resolution-process-challenges-way-forward.html>> accessed 16 November 2023.

to conduct due diligence¹⁹ which can be replaced with an AI trunk system, which is quicker and more transparent.

Similarly, many processes which do not require the votes of the CoC may be streamlined. These include a range of possibilities, with one being the sharing of information by IU under the Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017 (IU Regulations),²⁰ due diligence on the multiple applicants for both being recognized as creditors, sureties etc. and for proposing a resolution plan.²¹ AI can also make the plethora of decisions before the CoC more lucid by providing unbiased datasets quicker than any human.²²

IV. AI IS NOT A REPLACEMENT FOR THE RESOLUTION PROFESSIONAL

The pith and substance of the Resolution Professional's job is to ensure a fair and legally sound CIRP. In ensuring fairness the RP is expected to maintain all financial records and deter any non-deserving applicant from entering or disrupting the CIRP process. An Informational Utility (IU) primarily holds all the data required by the RP.

The multiple occasions on which the RP is legally expected to perform due diligence can be replaced by an AI which gives all the relevant information to the RP by processing the datasets held by the IU (which already uses such technologies).²³ The RP is not being replaced; rather the AI is simply reducing the redundancy which the RP suffers from, leaving him/her to focus on organizing the CoC and skipping over unnecessary litigation arising out of the RP's decision regarding the applications.

19. The Insolvency and Bankruptcy Code 2016, s 29A.

20. 'Discussion Paper on Corporate Insolvency Resolution Process' (Insolvency and Bankruptcy Board of India) <<https://ibbi.gov.in/uploads/publication/ee64e0a0330c81c11c0ab-538b5e4b946.pdf>> accessed 17 November 2023.

21. Ankita Pugalía, 'Corporate Insolvency Resolution Process under IBC' (Incorp Advisory, 25 November 2022) <<https://incorpadvisor.in/blog/corporate-insolvency-resolution-process-under-ibc/>> accessed 20 November 2023.

22. Yuri Zelenkov, Nikita Volodarskiy, 'Bankruptcy prediction on the base of the unbalanced data using multi-objective selection of classifiers' (2021) 185 Expert Systems with Applications Volume.

23. 'Discussion Paper on Corporate Insolvency Resolution Process' (Insolvency and Bankruptcy Board of India) <<https://ibbi.gov.in/uploads/publication/ee64e0a0330c81c11c0ab-538b5e4b946.pdf>> accessed 17 November 2023.

Lastly, it is pertinent to note that the paper is not hypothesizing a futuristic technology. The required tech for the implementation of the paper's recommendations already exists.²⁴ India is a coming-of-age country and the trunk bone of this speedy development may be accredited to the interplay of law and technology.²⁵ Illustriously, the expedition of procedural timelines in ADR disputes was achieved by way of introducing AI and technology.²⁶

Moreover, the Ministry of Corporate Affairs is inviting comments on changes in the insolvency law starting January 2023. The changes explicitly ask for recommendations on the application of technology such as AI to bring together the fragmented state of the informational Utility. It also calls for recommendations regarding the introduction of technology in the pre-, during and post-insolvency process.²⁷ It is, therefore, not a mere *arguendo* to suggest that AI's augmentation to the CIRP process to reduce the time wasted via human redundancy is a definitive way forward for the revolutionization of IBC and the realization of its original intent.

V. CASE STUDIES

A. Australia and Insolvency through AI

In Australia, the Insolvency regime is already adopting AI in the pre-insolvency, CIRP and post-insolvency processes.²⁸ The prominent aim of Australians when it comes to using AI in insolvency is to reduce costs and increase efficiency.²⁹ As discussed previously in the paper, the Australians endeavour to augment redundant tasks of the Resolution Professional

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24. 'NCLT organized Colloquium on "NCLT- The Road Ahead",' (Press Information Bureau, 26 March 2022) <<https://www.pib.gov.in/PressReleaseDetailm.aspx?PRID=1810037>> accessed 23 November 2023.
 25. Generative Artificial Intelligence, (Press Information Bureau, 3 February 2023) <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1896016> accessed 23 November 2023.
 26. 'Designing The Future of Dispute Resolution: The ODR Policy Plan for India' (NITI Aayog, March 2023) <<https://www.niti.gov.in/sites/default/files/2023-03/Designing-The-Future-of-Dispute-Resolution-The-ODR-Policy-Plan-for-India.pdf>> accessed 27 November 2023.
 27. 'Insolvency and Bankruptcy Code, 2016', (Ministry of Corporate Affairs, Government of India, 18 January 2023) <<https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>> accessed 2 December 2023.
 28. M. Dickfos, 'AI and the Insolvency Profession: The State of Play' (2018) 26(172) *Insolv LJ* (Dickfos).
 29. Innes, 'Insolvency Law Reform Bill (CTH)' (2016) 17(2) *INSOLVENCY LAW BULLETIN* 20-23.

such as organizing meetings of CoC or redundant acts requiring due diligence.³⁰

The Bankruptcy Act, 1996 since its 2003 amendment³¹ suggests the ‘proposal without a meeting’ concept. Through this, the necessary meeting of the CoC can be skipped by an AI simply sending them the option on the table for them to choose from.³² This will greatly reduce the time taken up by these meetings and also the costs generated due to such meetings.

Directly following it is the Insolvency Law Reform Act 2016 (Commonwealth)³³ and the associated Insolvency Practice Rules (Commonwealth)³⁴ which aim to leverage technology for improved communication and transparency among stakeholders during interactions with creditors and the conduct of creditors’ meetings. This aims to enhance overall communication, transparency, and efficiency while reducing unnecessary external administration costs. There is talk of introducing AI as one of the technologies under this Act.³⁵

In the case of Small and Medium (*SMEs*) Industries corporate insolvency is dealt with by adopting the Do it Yourself (*D-I-Y*) method, which allows AI to augment the job of resolution professionals.³⁶ This allows for a reduced process option for companies that cannot afford to go through an extended and expensive CIRP process.

B. Insolvency and AI in the EU

The EU is known for being ahead of the curve when it comes to incorporating law and technology. This is apparent in its world-renowned GDPR legislation.³⁷ Recently in December 2023, the EU passed its EU AI Act

30. Insolvency Practice Schedules (Corporations) ss. 75-40(5)(a), (b) (AUS) (Insolvency Practice Schedules); Insolvency Practice Rules (Corporations) 2016 s 75-130 (AUS) (Insolvency Practice Rules).

31. Insolvency Law Reform Act, 2016.

32. Insolvency Practice Schedules (n 30); Insolvency Practice Rules (n 30).

33. Insolvency Law Reform Act, 2016.

34. Insolvency Practice Rules (n 30).

35. Dickfos (n 28).

36. ‘A Platform for Recovery: Dealing with Corporate Financial Distress in Australia: A Discussion Paper’ (ARITA, 2014) <<https://arita.com.au/common/Uploaded%20files/Technical/a-platform-for-recovery-2014.pdf>> accessed 13 December 2023.

37. European Union, General Data Protection Regulation, 679/2016.

which is a first-of-its-kind legislation dealing with the regulation of AI.³⁸ A 2022 directive discussed by the EU Parliament³⁹ suggests harmonizing the insolvency law and increasing the efficiency of the insolvency law.⁴⁰ Scholars are suggesting that efficiency can be increased by using AI to augment the insolvency process.

EU is on the precipice of introducing its own version of the insolvency law which requires an augmentation by AI. The EU AI Act and the 2022 directives are proof of the same. The Australian legislation was also born out of an amendment requiring increased efficiency and decreased time required for the insolvency process. The trend is clear and becomes clearer still in the following segment.

C. Colombia, Insolvency and AI

Colombia is one of those developing economies that have taken significant steps for the enhancement of the amalgamation of technology with law and the legal practices associated with it. COVID-19⁴¹ acted as the catalyst for the Colombian government to make fundamental strides in the areas concerned with insolvency law. The Government gave way to the integration of AI in the insolvency portal, a crucial system used by the bankruptcy court.⁴² The government has not restricted itself only to providing the accessibility of e-platforms to the insolvency portal but also provides better and more advanced inputs into the process of insolvency as a whole.

38. European Union, The Artificial Intelligence Act, 2023.

39. 'Directive of the European Parliament and of the Council harmonizing certain aspects of insolvency law', European Union (EU) <https://eur-lex.europa.eu/resource.html?uri=cellar:8adadc6c-76e9-11ed-9887-01aa75ed71a1.0001.02/DOC_1&format=PDF> accessed 29 November 2023

40. 'Proposed EU Directive to harmonise certain aspects of insolvency law across Member States'(Taylor Wessing) <<https://www.taylorwessing.com/en/insights-and-events/insights/2023/01/rii-proposed-eu-directive#:~:text=The%20Insolvency%20Directive%20seeks%20to,the%20efficiency%20of%20proceedings%2C%20and>> accessed 13 December 2023.

41. 'Supporting Colombia's COVID-19 Crisis Response' (World Bank, 9 April 2021) <https://www.worldbank.org/en/results/2021/04/09/supporting-columbia-s-covid-19-crisis-response> accessed 17 December 2023.

42. Nicolás Polanía Tello, 'Colombia is using AI to improve insolvency proceedings' (DLA Piper, 2022) <<https://www.dlapiper.com/en/insights/publications/panorama/2022/colombia-is-using-ai-to-improve-insolvency-proceedings>> accessed 19 December 2023.

Features like document submission, sharing of information, and access to that information are traditionally hallmarks of the insolvency process.⁴³ The introduction of AI has ensured a user-friendly experience leading to an increase in documentational efficiency. The AI tool even authenticates foreign persons by seeking relevant documents for identification and attachment of the required sources to the case in question. From a submission made to the system to verifying the adverse public database and determining the competition of submission, the AI tool acts as the facilitator.

Later these determinations are fed into the court's decision for the admission of the case into the formal insolvency process, leading to prompt decision-making and streamlining the process. The AI tool is capable of drafting the decision for the judge to sign.⁴⁴ The drafts include the request for accessing more information, in case the file remains incomplete or is just a proposed decision and not the final one, enhancing the AI's role in non-discretionary decision-making. This is not necessarily an application of judicial mind, instead, it displays a streamlined filing and steno process, reducing the time taken in the pre-insolvency stage with regard to interim judicial interference.⁴⁵

The insolvency regime in the country demonstrated foresight by not letting the AI completely substitute human involvement;⁴⁶ instead, providing redressal authority in the hands of the human operators if, in any instance, the AI tool makes a mistake in identifying foreign citizens. It also drew a mechanism by which AI learns from its mistakes to improve its functioning over time and utilize it in other insolvency procedures.

D. India, Information Utilities and AI

In 2019, the Ministry of Corporate Affairs notified the launch of the Compliance Monitoring system, which worked on artificial intelligence. It automatically detects non-compliance by the company and sends a

43. Ibid.

44. Akshaya Kamalnath, 'The Future of Corporate Insolvency Law – A Review of Technology and AI-Powered Changes' (Social Science Research Network, 7 August 2023) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4532286> accessed 25 December 2023.

45. Ibid.

46. Ibid.

Show Cause Notice digitally to the concerned stakeholder.⁴⁷ It is within 15 days that the company is required to submit its reply digitally via the MCA CMS portal in order to prevent any penal action taken by the registrar of companies.⁴⁸

In the final quarter of 2021,⁴⁹ the Ministry of Corporate Affairs sought public comments on matters concerning Corporate Insolvency resolutions and liquidation frameworks to strengthen the insolvency framework.⁵⁰ After the receipt of public inputs, several proposed changes are presently under consideration.⁵¹

For example, to resolve the complexities arising due to the operation on separate technological platforms by the Adjudicating Authority, the Insolvency and Bankruptcy Board of India (*IBBI*), service providers, and information utilities, the MCA is considering exploring the possibility of drawing a synergy among these platforms to streamline their interaction for better efficiency in decision making, maintaining transparency, and minimizing delays.⁵²

This e-platform will not only foster better and more efficient communication but also provide access to filing applications with the Adjudicating Authorities (*AAs*) by automated processes, enabling direct interaction of the IPs with the stakeholders.⁵³ It would help in incentivizing the active participation of other market players in the IBC ecosystem. Additionally, supervision by the *AAs* and regulators over their respective areas of operation will be bolstered via the consolidated information that will be available on the e-platform.

47. Dhaval Gusani, 'MCACMS – AI based Compliance Monitoring System' (TaxGuru, 06 Nov 2019) <<https://taxguru.in/company-law/mcacms-ai-based-compliance-monitoring-system.html>> accessed 30 December 2023.

48. 'MCA launches AI system to hunt out defaulters' (e-Startup India) <<https://www.e-startupindia.com/amp/blogdetailprocess.php?q=/blog/government-introduces-artificial-intelligence-system-in-mca-21-portal/10438.amp.html>> accessed 1 January 2024.

49. 'Insolvency and Bankruptcy Code, 2016' (Ministry of Corporate Affairs, Government of India, January 18, 2023) <<https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>> accessed 30 December 2023.

50. Dhaval Gusani, 'MCACMS – AI based Compliance Monitoring System' (TaxGuru, 06 Nov 2019) <<https://taxguru.in/company-law/mcacms-ai-based-compliance-monitoring-system.html>> accessed 1 January 2024.

51. *Ibid.*

52. Insolvency and Bankruptcy Board of India, 'IBC- Idea, Impressions and Implementation' (IBBI, 2022) <<https://ibbi.gov.in/uploads/whatsnew/b5fba368fbd5c5817333f95fbbod48bb.pdf>> accessed 2 January 2024.

53. Insolvency and Bankruptcy Code, 2016.

VI. ANALYSIS

To understand how the introduction of AI in the insolvency sector has helped these above-mentioned, it is imperative to divide it into three stages, i.e., pre-insolvency, CIRP, and Liquidation.

A. Pre-Insolvency and AI

In the Pre-Insolvency period, the AI system helps in predicting insolvencies at earlier stages to significantly reduce the risks associated with it and take the correct course of action promptly.⁵⁴ The same used to drain a lot of time of the insolvency professionals before the technological advancement, because of the high volume of information that had to be dealt with and also considering the company's financial health.⁵⁵ The introduction of AI algorithms allowed the companies to access these databases very efficiently, thus saving a significant portion of their time.

As seen in Colombia and Australia, the efficiency of an insolvency process is inhibited at the preliminary stage. Illustratively, a non-deserving creditor may insist that he wishes to be a part of the process, or the firm may declare insolvency to escape debts that it knew it could not pay.⁵⁶ Such instances can be countered by predicting the insolvency before it happens. Such information will allow the creditors and the government to take remedial steps and avoid the nursing process of insolvency altogether.⁵⁷

Today, instead of working the numbers to ascertain the financial health of the company big data analysis can go a long way in predicting a company's insolvency. Researchers have found that using classification algorithms will greatly increase the efficiency of predicting insolvencies which is a key feature of the pre-insolvency process.⁵⁸ As previously discussed,

54. Innes (n 29).

55. Ibid.

56. Vidya, 'Vijay Mallya had enough money in 2008-17 to repay banks but bought assets in Europe: CBI' (Business Today, 23 March 2023) <<https://www.businesstoday.in/latest/economy/story/vijay-mallya-had-enough-money-in-2008-17-to-repay-banks-but-bought-assets-in-europe-cbi-374522-2023-03-23>> accessed 30 December 2023.

57. Yuri Zelenkov, Nikita Volodarskiy, 'Bankruptcy prediction on the base of the unbalanced data using multi-objective selection of classifiers' (2021) 185 Expert Systems with Applications.

58. 'Scientists Use AI to Predict Corporate Bankruptcy' (TechXplore, 2021) <<https://techxplore.com/news/2021-10-scientists-ai-bankruptcy.html>> accessed 2 January 2023.

such data is already readily available in the form of Informational Utilities established by the Government of India. The 2021 reforms sought by the Ministry of Corporate Affairs show a clear trend toward harmonizing the Information Utilities with Resolution Professionals and Adjudicating Authorities.⁵⁹ Such a nexus is the perfect environment for predicting insolvency using big data and AI.

B. Corporate Insolvency Resolution Process

Once insolvency is declared the next step in the Corporate Insolvency Resolution Process (*CIRP*). It primarily includes reading into the functioning of the corporation and determining the liabilities owed to legally empowered creditors.⁶⁰ Previously, this was a drawn-out process of collecting the financial records of the companies and matching them with the applicant creditors. In cases of dispute, the insolvency process went way beyond the prescribed 180-day limit due to repeated appeals made by applicants before the AAs.⁶¹

The proposed nexus between the IU and AAs suggested by the Ministry of Corporate Affairs projects a principled collection of this information in a ratified state repository.⁶² From here, the AI can adopt the Columbian technology to establish the soundness of the Applicant Creditor's appeal.⁶³ Secondly, the use of AI in nexus with the IUs will greatly reduce the grunt work undertaken by the RP. This will leave the RP profession with more time to bring the CoC to an agreement regarding the Resolution Plan, which is their actual job as a human professional.⁶⁴

59. Insolvency and Bankruptcy Code, 2016 (Ministry of Corporate Affairs, Government of India, 18 January 2023) <<https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>> accessed 30 December 2023.

60. 'Corporate Insolvency Resolution Process' (IndiaFilings) <<https://www.indiafilings.com/learn/corporate-insolvency-resolution-process/>> accessed 1 January 2023.

61. 'Joint Committee on Insolvency and Bankruptcy Code, 2015' (Insolvency and Bankruptcy Board of India, April 2016) <https://ibbi.gov.in/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf> accessed 25 December 2023, pg. 48-51.

62. Insolvency and Bankruptcy Board of India, 'IBC- Idea, Impressions and Implementation, 2022', (IBBI, <<https://ibbi.gov.in/uploads/whatsnew/b5fba368fbd-5c5817333f95fbbod48bb.pdf>> accessed 2 January 2024.

63. Nicolás Polanía Tello, 'Colombia is using AI to improve insolvency proceedings' (DLA Piper, 2022) <<https://www.dlapiper.com/en/insights/publications/panorama/2022/colombia-is-using-ai-to-improve-insolvency-proceedings>> accessed 19 December 2023.

64. 'Resolution Professional: Role, Responsibilities, and Duties under IBC' (IndiaFilings) <<https://www.indiafilings.com/learn/resolution-professional-role-responsibilities-and-duties-under-ibc/>> accessed 1 January 2023.

In terms of the actual CIRP process, which includes the formation of the CoC, vetting of Resolution Plans and conducting due diligence on all these different stages, the use of AI can augment the lengthy process adopted by RPs today. Like in Australia, the Indian IBC ecosystem should be augmented by adopting the ‘Proposal Without a Meeting’ system.⁶⁵ Furthermore, taking another development from Australia, the Indian ecosystem can allow small corporations to conduct D-I-Y insolvencies.⁶⁶ The same is only possible by adopting a strong system of AI and IUs to ensure transparency and fairness in the Resolution Process.

In conclusion, the above suggestions are established practical possibilities that have statistically shown a decline in the time taken by the Insolvency Processes around the globe. Their application to India, as a logical corollary, is of great import to nurse the crippling issue of lengthy insolvency processes despite being a time-bound legislation.

C. Liquidation

If the CIRP fails then the corporation is liquidated, i.e., wound up and sold. This process is traditionally done by a sole liquidator who must go through all the data, both traditional and digital. Despite the Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2019⁶⁷ which limited the liquidation process to a maximum of one year the latest IBBI report shows that more than 75% of the liquidations exceed this timeline.⁶⁸

This is due to the redundancy in the traditional process. The time spent in collecting and processing the data by a liquidation professional is inefficient as such data is already available with the IUs. AI can simply reduce a complicated auction process into an easily accessible data market which

65. Dickfos (n 28).

66. Insolvency Practice Schedules (n 30) s 75-40(5)(a), (b).; Insolvency Practice Rules (n 30), s 75-130.

67. Insolvency and Bankruptcy Board of India, ‘Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2019’ (IBBI, 2019) <https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jul/Liquidation%20Regulations%2025072019%20final%20English_2019-07-25%2020:13:32.pdf> accessed 2 January 2023.

68. ‘Discussion Paper on Streamlining the Liquidation Process - Introduction’ (IBCLaw, 14 June 2022) <<https://ibclaw.in/discussion-paper-on-streamlining-the-liquidation-process-introduction-ibbi-dated-14-06-2022/>> accessed 3 January 2023.

allows the creditors to transparently put the assets up for sale.⁶⁹ Hence, the adoption of AI to augment the job of the Liquidator is one method through which the IBC ecosystem can be improved.⁷⁰

VII. CONCLUSION

Corporate Insolvency is primarily a nursing process. Liquidation is an effect of its failure. Money, or more accurately assets are not stock, rather they are fluid. This means that the passage of time is likely to affect the value they hold. Once a corporation declares bankruptcy the clock starts ticking. It is only for ease of processing that the code outlines different timelines for different stages of the process. Practically the assets, value and market image of the company's holdings are compromised the day it chooses to apply for bankruptcy.

Unnecessary delays, as already outlined in detail in this paper add to the further loss of value to these assets. The Act aims to save sinking companies by lawfully nursing them back to financial soundness, whilst protecting the interests of the creditors.⁷¹ If the delays are chronic, either due to malafide commercial wisdom or procedural inhibitions, the rights of the creditors will be utterly compromised and the potential to save the company will be lost. This will initiate the liquidation process. Hence, it is concluded that traditional delays in insolvency make the entire CIRP a redundant formality.

The paper has outlined that governments around the globe face this problem. Hence, they have taken to adopting AI and data processing to make the entire process more efficient. Escaping liquidation is a race against time, and the efficient processing of financial data, leaving the resolution professionals to deal with the human aspect of the job, i.e., bringing the CoC to a consensus, which further reduces avoidable delays. It is hence concluded, that one of the best and most accessible ways to achieve this is by adopting AI technologies which is no doubt a possibility for a technologically capable country such as India.

69. Jose M Garrido et al, 'The Use of Data in Assessing and Designing Insolvency Systems' (2019) 27(1) IMF Staff Papers.

70. Paul Dütting et al., 'Optimal Auctions through Deep Learning' (2021) 64(8) Communications of the ACM Vol. 64 109-116.

71. Insolvency and Bankruptcy Code, 2016, Statement of Objects and Reasons.

Navigating Turbulent Waters: Unravelling the Controversial Role of Taxation Authorities within the Insolvency and Bankruptcy Code's Waterfall Mechanism

—Oshin Beniwal and Devesh Pratap Mall*

ABSTRACT

The Insolvency and Bankruptcy Code, a landmark legislation in India, outlines a comprehensive framework for resolving insolvency and bankruptcy cases. The waterfall mechanism, a critical component of this framework, establishes the order of priority for distributing the proceeds from the liquidation of assets among various stakeholders. Amidst the evolving landscape of insolvency proceedings, taxation authorities have emerged as pivotal players, claiming a significant share of the liquidation proceeds.

Tax authorities, currently holding a Level 5 status in the priority order outlined by the waterfall mechanism, are at the centre of disputes, seeking to elevate their status to Level 2. This dispute revolves around categorising them as either secured or operational creditors. While the Companies Act aligns with Section 53 of the Insolvency and Bankruptcy Code (IBC), it is crucial to emphasise the IBC's precedence over conflicting enactments. The controversy arises concerning the creation of a charge and the subsequent establishment of secured interest, with certain courts deviating from the stipulated requirements. Globally, the established practices, for instance, in the USA and UK do not prioritise government claims over secured creditors, and operational creditors actively participate in Committees of

* The authors are students at National Law University, Jodhpur (NLUJ).

Creditors (COCs). In contrast, in India, operational creditors are not part of COCs. Firstly, this paper aims to elucidate the legislative framework concerning secured and operational creditors under the IBC. Secondly, it examines parallel provisions in various other statutes and the overriding effect of the IBC. Thirdly, the paper reviews the intention of the legislature in light of contrasting positions and the global position regarding the same. Lastly, the authors undertake the task of providing viable solutions to the challenges present in the regulatory framework and the rising conundrum in the apex court's decisions.

I. INTRODUCTION

Lord Mishcon said, “Insolvency is not a very thrilling or amusing subject”. However, Edward Jenks, a noted English jurist said, “...uninteresting as it may be, it is nevertheless a very important subject area”.¹

Insolvency Law has been at the forefront of a lot of private rights but due to the absence of any set procedure in law, there have been many instances of economic disruptions adversely affecting domestic as well as foreign investments.² The Insolvency and Bankruptcy Code came to fruition in 2016 and aimed at offering a set mechanism to regulate the process of providing creditors relief in recovering their dues from corporate debtors based on the UNCITRAL Legislative Guide on Insolvency Law.³ The Insolvency and Bankruptcy Code (IBC) facilitates the timely resolution of insolvency cases, offering a chance for a distressed company to revive through a structured mechanism. Under the IBC, successful bidders contribute funds that prioritise clearing the bankrupt company's dues.

Within the IBC, the waterfall mechanism guides the systematic distribution of proceeds from asset sales among stakeholders. This mechanism establishes a hierarchical order, ensuring certain stakeholders receive priority in claims, delineating a structured approach to distributing funds in insolvency cases. The prioritisation within the waterfall mechanism

1. Justice N.V. Ramana, ‘Judicial Sensitisation on Insolvency Law and Associated Best Practices’ (Live Law, Mar 6, 2020), <https://www.livelaw.in/pdf_upload/pdf_upload-370976.pdf> accessed 15 December 2023.

2. Ibid.

3. United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law, <https://uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law> (UNCITRAL Legislative Guide) accessed 10 December 2023.

is crucial, as it determines the sequence in which various stakeholders, such as creditors and investors, receive their shares from the proceeds, promoting a fair and organised resolution process for distressed companies under the IBC.⁴ There has been a rising conundrum on the position of governmental authorities especially the taxation authorities regarding where they stand in the priority list.

II. STATE OF PROCEEDINGS UNDER IBC AND THE LEGAL JURISPRUDENCE ON SECURED AND OPERATIONAL CREDITOR UNDER WATERFALL MECHANISM

“The law must lay out the priority of distributions in bankruptcy to all stakeholders. The priority must be designed to incentivise all stakeholders to participate in the cycle of building enterprises with confidence.”

– The Bankruptcy Law Reforms Committee⁵

When devising the IBC, the Parliament aimed to minimise delays in liquidation. According to the Carede Report (June 2023), over 2,100 Corporate Insolvency Resolution Processes (*CIRP*) experienced delays surpassing 270 days, affecting 65% of ongoing cases. These delays have shown an upward trajectory, with 75% facing delays in June 2021 and 61% in June 2022. The overall recovery rate has increased to 31.62% in Q1FY24. However, creditors still grapple with substantial write-offs, comprising around 68% of admitted claims in resolved cases.⁶

The Insolvency and Bankruptcy Board of India (*IBBI*) data indicates an increase in the recovery rate from 29.5% to 33% for admitted claims in the September quarter.⁷

4. The Corner Office Journal, ‘All About Waterfall Mechanism under India’s Bankruptcy Law’ (The Corner Office Journal, Mar 27, 2023), <<https://www.cornerofficejournal.com/news/bankruptcy/all-about-waterfall-mechanism-under-indias-bankruptcy-law>> accessed 12 December 2023.

5. Bankruptcy Law Reforms Committee, ‘The Report of the Bankruptcy Law Reforms Committee, Volume 1: Rationale and Design’ (2015) (Report of the Bankruptcy Law Reforms Committee), p. 29.

6. The Economics Times, ‘IBC: Banks worried over SC’s ruling to place govt dues on par with secured creditors’ <<https://bfsi.economicstimes.indiatimes.com/news/policy/ibc-banks-worried-over-scs-ruling-to-place-govt-dues-on-par-with-secured-creditors/104950881#:~:text=The%20legislative%20intent%20behind%20the,a%-20result%20of%20the%20judgment.>> (ET, IBC: Ruling) accessed 30 November 2023.

7. *Ibid.*

The waterfall mechanism, as outlined in Section 53 of the IBC,⁸ defines the priority sequence for distributing proceeds from the sale of liquidation assets. According to Section 53(1)(b)(ii), debts to secured creditors rank equally with specified debts, including workmen’s dues for 24 months before the liquidation commencement date. Additionally, Section 53(1)(e) covers the “amounts owed to the Central Government and State Government”.

Upon closer scrutiny, a “secured creditor” in Section 3(30)⁹ denotes an individual with an established security interest. Section 3(31)¹⁰ defines this interest as a “right, title, or interest, or a claim to the property, created for a secured creditor through a transaction securing payment or performance of an obligation.”

The IBC introduces the concept of ‘operational debt’ in Section 5(21), defining it as “a claim in respect of the provision of goods or services, including employment, or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the central government, any state government, or any local authority.”¹¹

Section 31 of the IBC mandates approval of a resolution plan by the adjudicating authority if it meets the requirements in Section 30(2), binding all creditors, stakeholders, and governments.¹² Thus, in corporate liquidation, strict adherence to a hierarchical order is mandatory, ensuring that actions align with the legislative intent of the code.

To align Indian practices with the global standards and to ensure that the proposed code’s objective is as discussed below,¹³ a re-evaluation of the “waterfall mechanism” in Section 53 is vital, advocating for lower priority status for government dues. The explicit inclusion of central and state government debts in Section 53(1)(e)¹⁴ stresses this. Altering government dues from Level 5 to Level 2 will render the legislative language, especially in Section 53(1)(e), devoid of significance. A comprehensive interpretation of Clause 10 in Section 3 of the IBC, coupled with

8. The Insolvency and Bankruptcy Code 2016, s 53.

9. The Insolvency and Bankruptcy Code 2016, s 3(30).

10. The Insolvency and Bankruptcy Code 2016, s 3(31).

11. The Insolvency and Bankruptcy Code 2016, s 5(21).

12. Ghanashyam Mishra and Sons Private Limited v Edelweiss Asset Reconstruction Company Limited [2021] 9 SCC 657 (Ghanashyam Mishra v Edelweiss).

13. UNCITRAL Legislative Guide (n 3).

14. The Insolvency and Bankruptcy Code 2016, s 53(1)(e).

Clauses 20 and 21 in Section 5,¹⁵ highlights that claims for dues¹⁶ under any prevailing law payable to the central, state, or local authorities, fall within the scope of ‘operational debt’. The decision in *Union of India v. Vijaykumar V Iyer*, affirming the central government as an operational creditor, underscores the need for such prioritisation.¹⁷

The NCLT¹⁸ instructed tax authorities to submit their claims as operational creditors to the resolution professional, who would review them in compliance with the code’s provisions. The NCLAT¹⁹ ruled that the Income Tax Department of the central government, the Sales Tax Department(s) of the state government, and local authorities are considered ‘operational creditors’ under Section 5(20) of the IBC. Any operational debt owed to the central government, a state government, or another local authority falls under the definition of an ‘operational creditor’ as per Section 5(20) of the IBC.²⁰

Hence, statutory obligations, such as income tax and value-added tax, are considered operational debts.²¹ However, in September 2022 came the judgement of *State Tax Officer v. Rainbow Papers Limited*, where it was held:

“In our considered view, the Committee of Creditors, which might include financial institutions and other financial creditors, cannot secure their dues at the cost of statutory dues owed to any Government or Governmental Authority or for that matter, any other dues.”²²

Here, the Supreme Court held that the term, “secured creditor” was broad enough to include the state under the debts owed to secured creditors under the GVAT Act and rank equally along with other specified debts including workmen’s debts. Through IBC, the priority order of government dues payment was changed, placing them lower than unsecured financial debts and workmen dues. However, the classification of

15. The Insolvency and Bankruptcy Code 2016, s 3 & s 5.

16. *Swiss Ribbons (P) Ltd. v Union of India*, [2019] 4 SCC 17.

17. *Union of India v Vijaykumar V. Iyer*, [2022] SCC OnLine NCLAT 689 (UOI v. Vijaykumar).

18. *Deputy Commissioner of Income Tax v Bhuvan Madan RP for Diamond Power Infrastructure Ltd. & Anth.*, [2020] IA No. 672/2019 in C.P. (I.B) No. 137/2018.

19. *Pr. Director General of Income Tax v Synergies Dooray Automotive Limited & Ors*, [2017] SCC OnLine NCLAT 317.

20. *Ghanashyam Mishra v Edelweiss* (n 12).

21. *Ibid.*

22. [2022] Live Law (SC) 743.

statutory dues as a “secured creditor” in the *Rainbow Papers* case may go against this objective of the code. The apex court, in *Rainbow Papers*, while deciding the case, has seemed to ignore the case of *Ghanashyam Mishra v. Edelweiss Asset Reconstruction*,²³ which was a larger bench judgement of the apex court and had examined the state tax matter thoroughly and determined that it qualified as an operational creditor.

III. DIGGING INTO THE PROVISIONS OF THE COMPANIES ACT AND THE CONCEPT OF PUBLIC INTEREST IN LIGHT OF CONTRASTING POSITIONS

The IBC, fortified by a non-obstante clause, possesses superior authority over any conflicting central or state government statute,²⁴ leading to disputes over its provisions conflicting with the Companies Act. The crux of the issue lies in the contrasting priority trajectories for debt payments. While the IBC establishes a distinct order, the Companies Act, particularly, Sections 326 and 327, prioritises workmen’s dues over debts related to revenues and taxes during a company’s winding-up. Section 326²⁵ of the Companies Act places the settlement of workmen’s dues at the forefront during winding-up, followed by debts to secured creditors under specific conditions. Section 327²⁶ further mandates the payment of specified sums, encompassing revenues, taxes, and specified remunerations, after the settlement of amounts under Section 326, before addressing other debts. Nevertheless, Section 327(7)²⁷ explicitly stipulates that this preferential payment order does not apply during a company’s liquidation under the IBC.²⁸ Sections 326 and 327 primarily aim to emphasise the priority of workmen’s dues, rooted in the argument of equity, recognising the vulnerable status of workmen.

23. Ghanashyam Mishra v Edelweiss (n 12).

24. Insolvency and Bankruptcy Board of India, ‘Understanding the IBC: Key Jurisprudence and Practical Considerations (October 2020).

25. The Companies Act 2013, s 326.

26. The Companies Act 2013, s 327.

27. Ibid.

28. Dylan Sharma, ‘India : The Dichotomy Between the Companies Act and the IBC Resolved’ (Mondaq, 28 November 2023) <<https://www.mondaq.com/india/corporate-and-company-law/1395368/the-dichotomy-between-the-companies-act-and-the-ibc-resolved#:~:text=Therefore%2C%20the%20waterfall%20mechanism%20of,can%20no%20longer%20be%20revived>> accessed 22 December 2023.

The resolution of this contentious issue emerged through the case *Moser Baer Karamchari Union through President Mahesh Chand Sharma v. UOI & Ors.*²⁹ Here, the Karamchari Union contended that Section 327(7) should be declared void as it contradicted the constitutional principle of upholding the right to livelihood under Article 21.³⁰ The Supreme Court, in its ruling, asserted that Section 53 waterfall mechanism would prevail during liquidation and debt settlement, guided by Section 36(4) of the IBC.³¹ The court grounded its decision in the IBC's overarching purpose, emphasising its role in fostering investments, safeguarding creditor interests, and contributing to the country's economic development.³²

In the *Moser Baer Karamchari Union through President Mahesh Chand Sharma v. UOI & Ors.* case, the Supreme Court emphasised the need for “some sacrifices” for the “greater good”,³³ asserting that the waterfall mechanism takes precedence over the provisions of the Companies Act. However, the apex court has, in various instances, deviated from the established procedure of the waterfall mechanism, presenting decisions inconsistent with the priority trajectory outlined in Section 53 of the Insolvency and Bankruptcy Code (IBC).

A notable departure from the waterfall mechanism occurred in the case of *Union of India v. Infrastructure Leasing & Financial Services Limited*,³⁴ where the court approved non-adherence to the established order. The National Company Law Appellate Tribunal (NCLAT) justified this departure, citing the implementation of the waterfall mechanism as being contrary to the principles of “public interest”. The court, in this context, introduced an exception under Section 241 of the Companies Act,³⁵ empowering the tribunal to issue “any order” deemed necessary

29. [2023] Writ Petition (C) No. 421 of 2019.

30. Constitution of India 1950, art 21.

31. The Insolvency and Bankruptcy Code 2016, s 36(4).

32. Aarna Law, ‘Moser Baer Karamchari Union Thr. President Mahesh Chand Sharma v Union of India and Ors.’ (Aarna Law, May 12 2023) <[33. Simran Malhotra, ‘Constitutionality of Section 327\(7\) of the Companies Act 2013: Sanctity of the Waterfall Mechanism’ \(IndiaCorpLaw, May 13, 2023\) <<https://indiacorplaw.in/2023/05/constitutionality-of-section-3277-of-the-companies-act-2013-sanctity-of-the-waterfall-mechanism.html>> accessed 19 December 2024.](https://www.aarnalaw.com/moser-baer-karamchari-union-thr-president-mahesh-chand-sharma-v-union-of-india-and-others/#:~:text=In%20Moser%20Baer%20Karamchari%20Union,2016%20(%E2%80%9CIBC%E2%80%9C).>” accessed 18 December 2023.</p>
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34. [2022] Company Appeal (AT) No. 346 of 2018.

35. The Companies Act 2013, s 241.

to address grievances. While this case signifies a departure from the waterfall mechanism, it stands as a singular instance, deviating markedly from the provisions of the IBC without invoking any exception based on “public interest”.

It is crucial to recognise that this case does not establish a precedent for subsequent cases but serves as an illustration of how tribunals and courts occasionally diverge from the Section 53 mechanism. The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes recommends that “creditor interest should be safeguarded by appropriate means that enable creditors to effectively monitor and participate in insolvency proceedings to ensure fairness and integrity.”³⁶ Applying this principle in alignment with the aforementioned rulings suggests that occasional deviations from the established legal procedures may occur to advance creditors’ interests in good faith. However, such departures are circumscribed to specific circumstances and do not set a precedent for future cases to follow.

IV. UNDERSTANDING THE OVERRIDING EFFECT OF THE IBC AND THE CONCEPT OF MORATORIUM

There shall be no presumption that statutory charges inherently receive priority status;³⁷ their treatment hinges on an authority’s ability to argue based on the statute. If the authority fails to substantiate the claims under the statute, it transforms into an operational debt. Generally, government assessments of statutory dues do not automatically confer an interest in the debtor’s property, unless mandated by law. The nature of statutory dues requires a case-specific examination in the context of relevant legislative acts. As per Section 82 of the GST Act, notwithstanding other laws, amounts owed for tax, interest, or penalties form a first charge on the debtor’s property, except as specified in the Insolvency and Bankruptcy Code, 2016.³⁸

The NCLAT noticed in a *Jet Aircraft Case*, that Section 82 of the Maharashtra Goods and Services Tax Act, 2017 created a first charge

36. Ministry of Corporate Affairs, ‘Report of the Insolvency Law Committee’ (February 2020).

37. Haryana through Excise and Taxation v Anup Sood Resolution Professional [2018] Company Appeal (AT) No. 346 of 2018.

38. The Central Goods and Services Tax Act, 2017, s 82.

for the government authority but made an exception for the IBC, indicating that the IBC would prevail. This shows that the Goods and Services Tax (GST) Act gives power to the IBC to decide the priority status. On January 19, 2022, the Ministry of Finance, issued a Master Circular on recovery and a write-off of arrears of revenue, dealing with the recovery of taxes and the creation of first charge; it said, “Though the Customs, Central Excise, Service tax and GST enactments have provisions for the liability to be the first charge on the property this charge is subject to the provisions of Section 529A of the Companies Act, 1956 (Section 326 of Companies Act, 2013), the Recovery of Debts Due to Banks and the Financial Institutions Act, 1993 (RDB Act), the Securitisation and Reconstruction of Financial Assets and the Enforcement of Security Interest Act, 2002 (*SARFAESI Act*) and the Insolvency and Bankruptcy Code, 2016.”³⁹ This indicates that the Ministry of Finance intended to keep the laws relating to tax authorities in line with the provisions of the IBC. Additionally, as per Section 238 of the IBC, the Supreme Court affirmed that the IBC takes precedence⁴⁰ over any conflicting provisions in other enactments.⁴¹

In a recent review of the *Vidarbha Industries Power Ltd. vs. Axis Bank Ltd.*⁴² judgment, the apex court emphasised that judicial utterances should not be treated as statutory provisions, as they are context-specific. This observation implies that the statements made in the *Rainbow Papers* case should be understood in light of its specific circumstances. *Rainbow Papers* clarified that statutory creditors, obtaining a charge through statutes, fall under the definition of “secured creditors”. However, the *Vidharba* review suggests that this clarification is case-specific. The Viswanathan Committee recommended a lower priority for government dues in the IBC to align with global practices.⁴³ The IBC, aiming to change the priority order of government dues, places them below unsecured financial debts and workmen dues. However, the classification of

39. Ministry Of Finance Press Release, ‘Master Circular on Recovery and Write-Off of Arrears of Revenue’ (19 January 2022) <https://old.cbic.gov.in/resources//htdocs-cbec/excise/cx-circulars/cx-circulars-2022/Circular_No_1082_02_2022-CX.pdf> accessed 7 January 2024.

40. CIT v Monnet Ispat & Energy Ltd. [2018] 18 SCC 786.

41. Edelweiss Asset Reconstruction Company Ltd. v Synergies Dooray Automotive Ltd. & Others, [2018] Company Appeal (AT) (Insolvency) No. 169 to 173 of 2017.

42. [2022] SCC OnLine SC 841.

43. Report of the Bankruptcy Law Reforms Committee (n 5).

statutory dues as “secured creditors” in *Rainbow Papers* may defeat the objective. The government can establish a secured interest by law, even if not traditionally considered a ‘secured creditor’.⁴⁴ The significance of statutory dues, as emphasised by the Supreme Court in *Dena Bank v. Bhikabai*, remains crucial. However, if a statute restricts their importance, their status may align with the IBC provisions.

During liquidation proceedings, proof of a security interest under Regulation 21 of IBBI Regulations, 2016⁴⁵ is essential. This can be established through records in an information utility, certificates or charge registrations from the Registrar of Companies, or the Central Registry of Securitisation Asset Reconstruction and Security Interest of India.⁴⁶ Non-adherence to the prescribed requirements, as seen in *Rainbow Papers*, nullifies the Supreme Court’s reasoning that taxation authorities are secured creditors under Section 3(30) of the IBC.

The court stressed that if a resolution plan overlooked the statutory obligations owed to a state government or legal authority, the adjudicating authority must dismiss the same. This interpretation appears to elevate unsecured government debts to the status of secured debts, contradicting the IBC’s liquidation waterfall mechanism.

Section 14(1)(a)⁴⁷ of the Insolvency and Bankruptcy Code (*IBC*) mandates that the adjudicating authority, on the ‘insolvency commencement date,’ must declare a moratorium, restraining the initiation or continuation of suits, proceedings, and execution actions against the corporate debtor.⁴⁸ The essence of the moratorium, as per the Viswanathan Committee report, is to preserve the corporate debtor’s value by ensuring uninterrupted operations.⁴⁹ The Delhi High Court, in *Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd.*, affirmed that the

44. *Dena Bank v Bhikhabhai Prabhudas Parekh*, [2000] 5 SCC 694.

45. Insolvency and Bankruptcy Board of India (Liquidation Process) Regulation 2016, Insolvency and Bankruptcy Board of India, Notification No. IBBI/2016-17/GN/REG005.

46. Nikunj Maheshwari, Dhruv Mairal & Puru Bansal, ‘Perfection of Security Interest’(AZB & Partners, 14 July 2021) <<https://www.azbpartners.com/bank/perfection-of-security-interest/>> accessed 20 December 2023.

47. The Insolvency and Bankruptcy Code 2016, s 14(1)(a).

48. Sombir Singh, ‘Impact of Moratorium U/s. 14 of IBC, 2016 on Income Tax Proceeding’ (Tax Guru, 14 July, 2021) <<https://taxguru.in/income-tax/impact-moratorium-section-14-ibc-2016-income-tax-proceeding.html>> accessed 23 December 2023.

49. The Insolvency and Bankruptcy Code 2016, s 36(4).

moratorium extends to “debt recovery actions” against the corporate debtor.⁵⁰

The Supreme Court held in *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*, that tax recovery must strictly adhere to prescribed procedures under the IBC.⁵¹ The court established that any new tax proceedings are prohibited during the moratorium, often termed the “calm period”. In the context of taxation, Section 14(1)(a) of the Code serves as a protective shield during the moratorium, aligning with the Supreme Court’s directive to ensure tax recovery strictly adheres to the IBC procedures. This underscores the critical importance of maintaining procedural integrity during the moratorium, emphasising it as a pivotal “calm period” essential for effective corporate resolution. It explicitly discourages the initiation of any taxation proceedings during this period, emphasising the need to respect the sanctity of the moratorium for a smooth corporate resolution process.

V. ANALYSIS OF THE MCA NOTICE FOLLOWING THE CHANGED POSITION

The position taken by the Constitution Bench of the Hon’ble Supreme Court, through its judgment in *Sales Tax v. Rainbow Paper*⁵² in 2022, led to the Ministry of Corporate Affairs (MCA) inviting comments from the public for consideration of changes to the IBC Code by issuing a notice dated January 18, 2023⁵³. In the said notice, under Paragraph 14, the ministry provided clarity in the treatment of security interests created by statutes. Therein, they took note of the above judgment by the apex court which held that any government is a secured creditor because a statutory charge is considered a “security interest”. They found, however, that this was confined to consensual transactions requiring agreement between parties. A “transaction” is defined as a documented agreement to transfer assets. As a result, regardless of statutory charge, all debts to the central and state governments are handled equally with unsecured creditors. The

50. *Power Grid Corporation of India Ltd. v Jyoti Structures Ltd.*, [2017] O.M.P (Comm.) 397/2016.

51. (2022) Civil Appeal No. 7667 of 2021.

52. *Ghanashyam Mishra v Edelweiss* (n 12).

53. Ministry of Corporate Affairs, ‘Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016’ (File No. 30/38/2021-Insolvency, Government of India, Ministry of Corporate Affairs, 18 January 2023).

government will be a secured creditor in priority only if a security interest emerges from a transaction between the government and the debtor. Debts due to the central and state governments are thus treated at par with unsecured creditors, regardless of statutory charge. Only when a security interest arises from a transaction between the government and the debtor does the government achieve secured creditor status in priority. This complex approach strikes a balance between recognising statutory charges as security interests and ensuring that such interests are consensual, as intended by the IBC. The clarification provided by the MCA provides a more precise framework for the management of government debts in bankruptcy proceedings, harmonising with both legal precedent and the practicalities of consensual transactions.

Thus, by taking this view of the above position, The Ministry of Corporate Affairs (MCA) has been cautious of the impact of the said position on the priority decided as per the waterfall mechanism.⁵⁴ This also shows the intent of the central government to maintain a position which is not detrimental to the interests of the financial and operational creditors, where one of the primary reasons for which the IBC code was brought into the picture was to protect the interests of creditors. However, the MCA has, to date, not issued any circular giving effect to the above conclusion.

VI. REVIEW OF THE INTENTION OF THE LEGISLATURE IN LIGHT OF CONTRASTING POSITIONS

The preamble of the Insolvency and Bankruptcy Code refers to the IBC as, “an Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.”⁵⁵ The *Rainbow Papers* judgment’s current interpretation, however, challenges the fundamental IBC framework.

54. The Insolvency and Bankruptcy Code 2016, s 53(1)(e).

55. The Insolvency and Bankruptcy Code 2016, preamble.

The legislative objective was to diminish the priority of government dues, causing confusion within the industry and compromising the interests of financial lenders.⁵⁶

In addition, the Bankruptcy and Law Reforms Committee stated, “The Committee has recommended keeping the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors... The government also will be the beneficiary of this process as economic growth will increase revenues.”⁵⁷ This clarifies the legislature’s intent to maintain lower priority for government dues in the distribution process, explicitly placing the term ‘government dues’ at Level 5. This strategic placement aims to enhance financial accessibility, reduce capital costs, foster entrepreneurship, and accelerate economic expansion over time. The BLRC also highlighted that prioritising government dues would be unfair to private commercial creditors, given the government’s ability to devise different recovery routes, leaving commercial creditors without prioritised claims.⁵⁸

VII. DELINEATING THE CONUNDRUM: UNRAVELLING THE MULTI-FACETED IMPACTS

The position taken by the apex court and its further reaffirmation by the Hon’ble Supreme Court through the Review Petition⁵⁹ in 2023 has changed the earlier position where under Section 53(1)(e)(i) the dues owed to the central and state government were way down in the priority list. This has also been held in the judgment by the apex court where the court had refused to grant primacy to the dues on account of sales tax over secured debt in favour of the bank.⁶⁰ This position was further affirmed by the apex court in the case of *Bombay Stock Exchange vs V.S. Kandalgaonkar*⁶¹ where it was held that the stock exchange, as a secured creditor, would take precedence over the Income Tax Department’s claim for taxes and the Income Tax Department cannot claim priority over

56. ET, IBC: Ruling (n 6).

57. Report of the Bankruptcy Law Reforms Committee (n 5).

58. Interim Report of the Bankruptcy Law Reform Committee (2015), p. 96.

59. Sanjay Kumar Agarwal v State Tax Officers [2023] Review Petition (Civil) No. 1620/2023.

60. Dena Bank v Bhikhabhai Prabhudas Parekh & Co, [2000] 04 SC CK 0168 (Dena Bank v Bhikhabhai).

61. [2014] Civil Appeal No. 4354 of 2003.

the dues to the Stock Exchange. This position reflected that the Supreme Court treated statutory dues distinctively from the dues owed to a secured creditor. However, now considering the new position, statutory dues are to be treated at par with the secured creditor under Section 53(1)(b)(ii) of the IBC. Instead of changing the position by an amendment, the court has indulged in judicial overreach. The said position brings multi-faceted impacts.

A. Tax Dues from being an unsecured Debt to Secured Debt

When we look at the IBC, it does not give us any impression to suggest that the outstanding dues to the government are to be treated as secured debt. Whereas, when we refer to Section 5(21) of the Code, which defines the meaning of the word, ‘operational debt’,⁶² it includes any dues owed to the Central or the State Government, which on the contrary gives the clear impression that the said taxation dues are to be categorised as operation debt. The fact that these statutory dues or taxes owed to the central government fall within the realm of operational debt makes them unsecured in character. This has also been held by the Supreme Court in the case of *Swiss Ribbons* (Paragraph 84).

“It will be seen that the reason for differentiating between financial debts, which are secured, and operational debts, which are unsecured, is in the relative importance of the two types of debts when it comes to the object sought to be achieved by the Insolvency Code.”⁶³

The above decision, delivered by the apex court in 2019, makes it clear that the operational debt is unsecured, however in light of the new position these dues owed to the government or taxation authorities have been categorised as secured in nature, which when we read Section 5(21) of the code with the *Swiss Ribbons* case, it appears to be unsecured. Even, when we refer to the purpose of the IBC and see the meaning of the word ‘secured creditor’ under Section 3(30) and Section 3(31) of the Code, we get the impression that the provision meant to categorise ‘secured creditor’ to those who have taken the risk by giving credit to the company and was not meant to be used by the government as a recovery mechanism.

62. The Insolvency and Bankruptcy Code 2016, s 5(21).

63. *UOI v Vijaykumar* (n 17).

A. Muddled Position Considering the Two Supreme Court Judgment

The Supreme Court, when it delivered the *Rainbow Paper* case judgement,⁶⁴ changed the existing position, treating the existing dues to taxation authorities at par with secured creditors, however within a year in 2023, the Supreme Court, in the case of *Paschimanchal Vidyut Vitran Nigam*⁶⁵ while referring to the *Rainbow Paper* case, held that the court had failed to notice and appreciate the ‘waterfall mechanism’ provided under Section 53 of the code, thus not affirming the position held in the case of *Rainbow Papers*. However, when a review petition was filed in the Supreme Court months later, the court reaffirmed the position taken in the *Rainbow Paper* case and when the *Paschimanchal Vidyut* case was referred, the court, without overruling or affirming the position held in the *Paschimanchal Vidyut Vitran case*, decided that a bench of equal authority could not critique the discretion or judgment of another bench of the same strength.⁶⁶ This has further broadened the confusion when the two Supreme Court judgments are considered while referring to Section 53 of the Code.

B. Impact on the Rights of the Other Operational Creditors and Alteration of Waterfall Mechanism

Financial creditors are usually entities such as banks and other lending institutions that have made loans to the company. To guarantee the financial system’s stability, these creditors have traditionally had a higher priority in the repayment hierarchy. Financial creditors may have more difficulties if taxation dues are moved to a higher priority. The available cash for distribution during insolvency proceedings would initially be used to settle tax obligations before meeting financial creditors’ claims. This change may result in lower recovery for financial creditors, reducing their willingness to offer credit or the terms on which they give funding. On the other hand, Suppliers, employees, and other entities that supply goods or services to the company in the normal course of business are

64. *Ghanashyam Mishra v Edelweiss* (n 12).

65. *Paschimanchal Vidyut Vitran Nigam Ltd v Raman Ispat Private Limited*, [2023] Civil Appeal No. 7976 of 2019.

66. *Dena Bank v Bhikhabhai* (n 60).

operational creditors. Under the former arrangement, they often had a lower priority than financial debtors. However, now under the new position, taxation dues will now have higher priority as compared to operating creditors. This will further disincentivise them to offer supplies in credit to the company in high amounts, which will affect the business structure of the country. In its prioritisation, it does not supersede the demands of banks, significant financial institutions, or other secured lenders. Instead, it diminishes the portion of the share that would have originally been set aside for smaller enterprises in the guise of unsecured ‘operational’ creditors.

C. Impact on Ongoing Cases and Resolution Plans in the NCLT

Due to conflicting decisions of the apex court, the stance that the resolution professional or the liquidator needs to adopt in ongoing cases poses a challenge. In instances where the approval of resolution plans or takeover under liquidation is pending before the NCLT, granting such approval in any manner would result in appeals being filed before the National Company Law Appellate Tribunal. Moreover, due to stakeholders filing such appeals, the execution of the resolution plan by the successful resolution applicant will also face delays, consequently causing setbacks in recoveries and introducing additional uncertainties.⁶⁷

Thus, the new position will bring a detrimental impact on the rights of operational and financial creditors. They should have been better placed to get their credit back at the time of default by the company. This was the exact reason for which Section 53 was incorporated into the code to secure the rights of financial and operational creditors. However, the recent position will allow the taxation authorities to use the setup as a recovery mechanism to claim their dues. This position has also altered the waterfall mechanism as taxation dues covered under Section 53(1)(e) of the code are now similarly placed to ‘secured creditors’ under Section 53(1)(b) of the code.

67. Margav Shukla, ‘Ambiguity Over Preference of Payment to Statutory Dues Under IBC Law Continues’ (Incorp advisory, Nov 6, 2023) <<https://incorpadvisory.in/blog/ambiguity-over-preference-of-payment-to-statutory-dues-under-ibc-law-continues/>> accessed January 2, 2024.

VIII. GLOBAL COMPARATIVE ANALYSIS OF THE PRIORITY ORDER AND THE EXISTING POSITION IN COMMITTEE OF CREDITORS

Traditionally, government debts have received preferential treatment in insolvency or liquidation proceedings. Nevertheless, a significant shift in this trend has occurred, reducing or eliminating this preference in most jurisdictions.⁶⁸ The UNCITRAL Legislative Guide on Insolvency Law also states that numerous legal systems assign low priority to state dues. This is done to favour other creditors who have assumed risks by extending loans or offering debts. Further, the Viswanathan committee report recommended giving lower priority status to government dues in the IBC to align with global practices and meet the Code's objectives.

D. Position in the United States of America

In the United States, the payment hierarchy in bankruptcy proceedings is structured to prioritise creditors with valid liens or security interests on the debtor's assets. Secured creditors are the first to receive payment, followed by the insolvency proceedings cost and government tax claims come at a much lower priority than secured creditors. This hierarchy reflects a legal and systemic approach that ensures a fair and orderly distribution of funds while addressing the varied interests and obligations of different creditor categories. Moreover, in the USA, the resolution plan has to be mandatorily approved by every class of creditors and stakeholders who will be affected by it.⁶⁹

The priority order of US is⁷⁰-

- Secured creditors
- Insolvency proceeding cost
- Claims that emerge during the interim period
- Compensation and perks for employees.
- Deposit claims
- Tax demands arising out of Governmental Claims
 - Unsecured claims

68. UNCITRAL Legislative Guide (n 3).

69. Report of the Bankruptcy Law Reforms Committee (n 5).

70. Dr. Binoy J. Kattadiyil & CS Peer Mehboob, 'Corporate Insolvency in India and Other Countries – A Comparative Study' (2020) 9 IJMER 7 (9).

- Equity interest

E. Position in the United Kingdom

The UK Insolvency Act of 1986 originally included a provision granting preferential status to crown debts, a concept that found reflection in Indian legal practice through the prioritisation of debts for a company undergoing liquidation under section 327 of the Companies Act, 2013. Notably, in 2003, the UK statute underwent a significant amendment, leading to the Crown relinquishing its preferential claim. Despite the original intent for this renouncement to be part of the initial statute, its introduction has been noted to be delayed. The UK tax authority, Her Majesty's Revenue & Customs (*HMRC*), possesses priority as a creditor. For certain taxes in UK insolvency proceedings, effective from 1 December 2020, thereby reinforcing HMRC's position at the expense of other creditors. Moreover, following the regulations of the Insolvency Act, of 1986 in the UK, a voluntary arrangement necessitates consent from three-fourths of the total value of the debtor's creditors and a majority in value of the members participating in a meeting for the allocation of assets to settle debts.

In administration or liquidation distributions, creditors are prioritised in descending order for payment:⁷¹

- Creditors holding fixed security over designated assets
- Costs related to the insolvency proceedings, including fees for the insolvency practitioner and any legal or professional fees
- Specific 'preferential' creditors, such as employees and the UK tax authority
- creditors with floating security over adaptable asset classes
- unsecured creditors
- Interest on particular debts accrued throughout the insolvency process, and
- shareholders⁷²

71. Peter Wiltshire, 'Restructuring and Insolvency Law in the United Kingdom' (CMS, Apr 8, 2022) <<https://cms.law/en/int/expert-guides/cms-expert-guide-to-restructuring-and-insolvency-law/united-kingdom>> accessed 1 January 2024.

72. *Ibid.*

The global practices point out that state dues or tax claims are kept at a lower priority than secured creditors. This aligns with IBC provisions, assigning lower priority to state dues. The inclusion of government dues in Section 53(1)(e)(i) clearly signifies this intent in the code's statutory framework. Considering this objective, it is apparent that Section 53(1)(e) establishes the hierarchy of government dues, including secured government dues under statutory charge, decisively below secured creditors extending credit to the corporate debtor.

Furthermore, compared with various jurisdictions, the operational creditors have the opportunity to express their views on the approval of the resolution plan, a practice not observed in India. Despite being integral to the business of the corporate debtor, operational creditors lack adequate representation within the committee of creditors (CoC) and are denied a proper platform for their opinions.

IX. SUGGESTIONS

To address the escalating confusion surrounding the Insolvency and Bankruptcy Code, it is imperative to enact legislative amendments that provide explicit clarification regarding the prioritisation of claims among various creditors, including government authorities, secured creditors, operational creditors, and financial creditors. This entails incorporating specific provisions to delineate the hierarchy of claims and the treatment of government authorities in insolvency proceedings. Despite the existence of Section 53 in the IBC, the disputed judgements have contributed to uncertainty. A legislative amendment or an addition of a proviso to Section 53(1), particularly focusing on the position of taxation authorities in the priority status, would effectively clear this confusion and establish a consistent procedural framework for future cases.

Moreover, the clarificatory amendment could introduce a comprehensive framework for creditor hierarchy, considering both the nature of claims and the public interest. This framework may take into consideration the crucial functions carried out by government authorities and aim to maintain a balance with the rights of other creditors. It could entail the establishment of distinct classes of government dues, each assigned different levels of priority based on the nature of their claims. To illustrate, the landmark judgment in the case of *Rainbow Papers*, as pronounced by

the apex court, underscores the inclusion of the State within the ambit of secured creditors, encompassing all government dues. While acknowledging the significance of government claims, it is imperative to distinguish between claims of varying importance. A broad interpretation labelling all government dues as secured creditors may introduce unfair bias, providing undue advantage to certain governmental authorities over other authorities that merit reasonable prioritisation. This underscores the need for a nuanced legislative amendment that ensures fair and equitable treatment of diverse claims in insolvency proceedings.

During the initiation of CIRP by the corporate debtor, the committee of creditors is appointed by an insolvency professional. Clause 10.3 of the Insolvency Law Committee Report⁷³ recommends that “insolvency law should specify that a creditor or equity holder whose rights are modified or affected by the plan should not be bound to the terms of the plan unless that creditor or equity holder has been allowed to vote on approval of the plan”.⁷⁴ The report was clearly aimed at establishing the Corporate Insolvency Resolution Process (*CIRP*) as an equitable and impartial procedure, allowing significant involvement of operational creditors in the decision-making phase. Therefore, to further that aim there shall be inclusion of taxation authorities in committees of creditors (*CoC*) and provide appropriate voting rights as well as a minimum fixed entitlement amount to be paid irrespective of any circumstances.

There can be an amendment to the IBC provisions that the distribution can be done following the set procedures as per the waterfall mechanism and after the claims have been settled following the order of priority, the remaining claims of the other unsecured creditors or operational creditors like state authorities can be settled on a proportional basis of the remaining unpaid debts. Such an outcome would signify a mutually beneficial scenario, wherein creditors stand to successfully recover their outstanding dues, all the while adhering to the prescribed protocol under the Insolvency and Bankruptcy Code.

Measures can be implemented to strengthen oversight and accountability for government authorities participating in insolvency proceedings. This may involve establishing an independent regulatory body like a

73. ET, IBC: Ruling (n 6).

74. UNCITRAL Legislative Guide (n 3), Recommendation 146.

specific tribunal or oversight mechanism, tasked with reviewing the actions of government authorities in insolvency cases, ensuring the reasonableness and necessity of their claims for the public interest. Simultaneously, it is crucial to consider the interests of taxation authorities. As previously discussed, the judiciary's decision to apply a moratorium under Section 14 provisions to taxation authorities could potentially result in a lasting prohibition on their appeals. A regulatory body, coupled with a targeted amendment, will facilitate decisions that consider the interests of all parties involved to strike a balanced and fair outcome.

Finally, a meticulous impact assessment has been absent in the rulings of the apex court. Before implementing substantial alterations to the treatment of government authorities in insolvency proceedings, a comprehensive impact assessment is necessary. This evaluation should take into account the potential repercussions on operational creditors, financial creditors, and the overarching insolvency resolution process.

X. CONCLUSION

The court's recent rulings have marked a substantial departure from the previously established stance, causing a wave of uncertainty among creditors. To facilitate the liquidation procedure, it is recommended that the Supreme Court re-examine the recent verdict, providing clarity on this matter. It is apparent that allowing the current legal stance to persist could undermine the intended purpose of the code. Consequently, potential resolution applicants may be dissuaded due to the added responsibility of addressing existing or potential government and legislative dues. This, in turn, might lead to a decrease in resolution applications, diminished asset values, and increased losses for creditors. Controversial decisions from the Supreme Court have given rise to unfair and prejudiced practices. Mr. Jayant Sinha, Minister of State in the Ministry of Finance while justifying the lower hierarchical status of government dues explained that the reason for prioritising employees over the government in the waterfall mechanism is rooted in the desire to prioritise the well-being of individuals.⁷⁵ This decision is based on the understanding that the funds

75. L Viswanathan, Animesh Bisht and Karan Sangani, 'An Analysis of the State Tax Officer vs Rainbow Papers Limited' (Insolvency Tracker, 31 October 2023) <<https://insolvencytracker.in/2023/10/31/an-analysis-of-state-tax-officer-vs-rainbow-papers-limited-verdict/>> accessed 3 January 2024.

involved primarily belong to depositors and taxpayers. Recognising the vulnerability and dependence of employees, the intention is to place the financial interests of the most dependent and vulnerable individuals, who are also taxpayers, ahead of the government. It is acknowledged that employees, being most reliant on these funds, should be given precedence over the government, which has alternative means of borrowing funds.⁷⁶ Furthermore, there is a growing reluctance among financial creditors, who might now reconsider before approaching the adjudicating authority. This unintended consequence runs counter to the original objectives of the Insolvency and Bankruptcy Code. The legislative body shall promptly take action and provide clarification through necessary amendments to the code. The clarification should assert that the rights of financial creditors hold precedence and should supersede any governmental dues. This measure is essential to ensure that the principal objective of the code, namely the revival of the corporate debtor, remains its primary focus and that any departure from the established practices envisioned by the legislature during the formulation of the IBC is nullified from the outset.

76. Ibid.

Sailing Through Sebi's Symphony of the Lodr (Second Amendment Regulations) 2023: How to Combat the Hidden Agreements Shaping India's Boardroom Overture?

—Sejal Gupta and Kim Korwani*

ABSTRACT

Picture this scenario: a well-established engineering giant sets its sight on acquiring a pioneering IT services company, triggering a hostile takeover by acquiring majority shares through indirect means enclosed in a web of undisclosed agreements. This paper plunges into the intricate details of how to combat such agreements and takeovers through SEBI's Second Amendment to the LODR, exploring the profound impact through the lens of real-world examples. The authors delve into the historical notes of corporate governance, the role of SEBI in shaping corporate practices, and the motivations underpinning recent regulatory amendments. The regulatory landscape unfolds in three movements: tracing the evolution of LODR Regulations since 2015, exploring recent trends in corporate governance, and unveiling the compelling need for regulatory adaptations in the face of dynamic business environments. Highlighting the dramatic NDTV-Adani Hostile Takeover, where undisclosed agreements and intricate regulatory manoeuvres take centre stage, and extending to the Amazon-Future Group Dispute, revealing the complexities of unrevealed agreements, the narrative unfolds. The authors also scrutinize the key changes brought about by SEBI's amendment, including Regulation 30A and materiality thresholds under Regulation

* The authors are students at Institute of Law, Nirma University.

30(4). *Stakeholder perspectives echo through the narrative, shedding light on the evolving responsibilities of shareholders, the transformative impact on business strategies for promoters, the changing role of directors, and the rising tide of investor activism. As the reader voyages through the challenges faced by companies and stakeholders, operational hurdles for listed companies, concerns regarding disclosure, and the balancing act of the scale required to adapt to regulatory changes come to the forefront. The authors also provide a thoughtful critique of the regulatory amendments, identifying the potential loopholes, delving into industry, and expert criticism. The paper concludes with practical recommendations and strategies, focusing on addressing identified loopholes, enhancing stakeholder communication, and fostering collaboration between regulatory bodies and industry participants.*

I. INTRODUCTION

In recent years, a slew of worldwide changes have transformed the corporate governance landscape, including higher expectations for the Board's oversight function, increased stakeholder participation, and improved transparency procedures. There is a consistent emphasis on the makeup of the Board, the required skill profiles of the directors, the promotion of diversity, and the construction of a robust mechanism of Board functioning that goes beyond '*the box-ticking exercise*'.¹

Notably, there is no distinct structure of "corporate governance" in the developed world, and the efficacy of one governance style over another is inherently subjective.² As a result, developing a corporate governance code for Indian businesses cannot be performed by simply importing one.

As India's integration into the global economy accelerates, the expectations of domestic and international investors have elevated, necessitating greater transparency, lucid justifications for pivotal decisions, and an unwavering commitment to enhancing shareholder value.³

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1. C.M. Daily and D.R. Dalton, 'The Relationship between Governance Structures and Corporate Performance in Entrepreneurial Firms' (1992) 7(5) *Journal of Business Venturing*, pp. 375, 386.
 2. S. Claessens, 'Corporate governance and development' (2006) 21(1) *The World Bank Research Observer* 91, pg. 122.
 3. Institutional Investor Advisory Services, 'Corporate Governance Scores – Increasing Expectations' (March 2023) <<https://iiias-cms.s3.ap-south-1.amazonaws.com/>

Corporate governance goes beyond simply complying with legal requirements and the Securities and Exchange Board of India (*SEBI*) Regulations. The detailed regulation of the frequency of financial and managerial disclosure, the fulfilment of fiduciary responsibilities by the board of directors towards shareholders, and the dedication to operating transparent companies that capitalize on long-term shareholder value cannot be mandated.⁴

Corporate governance is commonly employed to evaluate the efficiency of organisational operations.⁵ Investors use corporate governance to evaluate the competence of a company's management and the effectiveness of its Board of Directors. Companies are increasingly recognising the importance of strong governance standards for their long-term success and sustainability.⁶

In the seminal manifestation of its commitment to fortifying the pillars of corporate governance in the realm of listed companies, SEBI took a pivotal step on June 14, 2023.⁷ The enactment of the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 (*LODR*) constitutes a substantive overhaul of the extant regulatory framework meticulously crafted in 2015. These amendments, poised to bolster transparency and accountability among listed companies and their major stakeholders, were strategically devised in response to evolving market dynamics and recent high-profile incidents such as the Adani-Hindenburg and the Amazon-Future Group sagas.⁸

The Amendment Regulations of 2023, officially ratified on June 14, 2023, herald a significant regulatory milestone that took effect on July 14, 2023. This proactive initiative by the SEBI signifies a strategic response

CG_Scores_2022_Final_01_03_2023_140e30b57c.pdf (Institutional Investor Advisory Services) accessed 6 January, 2024.

4. K. Gollakota and V. Gupta, 'History, ownership forms, and corporate governance in India' (2006) 2(2) *Journal of Management History* 185, pg. 198.
5. A.C. Fernando, 'Corporate Governance- The time for a Metamorphosis' (*The Hindu Businessline*, 9 July 1997).
6. Bernard and Vikramaditya Khanna, 'Can Corporate Governance Reforms Increase Firms' Market Values? Event Study Evidence from India' (2007) 4 *Journal of Empirical Legal Studies* 749, pg.796.
7. Consultation Paper on Strengthening Corporate Governance at Listed Entities By Empowering Shareholders Amendments to the SEBI (*LODR*) Regulations, 2015.
8. 'Adani Entities make Open Offer for 26% stake in NDTV', (*Outlook*, August 23, 2023) <<https://www.outlookindia.com/business/adani-entities-make-open-offer-for-26-stake-in-ndtv--news-218390>> accessed 6 January 2024.

to address concerns articulated in consultation papers and deliberations, notably emanating from the Board Meeting convened on March 29, 2023.⁹ The pivotal focus of these amendments is to mitigate apprehensions surrounding undisclosed Shareholders' Agreements and agreements where the listed company is not a direct party.

The crux of the amendments lies in the introduction of a novel clause, namely Clause 5A, incorporated within para-5 of para-A of Part A of Schedule III of the Listing Obligations and Disclosure Requirements (LODR) (Clause 5A). Concerning future agreements, Clause 5A mandates the disclosure of agreements that impact the management or control of the listed entity, irrespective of the entity's direct involvement. Significantly, parties entering into such agreements are obligated to inform the listed entity within a concise timeframe of two working days. Furthermore, the board assumes a pivotal role by furnishing shareholders with a comprehensive rationale. Approval through a special resolution and securing "*the majority of the minority*" become imperative steps in this process.

The underlying thrust of these proposed amendments transcends the conventional scope of agreements directly involving listed companies. Instead, they seek to establish a framework ensuring information symmetry and diligent scrutiny of agreements impacting such entities, even in scenarios where the company is not a direct participant. This academic exploration underscores the nuanced and purposive nature of SEBI's regulatory measures, aligning them with broader corporate governance objectives. The overarching goal is to foster greater market symmetry and safeguard the rights of all investors in an environment where stakeholders, including vocal investors and regulatory bodies, are actively shaping the trajectory of corporate governance standards. As India embarks on this journey towards heightened standards, we delve into the noteworthy changes introduced by the Amendment Regulations 2023 to the Listing Obligations and Disclosure Requirements.

9. SEBI Board Meeting (29 March 2023) <https://www.sebi.gov.in/media/press-releases/mar-2023/sebi-board-meeting_69552.html> accessed 6 January 2024.

II. EVOLUTION OF REGULATORY FRAMEWORKS: NAVIGATING TRANSFORMATIONS IN GOVERNANCE AND DISCLOSURES FOR LISTED ENTITIES IN INDIA

A. Unveiling Horizons: Recent Trends in Corporate Governance

The evolution of Corporate Governance, both in domestic and global contexts, is characterized by a rich and intricate history. The exposition directs its focus towards the developments within Indian corporate entities, which saw the emergence of the agency problem, a foundational conflict between managerial and shareholder interests. Until the late 1970s, Managing Directors or CEOs wielded considerable influence in shaping the boards. However, this setup was not without its evident flaws, prompting a transformation in the late 1970s. This transformative period began with the U.S. Securities and Exchange Commission (*SEC*) urging the New York Stock Exchange (*NYSE*) to incorporate independent directors, among other changes, setting a precedent that resonated globally.¹⁰

Beyond the initial managerial-shareholder conflict, a subsequent discord emerged between dominant and minority shareholders. This sparked challenges in reconciling shareholder interests with broader stakeholder responsibilities. Modern regulations now assign directors the crucial duty of safeguarding all stakeholders' interests, reflecting a nuanced and comprehensive approach to corporate governance.¹¹ The contemporary landscape emphasizes the director's role in balancing the diverse interests of both shareholders and stakeholders.

1. *Primary Agencies for Independent Directors to Ensure Corporate Governance*

In the Indian legal landscape post-2013, there was an unequivocal clarity that directors bear the responsibility for all stakeholders, encompassing employees, customers, and the community. However, a notable ambiguity persisted, particularly concerning creditors, as neither the Companies Act nor SEBI LODR explicitly addressed this stakeholder group. The

10. Deb, Saikat Sovan and Chakrapani Chaturvedula, 'Ownership Structure and Firm Value: Empirical Study on Corporate Governance System of Indian Firms' (2004) <<http://ssrn.com/abstract=5942212>> accessed 6 January 2024.

11. H. Demsetz and K. Lehn, 'The structure of corporate ownership: Causes and Consequences' (1985) 93(6) *Journal of Political Economy* 1155, pg. 1177.

paradigm underwent a pivotal shift with a dedicated chapter in the LODR principles. Here SEBI introduced the principle prevailing over the language of the law in cases of government conflicts, signifying a substantial departure from conventional legislative drafting practices.

The enactment of the Insolvency and Bankruptcy Code (*IBC*) in 2016 marked a transformative moment, explicitly incorporating the directors' responsibility and obligation towards creditors into the statutory framework. This legislative evolution underscores the dynamic nature of corporate governance principles as they adapt to the multifaceted landscape of shareholder relationships.¹²

In this context, it becomes imperative to explore:

- The fiduciary role of Independent Directors on corporate boards.
- The available tools at the disposal of Independent Directors.
- Identification of gatekeepers of governance or agencies that Independent Directors can access for assistance and guidance.
- **Auditors**

Boards, particularly independent Directors, must actively engage with auditors, discussing key matters like Related Party Transactions and audit concerns. Neglecting auditor advice breaches fiduciary duties. The board should cultivate a culture of structured interactions, providing a platform for IDs to discuss concerns and solicit perspectives. Recognizing auditors as valuable gatekeepers, it is acknowledged that no single gatekeeper is exhaustive.¹³ Leveraging an auditor's expertise is crucial. Both the Companies Act and SEBI regulations empower the IDs to summon auditors when needed, with the Audit Committee facilitating such interactions for optimal levels of outcomes.¹⁴

- **Proxy Advisory Firms**

12. Daizy Chawla and Neha Mittal, 'Building a Better Boardroom: The role of IBC in advancing corporate governance in India' (The Economic Times, 30 December 2023) <<https://economictimes.indiatimes.com/small-biz/legal/building-a-better-boardroom-the-role-of-ibc-in-advancing-corporate-governance-in-india/articleshow/106394469.cms?from=mdr>> accessed 6 January 2024.

13. OECD, 'The Role of the Board in Related Party Transactions' <<https://www.oecd.org/daf/ca/corporategovernanceprinciples/37175418.pdf>> accessed 4 January 2024.

14. L.D. Alhaji and Yusoff, 'An Empirical Study of the Roles of Audit Committee in Promoting Good Corporate Governance' Proceedings of 3rd International Conference on Business and Economic Research (2012) W.F.B.W. 165, pg. 177.

Commencing with an alternate perspective, proxy advisory firms stand as integral components of the corporate governance architecture, operating as regulated entities under SEBI in India. Despite occasional misconceptions associating them with activism or undue interference, these firms offer valuable contributions by providing timely and informative insights. Recognizing the significance of their role, companies are encouraged to establish a practice of comprehensive discussions in response to red flags raised by proxy firms or analysts, thereby underscoring their pivotal role in fortifying governance frameworks.

- **Whistle-blowers**

Shifting the focus, an additional gatekeeper in the corporate governance realm is represented by the whistle-blowers. They serve as a crucial source of insights for boards, necessitating in-depth discussions on the flagged issues. Repeated concerns raised by the whistle-blowers offer a window into the organizational culture. Instances of abrupt board meetings or inadequate agenda sharing require scrutiny, emphasizing the need for culture rectification rather than concealing facts. Examining cases like Kobe Steel¹⁵ and Volkswagen¹⁶ underscores the consequences of suppressing findings and deliberate misrepresentation. Regulatory directives, such as SEBI's and the Ministry of Corporate Affairs' mandate for an annual meeting of Independent Directors, unaided by executives, present a valuable opportunity for Independent Directors to assess any unusual occurrences vigilantly.

2. *The Key Impacts of SEBI's Noteworthy Regulatory Shifts on Independent Directors*

In the board meeting in September 2021, SEBI implemented crucial changes with profound implications for Independent Directors (IDs):

- I. **Expansion of Related Parties Definition:** The definition of Related Parties has experienced a substantial expansion.¹⁷ Previously, a

15. Kobe Steel Ltd., 'Report on the Kobe Steel Group's misconduct' (6 March 2018) <https://www.kobelco.co.jp/english/progress/files/20180306_en.pdf> accessed 4 January 2024.

16. Bill Vlasic and Aaron M. Kessler, 'It took EPA pressure to get VW to admit fault' (The New York Times, 21 September 2015) <<https://www.nytimes.com/2015/09/22/business/it-took-epa-pressure-to-get-vw-to-admit-fault.html>> accessed 4 January 2024.

17. Bharat asani and Varun Khanna, 'RPT Regulations- Some Suggestions for SEBI's consideration' (Cyril Amarchand Mangaldas, 7 July 2022) <<https://corporate.cyrilamarchandblogs>>.

Related Party was defined as an entity that had a beneficial interest in the company's shareholding of up to 20%. As of April 1, 2023, the requirement has been decreased to 10%. IDs are now required to be more vigilant as the concept of Related Party becomes increasingly strict.

2. **Shareholder Approval for Related Party Transactions:** SEBI has implemented a revised criterion for obtaining shareholder approval in relation to transactions involving linked parties. The approval threshold is determined as the lesser of Rs. 1,000 crores or 10% of the combined turnover.
3. **SEBI's Enhanced Scrutiny of Transition Intent:** SEBI has granted itself the authority to closely examine the purpose or result of a transaction. This growth presents a complex aspect, as the evaluation of intention can be detailed and subjective.

Another important development was the implementation of SEBI's resolution to separate the chairman and managing director, which was delayed for two years due to different reasons and commenced on April 1, 2022.¹⁸ This allows Independent Directors to improve corporate governance standards. SEBI implemented Business Responsibility and Sustainability Reporting (*BRSR*) regulations in May 2021, with a specific emphasis on Environmental, Social, and Governance (*ESG*) aspects. The Business Responsibility and Sustainability Report (*BRSR*) is an enhanced version of the Business Responsibility Report (*BRR*).¹⁹ It offers measurable, standardized, verifiable, and comparable data, facilitating the evaluation of organizations' sustainability achievements.

SEBI additionally requires that domestic mutual funds be prohibited from investing in companies that do not report under BRSR. The combination of the International Integrated Reporting Council (*IIRC*) and the Sustainable Accounting Standards Board (*SASB*) to become the Value

com/2022/07/rpt-regulations-some-suggestions-for-sebis-consideration/#_ftn5> accessed 4 January 2024.

18. Split roles of chairperson, MD and CEO before Apr 2022 deadline: Sebi to listed cos' (The Economic Times, 6 April 2021) <<https://economictimes.indiatimes.com/markets/stocks/news/separation-of-cmd-roles-not-aimed-at-weakening-promoters-position-ajay-tyagi/articleshow/81928566.cms?from=mdr>> accessed 4 January 2024.

19. Melissa Cyrill, 'India's updated Sustainability Reporting Format and Rules for ESG Rating Providers' <<https://www.india-briefing.com/news/india-brsr-core-esg-rating-provider-regulation-29062.html>> accessed 3 November 2023.

Reporting Foundation (*VRF*) is a significant development on a global scale. SASB has released ESG reporting criteria for a total of 77 industrial sectors.²⁰ The merger between VRF and the International Financial Reporting Standards Foundation (*IFRS*) will establish the International Sustainability Reporting Standards Board (*ISSB*). This indicates a shift towards universally recognized sustainability reporting standards, akin to standards for financial reporting. Academic discourse on these issues should dive into the practical challenges and implications for corporate governance frameworks.

B. Evolution of LODR Regulations, 2015

The seismic shift in corporate governance paradigm within the Indian landscape over the past decade has been nothing short of a regulatory symphony, orchestrated by the LODR Regulations of 2015. This regulatory maestro, born out of the necessity to harmonize the discordant notes of the longstanding agency problem, has wielded its transformative wand with unparalleled vigour. Independent directors, akin to vigilant custodians, stand discreetly within the LODR framework, their roles intricately embedded in the delicate balance of audit committees and engagements with auditors.

The evolution of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (*LODR*) represents a dynamic trajectory in response to the exigencies of India's securities market. Rooted in the imperatives of bolstering corporate governance, transparency, and investor protection, the LODR has undergone a series of modifications and amendments, reflecting the evolving contours of the financial regulatory landscape.²¹

The inception of the LODR in 2015 marked a watershed moment in India's regulatory framework for listed entities. Framed by the SEBI, these regulations aimed to consolidate and streamline the myriad listing

20. Value Reporting Foundation, 'Value Reporting foundation has now consolidated into the IFRS Foundation' <<https://www.valuereportingfoundation.org/>> accessed 5 January 2024.

21. SEBI, SEBI's Notification, SEBI/LAD-NRO/GN/2023/131 (14 June, 2023) <https://www.sebi.gov.in/legal/regulations/jun-2023/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-second-amendment-regulations-2023_72609.html> accessed 5 January 2024.

requirements that were hitherto dispersed across different avenues. The overarching goal was to harmonize and enhance the disclosure standards for listed companies, fostering greater market integrity and investor confidence.

The LODR, in its nascent form, delineated disclosure obligations, corporate governance norms, and specific requirements for the timely dissemination of information to the public. However, the regulatory framework has been subject to iterative refinement, a testament to the regulator's commitment to adaptability and responsiveness to the evolving financial landscape. Subsequent amendments to the LODR have been informed by a confluence of factors, including market dynamics, global best practices, and the need for continuous enhancement of corporate governance standards. Noteworthy revisions have addressed issues ranging from board competition and committees to disclosure norms, all converging to fortify the regulatory edifice and align it with contemporary necessities.

III. ANALYSIS OF AMENDMENT REGULATIONS 2023: IMPLICATIONS AND IMPACT ON DISCLOSURE NORMS FOR INDIAN-LISTED COMPANIES

A. Regulation 30 A: Mandated Disclosures for Binding Contracts and Agreements

The Amendment Regulations 2023 herald a substantive evolution within the regulatory milieu, prominently encapsulated in the inception of Regulation 30A within the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The genesis of this regulatory evolution lies in the conceptual underpinnings articulated by SEBI in its discerning consultation paper of February 2023, an intellectual cornerstone shaping the regulatory landscape we presently contemplate.²²

Clause 5A pertains to agreements that are considered significant because of their ability to affect the control or imposition of restrictions or liabilities on the listed company outside of normal business operations. Stakeholders, including shareholders, promoters, and important

22. SEBI Board Meeting (25 March 2023) <https://www.sebi.gov.in/media/press-releases/mar-2023/sebi-board-meeting_69552.html> accessed 3 January 2024.

individuals, must promptly disclose such agreements within two business days of their execution. The scope includes any subsequent rescissions, revisions, or alterations.

The Amendment Regulations eliminate the initial necessity for board and shareholder approval, concentrating exclusively on the duty to publicly disclose. This modification simplifies the procedure, emphasizing the prompt distribution of information.

Instances in the real world, such as the hostile take-over²³ of NDTV by the Adani Group²⁴ and the conflict between Amazon and the Future Group,²⁵ highlight the significant influence that hidden agreements can have on corporate governance. Regulation 30A fills this void by guaranteeing openness, even for arrangements in which the listed business is not directly involved.²⁶

The extensive range of Clause 5A, which includes diverse agreements such as promoter agreements, security packages, voting agreements, warrant agreements, and proxy agreements, could provide difficulties in the absence of clear instructions. The lack of clearly defined criteria for “salient features” complicates the process of making determinations. Indian-listed businesses must aggressively identify agreements falling under Regulation 30A and engage with stakeholders to conduct a thorough examination.²⁷ The indeterminate extent of “salient features” requires meticulous deliberation while making determinations. Nonetheless all stakeholders, except for the listed business, should conduct a strategic assessment of their positions. The determination to proceed, transfer, or conclude agreements should be grounded in a comprehensive evaluation

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23. A.J. Auerbach, *Corporate takeovers: Causes and Consequences* (University of Chicago Press, 2013).
 24. ‘Adani Entities make Open Offer for 26% stake in NDTV’ (Outlook, 23 August 2023) <<https://www.outlookindia.com/business/adani-entities-make-open-offer-for-26-stake-in-ndtv--news-218390>> accessed 3 January 2024.
 25. Institutional Investor Advisory Services (n 3).
 26. Utkarsh Anand, ‘Decoding the multilayered Amazon-Future-Reliance legal drama,’ (Hindustan Times, 10 January 2022) <<https://www.hindustantimes.com/india-news/decoding-the-multilayered-amazon-future-reliance-legal-drama-101641839370846.html>> accessed 3 January 2024.
 27. ‘SEBI Fines NDTV, Prannoy Roy, For Allegedly Delaying Rs 450 Crore Income Tax Demand Disclosure’ (Outlook Web Bureau, 17 March 2018) <<https://www.outlookindia.com/website/story/sebi-fines-ndtv-prannoy-roy-for-allegedly-delaying-rs-450-crore-income-tax-deman/309622>> accessed 2 January 2024.

of potential enduring ramifications, taking into account SEBI's vast authorities.

The Amendment Regulations 2023 introduce significant obligations for Indian-listed companies, particularly under Regulations 30A. To address these changes effectively, the following analytical action items emerge:

1. **Identification of Agreements:** Listed businesses should prioritize the start of the identification process for agreements covered by Regulation 30A.
2. **Stakeholder Engagement:** Companies must engage with stakeholders proactively to determine whether any agreements within the stakeholders' domain may trigger disclosure requirements under the Amendment Regulations 2023.
3. **Specification of Salient Features:** As part of the disclosure procedure, listed businesses must identify the "salient features" of these agreements on their website and annual reports.
4. **Decision-Making by Stakeholders:** Stakeholders other than the listed firm should closely assess their position on agreements that may be subject to disclosure.

B. Determining Materiality Thresholds for Disclosures in Para B of Part A, Schedule III

1. Shift to Objective Materiality Framework

The Amendment Regulation 2023 introduces significant changes to the materiality determination framework under the LODR for listed companies in India. The existing subjective three-pronged test is replaced with an objective criterion, setting specific materiality thresholds. This transformation brings clarity and uniformity to the disclosure process, aligning with international best practices. The articulated materiality thresholds, linked to financial metrics such as turnover, net worth, and profit or loss, introduce a quantitative dimension to materiality, potentially streamlining decision-making processes for listed entities.

The inclusion of Sub-regulation (d) in Regulation 30(4)(i)(a) addresses the intricacies of ongoing events. Mandating disclosure within 30 days

for events evolving in materiality ensures a timely flow of information to stakeholders, enhancing the market's ability to make informed decisions.

2. *Safeguarding Materiality Policies and Regulatory Synergy*

The proviso to Regulation 30(4)(ii) safeguards the dilution of LODR requirements in Materiality Policies. Emphasizing alignment with LODR mandates, this regulation ensures that companies maintain a robust framework for identifying and reporting material events.²⁸

The deviation from the initial proposal regarding reliance on 'consolidated financial statements' instead of 'standalone financial statements' signifies a tactical adjustment. This shift acknowledges the importance of considering the holistic financial health of the listed company and aligning disclosure thresholds with consolidated figures.

The integration of material event disclosure under Regulation 30 with the definition of 'unpublished price-sensitive information' (*UPSI*) in insider trading regulations represents a holistic regulatory approach. This synergy reinforces the need for companies to view disclosure as a continuum, ensuring consistency in information dissemination.²⁹

3. *Analysis of Quantitative Materiality Thresholds in LODR Amendments*

The recent incorporation of quantitative thresholds within the Amendment Regulations 2023 signifies a pivotal step towards enhancing the transparency and precision of materiality determinations for listed companies in India. This strategic shift carries notable implications, particularly in the realm of litigation and disputes.

• **Impact on Litigation and Disputes**

The adoption of quantitative thresholds addresses the historical ambiguity surrounding materiality assessment, specifically concerning litigations and disputes. Instances where listed companies opted not to disclose such events, citing their potential impact falling under Part B of

28. SEBI, 'Consultation Paper on Review of Disclosure Requirements for Material Events or Information' in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI Consultation Paper) (2022).

29. *Ibid* at part D.

Part A of Schedule III, are set to undergo a transformative change. The introduction of mandatory disclosure litigations surpassed the stipulated thresholds and enhanced transparency, allowing stakeholders a clearer understanding of the potential risks associated with listed entities.³⁰

- **Challenges and Considerations**

While the move towards an objective criterion is commendable, there are potential challenges. The utilization of a 'lower of' threshold, while ensuring a cautious approach, may inadvertently lead to the disclosure of non-material events for companies operating on thin profit margins with a minimal net worth or those categorized as holding companies with low turnovers. Striking a delicate balance between comprehensive disclosure and avoiding information overload becomes imperative.

- **Strategic Action Items**

1. *Materiality Policy Update:* Swift and comprehensive updates to Materiality Policies are essential to seamlessly integrating the new quantitative thresholds. The revised policy should align closely with the LODR requirements, ensuring that it does not dilute any stipulations. Additionally, it should empower relevant employees to discern potential material events and facilitate communication with Key Managerial Personnel (*KMPs*).
2. *Ongoing Event Analysis:* A meticulous analysis of existing events or information of an ongoing nature is paramount. Companies must assess whether these events meet the newly established quantitative thresholds.

C. Verification Protocols for Market Speculation by Listed Entities: Evolution and Obligations

1. Pre-Amendment Dynamics

Prior to the Amendment Regulations 2023, listed companies retained the option to willingly affirm or negate reported events or information linked to market speculation. While stock exchanges could request clarification, the decision to confirm or deny rested with the company, and it was not

30. Ibid.

obligatory. Under the existing framework, stock exchanges could initiate inquiries based on media reports, promoting listed companies to furnish clarifications. However, the choice to confirm or deny remained within the purview of the company.

2. *Post-Amendment Dynamics*

Certain listed corporations must be verified under the current change. From October 1, 2023, the 100 largest listed companies and later the 250 largest listed companies in April 2024 must clearly confirm, deny, or clarify any mainstream media report on Regulation 30 matters.

The proposed modification appears to aim for market information parity. However, the regulation's broad reach renders it impracticable, which may encourage lawbreaking. This move should be measured against a recent Securities Appellate Tribunal (SAT) decision on a similar topic.³¹

In one case, SEBI penalised Reliance Industries Limited for neglecting to address Jio-Facebook³² merger rumours. Reliance Industries Limited claimed that the stories were published without a signed term contract, removing transaction certainty. They said the disclosure happened after the final transaction agreements were signed. SEBI has highlighted that listed businesses must confirm or deny market rumours to guarantee equal access to information. After an appeal to the SAT, the decision was temporarily halted, raising questions about whether every publicly traded corporation should handle a lot of global data.

The Amendment Regulations 2023 define mainstream media broadly, including content that fulfils the Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules 2021.³³ The concept includes the publisher's news and current affairs content and related companies, but excludes some categories. Regulation 30 of the LODR may be difficult to

31. Palak Shah, 'SAT stays SEBI penalty on RIL regarding disclosure of Facebook deal' (The Hindu Business Line, 28 September 2022) <<https://www.thehindubusinessline.com/markets/sat-stays-sebi-penalty-on-ril-regarding-disclosure-of-facebook-deal/article65947166.ece>> accessed 2 January 2024.

32. 'SAT stays SEBI penalty on RIL regarding disclosure of Facebook Deal' (The Hindu Business Line, 28 September 2022) <<https://www.thehindubusinessline.com/markets/sat-stays-sebi-penalty-on-ril-regarding-disclosure-of-facebook-deal/article65947166.ece>> accessed 2 November 2023.

33. Ministry of Information and Broadcasting (MeITY), 'IT (Intermediary Guidelines and Digital Media Ethics Code) Rules 2021.

enforce due to its wide range of issues, the news outlets it applies to, and the lack of a minimum definition of “investing public.” Thus, passionate market participants can exploit this law to validate their speculations.

3. *Strategic Recommendations*

1. Evaluation of Compliance Objective: Undertake an exhaustive examination, utilizing market capitalization data from the prior fiscal year, to ascertain whether the publicly traded organization is positioned among the top 150 or 250 listed entities. The assessment is of utmost importance in comprehending the scope of compliance responsibilities as stipulated in the Amendment Regulations 2023.
2. Establishing a comprehensive vigilance mechanism is crucial for the identification and monitoring of market rumours that originate from mainstream media outlets. By adopting this proactive stance, one guarantees prompt reactions to the potential dissemination of information, thereby adhering to regulatory obligations.

D. Enhancing Board Accountability: Regulation 17 (1D) Amendment

1. *Analyzing the Amendment to Regulation 17 (1D) reveals insights into regulating directorial tenure*

The addition of Regulation 17 (1D) in the Amendment Regulations 2023 signifies a notable change in the Listing Obligations and Disclosure Requirements (LODR) framework. The amendment, which takes effect on April 1, 2024, mandates that directors of listed companies must obtain shareholder consent in a public gathering at least once every five years following their first appointment or reappointment. In addition, directors who have been on the board for a period of five years or more without prior approval from shareholders as of March 31, 2024, are required to obtain such consent at the earliest public meeting following that day.

It is important to note that certain types of directors are exempted from this obligation. These include directors who work full-time, managing directors, managers, independent directors, and those whose appointment or reappointment is subject to shareholder approval under the Companies Act 2013 or the LODR. The exemptions also extend

to directors who are appointed by court order, government nominees (excluding public sector companies), nominees from the financial sector regulator, directors nominated by SEBI-registered debenture trustees, and those nominated by financial institutions regulated by the Reserve Bank of India under standard lending agreements.

The aforementioned modifications are a direct reaction to SEBI's consultation document, initiated in February 2023, which aimed to tackle the issue of board permanence, namely within promoter groups of publicly traded companies. The regulatory intervention guarantees that shareholders can assess the performance of all current board members. The consultation paper proposed broadening the scope of exclusions to encompass not just court-appointed directors but also government nominees, registered debenture trustees, and financial institutions. This is remarkable. This adjustment aligns with the overarching objective of enhancing corporate governance and board accountability in publicly traded companies.

2. *Fostering Governance in Light of Board Appointment Challenges: Analysis of Amendment Implications*

The Amendment Regulations 2023, which add Regulation 17 (1D) to the Listing Obligations and Disclosure Requirements (*LODR*), are likely in response to noteworthy incidents in the Indian business environment, such as Dish TV Limited and JK Cements Ltd. The modifications, which take effect on March 31, 2024, focus on board appointments and the possible issues that come with long tenures or seats that are not subject to rotation.³⁴

In the case of Dish TV Limited, the modification clarifies Mr. Jawahar Goel's nomination as an additional director "not liable to rotation" three months before the company's 2007 IPO. Subsequent events, including Mr. Goel's rejection as managing director at the 2022 annual general meeting, sparked a protracted legal struggle with significant shareholder

34. 'In High-decibel Battle with Yes Bank, Jawahar Goel Exits as Dish TV MD after Losing Vote at EGM' (MoneyLife, 27 June 2022) <<https://www.moneylife.in/article/in-high-decibel-battle-with-yes-bank-jawahar-goel-exits-as-dish-tv-md-after-losing-vote-at-egm/67574.html>> accessed 1 January 2024.

Yes Bank.³⁵ Similarly, JK Cements Ltd.³⁶ experienced shareholder opposition in 2021, with minority shareholders voting against a resolution proposing promoter directors' lifetime tenure.

These examples highlight the need to match articles of association and pertinent documentation with the new regulations, ensuring that no director is considered to have a "permanent" appointment or is "not liable to rotation." The modifications give shareholders the ability to examine and approve director selections, improving governance frameworks and responsiveness to shareholder concerns.

Strategic action items:

1. Evaluate Directors' tenure: Given the implications of the amendment beginning March 31, 2024, listed businesses should review each director's tenure to identify whether appointments and reappointments will require shareholder approval.
2. Amend Governing papers: The articles of organization and other essential papers must be modified to ensure conformity with the new regulations, prohibiting any director from being regarded as "permanent" or "not liable to rotation."
3. Improve Disclosure and Justification: Recognising rising shareholder activism, listed businesses should produce extensive reasons that showcase directors' contributions and work, particularly when seeking shareholder approval for appointments.

35. Jayshree P. Upadhyay and Gopika Gopakumar, 'Yes Bank to approach regulator over Goel's tenure on Dish board' (Mint, 28 June 2022) <<https://www.livemint.com/companies/yes-bank-to-approach-regulator-over-goel-s-tenure-on-dish-board-11656354824309.html>> accessed 1 January 2024.

36. Bhavya Dilipkumar, 'JK Cement's minority shareholders block changes to company's AoA' (Economic Times 26 August 2021) <<https://economictimes.indiatimes.com/industry/indl-goods/svs/cement/jk-cements-minority-shareholders-block-changes-to-companys-aoa/articleshow/85657906.cms>> accessed 2 January 2024.

E. Mandatory Shareholder Approval for Special Rights in Listed Companies

1. *Periodic approval of special rights in listed companies is a crucial step towards enhancing governance standards*

The Amendment Regulations 2023 include Regulation 31B (1), which requires listed businesses to seek shareholder approval via special resolution every five years for any special privileges granted to a specified group of shareholders. This clause seeks to accommodate the changing shareholder makeup by allowing for periodic review and approval of special rights packages. However, the lack of a specified scope for “special rights” creates interpretational issues, and the regulation’s rigidity may raise worries about attracting patient capital investments. The rule, which is based on SEBI’s February 2023 consultation document, emphasizes the need for transparency, but it might benefit from a more nuanced approach, such as upfront disclosure and shareholder approval at the outset. This would allow potential investors to make educated decisions regarding a company’s governance structure from the start, creating a favourable climate for long-term investments.

2. *Navigating Governance Changes: Steps for Indian Listed Companies*

In light of the Amendment Regulations 2023, Indian-listed firms should take the following actions:

1. *Review Existing Agreements:* Listed firms should swiftly analyze shareholder agreements, articles of association, and other relevant documents to identify any special rights provided to shareholders before listing. Given the absence of a defined description for “special rights” in the Amendment Regulations, insights from the February 2023 consultation document can help identify possible rights that will require shareholder approval over the next five years.
2. *Guidance for IPO Entities:* Entities planning an initial public offering (IPO) must perform a comparable evaluation to ensure compliance with the Amendment Regulations 2023. This proactive strategy will assist them in negotiating legal constraints and promoting openness in governance procedures.

IV. CASE STUDIES: WHAT CRESCENDOED SEBI TO INTENSIFY THE CORPORATE GOVERNANCE SAGA?

The SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023, which introduced Clause 30A in conjunction with Clause 5A of Schedule III Part A, are a proactive measure designed to enhance transparency and protect the interests of investors, shareholders, and the public. Recent instances like the Adani Group's hostile takeover of NDTV and the Amazon-Future Group dispute demonstrate the relevance of such agreements.

A. NDTV-Adani Hostile Takeover

1. *Background of the Takeover*

For an estimated INR 1.14 billion, Adani Enterprises Limited (AEL) deliberately purchased a 100% equity position in Vishvapradhan Commercial Private Limited (VCPL) which led to share warrants for RRPR Holdings Private Limited³⁷. As of November 28, 2022, RRPR's ownership of NDTV remained at 29.18%.³⁸

The conversion warrants issued by RRPR sparked a challenge, which referenced limitations enforced by SEBI in 2020 and the temporary attachment of NDTV shares by the tax authorities in 2017. SEBI was contacted for clarification, but none was given. Functioning under the presumption of a SEBI limitation until November 2022, at which point the conversion indirectly gave VCPL access to 29.18% of NDTV's voting rights, necessitating an open bid.

2. *Open Offer*

The Adani Group's acquisition of more than 25% of NDTV mandated an open offer in accordance with Indian regulations. A final Letter of Offer was issued when VCPL, AMG, and AEL released a Detailed Public Statement in compliance with SAST requirements. In this, it was stated

37. Bombay Stock Exchange, 'XML-data', para 3.1.4 (j)(i).

38. Adani, 'Outcome of Board Meeting held on 14th February 2023 and submission of Unaudited Financial Results for the quarter and nine months ended 31st December 2022.' <<https://www.adanienterprises.com/-/media/Project/Enterprises/Investors/Investor-Downloads/Financial/Q3-FY-23.pdf>> accessed 7 December 2023.

that 26% of NDTV's voting share capital will be acquired, with each equity share valued at INR 294.

Furthermore, as required by the SAST Regulations, the Adani Group, which is currently in charge of RRPR, intended to compensate public shareholders who tendered their shares for sale in response to the public offer through a Founder Purchase Transaction. Thanks to this calculated move, the Adani Group now holds a sizable 64.71% interest in NDTV, making it the company's dominant stakeholder.

3. *Role of Undisclosed Agreements*

Elon Musk made a number of calculated steps in his hostile takeover of Twitter Inc. recently. With a 9.20% stake, Musk eventually became the top shareholder after accumulating shares gradually.³⁹ The hostile takeover was started by Musk's offer to buy Twitter for a premium of about USD 54.20 per share,⁴⁰ a 38% increase over the day before Musk's investment became public.⁴¹ In response, Twitter activated a "*poison pill*," enabling current investors to purchase more.

There have been several hidden agreements in the Adani-NDTV takeover that pertain to the conversion of convertible warrants, the inter se transfer of promoter holdings, and a credit deal with Vishvapradhan Commercial Private Limited (VCPL). Concerns were raised in 2016 by SEBI about the lending arrangement between NDTV and VCPL and its possible connection to the purchase of NDTV shares. There have been concerns about whether the conditions of the loan arrangement have been followed, considering VCPL's convertible warrant conversion and Adani Enterprise's subsequent purchase of NDTV shares. Furthermore, there may be unstated rules or conditions associated with the *inter se transfer* of promoter stakes following the open sale. There were concerns over the accuracy of information available to the public, other shareholders, and regulatory agencies due to the lack of openness around these agreements.

39. 'Elon Musk takes control of Twitter in \$ 44bn deal' (BBC, 28 October 2022) <<https://www.bbc.com/news/technology-63402338>> accessed 4 November 2023.

40. SecuritiesandExchangeCommission,<https://www.sec.gov/Archives/edgar/data/1418091/000110465922041911/tm2211482d1_sc13g.htm> accessed 5 December 2023.

41. Clare Duffy, 'Twitter adopts 'poison pill' measure that could thwart Elon Musk's takeover bid' <<https://edition.cnn.com/2022/04/15/tech/twitter-elon-musk-poison-pill/index.html>> accessed 8 December 2023.

4. *Implications under Regulation 30A*

In August 2022, RRPR Holdings, holding a 29.18% equity stake in NDTV, notified VCPL that the tax authorities had provisionally seized NDTV's equity shares in 2017. A subsequent communication in 2018 indicated that this attachment would remain in force until the reassessment proceedings were completed.⁴²

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, including Regulation 30A, provide a comprehensive framework for disclosures in the event of substantial acquisitions or takeovers of listed companies.

The regulatory framework necessitates transparency through disclosure requirements for both the acquiring and target entities. As per Regulation 30(1) of the Takeover Regulations, any individual holding more than 25 percent shares or voting rights must disclose this information within 7 working days. Adani Enterprise's acquisition of VCPL, which held convertible warrants of RRPR Holdings, triggered the disclosure obligation under Regulation 30. Furthermore, in such cases, open offers become mandatory, necessitating an offer for an additional 26 percent stake, providing an exit option for dissatisfied shareholders.⁴³

1. To increase control, acquirers typically suggest offering prices that are higher than market rates. With NDTV shares trading above the offer price, Adani Enterprise's open offer created a special circumstance that complied with Regulation 8, which determines the lowest open offer price by utilising the volume-weighted average market price recorded during the sixty trading days preceding the public announcement.
2. A SEBI order limiting the Roys' access to the securities market for two years presented a possible roadblock to the takeover. In spite of what the Roys initially claimed, the order had no effect on the takeover because it was connected to an already-existing agreement and a simple warrant conversion.

42. Samantha Subin, 'Elon Musk offers to buy Twitter for \$ 43 billion, so it can be transformed as private company' <<https://www.cnbc.com/2022/04/14/elon-musk-offers-to-buy-twitter-for-54point20-a-share-saying-it-needs-to-be-transformed-as-private-company.html>> accessed 4 November 2023.

43. Disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (2022).

3. The *inter se transfer* of promoter stakes by Adani Enterprise complied with the exclusions outlined in Regulation 10 of the Takeover Regulations and was completed eighteen days following the open offer. In order to guarantee that leaving shareholders receive the same price within 26 weeks of the public offer announcement, Regulation 8 sets offer prices in certain situations.
4. In spite of these complexities, the regulatory body has not examined the disparity in the timeframe for completion following the open offer. This begs the question of what effect the Takeover Regulations may have on premium pricing.

B. Amazon-Future Group Dispute

1. Background of the Dispute

In 2019, Amazon and Future Group signed a contract. Amazon purchased a 49% share in the latter as part of this acquisition. Amazon gained several rights from this arrangement, such as a non-compete clause and a right of first refusal, which effectively gave Amazon indirect control over Future Retail.

The conflict started when the Future Group signed a deal to sell Reliance Retail Ventures Ltd. a portion of its assets in 2020. Citing its previous agreement with Future Group, which had a provision prohibiting Future Retail from selling its assets to a list of organisations, including Reliance, Amazon opposed this purchase.

2. Arbitration Proceedings

In October 2020, Amazon requested and was granted an emergency arbitrator's order by the Singapore International Arbitration Centre, thereby postponing the Future-Reliance agreement. Amazon has filed a request to enforce the SIAC's emergency arbitrator's decision with Indian courts, including the Supreme Court.

3. SEBI: Impact of the Second Amendment of LODR

Under the revised LODR regulations, Future Group and Amazon would have to uphold stricter corporate governance guidelines and disclosure

requirements regarding their business dealings and legal disputes. This entails informing investors and the market on a regular basis about the ongoing legal actions and any significant changes in the conflict.

C. Hostile takeover of Mindtree Limited by Larsen & Toubro (L&T) in 2019

L&T masterminded a hostile purchase of Mindtree Limited in a calculated manoeuvre evocative of the NDTV-Adani merger. By buying shares on the open market, L&T covertly accumulated a sizeable ownership stake and created the conditions for a corporate conflict.⁴⁴

Like the secret deals in the NDTV-Adani story, there were behind-the-scenes activities during the Mindtree takeover. The founders of Mindtree had signed a shareholder agreement that forbade the sale of external shares without board consent. But in an unexpected turn of events, L&T convinced VG Siddhartha of Coffee Day Enterprises, a significant Mindtree shareholder, to give up his ownership.⁴⁵

Concerns over a credit arrangement, convertible warrants, and the inter se transfer of promoter stakes surfaced in the context of hidden agreements. Similar to the regulatory scrutiny encountered in the NDTV-Adani case, SEBI had earlier raised concerns about a loan arrangement between NDTV and VCPL. Regulating 30A in the NDTV-Adani takeover, the lack of transparency around these agreements generated concerns about information completeness and regulatory conformance.

V. CRITIQUE OF THE LODR (SECOND AMENDMENT REGULATIONS) 2023

The Indian securities market is well known for placing a strong focus on transparency. As a result of SEBI's ongoing efforts to lessen information asymmetry, changes that support stakeholder participation and transparency have been made. Though the Proposed Amendment is in line with

44. Manish Kumar Sharma, 'Exemptions under the Takeover Code' (Singhania & Partners, 1 June 2020) <<https://singhania.in/blog/exemptions-under-the-takeover-code>> accessed 3 January 2023.

45. Shilpa Phadnis, 'Mindtree L&T Info merge, will form 6th largest IT services company' (Times of India, 7 May 2022) <<https://timesofindia.indiatimes.com/business/india-business/mindtree-lt-info-merge-will-form-6th-largest-it-services-company/article-show/91387005.cms>> accessed 7 January 2023.

SEBI's disclosure goals, market players are concerned about it because they think it will be burdensome.

Even though Clause 5A classifies situations like the Amazon-Future Group disagreement or the Adani-NDTV hostile acquisition as “*deemed material*,” it nevertheless requires that the listed firm be notified of them within two working days of any changes that may occur. Furthermore, the quantity and noteworthy characteristics of ongoing agreements must now be included in the annual report of listed firms, with comprehensive details available on the website of the business.

Although the change closes the information gap, SEBI still has to be more explicit about what exactly qualifies as “*salient features*” that must be disclosed. The identification of such agreements by listed companies, caution in identifying essential features for express disclosure, and stakeholder evaluation of the continuation, novation, or termination of agreements to prevent the disclosure of confidential information are among the immediate actions necessary for compliance.

A. Identification of Potential Loopholes

1. *Lack of Clarity on Applicability*

The proposed Clause 5A's expansive wording raises questions about its intended application and guiding principles, as it may encompass unanticipated contract types. There are difficulties with its actual use, possible retroactive application, and striking a balance between commercial interests and transparency. Concerns like these must be addressed by stakeholders, including SEBI, to guarantee transparent and equitable disclosure procedures that follow Regulation 30's tenets. It is also hard to understand how limitations or liabilities can be imposed by a contract that doesn't involve the listed firm.

2. *Practical or Enforcement Challenges*

- i. SEBI's strict enforcement of these regulations will determine how effective they are. The goals of the new regulations could be undermined by inconsistent enforcement.

2. Concerns have also been raised over SEBI's capacity to oversee and enforce compliance among a large number of listed companies.
3. Every disclosed agreement must be approved in the first general meeting, necessitating independent assessments and possibly turning into a laborious process.
4. Accelerated disclosure requirements for current agreements present secretarial issues for larger listed businesses.

3. Rise in the Role of Independent Directors and Proxy Firms

When evaluating the financial effects and possible conflicts that may arise from agreements, independent directors and proxy firms might become more important. As a result, under the proposed Clause 5A, shareholders' dependence on the judgements of independent directors about the financial implications of agreements may grow. It might cause conflict on boards, which would affect how decisions are made.

4. Retrospective Application Concerns

It is being discussed whether the proposed revisions will apply to agreements that already existed in the past, which would go against the expectations of stakeholders and the norms of fair disclosure. Disclosure obligations may apply to existing agreements that were not considered at the time of their creation.

5. Potential for Over-Regulation

Maintaining transparency while avoiding overburdening businesses with restrictions requires careful consideration. Innovation and an entrepreneurial spirit can be impeded by excessive regulation. The rising demand for compliance checks and disclosures may give rise to a "tick-box" culture in which form takes precedence over substance in governance.

6. Shareholder Activism and Engagement

Although the revisions are intended to enhance shareholder engagement, there is a chance that this could lead to heightened activism, which may not always be in the best interests of the company in the long run. It

may still be difficult for small shareholders to be heard, in spite of the improved participation mechanisms.

B. Industry and Expert Critique: Stakeholder Perspectives

LODR’s Second Amendment is not impervious to criticism from the business community and experts. Stakeholders, notably experts and professionals in the industry, voice qualms or misgivings regarding the regulatory changes’ potential effects, practicality, or unforeseen repercussions.

| | |
|---|---|
| Corporate Entities (Listed Companies) | <ul style="list-style-type: none"> • Increased Compliance Burden • Enhanced Corporate Governance |
| Investors (Institutional and Retail) | <ul style="list-style-type: none"> • Improved Transparency • Greater Protection of Minority Shareholders |
| Independent Directors and Board Members: | <ul style="list-style-type: none"> • Greater Responsibility and Scrutiny • Need for Enhanced Skills and Diligence in Board Members |
| Regulatory Authorities (SEBI) | <ul style="list-style-type: none"> • Effective Enforcement • Balancing Act of enhancing corporate governance with the need to maintain a business-friendly regulatory environment |
| Auditors and Legal Advisors: | <ul style="list-style-type: none"> • Increased Demand for Services • Complex Advisory Roles |
| Consumer and Public Interest Groups: | <ul style="list-style-type: none"> • Corporate Responsibility and Ethics • Concerns about Effective Implementation |
| Market Analysts and Economic Think Tanks | <ul style="list-style-type: none"> • Long-term Market Stability • Impact on Market Dynamics |

Overall, stakeholder views on the second amendment to LODR are diverse as a whole, with each group having its own distinct expectations, worries, and interests. The general tone is one of cautious optimism that, despite recognition of the difficulties in implementation and compliance, these improvements will result in improved governance and transparency in the Indian securities market.

VI. CONCLUSION: BALANCING TRANSPARENCY AND BUSINESS INTERESTS

It is quite difficult to strike an equilibrium between economic interests and transparency. Although increasing transparency is the main objective

of regulatory modifications, it is important to assess whether the chosen measures fairly balance the legitimate interests of businesses. Achieving this balance is essential to guaranteeing that the legal system promotes openness without unduly burdening companies or impeding their capacity to function effectively.

In the ever-changing landscape of corporate governance, the seismic shifts introduced by the Amendment Regulations 2023 to the LODR herald a transformative era. As the regulatory pendulum swings, it orchestrates a symphony of change, fundamentally altering the dynamics that govern the disclosure landscape of the listed entities. The labyrinth of amendments, meticulously woven into the LODR fabric, represents more than just a regulatory overhaul. It encapsulates a visionary response to the intricacies faced by the multifaceted stakeholders orbiting the realm of listed companies.

With the backdrop of SEBI's proactive engagement through consultation papers and regulatory amendments, this metamorphosis is not merely a legal exigency; it is a narrative sculpted to address the resonating concerns of a dynamic market. At their core, the amendments are a tapestry of balance- a delicate equilibrium where transparency dances with accountability, fair market practices intertwine with economic growth, and corporate development pirouettes with the interests of myriad stakeholders. The regulatory stage, meticulously set by the SEBI, orchestrates a performance where the interests of shareholders, directors and promoters harmonize, creating a governance symphony that resonates through the echelons of India Inc.

As we stand at the threshold of this regulatory Renaissance, the intent is clear: to propel holistic progress in the listed space. These amendments are not mere legislative strokes; they are the brushstrokes of a larger canvas painted in the hues of progress, fairness, and market integrity. The canvas is the living document, a testament to the symbiotic relationship between regulatory activism and corporate evolution. As the regulatory symphony plays on, the resonance will not be confined to boardrooms and shareholder meetings; it will echo in the very essence of India's corporate identity. The Amendment Regulations 2023 stand not just as legal statutes but as catalysts for a redefined corporate ethos where governance is not a mere obligation but a shared pursuit of excellence.

Bridging The Murky Chasm: A Proffered Legal Blueprint to Resolve the Copyright Quandary and Data Privacy Dilemma of Generative AI Training

—Krati Gupta and Raj Shekhar*

ABSTRACT

The emergence of Generative AI has ushered in a new era of innovation in the ever-evolving technological landscape that pushes the boundaries of what machines can achieve. However, Generative AI has raised unprecedented challenges in the realm of data privacy and copyright. Shedding light on these developments, the authors, through an interdisciplinary analysis spanning technology, law, and policy, elucidate how this technological synergy problematises notions of privacy and intellectual property. First, the temporary reproductions involved in training generative models potentially violate exclusive copyrights, challenging traditional constructions of fair dealing exceptions in the Indian jurisprudence. Second, pervasive data scraping enables tracking and linkage of personal data, infringing on recognised privacy rights.

After delineating the nature of conflicts, the paper proposes tailored solutions for the Indian context. Noting Generative AI's immense value for research and public good, judicious copyright reform is suggested to incorporate a limited right to mine data, balancing the interests of human creators and AI innovation. For personal data protection, a consent-based framework is recommended, classifying publicly available data as sensitive

* The authors are students at National Law University, Jodhpur (NLUJ) and National University of Study and Research in Law, Ranchi (NUSRL) respectively.

and non-sensitive. While stringent active consent would govern sensitive data, flexibility is proposed for non-sensitive personal data processing to advance public welfare. Overall, the paper's suggested legal amendments and policy changes attempt to stimulate AI progress in India while still upholding individual rights and safeguarding ethical data use. The analysis provides useful insights for Indian legislators and regulators grappling with the unprecedented challenges induced by emerging generative technologies and data harvesting practices.

I. INTRODUCTION

Artificial Intelligence (AI) has been at the cynosure of the Fifth Industrial Revolution. One specific type of AI that has garnered widespread attention owing to its multifarious applicative uses is Generative AI (*GenAI*). The European Union Artificial Intelligence Act 2023, Article 3(1)¹ defines GenAI as “a system designed to operate with autonomy and based on machine and/or human-provided data and inputs which produces system-generated outputs such as content”. A more business-oriented definition from the International Association of Privacy Professionals defines GenAI as a field of AI that uses deep learning trained on large datasets to create new content, such as written text, code, images, music, simulations and videos.²

In simpler words, GenAI is a system with the ability to generate new content from existing data. In the ever-evolving technological landscape, corporations are increasingly leveraging GenAI to gain a competitive edge by generating output. For instance, Meta's Code, Llama, is capable of writing codes,³ Baidu released its interactive chatbot, Ernie,⁴ and Adobe is offering GenAI features on its Adobe Sensei platform.⁵ These

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1. The European Union Artificial Intelligence Act 2023, art. 3(1).
 2. IAPP, 'Key Terms for AI Governance' (International Association of Privacy Professionals, 2023) <https://iapp.org/media/pdf/resource_center/key_terms_for_ai_governance.pdf> accessed 8 January 2023.
 3. Meta Staff, 'Introducing Code Llama, an AI Tool for Coding' (Newsroom, 24 August 2023) <<https://about.fb.com/news/2023/08/code-llama-ai-for-coding/>> accessed 8 January 2023.
 4. Emilia David, 'Baidu launches Ernie chatbot after Chinese government approval' (The Verge, 31 August 2023) <<https://www.theverge.com/2023/8/31/23853878/baidu-launch-ernie-ai-chatbot-china>> accessed 8 January 2023.
 5. Erin Di Leva, 'Adobe Unveils Future of Creative Cloud With Generative AI as a Creative Co-Pilot in Photoshop' (Business Wire, 23 May 2023) <<https://www.businesswire.com/news/home/20230523005521/en/Adobe-Unveils-Future-of-Creative->

AI models consume large volumes of data to train their large language models (*LLMs*) by exploiting the public accessibility of the web to obtain training data.⁶ Software programs designed to automate the downloading and parsing of data from the internet⁷ are called “web scrapers”.⁸ They interact with communication protocols to extract data from web pages⁹ in a process known as “web scraping”.

Web scrapers extract specific parts from website source codes, following the given instructions.¹⁰ Modern webpages, constructed with Hyper Text Markup Language (*HTML*),¹¹ render content from the underlying HTML code. Accessed via unique Uniform Resource Locators (*URLs*),¹² webpages are identified and displayed by browsers processing HTML code. Scrapers employ a similar method to copy HTML, facilitating diverse applications. For instance, Google’s search engine processes terabytes of HTML codes concurrently scraped by web scrapers.¹³ This copious HTML data, when coupled with statistical techniques, yields empirical insights for various purposes. Web scrapers enable systematic

Cloud-With-Generative-AI-as-a-Creative-Co-Pilot-in-Photoshop> accessed 8 January 2023.

6. Lauren Leffer, ‘Your Personal Information Is Probably Being Used to Train Generative AI Models’ (Scientific American, 19 October 2023) <<https://www.scientificamerican.com/article/your-personal-information-is-probably-being-used-to-train-generative-ai-models/>> accessed 8 January 2024.
7. Jay M Patel, *Getting Structured Data from the Internet: Running Web Crawlers/Scrapers on a Big Data Production Scale*, (ISBN: 9781484265765, California Aspress 2020), ch 17.
8. Andrew Sellars, ‘Twenty Years of Web Scraping and the Computer Fraud and Abuse Act’ (2018) 24 *BU J Sci & Tech L* 372, 382.
9. MDN Contributors, ‘What is the Difference Between Webpage, Website, Web Server, and Search Engine?’ (MDN Web Docs, 8 October 2021) <https://developer.mozilla.org/en-US/docs/Learn/Common_questions/Pages_sites_servers_and_search_engines> accessed 8 January 2024.
10. Khder Moaiad Ahmad, *Web Scraping or Web Crawling: State of Art, Techniques, Approaches and Application*, (2021) 13 (3) *IJASC* 145, pg.148.
11. Dennis Fetterly, Mark Manasse, Marc Najork, and Janet Wiener, ‘A Large-Scale Study of the Evolution of Web Pages’ (Proceedings of the 12th international Conference on World Wide Web, Budapest, 20 May 2003).
12. MDN Contributors, ‘What is a URL?’ (MDN Web Docs, 2 August 2023) <https://developer.mozilla.org/en-US/docs/Learn/Common_questions/Pages_sites_servers_and_search_engines> accessed 8 January 2024.
13. Google Staff Developers, ‘Advanced: How Search Works’ (Google Search Central, 1 December 2023) <<https://developers.google.com/search/docs/advanced/guidelines/how-search-works>> accessed 8 January 2024.

internet traversal,¹⁴ providing invaluable data for GenAI models, and enhancing their adaptability and content generation capabilities.

The GenAI training process often involves web scraping followed by the process of Text and Data Mining (TDM). GenAI models are created with complex, data-driven AI technology that is specifically designed to analyse large quantities of data input scraped through the internet and extract meaningful underlying patterns, styles, grammar, context, linguistic characteristics and other generalised relational principles that form part of their ‘learnt knowledge’.¹⁵ In the next step of machine learning, the learnt knowledge is further used to generate unique content through an iterative process aimed at self-improving the model’s performance output.¹⁶ Interestingly, NASSCOM’s 2023 report points to the burgeoning GenAI start-up landscape in India that currently looks promising with over 60 native companies – Blend AI, Pixis, and Contlo, to name a few.¹⁷ Given its huge business potential, several Indian companies such as Infosys, Zomato, Myntra and Tata Elxsi have integrated GenAI tech in their core or supplementary operations.¹⁸ Caught between the winds of digital regulatory overhaul, it is one of the few Indian sectors poised to witness a massive 15.4-fold growth from \$1.1 billion in 2023 to \$17 billion by 2030.¹⁹

However, the synergy between web scraping, TDM and GenAI opens Pandora’s box of complexities affecting India’s digital landscape. The large-scale application of data scraping and TDM collates and processes publicly accessible data that majorly includes copyrighted works and personal data. Unauthorised processing of copyrighted works and personal data for GenAI training raises legal concerns. With a slew of copyright infringement and data privacy class action suits filed against

14. Daniel Seng, *The State of the Discordant Union: An Empirical Analysis of DMCA Takedown Notices*, (2014) 18 Va JL & Tech 369.

15. Sanaa Alwidian, Hani Bani-Salameh and Alaa Alslaity, ‘Text data mining: a proposed framework and future perspectives,’ (2015) 18(2) *International Journal of Business Information Systems* 127, pg. 129.

16. *Ibid.*

17. ‘Generative AI Startup Landscape In India – A 2023 Perspective’ NASSCOM (June 2023) <<https://nasscom.in/knowledge-center/publications/generative-ai-startup-landscape-india-2023-perspective>> accessed 8 January 2023.

18. ‘India’s Generative AI Startup Landscape Report, 2023’ Inc42, <<https://inc42.com/reports/indias-generative-ai-startup-landscape-report-2023/#sponsor-report-pop-421622>> accessed 8 January 8 2023.

19. *Ibid.*

OpenAI, Microsoft, Google, Stability AI, and Midjourney, with the latest copyright infringement claim filed by the New York Times before the Southern District Court of New York on December 27, 2023, the future of GenAI lies in troubled waters.²⁰ This paper delves into the nuances of how the amalgamation of GenAI technologies challenges the boundaries of copyright and poses a profound threat to the delicate fabric of privacy. It shall then go on to recommend a suggestive framework that balances AI innovation with individual rights, for the benefit of the public and digital economy at large.

II. COPYRIGHT INFRINGEMENT CLAIMS AGAINST GENERATIVE AI TRAINING: PARSING THE FAIR DEALING EXCEPTION AND RE-CONCEPTUALISING THE FOUNDATIONS OF THE INDIAN COPYRIGHT ACT, 1957

During the training phase, GenAI models may create temporary copies of the original input dataset (often locally stored).²¹ Once training concludes, the locally saved transient copies of the original data are usually discarded and the trained model then works independently to produce new content based on the extracted learning.²² It is not debatable that the vast amount of training data may involve copyrighted works. For instance, OpenAI has admitted the inclusion of vast, publicly accessible data including copyrighted works in its AI training model, in a process that involves making copies of input datasets.²³ Therefore, the technical nature of the TDM process invites the inevitable question: whether the creation of temporary copies in the process of AI training violates

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20. 'OpenAI alleged of copyright infringement', (Financial Times January 5, 2023) <<https://www.financialexpress.com/business/digital-transformation-openai-alleged-of-copyright-infringement-3358323/>> accessed January 8, 2024; 'Sarah Silverman sues OpenAI and Meta claiming AI training infringed copyright' (The Guardian July 10, 2023) <<https://www.theguardian.com/technology/2023/jul/10/sarah-silverman-sues-openai-meta-copyright-infringement>> accessed January 8, 2024; 'Google faces lawsuit alleging data scraping and copyright violations for AI development' (Business Today July 12, 2023), <<https://www.businesstoday.in/technology/news/story/google-faces-lawsuit-alleging-data-scraping-and-copyright-violations-for-ai-development-389340-2023-07-12>> accessed 8 January 2024.
21. 'Thomas Margoni, 'Artificial Intelligence, Machine learning and EU copyright law: Who owns AI?' CREATE Working Paper 2018/12 (December 2018).
22. Xuyang Zhu, 'Using and Training Generative AI tools' Taylor Wessing <<https://www.taylorwessing.com/en/interface/2023/ai---are-we-getting-the-balance-between-regulation-and-innovation-right/using-and-training-generative-ai-tools---ip-ownership-and-infringement-issues>> accessed 8 January 2023
23. Julian Sancton v. OpenAI, Class Action Complaint (November 2023).

the exclusive right of reproduction vested with the authors/right-holders of the copyrighted works. Amidst the storm of tumultuous class action suits filed against GenAI companies around the world, very soon, similar suits may hit the doors of Indian courts, given that a portion of publicly accessible training data may include works protected under the Indian Copyright Act, 1957.

Under the Indian Copyright Act, 1957, Sections 14(a)(i) and 14(c)(i), the word, “copyright” is a collective term for a bundle of rights, including the right of reproduction of any literary, dramatic, musical or artistic work, exclusively enjoyed by the author or copyright-holder, irrespective of the registration status of such work.²⁴ The right of reproduction, a necessary aspect of ownership vested with the concerned author, means the right to make copies of the work in any material form, including storing it in electronic means.²⁵ A “copy” has been defined as a replica of the original material which comes so close to the original in resemblance to suggest the original to the mind of the viewer.²⁶ At first blush, the GenAI training mechanism that requires making transient “copies” of the training data (including publicly accessible copyrighted works) seems to unauthorisedly violate copyrights, which is the contention raised in the pending litigations. Authors Sarah Silverman, Christopher Golden and Richard Kadrey have alleged that OpenAI’s training module created copies of their authored works without permission, thus violating their copyright. In a similar copyright infringement suit, the New York Times alleges that OpenAI and Microsoft used millions of its copyrighted articles, to train ChatGPT and GPT-4, thereby commercially exploiting them without permission or compensation.²⁷ In its defence, GenAI companies claim their use for AI training to be sufficiently transformative and hence exempted under the ‘fair use’ exception of the US Copyright Code, Section 107.²⁸

24. Copyright Act, 1957, ss. 14(a)(i) and 14(c)(i).

25. Copyright Act, 1957, ss. 14(i) (a) and (e); *Rediff.Com India Ltd. v E-Eighteen.Com Ltd.*, MIPR 2013 (2) 333; [2013] (55) PTC 294 (Del).

26. *Mohendra Chundra Nath Ghosh v Emperor*, AIR 1928 Cal 359, para. 3.

27. *New York Times Company v Microsoft and OpenAI*, Complaint (27 December 2023)

28. ‘Openai’sResponsetoSarahSilverman’sLawsuitShowsMusicRightsholdersCouldBeInForA ToughFightOverCopyrightAndAI’(MusicBusinessWorldwide, 11 September 2023) <<https://www.musicbusinessworldwide.com/openais-response-to-sarah-silvermans-lawsuit-shows-music-rightsholders-could-be-in-for-a-tough-fight-over-copyright-and-ai/>> accessed January 8, 2023.

The Indian copyright law embodies the common law doctrine of ‘fair dealing’ instead of the broader ‘fair use’ doctrine applicable in the US and other countries. Interestingly, the Indian copyright law does not define ‘fair dealing’ but allows exceptions for fair dealing of any work for private or personal use including research, criticism, review and journalism. Accordingly, the Indian courts have found respite in the US fair use doctrine to lay down a three-step test to determine the fairness of any work for the purposes laid down in Section 52 – purpose and character of the work, amount and substantiality of the portion used, the likelihood of competition in the potential market.²⁹

Having said that, the Indian courts can be considered to have drawn critical principles from the UK and the US jurisprudence to give a unique interpretation to the fair dealing doctrine, which is restrictive and liberal, at the same time. Against this background, the authors examine whether the Indian fair dealing exception can be successfully invoked to defend copyright infringement claims against the GenAI training process. The authors believe that countless pending suits against GenAI might be an opportunity for the progressive application of copyright laws globally. While this section explores the debate in the Indian context drawing upon comparative experiences, the research findings and suggestions may be applicable for jurisdictions abroad.

A. Anatomising the Fair Dealing Doctrine to Defend Copyright Infringement Claims Against GenAI Training

To be exempted from copyright infringement under Section 52(a)(i),³⁰ the alleged work must be (a) for private or personal use including research and (b) meet the four-factor test of fair dealing.³¹ The training process of GenAI involving TDM can be analysed on the touchstone of fair dealing doctrine as follows:

29. *Civic Chandran & Ors. v Ammini Amma*, [1996] PTC 16 670, para 9.

30. Copyright Act, 1957, s 52.

31. *Syndicate of the Press of the University of Cambridge v B.D. Bhandari & Ors* DHC RFA (OS) No.21 of 2009.

1. “Private or personal use including research”

According to ordinary dictionary meaning, referred to in the *Blackwood* case, ‘research’ is a detailed investigation aimed at the discovery of a fact, or information by meticulous study or inquiry of a subject.³² The fair dealing exception based on the corresponding UK law conventionally applies to all research undertaken individually with no direct or indirect commercial use.³³ Pertinently, the bare text does not define the actor undertaking private or personal research. This necessarily implies that even a GenAI software that performs computation analysis on large datasets and creates temporary copies to systematically extract meaningful information, acts nothing more than a researcher. In so far as the results of the research are utilised for non-commercial ends i.e., when the GenAI software does not utilize the ‘research’ to produce output for a fee or consideration, this interpretation holds water.

The crucial question now arises - can a GenAI that commercialises the output of this ‘research’ be deemed to be acting for private or personal use? Applying the rule of statutory construction, since the text is itself silent on the commercial/non-commercial nature of the research output required to qualify as fair dealing, any additional word must not be implied. Contrastingly, when read in light of the author’s exclusive right to make the copies public under Sections 14(a)(ii) and 14(c)(iii),³⁴ it is reasonable to read the words, ‘private or personal use’ as antonyms of ‘public use’ rather than as synonyms of ‘non-commercial use’. Further, the Act specifically mentions “non-commercial personal use” when it so implies, for instance, Section 52(1)(ad) provides an exception from copyright infringement to “copies or adaptation of the computer program from a personally legally obtained copy for non-commercial personal use”.³⁵ Moreover, in *Super Cassettes Industries Ltd. v. Hamar Television Network Pvt*, the Delhi High Court affirmed that mere commercial use of the copyrighted work would not ipso facto deem it unfair.³⁶ In tune with this reasoning, the GenAI systems that do not make the transient

32. *Blackwood and Sons Ltd and Others v AN Parasuraman and Ors*, AIR 1959 Mad 410, para 84.

33. Matthew Sag, ‘Predicting Fair Use’ (2012) 73 Ohio St. L. J. 47, 61.

34. Copyright Act 1957, ss. 14(a)(ii) and 14(c)(iii).

35. Copyright Act 1957, s 52.

36. *Super Cassettes Industries Ltd. v Hamar Television Network Pvt. Ltd.* [2011] (45) PTC 70 (Del).

copies available to the public, despite engaging in individual commercial or non-commercial research,³⁷ could meet the threshold of Section 52(a) (i).

2. *The three-step test of “fair dealing”*³⁸

The first factor, purpose and character of the use, weighs the subsequent disputed work with that of the original to determine whether the former serves a substantially different purpose than the latter.³⁹ The subsequent work must have a different character, with more than superficial changes to be held transformative.⁴⁰ A secondary work that uses the copyrighted expression of original work as a ‘raw material’ and transforms it into the creation of novel insights, aesthetics or information is recognised as fair use.⁴¹ To satisfy the first factor, the disputed work must not merely be transformative but also meet the subjective degree of transformation. Often, this is a factual inquiry for the courts. Illustratively, in *Authors Guild v. Google*, the creation of a searchable database, despite being motivated by commercial gain, was held to be sufficiently transformative since it added new value to the original work.⁴² Whereas, in *Warner Bros. Entertainment, Inc. v. RDR Books*, the court concluded that producing a Harry Potter encyclopedia was only slightly transformative, owing to extensive direct reproduction from the original work, to profit from the inherent entertainment value of the original work.⁴³

In yet another recent case, *Andy Warhol Foundation v. Goldsmith*,⁴⁴ the court held that the coloured version of the original portrait, was not sufficiently transformative, owing to their same purpose- to illustrate a magazine write-up about the prince. While the application of this ruling on GenAI creations, particularly image generators, is subject to jury trial in *Thomson Reuters v. Ross Intelligence*, it is noteworthy that the earlier rulings in similar cases, such as *Authors Guild* and *RDR Books*, did not

37. Jessica D. Litman, ‘Lawful Personal Use’ *Tex. L. Rev.* 85, no. 7 (2007) 1871-920, pg. 1894.

38. *Folsom v Marsh*, 9 F. Cas. 342, 348 (C.C.D. Mass. 1841); *Civic Chandran & Ors. v Ammini Amma*, 1996 PTC 16 670, para 9.

39. *Campbell v Acuff-Rose*, [1994] 510 U.S. 569 (*Campbell v Acuff-Rose*).

40. *R.G. Anand v M/s. Deluxe Films*, 1978 (4) SCC 118,

41. *Campbell v Acuff-Rose* (n 39) para 579.

42. *Authors Guild v Google* 721 F.3d 132

43. *Warner Bros. Entertainment Inc. v RDR Books*, [2008] 575 F. Supp. 2d 513.

44. *Andy Warhol Foundation for the Visual Arts, Inc. v Goldsmith*, 598 U.S. 2023.

proscribe making digital copies of the entire original work and rather, recognised fair use when such digital copies were used as an input to create a distinguishable transformative output with a different purpose. Moreover, the idea-expression dichotomy⁴⁵ captured under the Indian Copyright Act suggests that the idea itself is non-copyrightable, only its original expression is.⁴⁶ In the same vein, it can be argued that the creation of digital copies during the TDM process as an archival input for further systematic extraction of non-copyrightable ideas, utilised for the creation of distinguishable output is indeed highly transformative.⁴⁷ However, agreeably so,⁴⁸ fair use may not apply when the generated output is substantially similar to the original work but the AI creator did not take sufficiently foreseeable steps to prevent such similarity.

The second factor, amount and substantiality of the portion used in relation to the copyrighted work, requires both qualitative and quantitative analysis of the disputed work to enquire into the extent of fundamental, material or substantial similarities of the mode of expression (and not the idea itself).⁴⁹ Often, the court indulges in a context-based investigation to decipher whether the reproduced copies form the “heart and soul” of the copyrighted work based on the substantial similarity yardstick.⁵⁰ Contextually speaking, the application of this reasoning is limited to the output of GenAI creations. Based on the limited U.S. case laws related to advanced computational technologies such as plagiarism detection software⁵¹ and the creation of searchable databases⁵² and thumbnail images,⁵³ wholesale copying of copyrighted works has been permitted so long as the same was technically necessary to achieve the

45. Ricketson & Ginsburg, *International Copyright and Neighbouring Rights* (Columbia Law School, 2010) para. 407.

46. *Chancellor Masters and Scholars of the University of Oxford v Narendra Publishing House and Ors.*, 2008 (38) PTC 385 (Del), para 16.

47. MW Carroll, ‘Copyright and the Progress of Science: Why Text and Data Mining Is Lawful’ (2019) 53 UC Davis Law Review 893, pg. 894.

48. Mark A Lemley and Bryan Casey ‘Fair learning’ (2020) *Tex. L. Rev.* 99, pg. 743; Benjamin LW Sobel, ‘Artificial intelligence’s fair use crisis’ (2017) *Colum. JL & Arts*, 41, 45.

49. *Academy of General Edu, Manipal and Anr v B Malini Mallya* AIR 2009 SC 1982, para 19; *Eastern Book Company and Ors v DB Modak and Anr*, AIR 2008 SC 809, para 38.

50. *Harper & Row Publishers v Nation Enterprises* 471 US 539.

51. *iParadigms*, 562 F.3d at 640; *Perfect 10, Inc. v Amazon.com*

52. *Authors Guild v Google, Inc.* [2015] 804 F.3d 202; *Authors Guild v HathiTrust*, [2017] 755 F.3d 87.

53. *Kelly v Arriba Soft Corp.*, [2003] 336 F.3d 811.

transformative purpose of the disputed work.⁵⁴ Since Indian courts have drawn rather heavily from the U.S. fair use jurisprudence, potentially, arguments based on these cases prove to make a strong case for fair use in making transient copies for training GenAI, so long as the trained AI model is programmed in a way that the output does not *substantially* reproduce the original work.

The third factor, the effect of the disputed use on the potential market of the copyrighted work, analyses whether the disputed use forms a market substitute for the original work with an “intention and motive” to compete with it to eat away the commercial opportunities of the original work.⁵⁵ Ascertainment of transformative use makes a positive case for fair use that does not constitute a market substitute.⁵⁶ In *Fox News Network v. TVEyes*, the defendant recorded large volumes of the broadcast to create a searchable database, accessible for a maximum of 10 minutes and downloadable entirely for a \$500/monthly subscription fee. However, the same was not held to be transformative, but rather for the same purpose of *learning the information reported*.⁵⁷ This potentially affected the viewer market for the Plaintiff’s broadcast. Notably, the recording of the entire broadcast was not held to be a copyright infringement in itself. In the case of GenAI training, the creation of temporary copies in itself is an intermediate step in the transformative use of copyrighted data. The final output serves the purpose of facilitating informational retrieval, research, analysis and content creation, customisable to the needs of the user. In that sense, the output is directed towards a different market from that of the original input, with no intention to compete with it.

The value of GenAI training datasets is obtained from the diversity of input sources that form the fabric of its learnt information. In most circumstances, the proportion of reliance on a single input source is minimal and therefore, a case of de minimis defence might defeat the claim of copyright infringement even without conducting a fair dealing or fair

54. Amanda Levendowski, ‘How Copyright Law Can Fix Artificial Intelligence’s Implicit Bias Problem’ Wash. L. Rev. 98(2) 2018, <<https://digitalcommons.law.uw.edu/cgi/viewcontent.cgi?article=5042&context=wlr>> accessed January 8, 2023.

55. *Espn Star Sports v Global Broadcast News Ltd. & Ors.*, DHC RFA (OS) No.25/2008, para 30.

56. *Authors Guild, Inc. v HathiTrust*, [2014] 755 F.3d 87, 96.

57. *Fox News Network, LLC v TVEyes Inc.*, [2018] No. 15-3885.

use analysis.⁵⁸ OpenAI asserts that its AI model rarely regenerates content from any particular input in the training corpus.⁵⁹ Rather, the output is entirely new content, unique in expression. To the extent that the AI creator has taken reasonably foreseeable measures to prevent verbatim reproduction of any copyrighted training input and has no intention to commercially exploit the market of the original work, no mischief of copyright infringement exists in making temporary copies of the work for model training purposes.

There could be an alternative finding reached when the GenAI produces an output which is substantially similar to the copyrighted content, though the investigation into the substantiality of the similarity is a subjective consideration for courts.⁶⁰ For instance, the NYT's copyright infringement complaint against OpenAI reproduces snapshots of prompted GPT-4 and Microsoft Bing output that quotes verbatim paragraphs from its news article.⁶¹ NYT alleges that such synthesised output, which is commercially exploited, substantially diminishes the need to access its articles, to the extent that these news stories represent individual expression and not simply "facts". NYT's claim may hold ground. However, the authors submit that no such copyright violation exists in the mere use of copyrighted material for GenAI training purposes.

B. A Step towards Data Democratisation: Incorporating a Limited Right to Mine Data in the Indian Copyright Act

The jurisprudential understanding of copyright protection is embedded in the Lockean theory of property, which suggests that humans gain private property rights in the products of their labour which ought to be protected.⁶² By extension, the law must protect intellectual property rights

58. *Sandoval v New Line Cinema Corp.*, [1998] 147 F.3d 215; Sheng-Yu Wang, Alexei A. Efros, Jun-Yan Zhu, Richard Zhang, 'Evaluating Data Attribution for Text-to-Image Models' Cornell University (2023), <<https://arxiv.org/abs/2306.09345>> accessed 8 January 2024.

59. Comment Regarding Request for Comments on Intellectual Property Protection for Artificial Intelligence Innovation (Docket no. PTO-C-2019-0038), pg 9.

60. *India Tv Independent News Service v Yashraj Films Pvt. Ltd.*, 2012 SCC OnLine Del 4298, paras. 25-28

61. *New York Times Company v. Microsoft and OpenAI*, Complaint (27 December 2023) p. 30-32.

62. Moore, Adam D., 'A Lockean Theory of Intellectual Property' (1997) *Hamline Law Review* 21, pp. 65, 65.

which are fruits of an individual's mental labour.⁶³ However, such legitimate right of the creator is often trumped by varying standards of public interest in different jurisdictions. With the increasing use of AI for the advancement of research, cultural development, and social benefits such as the development of medicinal drugs, access to information, economic productivity through automation, and novel literary, and creative ideas, there is a need to overhaul the copyright laws to facilitate AI innovation.

The purpose of fair dealing or fair use exception is to balance the interest of copyright holders with legitimate social interest in the use of copyrighted data.⁶⁴ International treaties such as the Berne Convention for the Protection of Literary and Artistic Works (1886)⁶⁵ and the WIPO "Internet Treaties" (1996),⁶⁶ to which India is a signatory, require member countries to impose stringent regulations for the protection of copyright, subject to discretionary exceptions based on domestic legislative policy.⁶⁷ Illustratively, in 2019, Japan which considers AI as a potential solution to resolve economic and social problems,⁶⁸ introduced an exception for both commercial and non-commercial TDM processes, recognising it as "necessary" for machine learning.⁶⁹ Soon after, E.U. followed with a much-constricted exception, allowing TDM carried out by scientific research organisations and cultural heritage institutions whereas TDM for any other purpose is permissible so long as the use is pursuant to lawful access and the rightsholder has not prohibited or reserved the use of its copyrighted work.⁷⁰

63. Ankita Singhania, 'Copyright Laws in India and Maintenance of a Welfare State' (2006) 11 NLSIR Journal of Intellectual Property Studies 43, 45.

64. 'Copyright and Fair Use', Harvard University, Office of General Counsel, <<https://ogc.harvard.edu/pages/copyright-and-fair-use>> accessed 8 January 8 2023.

65. The Berne Convention for the Protection of Literary and Artistic Works, 828 U.N.T.S. 221 (1972).

66. WIPO Copyright Treaty (1996); WIPO Performances and Phonogram Treaty (1996).

67. Sean M. Fiil-Flynn, Brandon Butler, Michael Carroll, Or Cohen-Sasson, Carys Craig, Lucie Guibault, Peter Jaszi, Bernd Justin Jütte, Ariel Katz, And Jorge L. Contreras, 'Legal reform to enhance global text and data mining research' (1 December 2022) <<https://www.science.org/doi/pdf/10.1126/science.add6124>> accessed 8 January 8 2024.

68. 'Japan Amends Its Copyright Legislation To Meet Future Demands In Ai And Big Data' (European Alliance for Research Excellence, September 3, 2018) <<https://eare.eu/japan-amends-tdm-exception-copyright/>> accessed 8 January 2024.

69. Copyright law of Japan, art. 47(7).

70. Directive (EU) 2019/790 of 17 April 2019 on copyright and related rights in the Digital Single Market, [2019], arts. 3 and 4 (EU Copyright Directive).

This effectively means that the user would need to first pay to seek lawful access to the copyrighted work and then incur expenses for licensing fees. Since 2014, the U.K. has provided a copyright violation exemption for non-commercial computational analysis of copyrighted work, provided the access to the work is lawful,⁷¹ though it recently shelved a Japan-like proposal to extend this exemption for all purposes owing to concerns raised by rightsholders.⁷² While a Japanese-style absolute right to mine data disincentivises human authors,⁷³ the requirement of permission or licensing from the rightsholder may lead to exploitation by monopoly input suppliers who may demand an out-of-range licensing fee,⁷⁴ leading to delay and heavy costs particularly affecting the growth of smaller and newer firms. Resultantly, potential start-ups would be discouraged from entering the GenAI space, dominated by existing companies with deeper pockets and access to resources. All in all, this puts India's AI sector in an unfavorable competitive position against the world market.

Our earlier analysis in Part III.1. reveals that Section 52 of the Indian Copyright Act might be capable of defending copyright infringement suits against GenAI training. However, the absence of a clear exception for AI training creates ground for subjective judicial interpretation. More often than not, cautious judges could favour a restrictive interpretation of fair dealing exceptions that hinder model training. This could serve as a roadblock for potential uses of GenAI particularly in the development of start-ups in the GenAI space, resulting in an imbalance of power in favour of entities that already hold vast concentration of unlicensed data. Notably, the 161st Parliamentary Committee Report supported the creation of a separate category of rights for AI and AI-related works.⁷⁵ Hence, in light of India's unique position as a developing nation that values human creation and requires AI innovation for economic growth,

71. Copyright, Designs and Patents Act 1988, s 29A.

72. 'UK withdraws plans for broader Text and Data Mining (TDM) copyright and database right exception' (HSF Notes March 1, 2023) <<https://hsfnotes.com/ip/2023/03/01/uk-withdraws-plans-for-broader-text-and-data-mining-tdm-copyright-and-database-right-exception/>> accessed 8 January 2024.

73. 'Artificial Intelligence and Copyright' Comment of The United States Federal Trade Commission (Docket No. 2023-6), 30 October 2023 <https://www.ftc.gov/system/files/ftc_gov/pdf/p241200_ftc_comment_to_copyright_office.pdf> accessed January 8, 2024

74. Andy Warhol Foundation for the Visual Arts, Inc. v Goldsmith, 598 U.S. 202, p. 16.

75. The Standing Committee on Commerce, 'Review of the Intellectual Property Rights Regime in India' (2021).

the authors suggest the following framework for a limited right to mine data that finely balances the need for GenAI development with legitimate interests of rightsholders in their copyrighted work.

1. *Creating temporary copies during GenAI training must be a permitted technical/non-expressive use*

Copyright infringement involves the unauthorised use of the work for its expressive nature⁷⁶ rather than a mere use of its material or technical form for non-communicative or de-intellectualised⁷⁷ purposes. Expressive use means exploitation of copyrighted work which is not for personal enjoyment or causing others to enjoy the idea or expressions present in the work.⁷⁸ In *Sega v. Accolade*, the Ninth Circuit Court differentiated between a transformer and a slavish copyist, holding that reverse engineering of a video game, which was the only way to get access to ideas in a computer program, was a form of intermediate copying protected under the fair use exception.⁷⁹ Accordingly, Accolade was using Sega's video simply for a non-communicative purpose to extract unprotected, non-expressive data.⁸⁰ Similarly, in *Kelly v. Arriba*⁸¹ and *Perfect v. Amazon*,⁸² the court found that image search engine services, that reproduced images in thumbnail format, used copyrighted images for an instrumental purpose, rather than for its protected expressive purpose – artistic or aesthetic.⁸³ Therefore, a distinction exists between using 'works as works' (expressive use) and 'works as data' (non-expressive use).⁸⁴ However, Indian courts have not yet delved into the 'nature' of use for analysing its fairness quotient. Therefore, the authors suggest that creating intermediate temporary

76. *Baker v Selden*, [1879] 101 U.S. 99.

77. Borghi M, Karapapa S, 'Non-display uses of copyright works: Google Books and beyond' (2011) 21 *Queen Mary J Intellect Prop* 1, p. 45.

78. Sean M. Fiil-Flynn, Brandon Butler, Michael Carroll, and Ariel Katz, 'Legal reform to enhance global text and data mining research' (1 December 2022) <<https://www.science.org/doi/pdf/10.1126/science.add6124>> accessed 8 January 8 2024; Copyright Law of Japan, 2018 Amendment, arts. 30-4.

79. *Sega Enters. v Accolade, Inc.*, [1992] 977 F.2d 1510.

80. James Grimmelmann 'Copyright for Literate Robots' (2009) 101 *Iowa Law Review*, 657, 662.

81. *Kelly v Arriba Soft Corporation*, [2002] 280 F.3d 934.

82. *Perfect 10, Inc. v Amazon.com, Inc.*, [2007] 508 F. 3d 1146.

83. Jenny Quang 'Does Training AI Violate Copyright Law?' (2021) 36 *Berkeley Technology Law Journal* 1407.

84. Martin Senftleben 'Generative AI and Author Remuneration' (2023) 54 *International Review of Intellectual Property and Competition Law*, 1535.

(digital) copies for GenAI training is a mere instrumental, non-expressive purpose that must be permitted use under Section 52(1)(a).

2. *Safe harbour provision*

The EU Copyright Directive provides a safe harbour provision for non-commercial TDM conducted by scientific research institutions and cultural heritage organisations, whereas an opt-out option has been provided to the copyright holder for all other commercial uses of TDM.⁸⁵ A critical analysis reveals that such a blanket opt-out option to the rightsholders puts them in a monopoly position enabling them to charge exorbitant fees for the use of their works as GenAI training inputs. This is feared to result in algorithmic discrimination since fledgling firms lacking in financial cushion would be inclined to train their AI systems on older, cheaper data whose copyright has expired.⁸⁶ Therefore, the authors suggest creating a safe harbour provision for all kinds of commercial and non-commercial TDM processes undertaken through lawful acquisition of datasets, so long as the same does not generate substantially similar output which competes with the original work. Provided that, any commercial use of the TDM process must compensate the rightsholders through a revenue-sharing mechanism as explained hereunder.

3. *Safeguarding the rightsholders: transparency in AI training modules and revenue-sharing mechanism for commercial use of TDM process*

The primary concern against the use of GenAI is its ability to eventually replace the need for flesh and blood authors, whose very works form the basis of its creative abilities. While the use of non-commercial TDM could be justified under public interest purposes, it is difficult to consider commercial TDM on the same scale owing to its economic benefits that outweigh public interest consideration. Therefore, to incentivise human authors whose creations are necessary input data for GenAI to continuously improve itself and keep pace with the evolving needs of society, the authors propose an equitable remuneration model coordinated by

85. EU Copyright Directive, arts. 3 and 4.

86. Thomas Margoni Martin Kretschmer Mon, A Deeper Look Into the EU Text And Data Mining Text, CREATE Working Paper 2021/7.

copyright collection societies, registered under Section 33 of the Indian Copyright Act.⁸⁷ This model envisages the use of data attribution techniques⁸⁸ to quantify the amount of copyrighted data used in an individual AI creation, and distributing it amongst human authors equitably once a year.

Recently, companies such as Adobe and Stability AI have been remunerating human authors who provide their work for AI training.⁸⁹ Canva has established a \$200 million corpus for remunerating artists who contribute their works to the training data.⁹⁰ However, it is crucial to consider that such revenue-sharing models restrict access to quality content for AI models belonging to big AI developers. Therefore, the proposed remuneration model is in the interest of data equity and algorithmic equality. Further, it prevents exploitation by dominant AI developers with higher bargaining power who may swindle human authors to give away their copyrighted works at minimal compensation rates. Additionally, to be able to enforce their right to seek compensation, it is crucial to compel transparency in training data requiring AI developer companies to disclose the source of copyrighted training data, similar to Article 28b of the EU's AI Act.⁹¹

III. DEMYSTIFYING THE EXCEPTION OF 'PERSONAL DATA MADE PUBLICLY AVAILABLE' UNDER THE DPDP ACT

Web scrapers used for GenAI training rely on data accessible in the public domain, i.e., posted on the publicly accessible parts of the internet such as social media, discussion forums, web pages etc. The data available on various websites can be broadly classified into two categories: "personal data" and "non-personal data".⁹² However, for this Part, we shall be strictly dealing with personal data made publicly available on online platforms as data protection legislations, such as EU GDPR, DPDP Act,

87. Copyright Act, 1957, s 33.

88. Sheng-Yu Wang, Alexei A. Efros, Jun-Yan Zhu, Richard Zhang, 'Evaluating Data Attribution for Text-to-Image Models' (Cornell University, 2023).

89. Michelle Cheng 'How should creators be compensated for their work training AI models?' (QZ October 20, 2023) <<https://qz.com/how-should-creators-be-compensated-for-their-work-train-1850932454>> accessed January 8, 2024.

90. Ibid.

91. European Union, Artificial Intelligence Act 2023, art. 28b

92. Daniyar Supriadi, 'Personal and Non-Personal Data in the Context of Big Data', (LLM Thesis, University of Tilburg 2017).

etc., are strictly applicable to personal data of individuals and do not regulate non-personal data.⁹³ Given the inherent privacy risks associated with personal data, it is imperative to prioritise its protection, thereby safeguarding individuals' rights and mitigating the potential for discriminatory practices.⁹⁴

The United Nations, in its Personal Data Protection and Privacy Principles⁹⁵; the European Union through its General Data Protection Regulations (*GDPR*)⁹⁶; and several other global legal instruments, have defined “personal data” to mean information relating to an identified or identifiable natural person. These definitions do not define “data”. However, the Digital Personal Data Protection Act⁹⁷ (*DPDP Act*), under Section 2(h),⁹⁸ defines ‘data’ as: “a representation of information, facts, concepts, opinions or instructions in a manner suitable for communication, interpretation or processing by human beings or by automated means”. Further, even “personal data” has been defined under Section 2(t)⁹⁹ of the DPDP Act as: “any data about an individual who is identifiable by or in relation to such data”. This could include data such as demographics, financial credentials, sexual orientation, etc.

Web scrapers empower dominant and sophisticated entities in the digital market to conduct extensive, non-consensual surveillance across diverse internet domains that enables pervasive tracking, storage, and linkage of user data, unveiling political, religious, and personal information, infringing data privacy rights.¹⁰⁰ As personal data is amassed

93. Julia Clark, ‘Data Privacy Practitioner’s Guide’, (The World Bank ID4D, 11 November 2021) <<https://id4d.worldbank.org/guide/data-protection-and-privacy-laws>> accessed 8 January 2024.

94. Ians, ‘National Security at Risk: Implications of Personal Data Breaches’, (The Economics Times, 13 November 2023) <<https://ciso.economictimes.indiatimes.com/news/data-breaches/national-security-at-risk-implications-of-personal-data-breaches/105176369>> accessed 8 January 2024.

95. UN High Level Committee on Management (HLCM), Personal Data Protection and Privacy Principles (36th Meeting, 11 October 2018).

96. Regulation (EU) 2016/679, Directive 95/46/EC (General Data Protection Regulation) OJ 2016 L 119/1.

97. The Digital Personal Data Protection Act, 2021 (DPDP Act).

98. DPDP Act, s 2(h).

99. DPDP Act, s 2(t).

100. L. Rocher, J.M. Hendrickx, and YA de Montjoye, Estimating the Success of Re-Identifications in Incomplete Datasets Using Generative Models, (2019) 10 Nat Commun 30.

without consent, individuals are unknowingly exposed to privacy risks.¹⁰¹ Such practices highlight the ethical implications of surreptitious data collection, questioning the boundaries of acceptable use of personal data, in an era where information is both power and vulnerability.

Though the DPDP Act governs the legitimate processing of personal data based on specific and informed consent of the data principal, government purposes such as providing subsidies, licenses, etc., personal data made available to the public by the data principal is excluded entirely from the ambit of the protective framework under DPDP Act.¹⁰² This breeds ground for criminal activities, such as malafide deep fakes creation, financial frauds, etc., in addition to the violation of privacy which has been recognised as a fundamental right in *K.S. Puttaswamy v. Union of India*.¹⁰³

Now, a question arises: if publicly available scraped data includes personal data, how should an individual's right to protect her data be exercised, if at all such right exists for personal data which has been made available in the public domain by the data subject herself? Pertinently, the protection offered to personal data made publicly available on platforms like LinkedIn, Facebook, etc. which are often subjected to web scraping has been a debatable topic. For example, if a public post was made by Mr X on a public Facebook group and the contents of the post included his personal information. In such a scenario, what shall be the protection offered to that personal data? Should active and informed "consent" be required or the mere act of the data principal making their personal data "publicly available" be understood as sufficient 'deemed consent' to scrape such data?

A. Regulating Publicly Available Personal Data: DPDP Act, 2023 and erstwhile SPDI Rules, 2011

Before the DPDP Act, personal data in India was governed by the Information Technology (Reasonable security practices and procedures

101. A Winograd, Loose-lipped Large Language Models Spill Your Secrets: the Privacy Implications of Large Language Models, (2023) 36(2) Harv. Jour. L&T 616, 634.

102. DPDP Act, ss. 3(c)(ii), 7.

103. *KS Puttaswamy v Union of India*, [2017] 10 SCC 1.

and sensitive personal data or information) Rules, 2011¹⁰⁴ (*SPDI Rules*). These rules classified personal data such as passwords, financial information, medical records and others into “sensitive personal data or information” which were given special protection.¹⁰⁵ However, these rules did not apply to any information freely available in the public domain or retrievable under the Right to Information Act, 2005¹⁰⁶ or any other law. Unlike provisions under the DPDP Act, this does not consider ‘who’ made such data public i.e., a data principal or a third party.

The DPDP Act marks the beginning of India’s first comprehensive data protection regime. The DPDP Act, under Section 3(c)(ii),¹⁰⁷ exempts its application in two cases. Firstly, when any personal data is made or caused to be made publicly available by the data principal to whom it relates. For example, when an individual while blogging her views, has publicly made available her personal data on social media. Secondly, in cases where any personal data is made or caused to be made publicly available by a third party who is under an obligation under any law to make such personal data publicly available. Such blanket exclusion is based on the assumption that the mere act of making personal data publicly available by the data principal indicates ‘deemed consent’ for its unrestricted use.

B. DPDP Act, Section 3(c)(ii): Exploring the Applicability of US’ Third-Party Doctrine in India

Section 3(c)(ii)¹⁰⁸ of the DPDP Act seems to follow the US data protection regime. Notably, most of the U.S. State laws exclude publicly available information from their definitions of personal information. For example, the California Privacy Rights Act,¹⁰⁹ under Section 14(v)(2),¹¹⁰ defines “publicly available data” and excludes it from the purview of “personal data”. For purposes of this section, publicly available information includes data lawfully accessible from government records, information the business reasonably believes is public, and details shared by the con-

104. The Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data Or Information) Rules, 2011.

105. The Information Technology Act 2000, s 43A.

106. The Right to Information Act 2005.

107. The Digital Personal Data Protection Act 2021, s 3(c)(ii).

108. *Ibid.*

109. The California Privacy Rights Act 2020.

110. The California Privacy Rights Act 2020, s 14(v)(2).

sumer or widely distributed. However, it excludes biometric information collected without the consumer's knowledge. Such an approach provides corporations with a leeway to process publicly available personal data for their business purposes with free reign

The US jurisprudence allows the practice of extracting personal data which are publicly available, irrespective of a website's terms of use or self-placed technical measures against data scraping like *robot.txt*.¹¹¹ For instance, examining Section 502(c) of the California Penal Code¹¹² and Section 1030 of the federal Computer Fraud and Abuse Act,¹¹³ the Ninth Circuit Court held, in *hiQ Labs v. LinkedIn*,¹¹⁴ that publicly accessible data could be scraped by third parties, regardless of site terms or technical measures against scraping to prevent selectively hindering potential competitors. This free reign was evident in the judgment where it was determined that hiQ's operational model relied on accessing publicly available data from LinkedIn and LinkedIn's claims that hiQ could obtain workforce data through alternative methods was dismissed. Additionally, the court rejected LinkedIn's contention that permitting hiQ to scrape its site posed any significant threat to user privacy.

The court opined that the use of public information was unlikely to cause damage or violate any reasonable expectation of privacy held by LinkedIn users. The decision stemmed from the third-party doctrine that operated in the US. This approach is based on the "third-party doctrine" which says that data principals who voluntarily give information to third parties—such as banks, internet service providers (ISPs), and e-mail servers—have "no reasonable expectation of privacy" on such information.¹¹⁵

Contrastingly, in India, it has been held, in *Distt. Registrar & Collector, Hyderabad & Anr v. Canara Bank*,¹¹⁶ that voluntarily handing over private information to a third party does not extinguish the right to privacy in that information. The Court emphasised that the right to privacy lies with the individual and not places, hence, the mere transfer of information from one place to another does not extinguish an individual's

111. Alex Cato, 'Robot. txt and Linking the Internet' (2016) 24 *Austl. L. Libr.* 37.

112. The California Penal Code 1878, s 502(c).

113. The Computer Fraud and Abuse Act 1986, s 1030.

114. *hiQ Labs, Inc. v LinkedIn Corp.*, 938 F.3d 985.

115. Robert Lipman, *The Third-Party Exception: Reshaping an Imperfect Doctrine for the Digital Age* (2014) 8 *Harv. L. & Pol'y Rev.* 471.

116. *District Registrar & Collector, Hyderabad v Canara Bank*, [2005] 1 SCC 496.

right to privacy which is inherently present. In *Justice K.S. Puttaswamy (Retd.) & Anr. vs. Union of India & Ors.*,¹¹⁷ Justice Nariman revisited the *Canara Bank* case (paragraphs 47 and 59) and reaffirmed its validity. Therefore, it is clear that the third-party doctrine has become inoperable in India. Hence, the Indian jurisprudence supports the idea of extending reasonable protection over personal data that has been made publicly available by the data principal herself. However, the DPDP Act, by excluding personal data that has been made publicly available by the data principal from the protection of the DPDP Act, has digressed from past jurisprudence. To rectify such digression, reliance should be placed on jurisdictions where the third-party doctrine is inapplicable and suitable amendments should be made to the DPDP Act.

C. EU and the ‘Manifestly Made Public’ Standard: An Interesting Consideration

The EU is one such jurisdiction where the third-party doctrine is inapplicable.¹¹⁸ As per the EU’s jurisprudence, disclosing one’s personal data publicly does not automatically render the data unprotected. Such disclosures have to satisfy the GDPR, Article 9(2)(e)¹¹⁹ standard of “manifestly made public”.¹²⁰ There has been limited guidance, during the debate stages or in the recitals or legislative text, on the “manifestly made public” standard.

To be manifestly made public, the data must be realistically accessible to a member of the general public. Disclosures to a limited audience are not necessarily ‘manifestly public’ for these purposes. Further, the Handbook on European Data Protection Law, published jointly by the Council of Europe and the European Union, provides high-level guidance on this exemption¹²¹ by stating that “it must be construed strictly and as requiring the data subject to deliberately make his or her personal

117. *K.S. Puttaswamy and Anr. vs. Union of India*, (2017) 10 SCC 1.

118. Eunice Park, ‘Objects, Places and Cyber-Spaces Post-Carpenter: Extending the Third-Party Doctrine beyond CSLI: A Consideration of IoT and DNA’ (2019) 21 YJLT 1.

119. Regulation (EU) 2016/679 Directive 95/46/EC, art 9(2)(e) (EU GDPR).

120. Edward S. Dove and Jiahong Chen, ‘What does it mean for a Data Subject to Make their Personal Data ‘manifestly public?’ (2021) 11 Int. D. Pri. Law, 107, 114.

121. European Union, European Union Agency for Fundamental Rights, European Court of Human Rights, European Data Protection Supervisor (Publications Office of the European Union 2018) 162, pg. 163.

data public. Even when the processed personal data is public, it does not exempt controllers from their obligations” like those of purpose limitation, notice requirement, etc.

In a nutshell, the terms “manifestly made public” and “made publicly available” refer to distinct aspects. “Manifestly made public” implies that the information is deliberately disclosed by the data subject with the intention of making it widely available without restrictions. On the other hand, “made publicly available” pertains to data that is released to the public by the data principal herself and is legitimately and lawfully accessible to the general. While both concepts involve the accessibility of information, the former emphasises the intentional act of disclosure by the data subject for further processing, the latter focuses on the mechanical act of making the data available to the public by oneself.

It would mean that posting personal data on public platforms would not automatically render the data unprotected. As long as the data was “made public”, i.e., posted on public platforms and not “manifestly made public”, as explained above. The above understanding is reflected in the EU GDPR case involving Clearview AI, a company offering facial recognition software trained on facial images scraped from the internet.¹²² The Italian regulator fined Clearview AI €20 million after it was found to be selling its database of scraped facial images. The regulator concluded that there was a violation of the GDPR transparency, purpose limitation and storage limitation requirements.¹²³ Additionally, in *Bisnode v. UODO*¹²⁴ it was reaffirmed that when processing publicly available personal data, the notice requirement for consent¹²⁵ and processing¹²⁶ under the GDPR still subsists.

122. Clearview AI v Garante per la protezione dei dati personali (Italy) 9751362.

123. Press Release, ‘Facial recognition: Italian SA fines Clearview AI eur 20 million Bans use of biometric data and monitoring of Italian data subjects’ (Garante Per la Protezione Dei Dati Personali, 9 March 2022) <<https://www.garanteprivacy.it/home/docweb/-/docweb-display/docweb/9751323>> accessed 8 January 2024.

124. *Bisnode v UODO* (Poland), ZSPR.421.3.2018.

125. EU GDPR, art 7.

126. EU GDPR, art 6.

IV. DEFINING THE INDIAN APPROACH: A SUGGESTIVE FRAMEWORK

EU and Indian jurisprudence align, but India's growing digital economy tempts a US-style pro-corporate approach. Hence, a question arises: what stance should India adopt to safeguard publicly available personal data? The EU prioritises individual rights, the US favours corporate interests. The DPDP Act's preamble guides our assessment of these approaches. The preamble acknowledges both the rights of individuals and the necessity to lawfully process personal data. Thus, the Indian approach needs to strike a delicate balance between safeguarding individual rights and accommodating corporate interests.

A. Categorising personal data and sensitive personal data

Based on associated risk and public interest considerations, the authors suggest distinguishing personal data from sensitive personal data. Under Articles 4(13),¹²⁷ 4(14),¹²⁸ and 4(15),¹²⁹ the GDPR ensures distinct processing conditions for sensitive data. The 2018¹³⁰ and 2019¹³¹ Personal Data Protection Bills and the Joint Parliamentary Committee report echo this classification. Despite this, the current DPDP Act foregoes this explicit categorisation. The Standing Committee on Communications and Information Technology, in its Report on Citizens' Data Security and Privacy,¹³² states that the classification of personal data was discontinued to protect personal data as a whole without additional interpretation.¹³³ The Committee was aware that the Government took into consideration the best global practices observed in the personal data protection laws of Singapore, Australia, the European Union, and the prospective federal legislation of the United States of America.¹³⁴

127. EU GDPR., art 4(13).

128. EU GDPR, art 4(14).

129. EU GDPR, art 4(15).

130. The Personal Data Protection Bill, 2018.

131. *Ibid.*

132. Standing Committee on Communications and Information Technology, 'Report on Citizens' Data Security and Privacy' (48th Report, 17th Lok Sabha) (Citizens' Data Security and Privacy Report) <https://sansad.in/getFile/lsscommittee/Communications%20and%20Information%20Technology/17_Communications_and_Information_Technology_48.pdf?source=loksabhadocs> accessed 8 January 2024. (Citizens' Data Security and Privacy Report).

133. Citizens' Data Security and Privacy Report (n 132), Point 14(a).

134. *Ibid* at point 6.

Except for Singapore, all the mentioned jurisdictions have specific provisions for categorising personal data as ‘sensitive,’ acknowledging the need for enhanced protection due to the elevated risk of harm associated with its breach or misuse. While the Personal Data Protection Act of Singapore may not establish a distinct ‘sensitive’ personal data category, the Personal Data Protection Commission of Singapore adopts a stringent approach, particularly in cases involving compromised sensitive data.¹³⁵ For example, a client’s financial and identifying information can be classified as ‘sensitive’ personal data, requiring a higher standard of protection as emphasised by the PDPC.¹³⁶

Singapore, though initially not classifying personal data, eventually issued an advisory recognising certain data as sensitive and subject to heightened regulations. India can glean insights from this and consider introducing an early classification of ‘sensitive’ personal data under the DPDP Act. Following the model of Rule 3 in the SPDI Guidelines, the initial definition of ‘sensitive personal data’ can be outlined, allowing subsequent expansion through competent authority notifications. This proactive approach, implemented in the early phases, addresses potential issues preemptively. All other non-SPD would fall under a broader category of ‘personal data’, streamlining regulatory processes and fortifying data protection measures.

B. Active Consent Model for SPD Made Publicly Available

The fact that third-party doctrine is inapplicable in India advocates for the protection of publicly available SPD. As discussed above, the DPDP Act currently does not apply to “personal data that is made or caused to be made publicly available”.¹³⁷ To address this, a proviso can be added to Section 3(c)(ii) stating that the exemption shall not apply in case the impugned personal data is SPD. By adding a proviso, SPD available publicly would be protected under the DPDP Act. Even in cases of SPD being made public, the requirements of obtaining active consent before

135. Personal Data Protection Commission, ‘Being Accountable to Stakeholders’ (Data Connect, September 2019) <<https://www.pdpc.gov.sg/-/media/Files/PDPC/DPO-Connect/Sept-19/Being-Accountable-To-Stakeholders>> accessed 8 January 2024.

136. *Ibid.*

137. DPDP Act, s 3(c)(ii).

processing shall subsist.¹³⁸ This shall mean that for processing SPD, active consent of the data principal would be required, i.e., consent obtained by an unambiguous and clear affirmative action.¹³⁹

C. Passive Consent Model for Personal Data Made Publicly Available

The potential risks associated with the disclosure of personal data are comparatively lower than those associated with SPD.¹⁴⁰ The associated low-risk factor can allow the regulators to provide less stringent measures to protect publicly available personal data, than those accorded to publicly available SPD. Hence, unlike the active consent requirement as applicable to SPD, a requirement of passive consent, in cases of processing for public interest, can be made applicable to publicly available personal data.

GenAI, as discussed above has great potential to serve the public interest. The integration of generative AI in education has emerged as a transformative force in the Asia-Pacific region.¹⁴¹ Not limited solely to education, GenAI models are incredibly diverse and can provide a boost to business operations,¹⁴² leading to a better economy and a healthier Human Development Index in the long run.¹⁴³ GenAI can process and analyse vast amounts of data more efficiently than a human could. This capability can help public sector organisations gain valuable insights and make more informed decisions. It can aid in optimizing resource allocation by analysing historical data, demand patterns and other relevant factors.¹⁴⁴

138. DPDP Act, s 4.

139. DPDP Act, s 6.

140. P Quinn and G Malgieri, 'The Difficulty of Defining Sensitive Data—The Concept of Sensitive Data in the EU Data Protection Framework' (2021) 22(8) *Ger. L.J.* 1583, 1587.

141. UNESCO, 'How generative AI is reshaping education in Asia-Pacific' (Newsroom, 30 November 2023) <<https://www.unesco.org/en/articles/how-generative-ai-reshaping-education-asia-pacific>> accessed 8 January 2024.

142. Thomas H. Davenport and Nitin Mittal, 'How Generative AI Is Changing Creative Work' (*Harvard Business Review*, 14 November 2022) <<https://hbr.org/2022/11/how-generative-ai-is-changing-creative-work>> accessed 8 January 2024.

143. Report, 'Generative AI could raise global GDP by 7%' (Goldman Sachs, 5 April 2023) <<https://www.goldmansachs.com/intelligence/pages/generative-ai-could-raise-global-gdp-by-7-percent.html>> accessed 8 January 2024.

144. Dave Levy, 'How The Public Sector Can Benefit From Generative AI' (*Forbes*, 15 November 2023) <<https://www.forbes.com/sites/forbestechcouncil/2023/11/15/how-the->

While the risk associated with the disclosure of personal data is comparatively lower, it still needs to be protected. Processing of personal data made publicly available should be allowed only when such processing is in the ‘public interest’ and shall be bound by the principle of purpose limitation. This shall mean that processing of such data shall be carried out for specified, explicit, and legitimate purposes of public interest and not further processed in a manner that is incompatible with those purposes. As an additional limitation, such processing shall be bound by the principle of storage limitation, i.e., the data cannot be retained or transferred to a third party for longer than it is needed.

While the above requirements would ensure the protection of publicly available personal data from misuse, mechanisms should be developed to provide data principals with ways to control its processing. This can be done by providing an opt-out mechanism coupled with a notice requirement. It shall be clarified that before processing publicly available personal data, the data fiduciary shall serve the data principal with a notice, 30 days in advance, and the option to opt out. In case, the opt-out option is not exercised, processing shall be allowed under passive consent, i.e., consent obtained by inaction. A similar approach was taken in the case of *Bisnode v. UODO*¹⁴⁵ where it was held that when processing publicly available personal data, the notice requirement for obtaining consent and processing, purpose limitation and storage limitation under the GDPR shall continue to subsist.

V. CONCLUSION

“With each stride in AI innovation, we are forced to navigate uncharted legal territory.”

In July 2023, Google was sued for copyright infringement and privacy violations in training its AI services such as Google Translate, and Gemini among others.¹⁴⁶ Similar lawsuits, filed against OpenAI,

public-sector-can-benefit-from-generative-ai/?sh=3d7169944ce3> accessed 8 January 2024.

145. *Bisnode v UODO* (Poland), ZSPR.421.3.2018.

146. ‘Google faces lawsuit alleging data scraping and copyright violations for AI development’ (Business Today, 12 July 2023), <<https://www.businesstoday.in/technology/news/story/google-faces-lawsuit-alleging-data-scraping-and-copyright-violations-for-ai-development-389340-2023-07-12>> accessed 8 January 8 2024.

Microsoft, Stability AI and other GenAI companies, reveal the murky chasm between the interest in AI innovation and that of human authors and data subjects. In the process of employing large-scale data scraping, GenAI has shaken the long-considered settled foundations of intellectual property rights and data privacy, in as much as the outcome of suits against GenAI remains awaited. This paper addressed two main concerns common to most GenAI-related suits: copyright infringement and data privacy since the process of GenAI training often requires the processing of publicly available information, which often includes copyrighted works and personal data. In light of the above discussion, it would be interesting to witness how India keeps in step with global jurisdictions to embrace changes to its fair dealing doctrine.

While the fair dealing provision contained in Section 52 of the Indian Copyright Act might be sufficient to deal with copyright infringement claims against GenAI, in the interest of certainty and uniformity, it is advisable that the legislature clearly defines the threshold and magnitude of protection available for GenAI training in so far as it does not disincentivise the human authors. Accordingly, Section 52 must delineate specific exemptions for temporary copies created during the AI training process as an essential intermediary step in the transformative creation process. AI developers must be accorded a safe harbour from copyright infringement claims for commercial and non-commercial TDM, however, an equitable compensation mechanism based on data attribution in GenAI outputs is suggested for all kinds of applications of commercial TDM. This is to ensure that the human authors feel sufficiently recognised for any economic use of their artistic or literary creations while avoiding any imbalance of power between the human authors and AI developers in terms of licensing negotiations.

Further, the paper analysed the difference between the thresholds of protection accorded to personal data made publicly available by the data principal in India, the E.U. and the U.S. and discussed the need to recognise reasonable expectations of interest in processing such data. A risk-based classification of personal data scraped for AI training has been suggested. By restricting the ambit of stringent data protection requirements in the form of 'active consent' to only sensitive personal data and keeping personal data relatively more accessible for AI training through

the 'passive consent' model, India's DPDP Act could balance AI development with data protection.

Lastly, AI innovation is itself a means of progressing humanity as a whole. Law as a tool of social engineering must therefore embrace the technological change and support rather than hinder the growth of AI creativity while balancing the legitimate interests of copyright holders and data principals. All in all, it is not a battle of 'AI v. Humans', rather it is a mission towards 'AI for humans'.

Taxing Times: Assessing the Burden of Recent Tax Amendments on Online Skill Gaming

—Kaustubh R Kulkarni and Aniket Rout*

ABSTRACT

The authors of this paper seek to elucidate the potentially detrimental impact of an impending amendment on online skill games, particularly games like rummy and poker, portraying it as a harbinger of their demise. Initially, the paper evaluates the current state of the gaming industry in light of the introduced amendments and regulations. Subsequently, it delves into the commercial feasibility of the newly instituted tax framework, contending that while its imposition might contravene the tenets of Constitutional Courts, it undeniably lacks commercial viability.

To bolster their argument, the authors embark on a comparative analysis of international best practices, citing the examples of the UK and France. Both countries have recognized the benefits of levying a reasonable tax on Gross Gaming Revenue (GGR), illustrating how such measures can ultimately bolster the national treasury. Drawing from these examples, the authors highlight the disparity between these successful models and the proposed amendment, underscoring the potential pitfalls of the latter.

In light of these observations, the paper concludes with a series of recommendations aimed at resolving the prevailing uncertainties within the online gaming industry. These proposed measures aspire to reconcile the conflict between regulatory

* The authors are students at the National Law University Odisha, Cuttack (NLUO).

needs and industry sustainability, fostering an environment conducive to both compliance and prosperity. Ultimately, the authors advocate for a reconsideration of the impending amendment, urging policymakers to adopt a more balanced and informed approach that aligns with Constitutional principles while ensuring the commercial viability of online skill gaming.

I. INTRODUCTION

In the era of rapid technological advancements and innovation, India's online gaming sector has been consistently making progress over the last decade.¹ Over the last five years, the industry has been growing with an annual compounded growth rate of around 30%.² Moreover, according to industry projections, the worldwide online gaming market is anticipated to expand from \$38 billion in 2019 to \$122 billion by 2025. Similarly, the Indian online/real money gaming sector is predicted to experience growth from \$2 billion (INR 15,000 crores) in 2022 to surpass \$5.4 billion (INR 40,000 crores) by 2025.³

The emergence of affordable internet plans and smartphones has proven to be a game changer for the online gaming industry. Thanks to better accessibility, online money gaming extends beyond metropolitan areas, reaching tier 2 and even tier 3 cities and towns across the country. The sector is experiencing almost the same enthusiasm from gamers in these cities as it had been doing in metro cities. These factors have helped in dispelling the stigma associated with online money gaming and has helped in the greater acceptance of online gaming as an accepted form of entertainment.

On July 11, 2023, India's GST Council declared that every online money gaming company will be subject to a standardised 28% tax on the full-face value of services, which includes the total value of the bets

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1. Thiruvananthapuram S Ramakrishnan, 'Retrospective GST Taxation Will Kill the Online Gaming Industry' (Deccan Herald, 5 November 2023) <<https://www.deccanherald.com/opinion/retrospective-gst-taxation-will-kill-the-online-gaming-industry-2757862>> accessed 2 January 2024.
 2. Nikhil Inamdar and Meryl Sebastian, 'GST: India's Online Game Tax Could Kill a Booming Industry' (BBC News, 13 July 2023) <<https://www.bbc.com/news/world-asia-india-66161596>> accessed 1 January 2024.
 3. 'GST on Online Skill-Based Gaming' (E&Y, August 2022).

placed.⁴ This decision came into force on October 1, 2023, as the existing GST laws were amended to implement the changes made. Previously, all online gaming companies were subject to a standardised tax rate of 18% on the gross revenue earned by them. However, with this amendment, “online money gaming” has been separated from “online gaming” and is now taxable at the same rate as betting, gambling and lottery. As a result of this, many online gaming companies have received show cause notices worth more than Rs 1 lakh crore for tax evasion.⁵ This ruling came as a huge shock to the gaming operators and investors as it is very likely to hinder the growth of a rapidly growing gaming industry.

II. CURRENT SCENARIO IN INDIA

The Goods and Services tax introduced in 2017 replaced Value Added Tax (VAT), service tax, and excise duty. The Rajya Sabha on 11 August, 2023, passed the GST Amendment Bill amending Section 2 and Schedule 3 of the Act.⁶ This amendment specifically replaced “lottery, betting, and gambling” with “specified actionable claims” in Schedule 3 while defining the elements that were included in “specified actionable claims,” including “online money gaming” in Section 2. Online money gaming is now described in the Act as any online game that is played by depositing money or money’s worth, categorically including both games of skill and chance.

GST is levied on the supply of goods and services. Further, Section 15(5) of the CGST Act, 2017 allows the government to determine what can be considered as “value of goods supplied” on the basis of the recommendation of the GST council. In this context, the Government has amended the CGST rules, adding Rule 31B.⁷ Rule 31B expounds that

4. Meyyappan Nagappan, Saranya Ravindran and Eeshan Sonak, ‘India’s 28% Online Gaming Tax Is a Major Challenge for Operators’ (Bloomberg Tax, 19 July 2023) <<https://news.bloombergtax.com/daily-tax-report-international/indias-28-online-gaming-tax-is-a-major-challenge-for-operators>> accessed 2 January 2024.

5. ‘Centre Serves Tax Notices Worth Rs 1 Trillion to Online Gaming Companies’ (The Indian Express, 25 October, 2023) <<https://indianexpress.com/article/business/economy/centre-serves-tax-notices-worth-rs-1-trillion-to-online-gaming-companies-says-report-8998488/>> accessed 3 January 2024.

6. Central Goods and Services Amendment Bill, 2023.

7. Central Goods and Services (Amendment) of Tax Rules, No. 45/2023.

the value of the supply in the case of online money gaming shall be construed as the amount that is paid, payable, or deposited with the gaming platform.

A. Game of Skill v Game of Chance

“Online money gaming” in the definition of the government is inclusive of both games of skill and of chance, treating them on par for the purpose of taxation. However, the Supreme Court of India and various High Courts in India have decided, in a catena of judgements, that games of skill should be treated on a different pedestal from games of chance, starting with *RMD Chamarbaugwala (RMDC-I)*.⁸ There, the Apex Court held that a game of skill is one in which success depends substantially on the skill exercised by the player. Hence, it is a clear observation that no game is free of a percentage of chance or luck, which has to be determined by the courts on a case-by-case basis.

Recently, in *Gameskraft Technologies Private Limited (GTPL)*,⁹ the Karnataka High Court, in dismissing the claims of the Directorate General of GST Intelligence (*DG*) that *GTPL* is liable to pay dues amounting to approximately 21,000 crores, declared the notice issued as ultra vires. In lieu of this, the court has laid down that games of skill and chance can’t be treated on the same pedestal for the purpose of taxation. The Court rejected the argument of the *DG*, which placed reliance on *RMDC-I*, in order to argue that if a game of skill is played with stakes, the same would amount to a game of chance and hence should be subjected to tax. Justice S.R. Krishna Kumar, expressing that *RMDC-I* was wrongly interpreted by the *DG*, held that all manner of forecasting cannot be deemed to be gambling and cannot be grouped as a game of chance.

In another significant decision, the Madras High Court, upholding the Tamil Nadu Prohibition of Online Gaming and Regulation of Online Games Act, 2022, held that the same cannot be made applicable to games of skill like Rummy and Poker.¹⁰ Further, in *All India Gaming Federation v State of Karnataka*,¹¹ it was held by the Karnataka High Court that

8. AIR 1957 SC 699.

9. *Gameskraft Technologies Private Limited v Directorate General of Goods Services Tax Intelligence*, [2023] SCC OnLine Kar 18.

10. *All India Gaming Federation v State of Madras and Ors.*, [2023] SCC OnLine Mad 6973.

11. *All India Gaming Federation v State of Karnataka* [2023] SCC OnLine Kar 18.

playing games of skill with stakes would still retain their element of being a game of skill. Moreover, the Supreme Court passed an order after hearing an SLP,¹² where the petitioner argued that fantasy sports can be given a colour of game of chance, dismissing the petition in light of the judgements of the Punjab and Haryana High Court and the Bombay High Court.¹³ The amendment in this light turns a blind eye towards online gaming jurisprudence.

The 276th Law Commission Report, which was submitted under the leadership of Dr. Justice B.S. Chauhan, emphasised the intelligible differentia between a game of skill and a game of chance. It relies on *K.R. Lakshmanan v State of Tamil Nadu*,¹⁴ to argue that those games in which success depends principally upon the superior knowledge, training, attention, experience, and adroitness of the player would necessarily constitute a game of skill.

B. Testing Constitutionality

Imposing a uniform tax on online money gaming can be seen as violating Article 14 of the Constitution of India. While the courts have not interfered with the government's decision to put an item under a particular tax bracket, the Apex Court holds full right to test the constitutionality in light of any alleged violation of a Fundamental Right. In *Meenakshi v State of Karnataka*,¹⁵ the SC held that the legislature enjoys the latitude to decide the tax rate and objects to tax, unless the same is determined to be unreasonable in nature.

In this context, the Apex Court's judgement in *State of Kerala v Haji K. Kutty Naha & Ors.*,¹⁶ where Justice J.C. Shah observed that the Kerala Building Tax Act, which was enacted by the Kerala legislature, did not make a rational classification between the kinds of buildings and the purposes for which they were built and imposed a uniform rate of tax. It

12. 'Supreme Court upholds Dream11 fantasy sports format as game of skill' (ET Bureau, 4th August 2021) <<https://economictimes.indiatimes.com/tech/startups/supreme-court-upholds-dream11-fantasy-sports-format-as-game-of-skill/articleshow/85040855.cms?from=mdr>> accessed on 23 December 2023.

13. *Shri Varun Gumber v Union Territory of Chandigarh and Ors* [2017] SCC OnLine P&H 5372; *Gurdeep Singh Sachar v Union of India* [2019] SCC OnLine Bom 13059.

14. AIR 1996 SC 1153.

15. AIR 1983 SC 1283.

16. AIR 1969 SC 378.

was held that in certain cases, the legislature's refusal to make a rational classification in itself operates as denying equality, violating Article 14. However, this is subject to the appeal, which is pending before the Hon'ble Supreme Court in the GTPL case.¹⁷

Be that as it may, the commercial ramifications in themselves should be a compelling reason for the government to switch back to the earlier rate of taxation.¹⁸ While an increase in the tax rate now can imminently benefit the exchequer, a lower tax rate would be compensated for the eventual growth of the industry.

C. The Amendment Paradox

When the Ministry for Electronics and Information Technology notified the Online Gaming Rules in April 2023,¹⁹ it was described as a huge relief to the industry,²⁰ given that a framework had been set for the regulation of the gaming industry. The rules in a highlight provided for a Self-Regulation Body (*SRB*), which would be responsible for the regulation through verification and registration of Online Gaming Intermediaries in the context of online money gaming. The SRB was set to hold powers to permit the functioning of an intermediary. These rules were made in order to ensure a greater aim of maintaining a sense of uniformity in compliances that the online gaming industry was subject to.

Moreover, the Prime Minister has expressed on several occasions that India needs to amp up online gaming applications in order to compete internationally.²¹ The PM foresaw this sector yielding a significant

17. *State of Karnataka v Gameskraft* [2023] SLP(C) No. 019369/2023.

18. Subimal Bhattacharjee, 'Of Skill and Chance: 28 Percent GST on Online Gaming is Killing the Industry' (The Quint, 1 August 2023) <<https://www.thequint.com/opinion/of-skill-and-chance-28-percent-gst-tax-on-online-gaming-is-killing-the-industry>> accessed 5 January 2024.

19. The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021 (updated 6 April 2023).

20. Ranjana Adhikari, Sarthak Joshi and Shashi Misra, 'MeitY Notifies Amendments to IT Rules 2021: Online Real Money Gaming Platforms Now Regulated By The Centre' (Mondaq, 18 April 2023) <<https://www.mondaq.com/india/gaming/1305570/meity-notifies-amendments-to-it-rules-2021-online-real-money-gaming-platforms-now-regulated-by-the-centre>> accessed 1 January 2024.

21. 'Gaming sector has huge int'l market, India trying to increase its footprint in it: Modi' (The Indian Express, March 3, 2022) <<https://indianexpress.com/article/cities/delhi/gaming-sector-huge-intl-market-india-trying-increase-footprint-modi-7797747/>> accessed 3 January, 2024.

number of jobs. The 2022 Budget of the Indian Government, which was themed around *Atma Nirbharta*, aimed at building a prosperous AVGC (Animation, Visual Effects, Gaming, and Comic) sector.²² The sector was said to have the potential to create 20 lakh jobs,²³ which in 2022 employed 1.8 lakh people.

The CGST Amendment Act, 2023 in this light can be seen as a huge blow. It not only constricts the scope of the industry but also goes against the vision of the MeitY and the Prime Minister. A 28% tax on the total pool in an online game of skill has a two-pronged effect, one, that the SRB now loses significance in the light of a uniform taxation across the industry and two, that there is discord between the MeitY and the Finance Ministry. The latter has been rather evident.²⁴

D. Morality, Gambling and Online Skill Gaming

The GST Council, in its 50th meeting on July 11, 2023, recorded its dilemma in lieu of regulating the online gaming industry: that it is torn between economic growth and job creation and the “adverse” impact on the youth.²⁵ Ironically, the council has remarked that a fine way has to be worked around the same in order to maintain a delicate balance.

The Government, in its full right, can regulate any activity undertaken as a fundamental right under Article 19(1)(g), which leads to societal harm, through Article 19(2) of the Indian Constitution. In RMDC-1, the Apex Court for the first time introduced the doctrine of “*res extra commercium*,” simply meaning beyond commerce. The judgement classified gambling as falling under the ambit of the same. Liberty is one of the core elements of our constitution, reflected through fundamental rights. J.S. Mill’s notable work, “On Liberty and Utilitarianism,” emphasised on

22. Report on Taxation of Digital Economy: International Best Practices for Online Gaming, Lakshmikumaran and Sridharan (Report on Taxation of Digital Economy) March 2022.

23. Meenakshi Verma Ambwani ‘Budget 2022: Centre to set up AVGC promotion task force’ (The Hindu Businessline, 1 February 2022) <<https://www.thehindubusinessline.com/economy/budget/budget-2022-centre-to-set-up-avgc-promotion-task-force/article64961175.ece>> accessed 27 December 2023.

24. Pranav Mukul, ‘Finance ministry, MeitY differ over 28% eGaming levy’ (Economic Times, 24th July 2023) <<https://economictimes.indiatimes.com/tech/technology/finance-ministry-meity-differ-over-28-egaming-levy/articleshow/102061579.cms?from=mdr>> accessed 18 December 2023.

25. Minutes of Meeting, 50th GST Council Meeting, July 11, 2023.

the role of the state in regulating actions of individuals particularly when they have adverse effects on the society.²⁶

The Supreme Court in *Gherulal Parakh v Mahadeodas Maiya & Ors*²⁷ interpreted the word “immoral” to the extent that it is “*what is repugnant to good conscience,*” and that an activity can be concluded to be immoral. The Calcutta High Court, has further held that betting and gambling are games that affect the morality of the society and, ergo infringe on Article 21.²⁸

Online skill gaming on the other hand has for long been distinguished from games of chance, in numerous decisions of the Constitutional Courts. Further, online skill gaming has been studied to improve human cognitive abilities on multiple occasions.²⁹ In a 2021 survey conducted by the All-India Gaming Federation it was noticed that over 26% of the respondents were of the opinion that online gaming acts as a stress buster.³⁰ Online skill gaming neither can be categorically said to be bearing an adverse effect on the youth nor has been categorised as immoral by the courts. Hence, the argument of the government, which has been utilised by it conveniently, does not hold water.

III. COMMERCIAL VIABILITY OF THE MOVE

The skill-based real-money gaming market in India is one of its biggest gaming sub-sectors, having been a major contributor to the \$2.9 billion online gaming industry by revenue in 2022. It has already attracted global funding of around \$2.5 billion across almost 400 start-ups in the online money gaming industry.³¹ It also boasts the biggest fantasy gaming market in the world, with a user base of 180 million people.³²

26. J.S. Mill, *On Liberty and Utilitarianism* (Bantam Classic, New York, 2008).

27. AIR 1959 SC 781.

28. *Guru Prasad Biswas & Anr. v State of West Bengal & Ors* [1998] 2 Cal 215.

29. Anil Srivastava ‘Online skill gaming improves cognitive abilities’ (Times of India, 3 November 2022) <<https://timesofindia.indiatimes.com/blogs/voices/online-skill-gaming-improves-cognitive-abilities/>> accessed on 1 January 2024.

30. *Ibid.*

31. Shouvik Das, ‘Top Investors Ask PM Modi to Review Online Gaming Tax’ (Mint, 21 July 2023) <<https://www.livemint.com/companies/news/top-investors-ask-pm-modi-to-review-online-gaming-tax-11689965504691.html#.>> accessed 30 December 2023.

32. Sneha Vaitheeswaran and Vibha Shyam Sekar, ‘Taxing Online Gaming: Killing the Ace of the Industry?’ (Centre for Tax Laws, 16 September 2023) <<https://ctl.nalsar.ac.in/2023/09/16/taxing-online-gaming-killing-the-ace-of-the-industry/>> accessed 31 December 2023.

However, the introduction of a new tax regime for the online skill gaming industry has the capability to completely hinder the growth and development of this industry. A sudden increase in taxation in this manner can end up making India uncompetitive in the global scenario, as many of the current and future users of this industry would rather engage with offshore online gaming companies that can provide a better regulatory and taxation system.³³

A. Understanding KPIs

Before exploring the commercial aspect of this decision in detail, it is important to understand certain money-related Key Performance Indicators (*KPI*). These indicators speak of the online gaming company's revenues and profits.³⁴

Gross Gaming Revenue (*GGR*) is the revenue that companies generate from the money wagered by the players.³⁵ It is also referred to as the platform fee for the companies. It is calculated by subtracting the total player winnings from the total amount wagered by them.³⁶ This amount is the revenue of these companies in the online gaming industry and is different from earnings or profits.³⁷

GGR can be calculated by using the following formula:

Gross Gaming Revenue (GGR) = Total wagered amount – Prize pool

On the other hand, the Net Gaming Revenue (*NGR*) is the actual profit made by the companies. This can be measured by subtracting all the expenses from the Gross Gaming Revenue.³⁸ Expenses can include

33. Ibid.

34. MaxTrafimovich, 'Main Online Casino KPIs to Analyse and Improve' (Softswiss, 13 November 2023) <<https://www.softswiss.com/knowledge-base/kpi-online-gaming/>> (Trafimovich) accessed 2 January 2024.

35. 'Gross Gaming Revenue (GGR)' (Corporate Finance Institute, 7 November 2023) <<https://corporatefinanceinstitute.com/resources/valuation/gross-gaming-revenue-ggr/>> (GGR) accessed 26 December 2023.

36. 'Online Casino Performance Indicators: Main Difference between GGR and NGR' (Slotegrator, 12 July 2023) <https://slotegrator.pro/analytical_articles/online-casino-performance-indicators-main-difference-between-ggr-and-ngr.html#h2-3> accessed 28 December 2023.

37. Trafimovich (n 34).

38. Matthew Retzloff, 'Gross Gaming Revenue (GGR)' (Wall Street Oasis, 13 December 2021) <<https://www.wallstreetoasis.com/resources/skills/finance/gross-gaming-revenue-ggr>> (Retzloff) accessed 28 December 2023.

the costs of maintaining the platform, salaries, bonuses, commissions, royalty fees, taxes etc.³⁹

NGR can be calculated by using the following formula:

$$\text{Net Gaming Revenue (NGR)} = \text{GGR} - \text{Total expenses}$$

The gaming companies use another indicator to measure the revenue margin. It is called the Gross Gaming Revenue Margin (*GGRM*). It measures the GGR as a percentage of the total wagered amount.⁴⁰

GGRM can be calculated using the following formula:

$$\text{Gross Gaming Revenue Margin (GGRM)} = \text{GGR} / \text{Total wagered amount}$$

A higher GGRM indicates that a company is keeping more money as GGR from the total wagered amount. However, a very high GGRM can be unappealing to the players, who would look for alternative platforms, where the GGRM might be lower, to increase their winnings, and this can lead to a loss of user base for the company.⁴¹ Hence, it is important for the gaming companies to moderate the GGRM in such a manner that it attracts more users while also generating a sizeable amount of revenue.

B. Change in GST revenue in the instant year

The revenue of the online gaming companies comes from the pre-determined percentage of the entry fee paid by the users to participate in the games. This amount is the platform fee or the GGR of the companies and does not indicate profits. The remaining amount from the total CEA becomes the prize pool for the users. This amount is given back to the winners, and the online gaming companies have no claim over such an amount as they were merely holding the money as an intermediary.

The shift in the GST rate from 18% on GGR to 28% on CEA has the potential to disrupt the entire sector. According to industry experts, this change will make it difficult for the companies to thrive. The table below is an illustration of how GST revenue changes as a result of the amendment, while also exploring another alternative method of taxation. For the purposes of the illustration, the GGR is taken to be 13% of the CEA

39. Trafimovich (n 34).

40. GGR (n 35).

41. Retzloff (n 38).

and exclusive of GST in accordance with industry inputs on consumer sensitivity.⁴²

From the above illustration, it is clear that the potential GST collection post amendment can go as high as two times of the entire gross revenue earned by the industry, thus exposing its unfeasibility. Further, the increase in tax payouts post amendment in the instant year is ridiculously high, potentially more than 10 times the level of tax payouts made in pre-amendment era.

C. Change in cost per-game for the user

In today's era, online gaming can be seen as an upcoming, widely accepted form of entertainment, consistently challenging conventional sources of entertainment. Therefore, it is no surprise that any significant changes made to the tax structure in this industry will have a direct impact on the user base and their interactions with these platforms. If there is a considerable rise in GST collection from this industry, the same has to be paid from the prize pool, thus reducing it substantially. Hence, there would be a natural increase in the per-game cost for the users.

In the following illustration, we have assessed the potential difference in the cost per game for the users before and after the amendment, while also exploring another possible system of taxation. For this, we have maintained a constant entry fee of INR 100 for a game of two users, an opening balance in the wallet of INR 200, and a constant platform fee/GGR at the rate of 13 percent of CEA.

From the above illustrations, it is evident that the cost per game for a user can increase by almost three times if GST is levied on the total CEA at a rate of 28%. As a result of that, a user's ability to play games will also decrease, thus creating a disinclination among the users to participate in these games. Leaving GST aside, any winnings received by the users from online gaming are taxable at 30% as per the amended Income Tax laws in India.⁴³ Therefore, the increased GST rate is further adding to the woes

42. FIFS and Deloitte, 'GST on Online Gaming' (Deloitte, July 2023) (GST on Online Gaming).

43. CA Pradeep Agarwal, 'Section 194BA – TDS on Winning from Online Games' (TaxGuru, 2 June 2023) <<https://taxguru.in/income-tax/section-194ba-tds-winning-online-games.html>> accessed 30 December 2023.

of the users, who were already facing a double taxation system before the amendment.

These conditions might become a breeding ground for unregulated illegal platforms, which will offer users the same gameplay but with a higher prize pool, owing to the non-payment of taxes by such platforms. This will encourage users to shift to illegal platforms, which is not only risky but is also detrimental to GST collection and the revenues of legitimate companies. These aspects will be explored in detail following the illustrations, which model the possible impact of different taxation systems in the long run.

D. Modelling the effect of different taxation systems on the industry in the long run

While the decision made by the government might be taken keeping the immediate increase in tax revenues in mind, the effect of such a change must be evaluated by considering other factors that are equally essential for the sustenance of the industry as well as its growth, like its impact on consumer behaviour and its impact on the industry's commercial viability. To model the projected growth or degrowth in different scenarios, the following common assumptions have been made:

1. The Contest Entry Amount (*CEA*) per user is INR 50 and there are a total of 10 users.
2. The platform incurs a cost (*GGR*) of 11 percent of consumer expenditure (*CEA*) per game per user. This cost encompasses expenses related to software, infrastructure, marketing, customer acquisition, and other factors.⁴⁴
3. The growth rate of the industry denotes the growth rate of the user base.

SCENARIO 1: GST levied on GGR at the rate of 18%

Prior to the amendment, online gaming companies had to levy GST at a rate of 18 percent on the Gross Gaming Revenue (*GGR*). Compound Annual Growth Rate (*CAGR*) for the online gaming industry was 33 percent for the pre-amendment scenario for the next five years.⁴⁵ The

44. GST on Online Gaming (n 42).

45. Ibid.

following table gives the projected growth of the industry and GST collection as per the old taxation system.

Based on the calculations made in the given table, it is very evident that the online gaming industry was sustainable and would have continued to grow at a rapid rate, thus becoming a stable revenue source for the exchequer.

Since the amendment came into force in October, online skilled gaming services have been included in the definition of the term “online money gaming”. Therefore, instead of being taxed at the rate of 18 percent on the GGR in accordance with Online Information Database Access and Retrieval (*OIDAR*), it is now taxable at the rate of 28 percent on the full-face value (*CEA*) as per the CGST Act.

To shoulder this increased liability, the industry has the option to either pass on the additional liability entirely to the users or pass on the liability partially by reducing their GGR to ease the burden on the users.

SCENARIO 2: GST levied on CEA at a rate of 28%, and the entire tax burden is passed on to the users.

In this scenario, the online gaming companies are not taking any steps to mitigate the impact of additional taxes. Essentially, the entire difference in costs as a result of higher taxes is directly transferred to the users. As a result, the GGR charged by the online gaming companies would remain unchanged from the pre-amendment scenario, and the entire tax liability would fall upon the users. The entire financial burden will fall on the users, meaning that the potential prize pool of the users will decrease significantly on these platforms.

As per the sensitivity analysis conducted by the industry, it is projected that the industry will go through a 70 percent decline in consumer expenditure (*CEA*) in the first year itself, followed by a year-on-year reduction of 30 percent in *CEA* in the upcoming four years.⁴⁶

In the given scenario, the industry revenue in the 5th year is decreasing more than 43 times in comparison to the pre-amendment scenario, where GST was being levied at a rate of 18 percent on GGR. The market contraction, the decline in *CEA*, and the reduced profits would pose

46. GST on Online Gaming (n 42).

enormous difficulties to the legitimate online gaming platforms, ultimately forcing some of them to cease operations.

With the significant increase in taxes, acquiring new users would be more expensive and would eventually amplify the financial strain on these companies. Industry experts have contended that the additional tax burden is expected to hamper the profitability of the platforms, thus making it harder for them to remain in operation. It is a matter of concern that among the 500 online skill gaming companies registered in India, less than five of them are profitable.⁴⁷ This is a clear signal that these companies have higher operational costs compared to the revenue they generate from the GGR. Since many of these companies are start-ups, they are already dealing with such financial imbalances. With the additional tax liability coming into effect, these start-ups are bound to shut down.

On the other hand, the GST revenue generated in this scenario is not ideal either. While it is true that the initial GST revenue is much higher compared to the pre-amendment scenario, it can be noticed that the pre-amendment scenario ends up providing a higher tax collection starting in the third year. The loss of user base, negative growth of the industry, and lesser GST revenue in the long term suggest that this scenario will eventually lead to a slow death for the online gaming industry.

SCENARIO 3: GST is levied on CEA at a rate of 28%, and the tax burden is passed on partially to the users.

In the above scenario, it was very evident that passing on the additional tax burden entirely to the users would have a significantly detrimental effect on the industry as a whole. To ensure the sustainability of the industry, the online gaming companies might consider a strategy to share the increased tax liability and mitigate the harm caused.

The possible mitigation approach for these companies involves a partial transfer of the increased tax burden to the user while absorbing the other part of the burden themselves. This can be achieved by decreasing the GGR in order to alleviate the tax burden on the users. However, industry trends have suggested that GGR reduction can only mitigate user shifts by 5 percent. As a result, the industry is expected to undergo a

47. Ibid.

65 percent decline in CEA in the 1st year, followed by a 25 percent year-on-year degrowth for the next 4 years.

In the given scenario, the industry revenue in the 5th year is decreasing more than 33 times in comparison to the pre-amendment scenario, where GST was being levied at a rate of 18 percent on GGR. The degrowth of the market coupled with the decline in GGR will collectively impact consumer expenditure (*CEA*) as well as profit margins in the industry. The companies will have to operate at the break-even point, resulting in minimal technological innovations in the industry.

Similar to the previous scenario, the initial GST collection will be very high due to the huge increase in tax; however, it is expected to reduce exponentially in the third year as a result of the decline in the industry and its user base. Therefore, the pre-amendment scenario is expected to return more GST revenue to the exchequer in comparison to the post-amendment scenario.

SCENARIO 4: GST levied on GGR at the rate of 28%

In this alternative scenario, there is an increased tax liability for the industry in comparison to the pre-amendment scenario. The industry's growth is anticipated to decline by 5 percent in the first year but is expected to make a recovery with a year-on-year growth of 15 percent in the next 4 years. The slowdown in growth is linked to decreased user retention, smaller margins of profit, and reduced marketing expenditure. Consequently, the prize pool for users gets smaller.

In the given scenario, the profitability of the companies experiences a substantial decline, and this can bring about financial difficulties for the majority of these platforms. Further, the GST revenue, which does see an increase in the first three years, is also projected to be lesser in comparison to the pre-amendment scenario from the fourth year, due to the slow growth rate of the industry caused by a higher tax slab.

The changes brought about by GST regulations have a direct impact on the prize pool for the users, thus influencing their behaviour and participation in the online gaming industry. An increase in the tax rate is going to adversely affect the emerging start-up ecosystem, and many of these companies will have to withdraw from their expansion plans due to reduced profits and slow market growth. As the Indian online gaming

industry is still in its early stages of development, a higher tax rate can prove to be a detriment to the industry, potentially reducing investments and decreasing job creation in the industry.

E. Key Observations

Levying GST at the rate of 28 percent on CEA will have severe negative repercussions on GST revenue growth and the sustainability of the industry. The initial boost seen in GST revenue in the post-amendment scenario results in value destruction for the online gaming sector and leads to a reduction in future GST revenues. Even if mitigation measures are implemented by the companies, the industry's revenue is expected to decline substantially, albeit with slight variations in comparison to the scenario where no mitigation measures are taken. Projected figures clearly demonstrate the severe negative impact on both the growth of the industry as well as the potential GST revenue that can be caused as a result of the shift in tax structure by taxing CEA instead of GGR.

F. Possible effects of the change on the industry

1. A Decrease in GST revenue collection in the long run

The GST revenue derived from the increased taxation rate of 28% on CEA is expected to fall significantly in the long run. This significant reduction in GST revenue can be a result of multiple factors, ranging from reduced user participation in the regulated market to the tendency to shift to illegal platforms. The preceding tables and the graphical representation of the GST collection are indicative that levying GST on the full-face value (*CEA*) will most definitely have a negative effect on GST revenue in the coming years.

2. Shift of users to illegal offshore gaming platforms

The sudden rise in tax rates would mean that users would earn significantly less by participating in the regulated market. This situation might create a tendency among a certain part of the user base to shift to illegitimate offshore platforms. These companies can lure users by offering them a better prize pool and letting them earn money by evading taxes. This will result in a higher rate of degrowth for the industry as well

as steep decreases in GST collection. Apart from that, transacting with illegal platforms is always risky since there would be no mechanism for addressing the grievances of the users if there was a commission of fraud or other wrongdoings on behalf of the offshore illegal platforms.

3. *A Decrease in job creation in the industry and gaming start-ups will be unviable*

The increase in tax rates in the online gaming industry will wipe out the entire online gaming industry in India and lead to job losses for lakhs of people in the long run.⁴⁸ A reduction in profit margins will lead to severe financial challenges for the startups, and they might start offloading employees to stay afloat. It is projected that around 60,000 jobs could be in jeopardy, and the industry would miss out on the opportunity to generate approximately 20,000 skilled jobs.⁴⁹

4. *Degrowth of the industry*

To address the heightened tax burden, the industry might need to cut down on costs, triggering a series of consequences. Legitimate industry revenue is projected to contract significantly, ranging from 33 to 43 times the current levels within the initial five years. This is anticipated to lead to diminished investments in Research and Development (*R&D*), decreased innovation, and reduced expenditures on marketing and IT services. Additionally, industries connected to the gaming sector might also face negative impacts. Such a move will have far-reaching consequences for the industry and its contribution to India's economy.

IV. INTERNATIONAL BEST PRACTICES

Globally, Gross Gaming Revenue (*GGR*)-based taxation and Turnover (*CEA*)-based taxation are the two most prevalent models of taxation in the online gaming industry. In the *GGR*-based taxation model, tax is calculated as a percentage of the gross revenue earned by the companies,

48. 'A 28% Tax on Online Gaming Will Wipe out the Industry, Lead to Job Losses, Say Experts' (The Wire, 12 July 2023) <<https://thewire.in/business/a-28-tax-on-online-gaming-will-wipe-out-the-industry-lead-to-job-losses-say-experts>> accessed 2 January 2024.

49. GST on Online Gaming (n42).

whereas in the CEA-based taxation model, tax is calculated as a percentage of the entire entry amount paid by the users.⁵⁰

A. United Kingdom

In 2001, the UK abandoned its turnover-based taxation approach, which imposed a 6.75% tax on consumer expenditure (CEA) and followed it by implementing a Gross Gaming Revenue (GGR)-based taxation system.⁵¹ However, with the adoption of the GGR taxation system, the tax rate changed to 15% of the revenue, excluding the winning prize. The primary motive behind this shift was to curb the migration of companies to offshore locations with more favourable tax structures, which was causing a loss of duty revenue for the government.⁵² Apart from that, they also had evidence that taxing the GGR could prove to be a more efficient way of taxing these businesses than the traditional taxation system.⁵³

After one year of abandoning the previous taxation system, the UK Government noted a number of indicators that proved that the changes made were working well: (A) Offshore online operators and telephone operators quickly relocated their operations to the UK which enabled the Government to bring in the new tax regime earlier than scheduled; (B) There was creation of many new jobs within the UK, both in the traditional betting shops and in call centres which were used to operate the ever-growing betting markets; (C) It enabled the bookmakers to absorb the GGR tax themselves and remove deductions, thus users were able to receive “tax-free” returns; (D) The industry turnover rose by around 35-40%; (E) A huge decline in the operations of illegal bookmakers was reported by the major bookmakers, since the “tax-free” incentive to use unregulated bookmakers had vanished; and (F) The tax revenues collected until this point were matching the expected revenues.

Later on, the Gambling Act 2005 was introduced, which changed the regulations of gambling until then and made it possible for people based in the UK to provide online gaming services (remote gaming). Like other

50. Report on Taxation of Digital Economy (n 22).

51. ‘Brown scraps betting duty’ (BBC Sport, 7 March 2001) <http://news.bbc.co.uk/sport2/hi/front_page/1207748.stm> accessed 4 January 2024.

52. Report on Taxation of Digital Economy (n 22).

53. Paton D, Siegel D and Williams LV, ‘An Economic Analysis of the Options for Taxing Betting’ (HM Customs and Excise, 2000).

activities, remote gaming also became a mainstream gambling activity and was brought within the scope of gambling taxation so that it could make its own contributions to the tax revenue. A Remote Gaming Duty (*RGD*) was introduced in the Finance Act, 2014⁵⁴ which is a duty on the income from online gaming. At the time of introduction, the RGD tax rate was 15% on GGR. This was increased to 21% in the year 2019, which is the current applicable rate in the UK.⁵⁵

B. France

Historically, the French Government restricted gambling and related activities to a lottery operated by the state-owned Groupe Française des Jeux and horse racing managed by the state-owned Pari Mutuel Urbain (*PMU*). All other forms of gambling activities were banned. However, this situation changed with the implementation of the Gambling Act⁵⁶ in year 2010, which opened the door for regulated online gaming. The objective of this legislation was to combat gambling addiction and money laundering while safeguarding the market share of existing French operators.⁵⁷

However, it came with its own challenges. France had decided to follow the turnover (*CEA*)-based taxation model. It levied a tax on CEA at the rate of 11%.⁵⁸ This was considered to be extremely high, as it forced several operators out of business from time to time. Another major problem with this system was that the domestic operators were required to pay the taxes on players' winnings instead of the players. This put a huge undue burden on the regulated operators in France, who then started closing down their operations or shifting their operations to the black market.

In a study conducted by the national gambling authority of France (*l'Autorité Nationale des Jeux*), it was estimated that the worth of France's black market for online gambling was around 1.5 billion euros annually

54. Finance Act (No. 2), 2014.

55. Annie Lingerman 'UK Online Gambling Taxation' (Law & Trust International, 10 January 2020) <<https://lawstrust.com/en/autor/klymenko/uk-online-gambling-taxation>> accessed 4 January 2024.

56. French Gambling Act (No 2010-476), 2010.

57. 'French Online Gaming' (Casino City) <<https://www.casinocity.fr/online-gaming/#:~:text=The%20effective%20tax%20rate%20on,pot%20or%20tournament%20prize%20pool.>> accessed 2 January 2024.

58. GST on Online Gaming (n 42).

in Gross Gaming Revenue, which was equal to nearly half of France's revenue from regulated online gambling.⁵⁹ To safeguard the players and to foster a safe and regulated environment for these activities, the EU urged the French authorities to reassess their taxation regime.⁶⁰

In its 2015-16 activity report, ARJEL noted that taxing the stakes was too burdensome and hindered the balanced development of the market. The report prepared by the Court of Auditors in October 2016 further confirmed that the French taxation system was very heavy because it collected taxes with the CEA as the base instead of GGR.⁶¹ Therefore, both ARJEL and the Court of Auditors had proposed to change the taxation base to GGR.

In 2020, France's Senate finally took action and passed a bill, which included an amendment to calculate the tax on online gaming activities based on GGR instead of turnover (*CEA*). The Senate pointed out that many reports were made in the recent past that highlighted the harsh repercussions of levying tax on players' stakes instead of on GGR.⁶² They further added that the old taxation system used to tax operators on "sums that they do not receive".⁶³ However, by taxing the revenue generated, the operators and the state treasury would be sharing the luck since the tax bills would be dependent on players' success or failure.⁶⁴ It is expected that there will be positive changes with regard to the curbing of black market operations as well as increasing the channelisation rate once the bill comes into force.

C. Learnings

More and more countries worldwide are shifting to the more favourable tax practice of taxing only the GGR instead of the entire amount

59. 'EGBA Calls on France to Regulate Online Casino amid Growing Black Market Concerns' (EGBA, 5 December 2023) <<https://www.egba.eu/news-post/egba-calls-on-france-to-regulate-online-casino-amid-growing-black-market-concerns/>> accessed 3 January 2024.

60. Ibid.

61. John Isaac, 'French Senate Approves Shift to GGR Tax on The Gambling Industry' (Online Gambling, 1 January 2020) <<https://www.online-gambling.com/news/french-senate-approves-shift-to-ggr-tax-on-the-gambling-industry.html>> accessed 4 January 2024.

62. Daniel O'Boyle, 'French Senate Approves Shift to GGR Tax for Gambling' (iGB, 6 October 2020) <<https://igamingbusiness.com/casino-games/french-senate-approves-shift-to-ggr-tax-for-gambling/>> accessed 1 January 2024.

63. Ibid.

64. Ibid.

paid by the users. Additionally, selecting an ideal tax rate is essential for the development of the industry. The 2016 Copenhagen Economics report stated that most of the developed countries have chosen their tax rates between 15-20% on GGR. Higher tax rates have been found to be less attractive and detrimental to operators, especially those operating on smaller margins. The examples of the UK and France have shown the positives of taxing GGR at a moderate rate and the negatives of taxing CEA at a high rate, respectively.

V. RECOMMENDATIONS

The authors, after a thorough scrutiny of the amendment and the changes it brings about in the Indian gaming industry, have observed that the GST Council, Finance Ministry, and MeitY have to work in tandem and bring about a certain framework that considers the complexities of the online money gaming industry.

1. **Defining “online game of skill”:** The Government and GST council should take cognizance of the fact that “games of skill” do involve a great deal of effort and mastery in order to be successful. The council’s blind eye towards games of skill, categorising them as any other online game with stakes, is very evident.⁶⁵ The authors recommend that, relying on the jurisprudence that exists on the same, be it in the cases of Gameskraft Technologies Private Limited, All India Gaming Federation, etc., a definition can be arrived at for “games of skill.” A “online game of skill” can be defined as “any online game played with or without stakes in which there is a predominance of application of knowledge, training, adroitness, attention, and experience.” This would solve the legislative incongruence.
2. **Reverting back to 18% on GGR:** There are three compelling reasons for reverting back to a previously existing taxation rate of 18% on GGR. One is that the growth of the industry should not be compromised in the long run at the cost of enriching the exchequer in the short run. It has been convincingly demonstrated by the authors that the industry would take a huge hit

65. Minutes of Meeting, 50th GST Council Meeting (GST Council Meeting) 11 July 2023.

in terms of revenue if a 28% GST was levied on CEA. This would mean that there would be offloading of employees, and furthermore India would lose the opportunity to be a gamer's paradise. Two, countries, like the UK and France, have already recognised the importance of taxing a percentage on the GGR; the UK in particular was very agile to revert back to the GGR from a turnover-based tax system.⁶⁶ The industry experts have recommended that the ideal rate at which the industry has to be taxed should be between 15-20%,⁶⁷ which would ensure that the industry grows while at the same time benefitting the exchequer. The commerce surrounding 18% tax on GGR has worked well for the gaming industry.

3. **Increasing Transparency in the GST Council:** While the GST Council does publish the minutes of the meeting, there has to be better clarity on expert consultations, which result in the council making recommendations. The Group of Ministers, which was responsible for the reports, was the basis on which the GST Council recommended changes. As much as they claim to have sought expert opinion, the minutes of the Council meeting do not disclose the opinions of the industry experts.⁶⁸ This would ensure that industry leaders are thoroughly consulted and not result in discord after a change in the tax regime, which unfortunately is the case here.⁶⁹
4. **Player Regulations:** In order to tackle the adverse effects on youth, an economic measure is not necessarily the solution. Rather, a qualifying criterion can be developed in order to ensure that underage youth are not impacted by the online games. These criteria can be that of age and the amount of money that has been invested and lost by the player. The Online Money Gaming Platforms can be mandated to meet these qualifying criteria by the Ministry of IT. This measure would serve

66. Report on Taxation of Digital Economy (n 22).

67. *Ibid.*

68. GST Council Meeting (n 65), pg. 47.

69. Mehuel Reuben Das, 'Billions Down The Drain': What do industry experts have to say on 28% GST on online gaming' (Firstpost, 12 July 2023) <<https://www.firstpost.com/tech/news-analysis/billions-down-the-drain-what-do-industry-experts-have-to-say-on-28-gst-on-online-gaming-12859342.html>> accessed 20 December 2023.

all three stakeholders-the gaming industry, gamers, and the government-positively.

5. **Settling the discord between MeitY, the Finance Ministry, and the GST Council:** In order to resolve the great deal of discord between the MeitY and the Finance Ministry, it is indicated that the governance has been lacking. The IT Minister for State has, in fact, has resented the decisions of the Council and the Finance Ministry. In this “AI world,” all the arms of the government have to function in tandem with the IT Ministry; hence, a framework has to be adopted where a representative of the IT Ministry finds a voice in cases related to AI, gaming, and Information Technology in general, among various other ministries. This would ensure that any decision that is arrived at can be observed through the lens of IT, through which niche problems can be effectively tackled.

Sugarcane Farmers in Limbo: Analysing their Position as Bajaj Hindusthan Sugar's Operational Creditors

—Ashita Mathur*

ABSTRACT

This paper aims to analyze the financial troubles Bajaj Hindusthan Sugar Ltd. has been facing in the past decade, with multiple lending banks and farmers alike claiming unpaid dues worth thousands of crores over the years. The lenders had sought remedy by way of a Section 7 Petition to the National Company Law Tribunal's Allahabad Bench, seeking initiation of the Corporate Insolvency Resolution Process. On the other hand, sugarcane farmers have been engaged in protests since June of 2023, seated in front of the 14 sugar mills owned by the company in the state of Uttar Pradesh. Considering such contrasting claims, this paper aims to study the instances in which the company has narrowly avoided the CIRP, despite frequent defaults on operational and financial debts. The author also attempts to ascertain whether BHSL may escape proceedings under the Insolvency and Bankruptcy Code, 2016 yet again whether at the hands of the farmers or the banks at a later stage, in the event of further default. The paper attempts to evaluate the farmer's perspective, while also considering whether it would be possible for them to attain relief under the IBC. At first, the potential reasons behind the defaults have been analyzed, followed by the legal position of the farmers as creditors in the present instance. Secondly, the SBI's request to the NCLT has been explored, and the implications of the petition's rejection have been discussed. And finally, the company's Ethanol segment has been explored as a possible saving grace for its current distress.

* The author is a student at the National Law Institute University, Bhopal (NLIU).

I. INTRODUCTION

Bajaj Hindusthan Sugar Ltd. (*BHSL*) has had a history of default, beginning in 2014, even prior to the NCLT's establishment.¹ As per reports, BHSL has been facing substantial sugarcane dues payable towards farmers,² who have been protesting in front of sugar mills across India.³ In Uttar Pradesh most notably, there have been sit-on protests in front of the 14 Bajaj Sugar Mills in the state.⁴ The broad context seems to be that the farmers claim to have not received full payment for their crops since 2020.⁵

The sale of sugarcane is orchestrated in a manner which ties farmers to a particular mill, an approach which consequently binds the fate of the farmer to the financial health of that specific mill.⁶ The process currently involves the state government constituting a sugarcane committee, which has the responsibility of issuing tickets to farmers allowing them to sell their crops to a single mill, which is by norm the closest available one.⁷

The farming of sugarcane is a field ridden with economic insecurity, and unpaid dues by mills cause the farmers to seek loans from the unorganised sector in order to sustain themselves for the next season, leading to a cycle of debt. The sugarcane industry has been facing unfavourable climate conditions and a decreasing profit margin. The crop largely fails

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1. Rajendra Jhadav, 'Sugar Mill Defaults on Bank Loans, Others May Follow', (Livemint, 9 October 2014) <<https://www.livemint.com/Industry/V7T7yNDCQXz5tixQAkyhzN/Sugar-mill-defaults-on-bank-loans-others-may-follow.html>> accessed 4 August 2023.
 2. Bajaj Hindusthan Sugar Limited, '90th Annual Report 2021-2022' (BajajHindustan) <<https://www.bajajhindusthan.com/bajajHindustanCMS/uploads/downloads/90TH%20ANNUAL%20REPORT%202021-2022.pdf>> accessed 8 August 2023.
 3. Keshav Agarwal, 'Cane Farmers on Indefinite Protest at Over Two Dozen Sugar Mills Across UP' (Times of India, 2 January 2023) <http://timesofindia.indiatimes.com/articleshow/96691190.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 4 August 2023.
 4. Mohd Dilshad, 'Farmers Protesting for Last 2 Months Over Pending Cane Dues of Rs 250 Cr' (Times of India, 4 August 2023) <http://timesofindia.indiatimes.com/articleshow/102406498.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 5 August 2023.
 5. Ibid.
 6. Ajoy Ashirwad Mahaprashasta, 'In UP's Sugarcane Belt, Anger Over Farmers' Dues May Influence Electoral Outcome' (The Wire, 18 January 2023) <<https://thewire.in/agriculture/uttar-pradesh-election-sugarcane-farmers-dues-anger-influence>> accessed 21 August 2023.
 7. Department of Food and Public Distribution, 'Sugar Policy' (Department of Food and Public Distribution, 2023)

to offer the anticipated high returns.⁸ Since switching crops is an intensive and highly expensive process, sugarcane is known for trapping farmers in a vicious cycle by sowing the “water-guzzling” crop, and facing failure of the crop due to unpredictable monsoons and a declining groundwater table level.⁹

In light of such obstacles, one must acknowledge the steady rate at which farmers’ suicides in the country has been rising.¹⁰ While it would be erroneous to pinpoint a single cause for this state of affairs, unpaid debts and failing crops contribute to their burdens. Sugarcane’s supposed status as one of the most profitable crops persists, and farmers continue to switch to growing the trouble-riddled crop, only to face failure, if not due to the failure of the crop, then by the hand of defaulting sugar mills.¹¹

The paper attempts to evaluate the farmer’s perspective, while also considering whether it would be possible for them to attain relief under the IBC.

Firstly, the potential reasons behind the defaults have been analyzed, followed by the legal position of the farmers as creditors in the present instance. Secondly, the SBI’s request to the NCLT has been explored, and the implications of the petition’s rejection have been discussed. And finally, the company’s Ethanol segment has been explored as a possible saving grace for its current distress.

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8. Vishwa Mohan, ‘Farmers prefer water-guzzlers sugarcane and paddy over climate resilient nutri-cereals’ (Times of India, 15 September 2018) <<https://timesofindia.indiatimes.com/india/farmers-prefer-water-guzzlers-sugarcane-and-paddy-over-climate-resilient-nutri-cereals-7-dip-in-sown-area-for-jowar-bajra-ragi-small-millet/articleshow/65815917.cms>> accessed on 21 August 2023.
 9. Ruchira Singh, ‘Farmers prefer to sow rice, sugarcane’ (Livemint, 20 August 2012) <<https://www.livemint.com/Politics/9NuLxOqjVgiBJP5pIRMVKJ/Farmers-prefer-to-sow-rice-sugar-cane.html>>accessed 21 August 2023.
 10. Janos Chiala, ‘India’s sugarcane farmers: A cycle of debt and suicide’ (Aljazeera, 3 April 2017) <<https://www.aljazeera.com/features/2017/4/3/indias-sugarcane-farmers-a-cycle-of-debt-and-suicide>>accessed 24 August 2023.
 11. Ramesh S Arunachalam, ‘Financial inclusion of sugarcane farmers in modern-day India’ (Moneylife, 3 September 2011) <<https://www.moneylife.in/article/financial-inclusion-of-sugarcane-farmers-in-modern-day-india/19425.html>>accessed 25 August 2023.

II. THE BACKGROUND OF BAJAJ HINDUSTHAN SUGAR'S TROUBLES

In the year 2014, BHSL defaulted on loan payments and negotiated a deal with the Joint Lender's forum, restructuring its loan.¹² On this restructured loan, BHSL defaulted yet again in 2017, and following the RBI's scheme under the Scheme for Sustainable Structuring of Stressed Assets Scheme, known otherwise as S4A, a part of the debt was converted into equity.¹³

BHSL finally managed to clear its debt in 2019 and again in 2022 after facing Section 7 proceedings under the IBC by a consortium of banks led by SBI.¹⁴ However, the debts it has claimed to repay have been those owed to lending banks. BHSL has currently not issued any comments on the debts that are being claimed by sugarcane growers.

Farmers in the state of Uttar Pradesh had claimed unpaid dues upwards of Rs. 2860 crore from BHSL's 14 mills in the state as of July 2022. As per the farmers, BHSL mills were known for delaying payments for 12-14 months, as against the 14-day payment cycle put in force through the Sugarcane Control Act.¹⁵

It has been speculated that the reason behind the default on the part of mills is the price of canes shooting up, coupled with the ex-factory rates of sugar falling.¹⁶ The farmers' demands remain that the Fair and

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12. 'Bajaj Hindusthan Sugar: Updates on Outcome of Board Meeting - Restructuring of Loans under Joint Lenders Forum (JLF) Route' (Value Search Online, 26 December 2014) <<https://www.valueresearchonline.com/stories/eb766coa-7cc5-4b4c-840e-a15e89f82eee/news-announcement/>> accessed 21 August 2023.
 13. Saloni Shukla, 'JLF to take Bajaj Hindusthan Sugar's loan account to S4A' (Economic Times, 23 June 2017) <<https://economictimes.indiatimes.com/industry/banking/finance/banking/jlf-to-take-bajaj-hindusthan-sugars-loan-account-to-s4a/articleshow/59287966.cms?from=mdr>> accessed 25 August 2023.
 14. 'SBI starts insolvency proceedings against Bajaj Hindusthan Sugar' (Livemint, 16 Aug 2022) <<https://www.livemint.com/companies/news/sbi-starts-insolvency-proceedings-against-bajaj-hindusthan-sugar-11660654526929.html>> (Bajaj Hindusthan) accessed 21 September 2023.
 15. Deepa Jainani, 'Sections of UP cane farmers in a quandary as Bajaj Hindusthan turns NPA; Company's unpaid dues to farmers at Rs 2,860 crore' (Financial Express, 9 July 2022) <<https://www.financialexpress.com/industry/sections-of-up-cane-farmers-in-a-quandary-as-bajaj-hindusthan-turns-npa-companys-unpaid-dues-to-farmers-at-rs-2860-crore/2588002/>> accessed 21 September 2023.
 16. PTI, 'Bajaj Hindusthan promoters pledge entire stake to SBICap' (Economic Times, 23 February 2015) <<https://economictimes.indiatimes.com/markets/stocks/news/bajaj-hindusthan-promoters-pledge-entire-stake-to-sbicap/articleshow/46346292>>.

Remunerative Price (*FRP*) declared by the government must be paid by the mills to the farmers.¹⁷ Additionally, to further safeguard farmers' rights, the governments of the major sugarcane producing states have put in place the State Advised Price (*SAP*), which is usually higher than the *FRP*.

The Sugarcane Control Order of 1966, issued under the Essential Commodities Act, of 1955 mandates that mills must clear payment of the *FRP* within 14 days of delivery of the cane. The U.P. Sugarcane (Regulation of Supply and Purchase) Act, 1953, of interest in the present matter, also mandates the same. Interest accrues on the principal amount in the event of non-payment. If the debt remains unpaid, the collector is (upon intimation from the Cane Commissioner) empowered to recover the amount from the occupier, as if it were an arrear of land revenue.¹⁸ This would be done through the process of attachment and sale of the defaulter's moveable and immovable properties.

As noted by the Supreme Court in 2021, the *SAP* is likely to cause more defaults owing to its value being unreachable by mills at some times.¹⁹ Contrastingly, courts have also, in certain instances, ordered mills to pay the *FRP*, and not the *SAP*, prioritising the farmers' well-being.²⁰ The Supreme Court has also lauded attempts by the government to reduce arrears, through setting remunerative and assured prices of ethanol, financial assistance to mills and enhancement and augmentation of ethanol production capacity and to molasses based stand-alone distilleries.²¹

However, the reality remains that despite the statutory protection afforded to the sugarcane growers, they struggle to be repaid their due

cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppstaccessed> accessed 21 September 2023.

17. Cabinet Committee on Economy Affairs, 'Government approves Fair and Remunerative Price of sugarcane payable by Sugar Mills to sugarcane farmers for sugar season 2023-24' (PIB, 28 June 2023) <<https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1935899>> accessed 21 September 2023.
18. The U. P. Sugarcane (Regulation of Supply and Purchase) Act 1953, s 17 (4).
19. Dhananjay Mahapatra, 'How to pay Rs. 20,000 crore dues of sugarcane farmers, CS asks 11 states' (Times of India, 5 August 2021) <https://timesofindia.indiatimes.com/india/how-to-pay-rs-20000-dues-of-sugarcane-farmers-sc-asks-11-states/article-show/85059315.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed (Mohapatra) 23 September 2023.
20. P. Ayyakanu v Government of Tamil Nadu, Rep. by its Secretary, Agriculture Department & Ors [2023] SCC OnLine Mad 3163.
21. Mohapatra (n 19).

amounts, and payments take up to an year if at all given.²² It has been observed that virtually no miller pays interest to the farmers on the due payments.²³ It has become apparent that the implementation of the statutory sugarcane framework has been lacking. Owing to such inefficiencies, the farmers have put forth a large claim of being treated as Financial Creditors under the IBC.

Although BHSL has not stated much about the alleged debt, the sugarcane growers have been engaged in protests against the company at various points in the past year. They had sought recourse through an application to be impleaded in the Section 7 petition by the SBI against the company, and had been impleaded before the NCLT ultimately allowed the bank to withdraw its petition. The Agragami Kissan Samiti U.P, a farmers union had filed the application, which did not contain an exact amount of default on debt claimed. As has been stated above, an estimate of 2860 crores of default has been reported.²⁴

The lenders' consortium of the BHSL includes a multitude of banks led by SBI, who claimed debts above Rs.4600 crore, which the company claimed to have settled shortly after the SBI approached the NCLT.

III. FARMERS AS CREDITORS

At the time of enactment of the Code, many hailed it as a fix to the troubles plaguing India's agrarian debts. The Fresh Start Process available under Section 81 was envisioned to include farmers in the capacity of debtors, and it was envisioned they too could seek a waiver of pending debts.²⁵ While the practicality of a farm loan waiver has been hotly debated, there exists merit in the idea of the Code extending aid to farmers as well, classifying them as Operational Creditors (OCs).

Recently, the resolution plan of New Phaltan Sugar Works Limited was in front of the NCLAT, with a group of OCs contending that the

22. Institute of Rural Management, 'Policy Brief on Sugarcane Supply Chain in Uttar Pradesh' (IRMA) 6.

23. *Ibid* at 7.

24. Deepa Jainani, 'Sections of UP cane farmers in a quandary as Bajaj Hindusthan turns NPA; Company's unpaid dues to farmers at Rs 2,860 crore' (Financial Express, 9 July 2022) <<https://www.financialexpress.com/business/industry-sections-of-up-cane-farmers-in-a-quandary-as-bajaj-hindusthan-turns-npa-companys-unpaid-dues-to-farmers-at-rs-2860-crore-2588002/>> accessed 30 September 2023.

25. The Insolvency and Bankruptcy Code, 2016, s 81.

sugarcane farmers had been given unfair priority over not only other OCs, but all financial creditors as well. While other creditors had been given haircuts in the proposed Plan, the farmers as OCs were to be repaid the full value of their admitted claim.

The OCs contended that the Code did not allow for any distinction between various operational creditors. Two classes of creditors who are similarly placed, and are on the same footing, must be treated equally, with no discrimination in the Plan.²⁶ The fact that these OCs were given priority over all financial creditors as well was not in contention, which may provide room for an assumption that the aggrieved OCs wished to gain such priority over other creditors as well.

The Hon'ble Tribunal rejected such arguments, stating that it was apparent in the present instance that the farmers were not placed on a similar footing as the aggrieved OCs. It was held that the Corporate Debtor being part of an agriculturally dependent industry, relied on the farmers heavily, and such sugarcane farmers were in fact the backbone of the sugar industry. It would not be just and fair to treat them similarly to other OCs when it would have been impossible for the survival of the Corporate Debtor without their involvement. The same could not be stated for the aggrieved.

The Tribunal therefore supported the contentions made on behalf of the farmers, stating that an excess of 4500 farmers along with their families were dependent on the factory of the Corporate Debtor for their survival. Additionally, the tribunal agreed that it would not have been possible to implement the proposed resolution plan without paying the farmer's dues, which had been pending for 2 years. A reading of the discussions of the Committee of Creditors' meetings further showed that the Secured Financial creditors themselves agreed to bear the burden of repaying 100% of the dues owed to the farmers.

In another objection to the resolution plan, the tribunal reprimanded the OCs by stating that they were not conscientious of the fact that several farmers had committed suicide post-closure of the Corporate Debtor, expecting to never be repaid debts owed to them. Any further delays to

26. Amit Goel v Piyush Colonizers Ltd. & Anr. [2023] Comp. App. (AT) (Ins.) No.981/2023.

the implementation of the plan would cause further devastating complications, which the tribunal elected to avoid.²⁷

One must also consider the case of *P. Ayyakanu v. Government of Tamil Nadu, Rep. by its Secretary, Agriculture Department & Ors.*,²⁸ in which the Madras High Court acknowledged the plight of sugarcane farmers, and directed they be repaid the outstanding amount of the FRP.²⁹ The court stated that the state should have taken appropriate measures to ensure the farmers received the SAP and had said,

“Firstly, we have to understand the plight of the farmers. Sugarcane itself is a distant attraction/greener pasture on the other side of the river to any small and marginal farmer. The average small and marginal farmers, finding themselves facing certain difficulties and unable to bear the vagaries of the monsoon, availability of water and market fluctuation in respect of the paddy and other regular crops, switched over to sugarcane..... The Fair and Remunerative price is the barest minimum price which is fixed by the Central Government and even as per the fair and minimum price, a total sum of Rs. 78.48 crore is now admittedly due by the parties.For the above, the farmers cannot be put to loss and therefore, they are entitled to payment of at least the minimum price being the Fair and Remunerative Price, if not the State Advised Price with further interest.”³⁰

(Emphasis added)

The court also highlighted the exact difficulties of the small and marginal farmers and stressed upon certain steps the state must endeavour to take to protect their survival, including ensuring the repayment of their debts by defaulting sugar mills.³¹ In the judgment, the farmers had ultimately been paid the remaining outstanding amount (in accordance with the FRP).

In terms of liquidation, Section 53 of the Code outlines different priorities for the payment of Employees, Statutory dues and other OCs, the stipulated waterfall mechanism may not be appropriate for every industry.³²

27. *The Cosmos Co-op Bank Ltd v. New Phaltan Sugar Works Ltd* [2019] SCC OnLine NCLT 23248.

28. *P. Ayyakanu v. Government of Tamil Nadu, Rep. by its Secretary, Agriculture Department & Ors.* [2023] SCC OnLine Mad 3163; [2023] 2 LW 973.

29. *P. Ayyakanu* (n 28), para 21.

30. *Ibid* at para 6.1.

31. *Ibid* at para 21.

32. *The Insolvency and Bankruptcy Code, 2016* (31 of 2016) s 53.

The facts and circumstances, along with the nature of the industry, may cause variations when deciding upon the priority of payments. The functioning or Modus Operandi of the Corporate Debtor must have a bearing on identifying who the preferred creditors of a particular debtor may be. For a particular set of cases (especially those in which public policy suggests otherwise), they may be treated as a general guideline to fall back on, rather than a universally applicable, compulsorily binding scheme.

In October 2014, a SC bench of Chief Justice H.L. Dattu, Justice Madan B. Lokur and Justice A.K. Sikri, said “if farmers are not paid, they will commit suicide”.³³ In 2021, multiple distressed sugarcane farmers approached the Supreme Court, seeking recovery of debts collectively reaching Rs. 20,000 crores.³⁴ The court had issued notices to the Central Government, 11 states as well as 4 major sugar mills including BHSL, directing them to put in place appropriate mechanisms to ensure the speedy recovery of the debt.

In recent days, it has become apparent that public focus tends to revolve primarily around farmers defaulting on loans, and the status of insolvent farmers. Little has been notified in reference to the issue of farmers not being repaid debts by mills and other intermediaries. Currently, in the event of a mill delaying payments, the Cane Commissioner has the option to ensure recovery of the unpaid amounts by directing the attaching the property of the mills to the Collector.³⁵ Yet, the plight of sugarcane farmers in particular grows more distressing day by day and requires attention by providing them sufficient remedy under the Code.

IV. THE SBI LEADS BANKS TOWARDS THE NCLT

The aforementioned application by SBI to the NCLT’s Allahabad Bench, on 16th August 2022, detailed debt to the tune of Rs.1100 crores as of 2nd August.³⁶ Cumulatively, an amount higher than Rs.4600 crores was owed to banks and sugarcane farmers by BHSL. While the tribunal was

33. ‘SC gives precedence to sugarcane farmers over banks’ (Business Standard, 13 October 2014) <https://www.business-standard.com/article/news-ians/sc-gives-precedence-to-sugarcane-farmers-over-banks-114101300399_1.html> accessed 30 September 2023.

34. Mahapatra (n 19).

35. ‘Sugar Mills to Pay Interest on Delayed Payments,’ (Times of India, 15 December 2016) <<https://timesofindia.indiatimes.com/city/lucknow/sugar-mills-to-pay-interest-on-delayed-payments/articleshow/55973344.cms>> accessed 9 September 2023.

36. Bajaj Hindustan (n 14).

all set to hear the matter in December of that year, a mere five days before the matter was listed, BHSL claimed to have repaid the debt entirely.³⁷ This move followed a common practice employed by Corporate Debtors that default on payments regularly, to clear minimum dues payable once creditors initiate insolvency proceedings against them.³⁸

As of the 27th of October, the lenders' plea to withdraw the petition has been approved by the NCLT. The banks, led by SBI had previously not accepted BHSL's claim that all dues have been settled. Until their application, they appeared eager to continue their application for CIRP under the Code. However, while the banks have claimed the outstanding amount has been paid by the corporate debtor during the pendency of the petition,³⁹ the future of the farmers remains uncertain.

V. AN ALTERNATE FUTURE FOR THE FARMERS

Being OCs, it remains to be seen whether the NCLT would have taken action in favour of the farmer's interests over the secured class of financial creditors, i.e., the banks in the current scenario. In the event that the farmers do pursue their plea for CIRP, it is not necessary that the NCLT will follow the usual precedent for navigating OCs interests. Owing to the contrasting nature of the farmer's position with prior circumstances of other OCs (those placed on a different footing), the NCLT may exhibit preference towards the farmers.

As seen in 2014, the Supreme Court has set a precedent for favouring sugarcane farmers by placing their interests above those of the banks. The Hon'ble Court reasoned that farmers being vulnerable and in financial distress, are likely to commit suicide if unpaid.⁴⁰ In *New Phaltan Sugar Works Limited*, the Tribunal had opted towards favouring the interests of

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37. 'Bajaj Hindusthan Sugar Proposes Second Restructuring Plan,' (Economic Times, 18 June 2021), <<https://economictimes.indiatimes.com/news/company/corporate-trends/bajaj-hindusthan-sugar-proposes-second-restructuring-plan/articleshow/96287403.cms?from=mdr>> accessed 9 September 2023.
 38. Rounak Kumar Gunjan 'A US\$265M company's guide to defaulting on loans and evading insolvency' (The Ken, 3 January 2023) <<https://the-ken.com/story/a-265m-companys-guide-to-defaulting-on-loans-and-evading-insolvency/>> accessed 5 January 2024.
 39. *State Bank of India v Bajaj Hindustan Sugar Ltd NCLT CP (IB) No.79/ALD/2022 (SBI v Bajaj)*
 40. 'SC Gives Precedence to Sugarcane Farmers Over Banks,' (Business Standard, 13 October 2014), <https://www.business-standard.com/article/news-ians/sc-gives-precedence-to-sugarcane-farmers-over-banks-114101300399_1.html> accessed 10 September 2023.

the vulnerable sugarcane farmers and supporting the repayment of 100% of their debts to the detriment of other creditors.

In the present instance, it may arise that the NCLT allow an application for CIRP solely on the farmer's claims to be admitted, which have been accruing since 2021. Essentially, even though the lenders and the tribunal are satisfied that BHSL did indeed repay dues to SBI, it may find the farmer's claims sufficient for initiation of the Corporate Insolvency Resolution Process upon an application by them.

The possibility that the tribunal may, having agreed that all debts by BHSL towards the banks have been cleared, as claimed by the company, dismiss the claims by the sugarcane farmers, represented by the Agragami Kissan Samiti U.P, a farmer's body comprised primarily of sugarcane farmers, persists. This possibility exists due to the conventional opinion of OCs held under the code, and it being practically challenging to admit a claim solely on an OC's claims. Despite the existing precedent and appropriate mechanisms to admit an OC's application for CIRP, the standard for acknowledging a debt default of an OC becomes tricky to navigate. However, one must bear in mind the logistical challenges that will be faced by farmers' unions in collating the differences of opinions among farmers. Additionally, the sugarcane growers appear focused on purely recovering their debt, in complete antithesis to the Code's principle of resolution, not recovery.

In the event that the tribunal admits the farmers' claims, there may emerge difficulty collating their concerns. Many perplexities relating to the inclusion of farmers in the process have arisen in the past, with complaints by RPs that finding unanimity between the thousands of farmers proves to be an impossible task, and collation of their claims itself is immensely difficult. In the aforementioned case of P. Ayyakanu, the farmers had complained that the insolvency professional appointed to represent the farmers, had no connection with them, and had not succeeded in securing their agreement to recover 57% of the dues.⁴¹ They claimed that the representative had no interest in attempting to unite the farmers, and elected to organise separate mobile camps and villages wise, in the hope that approaching them separately would prove favourable. Even post such herculean efforts, only 10% of the farmers were in agree-

41. P. Ayyakanu (n 28) para 10.

ment with the haircut, and the representative reported their support in a manner that would suggest 100% of votes were cast in favour of the resolution. This further invited complaints from the farmers, as they believed it was unfair the views of a select few farmers were being represented as the consensus of all of the aggrieved.⁴²

It stands to be acknowledged that a dismissal or refusal to acknowledge the farmers' claims would be unlikely since the farmers are not placing any fraudulent claims on the company, and there exists precedent for safeguarding the farmers' interests. Additionally, the position of OCs as bona fide creditors entitled to claim relief under the Code has been steadily improving over the past few years.

Therefore, in the event that the NCLT does admit the claims put forth by the farmers, the logistics of the process would likely pose innumerable difficulties and would be prone to delays. Additionally, it is highly unlikely that the farmers would accept a haircut, and would seek repayment of the full amount due, as evidenced in New Phaltan Sugar Works Limited, as well as P. Ayyakanu.

Even in a scenario where the banks had pursued the CIRP, the fate of the farmers would have still been in limbo, considering the long delays that have become routine in such matters. The livelihood of sugarcane farmers depends upon the mills, and further delay may cause irreparable distress to them, along with their families.

VI. THE FUTURE OF THE ETHANOL BUSINESS

Ethanol production is heavily reliant on the fate of sugar stocks, being a bio-fuel that is produced through fermenting sugar with yeast. Its use is common in the production of plastics, polishes, cosmetics and most notably as an alternative source of fuel.⁴³ BHSL has placed high hopes on the potential of sugar in ethanol production with a focus on flex-fuel cars.⁴⁴ In the current Ethanol year that began in November 2022, 450

42. Ibid.

43. Anjana Shriram, 'Ethanol, price rise, production drop continue to fuel rally in sugar stocks', (Hindu Business line, 23 June 2023) <<https://www.thehindubusinessline.com/markets/ethanol-price-rise-production-drop-continue-to-fuel-rally-in-sugar-stocks/article66998548.ece>> accessed 30 September 2023.

44. Gunjan (n 38).

crore litres out of the cumulative 550 crore litres of ethanol produced has come from the sugar industry.⁴⁵

However, it must be noted that doubts regarding the green efficiency of Ethanol have already arisen, with reports claiming that it may be as carbon-intensive as petrol due to carbon emissions caused by the land-use changes to grow the crops, water exploitation and the entire process of making ethanol.⁴⁶ Additionally, sugarcane being a water-intensive crop is causing complications in various states, with the result being that sugarcane yields are falling across the country, increasing farmers' debts.

As per BHSL, Ethanol may be posited as the saving grace for its debts, with hopes that the government would release a policy soon on the use of Ethanol for cars run solely on ethanol in the near future, thereby boosting its business.⁴⁷

VII. CONCLUSION

It is apparent that the farmers are in dire need of help, and the Tribunal may take relevant measures to support them. They have made claims of being considered as Financial Creditors, helped in a manner similar to the NCLT rallying to protect the interests of homebuyers when they were facing issues regarding repayment of dues.⁴⁸ Insolvency is pervasive and stretches across sectors and the Tribunal must posit itself as a source of alternative remedy since all other modes have not provided sufficient relief to the sugarcane farmers. Even in the order allowing a withdrawal of the petition made by SBI, it was stated that.

45. 'Indian sugar industry demands roadmap on ethanol sourcing' (The Hindu, 23 August 2023) <<https://www.thehindu.com/business/sugar-industry-demands-roadmap-on-ethanol-sourcing/article67228041.ece>> accessed 10 September 2023.

46. Cheena Kapoor, 'A sweet solution? India's push to use sugar for fuel may create more problems than it solves' (The Third Pole, 9 February 2023) <<https://www.thethirdpole.net/en/energy/indias-push-to-use-sugar-for-ethanol-may-create-problems/>> accessed 29 September 2023.

47. Bhakti Makhwana, 'Sugar companies witness a sweet rally on ethanol excitement that may continue in 2022 as well' (Business Insider, 10 January 2022) <<https://www.businessinsider.in/stock-market/news/sugar-companies-witness-a-sweet-rally-on-ethanol-excitement-that-may-continue-in-2022-as-well/articleshow/88591715.cms>> accessed 30 September 2023.

48. Pioneer Urban Land and Infrastructure v Union of India [2019] SCC OnLine SC 1005.

“...the main petition is dismissed as withdrawn. However, all parties are left to their further rights and remedies in accordance with law.”⁴⁹

It may be speculated that should the farmers approach the tribunal separately by way of a Section 9 application under the IBC they would be able to obtain favourable relief.

In order to avoid situations where farmers claim their representative is an outsider indifferent to their concerns, as occurred in the case of P. Ayyakanu, the farmer’s unions may themselves be given the task of unifying their concerns and approaching the NCLT, to minimise bias by an outsider. As issues have arisen regarding coalescing their opinions and claims, allowing them to choose their representative would alleviate concerns they may have about foreign interference.

In the interest of public policy, it would be ideal that in cases where farmers are creditors, the justification provided in *New Phaltan Sugar Works Limited* be applied and used as precedent and farmers be repaid 100% of their claim, even if it is to the detriment of other creditors. Essentially, in cases where the corporate debtor owes dues to farmers, their status may be shifted from OCs to priority creditors, and their claims be ranked above those of even secured financial creditors.

Therefore, it has become apparent that in the interest of public policy, and in order to help the state in fulfilling its responsibilities towards a distressed class of people, the NCLT remains a viable option for the farmers to approach for the recovery of the amount they are indebted.

49. *SBI v Bajaj* (n 39).

Corporate Raiders or Do-Gooders? Analysis of Activist Investors In An Indian Context

—Manasvi Kanaparthi and Ayushman Biswal*

ABSTRACT

The corporate governance landscape in India has in recent times seen a departure from the well-established rule of the majority, in favour of a more proactive role for regulators and, tribunals. This is evidenced by the wide-ranging provisions in the Companies Act, 2013 and its allied legislations. The Securities Exchange Board of India has even gone so far as to establish a Stewardship Code 2020, mandating that institutional investors maintain. However, from the case study on Adani Group, we have found the current legal and regulatory framework to be inadequate with reference to their corporate governance and Environmental and Social Governance (ESG). In this light, the proliferation of activist investors within the large, family-controlled corporations in India would be favourable. Activist investors, a popular concept on Wall Street, are essentially private equity hedge funds which acquire a significant shareholding in companies which they believe to be underperforming or stuck in what is termed as ‘investment purgatory’. The motive of such acquisition is to influence the decision-making from within the boardroom. In recent times, hedge funds with motives of improving corporate governance or social and environmental impact have gained popularity abroad. The authors argue that with the inadequacies in the current regulatory mechanisms to monitor the operations of companies, the involvement of such actors would be beneficial. A hypothetical transplantation of the activist investor scenario to the case study of Adani Group proves that this will ease the

* The authors are students at Indian Institute of Management, Rohtak.

burden on courts, governmental agencies and other stakeholders by keeping an eye on such large corporations. Ensuring that their compliance with legal, regulatory as well as environmental and social standards is maintained. It is submitted further, that by recognizing and incentivizing these actors within the existing framework, the oversight mechanism has the potential to be efficient.

I. INTRODUCTION

In the traditional sense, although there is nothing traditional about the working of an activist investor, they are defined as hedge funds that acquire stakes enough to influence the decision-making of the company management, for a variety of outcomes which they consider favourable, including increase of dividends to shareholders, or selling off parts of the company they believe to be burdensome.¹

Hedge funds or private equity funds are essential to the process being analysed further, so it is important to first delineate the legal status of these funds in India presently.

In India, private equity or hedge funds are categorized as Alternative Investment Funds (AIF) and encompass various investment structures like trusts, companies, limited liability partnerships, or corporate bodies.² AIFs pool funds from diverse Indian and foreign investors, directing these funds according to a defined investment strategy for the benefit of their investors.³ Crucially, AIFs differ from SEBI-regulated mutual funds or collective investment schemes. Within AIFs, distinct categories exist:

Category I AIFs primarily invest in startups, SMEs, or sectors deemed economically and socially viable by the government.⁴

Category II AIFs include private equity funds or debt funds without specific incentives from the government or regulators.⁵

Category III AIFs, such as hedge funds, focus on short-term returns or operate as open-ended funds without specific incentives from authorities.

1. Bill G and Jay W, 'How to Outsmart Activist Investors' (Harvard Business Review, 2014) <<https://hbr.org/2014/05/how-to-outsmart-activist-investors>> accessed 4 December 2024.
 2. SEBI (Alternative Investment Funds) Regulations 2012, s 2(1)(b).
 3. Ibid.
 4. Ibid.
 5. Ibid.

These categories delineate the different investment approaches and incentives associated with various types of Alternative Investment Funds regulated under these guidelines.⁶

The hedge funds which are referred to in the American context of activist investors, would fall either into Category II or III AIFs in India. It is these funds which have the potential to acquire significant shareholding to bring about a change in the functioning of a company.

Activist investors employ different methodologies from ‘corporate raiders.’ These activists orchestrate campaigns aimed at persuading shareholders and management to endorse their proposed reforms.⁷ Despite the potential negative perception of activist investors, it often proves beneficial. Recent research indicates that hedge funds excel in monitoring management.⁸ It was found that hedge fund activism generated over 7% abnormal returns upon announcement.⁹ By acquiring a substantial ownership stake in the company, an entity may seek to implement significant changes, often through the pursuit of board representation.¹⁰

This may be done through accepting acquisition proposals, divesting specific business segments, or improving operational efficiencies, all aimed at averting adverse future outcomes, while also striving to achieve social and environmental objectives.¹¹ Within this volatile landscape, the strategic involvement of activist investors emerges as a crucial factor for adept guidance and resolution.¹²

6. Ibid.

7. Emily Washburn, ‘What’s An Activist Investor—And How Do They Exercise So Much Control?’ (Forbes, 3 February 2023) <<https://www.forbes.com/sites/emilywashburn/2023/02/03/whats-an-activist-investor-and-how-do-they-exercise-so-much-control/?sh=2d1f38862b8e>> accessed 4 December 2023.

8. Alon B, Wei J, Frank P and Randall T, ‘Hedge Fund Activism, Corporate Governance, and Firm Performance’ (2008) 63 *The Journal of Finance* 1729.

9. Robin G and Michael S, ‘Investor activism and takeovers’ (2009) 92 *Journal of Financial Economics* 92, pp. 362–375.

10. Ibid.

11. Walter Frick, ‘The Case for Activist Investors’ (Harvard Business Review, March 2016) <https://hbr.org/2016/03/the-case-for-activist-investors?ab=at_art_art_1x4_s04> accessed 3 December 2023.

12. Emily R and Randeep R, ‘Why Executives Should Start Acting Like Activist Investors’ (Harvard Business Review, 17 August 2022) <https://hbr.org/2022/08/why-executives-should-start-acting-like-activist-investors?ab=at_art_art_1x4_s01> accessed 7 December 2023.

Activist investors wield considerable wealth and influence, allowing them to amass substantial quantities of a company's shares, thereby securing significant voting rights on the board of directors. Their primary objective involves steering the strategic trajectory of the target company.¹³ Structurally, these firms comprise limited partners who hold a considerable portion of the fund, enjoying limited liability, while a general partner assumes unlimited liability.¹⁴ Capital is sourced from various investors willing to commit substantial funds for prolonged periods. Hedge funds, functioning as activist investors, possess multiple avenues to assume control of a public company. The fundamental aim of hedge funds is to generate returns for investors without constraints on the strategies they employ to achieve this goal.¹⁵

These investors, known for their capital activism, spearhead the proactive steering of capital flows by both functional and business leaders. Activist investors might advocate for specific changes in the company's investment portfolio. They could suggest selling off certain assets or divisions to free up capital for other investments they believe will generate higher returns.

II. PROCESS OF ACTIVISM: CASE OF EBAY

The well-known case involving Carl Icahn and eBay exemplifies the target companies for activist investors being those stuck in a phase termed "investment purgatory," denoting a situation where companies linger in a transitional state from growth to value, seemingly indefinitely.¹⁶ The role of activist investors in such scenarios is to expedite this transition. Investors are broadly categorized into two types: growth and value investors.¹⁷ Growth investors purchase stocks of rapidly growing but expensive companies, while value investors seek inexpensive stocks with

13. Ibid.

14. Ibid.

15. Ibid.

16. Cheyenne Devom, 'The No. 1 mistake this self-made millionaire sees first-time investors make: Your money is in 'financial purgatory' (CNBC, 24 May 2023) <<https://www.cnbc.com/2023/04/25/tori-dunlap-no-1-mistake-first-time-investors-make.html>> accessed 8 December 2024.

17. Joe Cornell, 'Activist Investors Urge eBay To Separate StubHub And Classifieds Businesses' (Forbes, 30 January 2019) <<https://www.forbes.com/sites/joecornell/2019/01/30/activist-investors-urge-ebay-to-separate-stubhub-and-classifieds-businesses/?sh=715385976137>> accessed 8 December 2023.

slower growth rates. Eventually, every growth company evolves into a value company.¹⁸ When growth slows, growth investors sell their stocks, which may not be favoured by value investors due to their perceived lack of affordability.¹⁹ The transformation from growth to value can span decades. Activist investors act as catalysts by acquiring shares and accelerating this transition. For instance, Carl Icahn, heading an activist investment firm, acquired a substantial stake in eBay, obtaining board rights and ultimately influencing the removal of the CEO.²⁰ Icahn's move involved selling his 46.3 million eBay shares and exchanging them for an equivalent number of shares in PayPal after the spinoff.²¹ This strategic manoeuvre was driven by the realization that eBay, while highly regarded by value investors for its robust revenue visibility and cost-effectiveness, had stagnated in growth. In contrast, PayPal, beloved by growth investors for its rapid expansion, prompted Icahn to advocate for the separation of the two entities.

They acquire stocks perceived as undervalued, subsequently exerting pressure on the company's management to undertake actions aimed at augmenting the stock's value.²² Their increasing involvement in corporate governance is evidenced by their pursuit of board seats, CEO replacements, and advocacy for specific business strategies. Empirical studies have indicated that their activism frequently results in a transient increase in share prices.²³ Furthermore, a notable study revealed that targeted companies exhibited enhanced operational performance over a span of five years.

18. Russ M and Andrea C, 'eBay agrees to spin off PayPal after pressure from activist investors' (Los Angeles Times, 1 October 2014) <<https://www.latimes.com/business/la-fi-ebay-paypal-20141001-story.html>> accessed 17 December 2023.

19. *Ibid.*

20. Adam Jeffery, 'Icahn exits eBay stake, opts for PayPal after spinoff' (CNBC 16 November 2015) <<https://www.cnbc.com/2015/11/16/carl-icahn-exits-ebay-stake-opts-for-paypal-after-spinoff.html>> accessed 15 December 2023.

21. David Goldman, 'Icahn settles with eBay over PayPal' (CNN Business, 10 April 2014) <<https://money.cnn.com/2014/04/10/technology/ebay-icahn/>> accessed 19 November 2023.

22. Robin G and Michael S, 'Investor activism and takeovers' (2009) 92 *Journal of Financial Economics* 92, pp. 362–375.

23. *Ibid.*

III. DISTINCTION BETWEEN ACTIVIST INVESTOR AND SHAREHOLDER ACTIVISM

While the terms “activist investor” and “shareholder activism” may appear synonymous, not all shareholder activism involves activist investors. Activism encompasses various actions by one or more shareholders of a publicly traded corporation aimed at instigating corporate change.²⁴ This change could pertain to altering the company’s strategy, financial framework, management, or board structure. Shareholder activism denotes endeavours by shareholders to effect desired alterations in business operations or influence management decisions, safeguarding shareholders’ interests.²⁵

An activist investor constitutes an individual or institutional investor endeavouring to procure a controlling stake in a target company by securing seats on its board of directors. These investors aspire to institute substantial changes within the target company, uncovering perceived latent value.²⁶ While both shareholder activism and activist investors pursue similar objectives, they employ distinct approaches. Activist investors typically acquire shares in companies undergoing a transitional phase between growth and value, expediting this transition. Conversely, shareholder activism functions as a mechanism through which a shareholder activist utilizes their shareholder rights in a publicly traded corporation to instigate or advocate for corporate change.

24. Mary C and PricewaterhouseCoopers, ‘Shareholder Activism: Who, What, When, and How?’ (Harvard law school forum on corporate governance, 2015) <<https://corpgov.law.harvard.edu/2015/04/07/shareholder-activism-who-what-when-and-how/>> accessed 10 December 2023.

<<https://corpgov.law.harvard.edu/2015/04/07/shareholder-activism-who-what-when-and-how/>> accessed 17 December 2023.

25. Kaustubh Kumar, ‘India: Empowering Shareholders: The Evolving Landscape of Corporate Law In Response To Shareholder Activism’ (Mondaq, 9 August 2023) <<https://www.mondaq.com/india/shareholders/1353120/empowering-shareholders-the-evolving-landscape-of-corporate-law-in-response-to-shareholder-activism#:~:text=Shareholder%20activism%20refers%20to%20the,to%20defend%20the%20shareholders%20interests.&text=The%20Companies%20Act%202013%20is,in%20India%20governance%20shareholder%20activism.>> accessed 10 December 2023.

26. *Ibid.*

IV. CURRENT INDIAN LEGAL LANDSCAPE

A. Rule of Majority

The early judicial outlook towards what is known today as corporate governance has chequered the past. It was believed by the courts that the internal functioning of the company was a private matter, not subject to judicial scrutiny, allowing the majority free reign. Scrutton L.J famously said “It is not the business of the court to manage the affairs of the company. That is for the shareholders and the directors.”²⁷

*Foss v. Harbottle*²⁸ was the very inception of the rule of majority being applied to companies. The suit was originally filed by two minority shareholders against the action of the majority, alleging misapplication of company property. The court established what is known as the rule of majority. Essentially, the court said that if any irregular act done by the directors, is ratified by the majority of shareholders in the general meeting, it is valid.²⁹

This being the common law position, in the current Indian corporate governance landscape, the measures available against autocratic decisions of the majority primarily stem from the law.

B. Legal Provisions Preventing Autocracy of the Majority

To this end, The Companies Act 2013 provides for the mandatory Annual General Meeting under Section 96,³⁰ to be conducted at intervals of not more than fifteen months. In order to allow shareholders to take part in the decision-making process.³¹ This provision is enforceable in the sense that any member may apply to the tribunal in case of default in calling the AGM, following which the tribunal itself may call the meeting.³² If such directions are not complied with, the act also provides for a penalty.

27. K. W. Wedderburn, ‘Shareholders’ Rights and the Rule in *Foss v. Harbottle*’ (1957) *The Cambridge Law Journal* 15(2), pp. 194-215.

28. *Foss v Harbottle* [1843] 67 ER 189.

29. *Ibid.*

30. The Companies Act 2013, s 96.

31. *Ibid.*

32. *Ibid.*

The act also delves deeply into the voting procedure that must be followed at such meetings. Sections 107³³ to 110³⁴ deal with the same.

The act also allows smaller shareholders to be represented fairly in the management and administration of the company, as per Section 151³⁵. Shareholders holding shares of less than twenty thousand rupees may collectively appoint a “small shareholder’s director” in order to represent their interest on their behalf.³⁶

The interests of minorities are also protected in part XVI of the Act,³⁷ dealing with oppression and mismanagement. These provisions are considered essential to the objective of corporate governance, which is to prevent misuse of power by the majority. Section 241³⁸ provides for any shareholder to apply to the tribunal in his individual capacity, if his own interest, that of the public, the company’s or any other member’s interest, is being compromised.³⁹ Additionally, the provision also allows for the individual shareholder to apply to the tribunal if a significant alteration to the Board, ownership, shareholding structure, membership or any other aspect may prejudice the company’s interest or that of any class of members.⁴⁰ The following section gives an elaborate list of the orders or directions that the tribunal may grant as a remedy to such an applicant.⁴¹

The rationale behind all these provisions and corporate governance in its entirety, is the same. All the members be given an opportunity to be heard and be part of the decision-making in a democratic manner. And that such participation be made accessible to all shareholders. The inclusion of diverse interests also performs another function; it not only allows for a more robust decision to be made but also a more legitimate one.

Despite that, the courts have displayed a reluctance to intervene in the internal functioning of the company’s management and have been known to leave certain matters to the better judgment of the majority. As a consequence of this, the very heart of the jurisprudence being stacked against minority shareholder, their only remedy is the occasional exception to the rule of majority.

C. Fault with the Rule of Majority

The predominant application of the rule, even with the statutorily laid down qualifications and exceptions is impractical in the Indian context

as was held by the Hon'ble Supreme Court in *ICICI v. Parasrampuriah Synthetic Ltd.*⁴² It was reasoned that the shareholding pattern in India is vastly different from that of other countries where several small and medium investors collectively form the investor body.⁴³ It was further held that in India, most such enterprises derive their funding from financial institutions, which also happen to be state-sponsored.⁴⁴ These institutions may hold a smaller percentage of shares but are the major contributors to funding. Taking this argument one step further, it is also submitted that many of the corporate enterprises in India are also family-held. Meaning that the majority power vests with one family and the supposed concept of shareholder democracy becomes moot.

In August of 2021, in the thick of the pandemic when the economy of the country and the world was taking a massive, unprecedented hit, Hero MotoCorp placed a resolution before its shareholders proposing to increase the remuneration of their chairperson and CEO. By a massive 10 percent. The ordinary resolution sailed through swimmingly. Despite opposition from 78 per cent of large investors, who held around 55 per cent of shares. Owing to the 35 per cent stake the promoters held. This is a classic example of the state of affairs in Indian corporate houses.⁴⁵

A similar scenario occurred at the general meeting of Bajaj Auto. The ordinary resolution which proposed that chairman emeritus, Rahul Bajaj be given an annual payment of Rs. 6 crores, a fully furnished house, a car and healthcare, was opposed by over 50 per cent of institutional investors but again sailed through smoothly due to the majority stake of the family. Such phenomena are not uncommon.⁴⁶

To this end, SEBI's Stewardship Code, inspired by the UK's stewardship concept was introduced. The word stewardship, as per the Oxford dictionary, means 'the job of supervising or taking care of something,

42. *ICICI Ltd. v Parasrampuriah Synthetics Ltd* [2002] 9 SCC 428.

43. *Ibid.*

44. Vedant S, 'The Rule of Majority in Company Law' (Manupatra Articles, 13 July 2021) <<https://articles.manupatra.com/article-details/The-Rule-of-Majority-in-Company-Law>> accessed 25 December 2023.

45. Varun S, 'Big investors reject exec pay proposals' Hindustan Times (22 August 2021) <<https://www.hindustantimes.com/business/big-investors-reject-exec-pay-proposals-101629654934350.html>> accessed 19 December 2023.

46. *Ibid.*

such as an organization or property'.⁴⁷ In the context of corporate governance, it gives institutional investors the duty to maintain oversight of the companies in which they are invested. It governs responsible capital management in listed entities. It mandates institutional investors to craft, disclose, and continually refine a comprehensive policy for stewardship obligations.⁴⁸ Emphasizing transparency, it addresses conflicts of interest, necessitates vigilant company monitoring, and specifies intervention criteria. To protect investor interests, it urges the public declaration of transparent collaboration policies with other institutions.⁴⁹ Notably, SEBI's code solely pertains to listed equities, excluding investments in listed debt, as clarified in its communication to Institutional Investors.

However, it is due to the insufficiency of such legislative and regulatory mechanisms that there still exists a vacuum within the corporate governance and ESG regimes in India, allowing large corporations the leeway to operate in questionable ways. This justifies the urgent need for changes in the system to allow actors from those very markets to regulate such behaviour.

V. CASE STUDY OF THE ADANI GROUP

This section expounds upon the hypothetical implications of activist investors operating within the Indian corporate sphere. We outline the challenges presently encountered by Adani Group, encompassing ethical, interlinkage, and environmental concerns. In our endeavour to tackle the challenges faced by the Adani Group, we propose potential resolutions derived from international studies of activist investors' interventions. Despite the non-existence of real activist investors in this context, we devise a hypothetical framework through which their strategic engagement could conceivably alleviate the aforementioned issues confronting the Adani Group.

The Adani Group is a highly diversified conglomerate headquartered in Ahmedabad, founded by Mr. Gautam Adani, consisting of ten publicly listed companies. Their operations span from power generation and

47. Taylor B, 'The Encyclopaedia of Religion and Nature' (Continuum, 2006).

48. Reddy BV, 'The Emperor's New Code? Time to Re-evaluate the Nature of Stewardship Engagement under the UK's Stewardship Code' (2021) 84 *The Modern Law Review* 842.

49. *Ibid.*

transmission, shipping, and green energy to infrastructure and consumer goods.⁵⁰ Earlier in 2023, the group came under fire from a report released by Hindenburg Research, a whistleblowing organization which performs forensic financial research on companies. The aftermath of the report was phenomenal, the stock prices of all Adani companies plummeted leading to astronomical losses for shareholders. The scandal went so far as to be brought up in parliament.⁵¹ Reasoning for our analysis of this conglomerate was two-fold, that the companies recorded astronomical growth within a short time, that the data available on the public domain was immense and due to the recent controversy stemming from the Hindenburg Report.⁵² In the process of our research, certain problem areas have been identified within the Indian system of corporate governance, through the example of the Adani Group through which we hope to prove the benefits of activist investors interventions.

A. Problem Areas and Intervention Points

1. *High Promotor shareholding and interlinkage*

Several instances revealed that the Adani Group has repeatedly demonstrated non-compliance with the mandates of the market regulator. The entities under the Adani umbrella, including Adani Wilmar and Adani Total Gas, have failed to comply with such regulations detailed in this section, which may consequently expose them to repercussions in the foreseeable future.⁵³

Section 19A of the Securities Contracts (Regulation) Rules, 1957,⁵⁴ subsequent to an amendment in 2010, delineates the obligatory adherence for listed companies in India concerning the sustenance of a minimum threshold of public shareholding. This mandate necessitates that

50. Adani Group, 'About Us: Growth with Goodness' <<https://www.adani.com/about-us#:~:text=Adani%20Group%20is%20a%20diversified,the%20state%20of%20Gujarat%2C%20India>> accessed 6 December 2023.

51. The Hindu Bureau, 'Why is government running away from a JPC probe into allegations against Adani if it has nothing to hide: Congress' (The Hindu, 14 February 2023) <<https://www.thehindu.com/news/national/if-nothing-to-hide-why-is-government-running-from-jpc-probe-into-adani-issue-congress/article66508301.ece>> accessed 19 December 2023.

52. 'Adani Group: How The World's 3rd Richest Man Is Pulling The Largest Con In Corporate History' (Hindenburg Research, 24 January 2023) <<https://hindenburgresearch.com/adani/>> (Hindenburg Adani Group) accessed 19 December 2024.

53. *Ibid.*

54. Securities Contracts (Regulation) Rules 1957, s 19A.

listed companies, excluding those within the public sector, ensure that no less than 25% of their shares remain in possession of the public.⁵⁵ Contingencies are outlined within this provision to facilitate companies previously below the 25% public shareholding threshold, allowing them a stipulated timeframe to progressively augment their public shareholding to meet the mandated 25%, as prescribed by the directives of the Securities and Exchange Board of India (*SEBI*). Additionally, should a listed company's public shareholding dip below the stipulated 25% at any juncture, it is incumbent upon said entity to restore the public shareholding to the minimum prescribed level within a span of 12 months, aligning with SEBI's delineated protocols.⁵⁶ Furthermore, SEBI has provided a reprieve to new companies, granting them a waiver period of three years to comply with the requisites for maintaining a 25% public float.⁵⁷

Adani Wilmar, listed on January 27, 2022,⁵⁸ has reportedly fallen short of meeting the mandatory requirement stipulating that a minimum of 25% of its shares must be held by the public, according to disclosures by the Bombay Stock Exchange (*BSE*).⁵⁹ Presently, the promoter group's ownership stands at 87.94% of the total shares, notably surpassing the specified threshold.⁶⁰ This failure to adhere to the prescribed public shareholding limit carries potential consequences, including the possibility of delisting from the stock exchange.⁶¹

The situation extends beyond Adani Wilmar, as another Adani holding, Adani Total Gas, finds itself perilously close to breaching regulatory thresholds. Listed on November 5, 2018,⁶² Adani Total Gas currently

55. *Ibid.*

56. Priyanka Gawande, 'Sebi tweaks rules for minimum public float for listed companies' (Mint, 3 February 2023) <<https://www.livemint.com/news/india/sebi-tweaks-rules-for-minimum-public-float-for-listed-companies-11675442995746.html>> accessed 16 December 2023.

57. *Ibid.*

58. Adani Wilmar, 'About' <About Us Adani Wilmar> accessed 10 November 2023.

59. BSEINDIA, 'Adani Wilmar' <<https://www.bseindia.com/stock-share-price/adani-wilmar-ltd/awl/543458/shareholding-pattern/>> accessed 9 December 2023.

60. *Ibid.*

61. Nikhil Agarwal, 'Adani Wilmar promoters to sell 1.6 crore shares to meet Sebi rule' (The Economic Times 23 December 2023) <<https://economictimes.indiatimes.com/markets/stocks/news/adani-wilmar-promoters-to-sell-1-6-crore-shares-to-meet-sebi-rule/articleshow/106232718.cms#:~:text=NEW%20DELHI%3A%20To%20comply%20with,the%20company%20next%20week%20onwards>> accessed 25 December 2023.

62. Adani Gas, 'Adani Gas Ltd gets listed slated to be the largest CGD Company in India' <<https://www.adanigas.com/newsroom/media-release/Adani-Gas-Ltd-gets-listed-slated-to-be-the-largest-CGD-Company-in-India>> accessed 5 December 2023.

treads the fine line of compliance, with the promoter group holding a notable 74.8% of the company's shares.⁶³ According to regulations, the ceiling for shares held by the promoter or promoter group stands at 75%, a threshold that Adani Total Gas is precariously approaching.⁶⁴ This close proximity to the stipulated limit raises concerns regarding potential non-compliance with the regulatory framework governing public shareholding requirements.

The motive behind requiring a minimum publicly traded float is to improve shareholder democracy within the company. It is a common practice in India that most business enterprises are family-owned, family-run and family-controlled,⁶⁵ however, that runs counter to the principles of corporate governance for publicly listed companies. The main aim is to prevent the concentration of power within an individual or their families. To improve shareholder democracy, and allow for efficient decision-making with the expertise and perspective of all stakeholders involved, and not just the group owning the controlling stake. The problem with the rule of the majority has been previously elucidated, and it is evident that in companies which are essentially 'family businesses' the rule of the family prevails.

This, however, is not the end of our argument. The fact that the conglomerate structure of all the Adani companies, combined with the fact that the shareholding pattern is not only concentrated but also extremely interlinked, there is a higher risk of failure, by a sort of domino effect. As is illustrated by the example of eBay. The intervention of a hedge fund with activist motives would be beneficial in the case of Adani as it has been with eBay.

2. Possible Solution

Between 2015 and 2017, eBay experienced a modest 5%⁶⁶ increase in sales, significantly lagging behind its competitors' growth rates. Elliott Management Corporation, an activist investment firm with stakes

63. BSE India, 'Adani Total Gas Ltd' <<https://www.bseindia.com/stock-share-price/adani-total-gas-ltd/atgl/542066/shareholding-pattern/>> (Adani Total Gas Ltd) accessed 4 December 2023.

64. *Ibid.*

65. Hindenburg Adani Group (n 52).

66. Joe Cornell, 'Activist Investors Urge eBay To Separate StubHub And Classifieds' (Forbes, 30 January 2019) <<https://www.forbes.com/sites/joecornell/2019/01/30/activist-investors->

in eBay, proposed to the management that eBay should prioritize its core Marketplace by divesting its StubHub (a ticket-selling site) and Classifieds (advertising) businesses.⁶⁷ This recommendation, outlined in their “Enhancing eBay” plan, aimed to facilitate accelerated growth and enhanced performance for eBay. Separating these business segments would enable eBay’s leadership to focus extensively on refining the primary Marketplace operations.⁶⁸

Following the potential separation, Elliott believed eBay could become an appealing acquisition target for major companies such as Walmart, Target, Google, and others seeking to compete with Amazon. Elliott forecasted that by the conclusion of 2020, eBay could attain a value of \$63 per share, representing a substantial increase from its then-current value. This projection suggested a potential surge of over 87% in eBay’s stock value within the next two years, contingent on the successful execution of the proposed strategies.⁶⁹

The success observed in the standalone performance of companies, such as the case of eBay and PayPal separation, demonstrates the efficacy of operating independently. Adani Holdings’ current situation, characterized by interlinkages that potentially pose risks and impede growth, mirrors the scenario previously highlighted in the eBay and StubHub separation. This instance illustrated that the separation resulted in higher projected profits when compared to their combined operations.

Furthermore, the history of eBay’s stagnant growth leading to the intervention of activist investor Carl Icahn, proposing the spin-off of eBay and PayPal, serves as an example.⁷⁰ This strategic move was aimed at enabling both entities to thrive independently due to their distinct growth trajectories. Activist investor mechanisms, proven effective in addressing issues stemming from interlinked structures, could offer solutions to the challenges faced by Adani Holdings.

urge-ebay-to-separate-stubhub-and-classifieds-businesses/?sh=715385976137> accessed 8 December 2023.

67. *Ibid.*

68. *Ibid.*

69. *Ibid.*

70. Adam Jeffery, ‘Icahn exits eBay stake, opts for PayPal after spinoff’ (CBNC, 16 November 2015) <<https://www.cnbc.com/2015/11/16/carl-icahn-exits-ebay-stake-opts-for-paypal-after-spinoff.html>> accessed 17 December 2023.

B. Ethical and Environmental Concerns

Adani Group purchased the greenfield Carmichael coal mine in central Queensland and the Port of Abbott Point in northern Queensland in 2010. Since then, the group has faced numerous allegations and resistance over its operations in these mines. Currently, it operates through its Australian subsidiary ‘Bravus Mining and Resources’.⁷¹

There have been several instances of the group’s environmental policy breaches with regard to the said mine. The area is said to be home to several endangered and rare flora and fauna, like the Black Throated Finch, koalas etc.⁷²

In November 2020, the Federal Department of Agriculture, Water, and the Environment fined the group \$25,920 for not conducting a mandatory survey of the land and not submitting a revised species management plan prior to the clearance of certain tracts of wooded land.⁷³ The mining operation has come under fire at every juncture by environmental and indigenous activists for destroying ancestral habitats and biodiversity. There have been five documented instances of the operation breaching the conditions of its approval permits,⁷⁴ and even more allegations.

Elaborate and widespread social media campaigns were launched using the hashtag “#StopAdani”. This movement in particular is spearheaded by indigenous aboriginal groups, Wangan and Jagalingou who are the Traditional Owners of the land where the mine is.⁷⁵ Adani’s operations

71. ‘AdaniurgesAustraliangovernmenttogive‘afairgo’forcoalmineproject’(TheHindu,17April 2019)<<https://www.thehindu.com/business/Industry/adani-urges-australian-government-to-give-a-fair-go-for-coal-mine-project/article26862244.ece>> accessed 1 January 2024.

72. ‘Adaniminecouldsnuffoutblack-throatedfinch’slastchancesofsurvival’(TheGuardian,2019)<<https://www.theguardian.com/environment/2019/nov/12/adani-mine-could-snuff-out-black-throated-finchs-last-chances-of-survival>> accessed 24 December 2023.

73. Toby Crockford, ‘“Deeply inadequate”: Adani fined \$25K for breaching environmental approval’ (Brisbane Times, 2 December 2020) <<https://www.brisbanetimes.com.au/national/queensland/deeply-inadequate-adani-fined-25k-for-breaching-environmental-approval-20201202-p56jy3.html>> accessed 15 November 2023.

74. The Guardian, ‘Adani admits breaching environmental conditions for Carmichael coalmine’ The Guardian (15 May 2021) <<https://www.theguardian.com/environment/2021/may/16/adani-admits-breaching-environmental-conditions-for-carmichael-coalmine#:~:text=Adani%20admits%20breaching%20environmental%20conditions%20for%20Carmichael%20coalmine,-This%20article%20is&text=Adani%20has%20admitted%20breaching%20its,without%20a%20promised%20wildlife%20safeguard.>> accessed 19 December 2023.

75. ‘#Stop Adani, Who We Are’ <https://www.stopadani.com/who_we_are> accessed 5 January 2024.

at the Carmichael mine have also been subject to repeated litigation in Australia's federal courts through judicial review mechanisms questioning the government's approval process for mining operations. The Land Court of Queensland has also seen several instances of litigation by locals and indigenous groups.⁷⁶

In 2017, the *Lancet Medical Journal* criticized the Carmichael mining plan as a 'public health disaster'.⁷⁷ An expert's report which was accepted by the Land Court of Queensland estimated that overall, the project will have the highest carbon potential emissions of all the mines in the world.⁷⁸ This being the prevailing international sentiment, considering the ethical and environmental concerns, the group is facing immense backlash. The involvement of activist investors here would be beneficial for the group, allowing it to change its current centralized decision-making, to a more environmentally conscious one.

C. Possible Solution

Exxon Mobil, an energy giant, has been the subject of much discussion in recent times for this very reason. In May 2021, an activist investor hedge fund, Engine No. 1 managed to elect three directors to the board of Exxon, with the aim of inducing the energy giant to reduce its carbon footprint.⁷⁹ While holding merely 0.02% of the shares, the hedge fund managed to gain the support of institutional investor giants like BlackRock, Vanguard and State Street. This move was not only aimed at controlling the environmental impact of the company's operations but also to improve profitability. The confidence of the market in the company increased phenomenally and this was evidenced by a shocking 45%

76. Sandra Cassotta, Vladimir Cueva and Malayna Raftopoulos, 'A case study of the Carmichael Coal Mine from the perspectives of Climate Change litigation and Socio-Economic Factors' (2021) *Law Environment and Development Journal* (Carmichael Coal Mine), pp. 1746-5893.

77. NAIF, 'Adani's Carmichael Coal Mine And Health' <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKewiGncnd8r6DAxVzzjgGHfpeC7EQFnoECAoQAQ&url=https%3A%2F%2Fwww.aph.gov.au%2FDocumentStore.ashx%3Fid%3De2e73134-0150-477b-b1f4-1c4e-0abc70e%26subId%3D514289&usg=AOvVaw3gUngqxuC_90Jv1kRA-zwt4&copi=89978449> accessed 19 December 2023.

78. Carmichael Coal Mine (n 78), pp. 1746-5893.

79. Lane Lambert, 'ESG Activists Met the Moment at ExxonMobil, But Did They Succeed?' <<https://hbswk.hbs.edu/item/esg-activists-met-the-moment-at-exxon-mobil-but-did-they-succeed>> accessed 5 January 2024.

rise in stock prices. This means that blatant ignorance of the climate impact erodes confidence in a company.⁸⁰

BlackRock, which also happens to be an investor in Adani's Australian mine project, after siding with Engine No. 1, has said "more needs to be done in Exxon's long-term strategy."⁸¹ With that being the case, there is a strong need for an activist investor player in Adani's corporate structure to successfully bring about changes from within the boardroom, taking into consideration both the climate impact and the public image of the company.

VI. RECOMMENDATIONS - THE WAY FORWARD

Given the circumstances that have been detailed above in the sections, it is evident that certain problems exist within the spheres of corporate, environmental and social governance in Indian companies which need to be addressed effectively, and in a targeted manner. It has also been evident that due to multiple constraints of jurisdiction, procedure, resources and expertise, the tribunals and courts have not been able to deal with them with the rigour and reform that is necessary.

In a recent communication to the parliament, the government has said that precisely 21,205 cases are pending before all the benches of the NCLT, and 8,242 filed under Company Law alone.⁸² On the same occasion, it was said that there were around 25 member vacancies in the tribunals. The regulatory framework, although not ineffective, needs to be revisited in order to allow market players to do what the regulators and courts themselves are unable to do. What we propose, is that the legal framework be modified in favour of these actors. This would allow the investors themselves to regulate the functioning of the errant company, while also keeping these matters outside the courts and tribunals.

80. Matt Phillips, 'Exxon's Board Defeat Signals the Rise of Social-Good Activists' (The New York Times, 9 June 2021) <<https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html>> accessed 19 December 2023.

81. BlackRock, 'Investment Stewardship Vote Bulletin: ExxonMobil Corporation' (26 May 2021) <<https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf>> accessed 19 December 2023.

82. 'More than 21000 cases were pending before NCLT till January- end :Govt' (The Economic Times, 14 March 2023) <<https://legal.economictimes.indiatimes.com/news/industry/more-than-21200-cases-were-pending-before-nclt-till-january-end-govt/98617972>> accessed 3 January 2024.

While recognizing that the concept of activist investor hedge funds is not one that is popular in India, we submit that if allowed, it is one that can be beneficial to not only our corporate governance regime but also the ESG regime. Encouraging the proliferation and active involvement of activist investors and the creation of investment funds with the targeted objectives of improving the legal and ethical compliances, and minimizing environmental impact will allow for socially conscious investors to be part of the decision-making, thereby simplifying the job left for regulators to do. As evidenced by several examples, these investment funds tend to turn out profitable after making their desired impact.

It is also our argument that the Stewardship Code 2020, put in place by the SEBI, although a commendable step in the right direction, fails to incentivize the said ‘stewardship’.⁸³ The principles under the code are relatively vague and difficult to ensure. The existing code aims at improving the participation of institutional investors like Mutual Funds, Alternate Investment Funds and Pension Funds to take a proactive role in corporate as well as ESG governance.

However, traditional institutional investors such as these were not formed with a motive of improving the company’s performance or social impact, these funds have a primary profit motive and give their investors the projected return. In India, as everywhere else, merely dictating vague norms for improvement may not work. As per Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Category II and III Alternate Investment Funds receive no incentives or concessions from the government. This implies that there exists no incentive for alternate investment or private equity funds to attempt to monitor either the corporate or ESG governance regime of the company.

This is in addition to the fact that merely imitating the UK’s Stewardship Code may not bode well for India.⁸⁴ Because of a stark difference in our corporate and social structures, it is quite evident from our previous submissions that institutional investors in India do not have enough sway within boardrooms to actually influence governance, even if they may wish. To that end, we propose the following:

83. Reddy BV, ‘The Emperor’s New Code? Time to Re-evaluate the Nature of Stewardship Engagement under the UK’s Stewardship Code’ (2021) 84 *The Modern Law Review* 842.

84. *Ibid.*

1. Incentivization of category II and III alternative investment and private equity funds which are created with the motive of improving corporate and ESG governance in investee companies on disclosure of such motive at the time of investing through tax benefits, concessions etc. Or,
2. Creation of another category of alternative investment funds, called 'activist investor funds' which are not only created with the requisite aim of improving the social and environmental impact of investee companies but also intend on using their investment to leverage change from within the company and incentivizing those funds. And,
3. Incentivizing investors who invest in those funds which are created with the aim of activist investing and reforming the ESG regime and corporate governance wherein they act as institutional investors through tax concessions and benefits. This would improve the participation of these investors and induce the creation of more such institutions.
4. Ensuring disclosure of activist motives of said funds at the time of creation, as well as at the time of acquiring shares in the investee company wherein the motive is to reform or improve the social impact, minimize environmental impact, or democratize the corporate governance of the company, will allow regulators to monitor them. A similar disclosure is required, by Section 13 (d) (1) of the Securities Exchange Act 1934 in the United States, which requires all hedge funds to disclose the quantity and purpose of acquiring said shares, if exceeding 5% of the total shares.

Opening the Doors of Private Enforcement: Analysing False Advertisement Claims from an Antitrust Lens

—Sunidhi Kashyap*

ABSTRACT

Disguise defeats the very foundation of legitimate expectation, which is the free choice of the people. Therefore, to advertise or offer goods and services by way of deceptive statements is unlawful, as it is likely to mislead a consumer with regards to the quality, status, and price of the product and, consequently, deny a customer the opportunity to judge independently. While a consumer, who plays the role of an ‘umpire’ in the arena of competition law, is afforded protection against such misleading claims, the real players of the game, i.e., the competitors, are assumed to be immune to such claims. The common argument against enforcing false advertising claims is that not all false advertising harms competition. This paper argues that it is illogical to completely exclude the ambit of antitrust analysis in claims against false advertising on two grounds: firstly, it is possible for deception or false advertisements to have an adverse effect on the market, as is shown in the ‘market of lemons analogy’. Secondly, a few pro-competitive effects of advertisement wars should not obscure the deep anti-competitive effects they have. The author makes a case for balancing the pro-competitive and anti-competitive effects of advertising by following the rule of reason. Throughout the paper, the main theme of protecting an individual competitor is constant, and, therefore, the author proposes a compensatory model based on private enforcement of antitrust claims.

* The author is a student at the Rajiv Gandhi National University of Law (RGNUL).

I. INTRODUCTION

The popular advertisement wars between brands such as Apple and Samsung, BMW and Audi, McDonald's and Burger King, and Pepsi and Coca-Cola display one thing in common: they are each other's direct competitors and want to exhibit their dominance over the other. These brands compete by providing similar products to the same target audience at almost the same price points. Since their products are so similar to each other, these companies often choose 'comparative advertising' so that consumers can easily differentiate between the brands.¹ However, there is another (down)side to comparative advertising: it enables companies to free ride on the reputation and attractiveness of other, more established companies.²

For instance, the front-page advertisement of Dabur's Anmol Gold coconut oil directly and explicitly compared itself with Parachute coconut oil to denote the better price value with the tagline, "So when are you switching your coconut oil?" Befittingly so, Parachute coconut oil happens to be the more popular choice in most Indian households.³ Through such an advertisement, Dabur made a compelling case for being the better choice, given the competitive price. Moreover, with this direct comparison, Dabur framed and linked itself with the reputation of Parachute, implying that it is equal in quality.⁴ Thus, through comparative advertising, the advertising company leverages the reputation of its competitor's product by promoting its own product.

Surprisingly, comparative advertising is permissible in India as long as it does not defame the goods of its competitor.⁵ In fact, as per the Advertising Standards Council of India Code (ASCI), comparative

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1. Conor Bond, '9 Comparative Advertising Examples to Help you Get Ahead' (WordStream, 11 February 2023) <https://www.wordstream.com/blog/ws/2020/01/13/comparative-advertising> accessed 4 January 2024.
 2. Michael A. Leon, 'Unauthorized Pop-Up Advertising and the Copyright and Unfair Competition Implications' (2004) 32 Hofstra L Rev 953.
 3. Suneera Tandon & Saumya Tewari, 'Dabur takes on Marico's Parachute oil in print advertisement' (Live Mint, 23 November 2019) <<https://www.livemint.com/industry/advertising/dabur-takes-on-marico-s-parachute-oil-in-print-advertisement-11574504829058.html>> accessed 4 January 2024.
 4. Bruce Buchanan & Donor Goldman, 'Us v. Them: The Minefield of Comparative Ads' (Harvard Business Review, 1989) <<https://hbr.org/1989/05/us-vs-them-the-minefield-of-comparative-ads>> accessed 4 January 2024.
 5. Reckitt & Colman of India v MP Ramachandran [1998] SCC OnLine Cal 422.

advertisements are permitted in the interest of public enlightenment and vigorous competition. It is also permissible for a tradesman to boast that their product is the best, even if such a declaration is untrue. Indian courts have taken a lenient view in matters concerning comparative advertising. It has allowed for direct comparison of brands until it possesses any disparaging content.⁶ However, the lack of any guidelines or a dedicated Statute on advertising has deeply affected how companies interact with each other and reach intended consumer base in a market.

Problems are bound to occur when such advertisements deliver a deceptive message that may harm the consumer or manipulate their choice. The dissemination of misinformation or inaccurate information has been the focus of consumer protection laws in general. However, this overarching aspect of ‘information manipulation’ has rarely been seen from an antitrust lens.⁷

The author makes an argument against false advertising for its anti-competitive effect. False advertising is commonly used as a tool to lure potential customers away from honest competitors by making false or deceptive remarks.⁸ In India, in such situations, the deception perpetrated by the misleading statements is regarded as a tort only against the consumer under the Consumer Protection Act, 2019 (COPRA) and the competitor or the company whose consumer base gets affected is given no redress.⁹ The author aims to prove that false advertising does injure competitors.¹⁰ Similar to a game of Monopoly, a person securing an advantage through means other than its merit or capability should not be the winner. The paper proves what false advertising *means* in a market, which helps secure an unfair advantage.¹¹

Throughout the paper, the author has discussed the position of false advertisements in the realm of antitrust law with the aim of safeguarding

6. Hindustan Unilever Limited v USV Private Limited [2021] SLP No. 2437/2021.

7. Colangelo and Maggiolino, ‘Manipulation of Information as Antitrust Infringement’ (2020) 26 Columbia Journal of European Law 2, pg. 63.

8. Irston R. Barnes, ‘False Advertising’ (1962) 23 Ohio State Law Journal 4, pg. 597.

9. Consumer Protection Act 2019, s 89.

10. Gary Schuman, ‘False Advertising: A Discussion of a Competitor’s Rights and Remedies’ (1983) 15 Loyola University Chicago Law Journal 1.

11. William Camanor & Thomas Wilson, ‘The Effect of Advertisement on Competition: A Survey’ (1979) 17 Journal of Economic Literature 2, pp. 453-476; Robert Ayanian, ‘Advertising and Rate of Return’ (1975) 18 J. Law. Econ. 2, pp. 479-506.

the interests of individual competitors. The paper rejects the common notion of false advertising leading to *de minimis* harm and attempts to prove that influencing demand patterns through unfair means can give the ability to distort the price levels of a product at the cost of other competitors.

In this backdrop, the paper is largely divided into four parts. The first part discusses the impact of manipulating information to influence consumer demand and highlights the problem of enforcing antitrust claims against deception. The second part refutes the argument that false advertisements do not affect the market as a whole and will prove that deception can create a market of ‘lemons.’ The third part further substantiates the stance of analyzing false advertisements from an antitrust lens by balancing pro-competitive ad anticompetitive effects and by observing the rule of reason. In the last part, the author proposes a framework for entertaining antitrust claims against false advertising on a model prioritizing compensation to the injured competitor. The model is premised on an enlarged scope of private enforcement to allow individual competitors to safeguard their interests.

II. INFORMATION MANIPULATION THROUGH MISLEADING CLAIMS

The meaning of power is regularly reviewed in the field of competition law. Overseeing cartels, mergers, and abuse of market power falls directly under its domain. In simpler words, competition law examines the way in which firms may use their dominant position to distort competition. However, neither the idea of market power nor the balance of power addresses the situation in which a company is capable of influencing consumer behaviour, competitors, and other counterparts by manipulating information.¹²

When consumers are on the receiving end of information manipulation, their liberty to choose independently is greatly sacrificed. Disseminating misinformation and distorted facts through advertisements to lure consumers into choosing one product over another seriously undermines the decision-making autonomy of a consumer. For instance, the investigation

12. Jon D. Hansan and Douglas A. Kysar, ‘Taking Behavioralism Seriously: The Problem of Market Manipulation’ (1999) 630 *New York University Law Review* 73, pg. 747.

conducted against Intel shows how consumers are strategically being cheated on to gain increased profits. Independent software sellers were compelled by Intel to label that their products were compatible with Intel (despite them also being compatible with Intel's competitors).¹³ This was a clear attempt by Intel to maintain its dominance in the microprocessor market and insulate itself from its competitors. An uninformed or ill-informed consumer would have no incentive to try products from other competitors if he was made to believe that there was no other option. Such kind of marketing shies away from full disclosure consumers and prevents other competitors from expanding their market shares.¹⁴

Keeping consumers in the dark is of great concern because this strikes at the very foundation of competition law- promoting competition and consumer welfare. Making choices based on incomplete or false claims is a lose-lose situation for both consumers and honest competitors.¹⁵ An example of how false advertising can harm honest competitors is aptly illustrated by AT&T. In 2010, AT&T was apprehensive about losing its monopoly of being the sole supplier of iPhones. Thus, in order to retain its clientele, AT&T came out with an offer to provide unlimited data only to those customers who would sign a long-term contract with them. However, this was bait, and AT&T had no plans of fulfilling its promises. It made false claims to its customers about its 'unlimited' data plans because their devices would start buffering if they ever breached a certain limit.¹⁶ Such a misleading claim not only cheated its consumers, but it drove consumer demand away from honest competitors.

The problem of information manipulation is further exacerbated because deception is traditionally out of the ambit of antitrust laws. Deception does not directly restrict or limit the production of goods in a market or result in the denial of market access, like in most antitrust cases. It instead operates in a very different way, by spuriously influencing

13. Press Release, 'FTC Settles Charges of Anticompetitive Conduct Against Intel' (2010) Federal Trade Commission <https://www.ftc.gov/news-events/news/press-releases/2010/08/ftc-settles-charges-anticompetitive-conduct-against-intel> accessed 7 January 2024.

14. Mark R. Patterson, 'Coercion, Deception, and Other Demand-Increasing Practices in Antitrust Law' (1997) 66 *Antitrust LJ* 1; Bowman, 'Tying Arrangements and the Leverage Problem' (1957) 67 *Yale L. J.* 19, pp. 365-381.

15. S. Nathani and P. Akman, 'The interplay between consumer protection and competition law in India' (2017) *Journal of Antitrust Enforcement* 5(2), pp. 197-215.

16. *FTC v AT&T Mobility LLC* [2015] Cal. 122.

consumers' demand for their product. In a way, misleading and false advertisements restrain free consumer choice with the aim of increasing its product's demand.

However, deception or information manipulation has rarely been seen from an anticompetitive lens because the threshold of unfairness to trigger the antitrust law is much higher and requires harm to be induced on the market level. However, false advertising claims can occur even when a single individual (whether a consumer or a competitor) is injured. This ease of alleging false advertising claims is also one of the reasons courts are skeptical of looking at it from an antitrust violation perspective.

III. THE ECONOMICS OF CONCEALMENT: THE POSSIBILITY OF BUYING A 'LEMON'

A classic explanation for a 'market of lemons' by George Akerlof successfully defeats the argument about deception, leaving a negligible impact on the market as a whole.¹⁷ Take the analogy of secondhand car markets, where a defective secondhand car is considered to be 'lemon' and a secondhand car in good condition as 'peach'. When a buyer is going to purchase a used car, it is difficult for him to discern a good car from a defective one. Now, because the buyer is uncertain about the quality of the car, he will use the average quality of such used cars in the market as a yardstick (even if the quality of that item is much higher than the average quality).¹⁸

Additionally, there will be asymmetric information- the owner of lemons will know much more than the potential buyer. This would further incentivize the seller to display its low-quality car as a high-quality one, ultimately decreasing product quality and consumer satisfaction. This would further lead to a reduced average quality of used cars available on the market and increase the probability of buying a 'lemon'. In such a situation where only the average quality of goods is considered, as Akerlof

17. George A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 3, pg. 488.

18. Robert Kerton and Richard Bodwell, 'Quality, Choice and the Economics of Concealment: The Marketing of Lemons' (1995) 29 *Journal of Consumer Affairs* 1, pg. 1.

calls it, ‘the bad will drive out the good’ even to the extent of bringing the market for that particular good to a complete halt.¹⁹

To put it simply, due to the absence of a medium to verify the veracity of claims like the quality of a used car, the consumer would naturally respond by disregarding such claims. The friction of trust would compel sellers of good-quality products (which are also costly to produce) to charge a lesser amount to consumers. Ultimately, the superior quality of products would be driven out.

Therefore, false advertising perpetuates the ‘lemons problem’ by inhibiting the consumer from making an educated and well-informed purchasing decision. Asymmetric information is prevalent in many industries, most commonly found in the automobile, food, healthcare, and pharmaceutical industries. Even the Competition Commission of India (CCI), in one of its policy notes titled ‘Making Markets Work for an Affordable Healthcare’ identified information asymmetry as interfering with the agency of a consumer and disrupting well-functioning markets. Expectedly, the note states that information asymmetry doesn’t necessarily violate competition law but does create conditions limiting competition in a market.²⁰ In this context, it is safe to say that false and misleading advertisements can, in fact, have an effect on the market as a whole.

IV. BALANCING THE PRO-COMPETITIVE AND ANTICOMPETITIVE EFFECT

A common argument against enforcing antitrust liability against false advertising is that it is pro-competitive, i.e., it increases output. In fact, it is considered an innovative and creative way for brands to compete with each other.²¹ However, it is important to understand that while false advertising or comparative advertising may increase demand and output, it can also injure an honest competitor. It is not incorrect to say that most of the false advertising done by companies does not go against antitrust

19. PTI, ‘Information asymmetry causes anti-competitive practices in healthcare sector: CCI’ (Times of India, 4 November 2018); Competition Commission of India (CCI), ‘Policy Note: Making Markets Work for Affordable Healthcare’ (October, 2018).

20. *Ibid.*

21. Phillip Nelson, ‘Advertising as Information’ (1974) 82 J. Politic. Econ. 4, pp. 729-754.

law.²² However, the inherent assumption of deeming false advertising to carry *de minimis* harm completely excludes the scope of locating anti-trust liability even when firms with tremendous market power engage in false advertising.

One way of examining whether false advertising is anticompetitive or pro-competitive is by focusing primarily on the element of market deception.²³ Following this approach, anticompetitive deceptive conduct would be gauged by determining whether the misrepresentation (performed intentionally) was done with the intent to secure reliance from consumers.²⁴ Anticompetitive behavior follows no standard pattern; it can occur in many different forms and types, which are heavily dependent on the facts and circumstances of each case. Thus, adopting a case-by-case approach would allow the courts to analyze false advertising claims in accordance with the unique facts of each case, individually.

In India, however, there is no sharp distinction between the per se rule or the rule of reason. Instead, antitrust liability arises only when there is an appreciable adverse effect.²⁵ But, to balance the pro-competitive effects with the anti-competitive effects of false advertising, the rule of reason should be applied. The Supreme Court, in *Tata Engineering and Locomotive Co. Ltd. v. Registrar of Restrictive Trade Agreement*,²⁶ gave a three-pronged test to determine whether a particular practice is anticompetitive or not. First, what are the particular facts about the business that led to the imposition of a restraint? Second, what is the impact of that restraint? By analyzing the before and after-effects, Lastly, what is the nature of the restraint imposed and its actual and probable effect?

Thus, even if the alleged false advertising does not lead to an adverse effect on the market as discussed above in the ‘lemons’ problem, applying the rule of reason on a case-by-case basis would help the injured

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22. William M. Landes & Richard A. Posner, ‘Market Power in Antitrust Cases’ (1981) 94 Harv. L. R. 93.
 23. Richard Craswell, ‘Tying Requirements in Competitive Markets: The Consumer Protection Issues’ (1982) 62 B. U. Law Review 661.
 24. Mark R. Patterson and Mason, ‘Antitrust Law in the New Economy: Google, Yelp, LIBOR and the Control of Information’ (Harvard University Press, 2017) pg. 70.
 25. Dr. Souvik Chatterji, ‘Indian Competition (Amendment) Act, 2007 has not made difference between per se rule and rule of reason’ (2019) Indian Comp. L. R. 60.
 26. *Tata Engineering and Locomotive Co. Ltd. v. Registrar of Restrictive Trade Agreement* [1977] SCR 685.

competitor (if proven) to not be left remediless. For instance, in the case of Parachute coconut oil and Dabur coconut oil, as discussed before, if the sales of Parachute coconut oil were affected by Dabur's advertisement, Parachute could bring a claim against Dabur and prove that it misled the consumers into thinking that both products are of the same quality and the only difference is in the price of the two.

However, to be able to entertain individual claims like these, the first step should be to expand private enforcement under the Competition Act, 2002 (*the Act*). Currently, private enforcement is recognized only as a follow-on action under Section 53N²⁷ of the Act, and no provision for stand-alone action exists.

It is submitted that the expansion of private enforcement of competition law not only aligns well with the objectives of the Act but is also long overdue. Due to the limited resources at its disposal, CCI only considers those cases where community interest is at stake. In fact, as per Section 27 of the Act,²⁸ the CCI has no power to compensate consumers or any market player. However, this is in striking contrast to the powers afforded to the Central Consumer Protection Authority (CCPA). The CCPA has the power to investigate alleged violations of consumer law and has the discretion to choose whether a preliminary inquiry is needed or not. It is argued that, just like the CCPA, the CCI should also be given similar authority to investigate and adjudicate claims alleging gross violations of the competition law.²⁹

Interestingly, Federal Courts in the US have admitted that a competitor also has a cause of action against false advertising under the Lanham Act. A company called Alberto-Culver, which deals in hair and skin beauty products, brought a claim against Gillette for its hair rinse commercial. Gillette contended that such a claim cannot be brought under the Lanham Act as the commercial said nothing about Alberto Culver products. However, the court held that in cases of false advertisements, competitors have a cause of action even if it is not named in the ad. So, a competitor who is likely to get injured by an advertisement can bring

27. The Competition Act, s 53N.

28. The Competition Act, s 27.

29. Nimit Rajesh Goyal, 'The Promise of Private Enforcement of Competition Law in India' (IndiaCorpLaw, 6 May 2022) <<https://indiacorpLaw.in/2022/05/the-promise-of-private-enforcement-of-competition-law-in-india.html>> accessed 7 January 2024.

a claim against such an advertiser. Meaning, unverified and unsubstantiated claims like “best in taste” or “healthiest snack” can be challenged by even unnamed competitors.

Following such an approach would ensure that individual competitors suffering harm due to false or misleading advertisements would not be deterred from bringing a claim to protect their interests and market shares. The case-by-case approach would enable the courts to examine the conduct as a whole, offering more flexibility.³⁰

V. FRAMEWORK

From the above discussion, it is clear that, contrary to common belief, false advertising can in fact lead to unfair competition or may even have an anticompetitive effect in the market. It is suggested that to ensure that no injured competitor is rendered remediless on account of misleading claims, the first change that is most called for is the expansion of private enforcement.³¹ It is rare for false advertising to have an endearing effect on the market overall, unless it has penetrated so deeply for a continuous amount of time and created a market of ‘lemons.’ A focus and expansion on private enforcement would ensure that even an individual competitor facing a loss in revenue due to false advertising is not sidelined.

The adequate private enforcement system to entertain false advertising claims should be compensatory in nature, where the object is to compensate the victim for the loss he has faced along with damages.³² In jurisdictions where private enforcement is still underway, there is an ongoing debate between choosing the deterrence approach, the compensatory model, or a mix of both. For instance, in the white paper issued by the European Commission in 2008³³ the primary objective is to compensate, with deterrence being secondary. According to the White Paper, the

30. Michael A. Carrier and Tushnet R, ‘An Antitrust Framework for False Advertising’ (2021) 106 Iowa Law Review 4, pg. 1841.

31. Shashank Mehrotra, ‘Commitments: Shutting the doors to private enforcement?’ (IndiaCorpLaw, 12 December 2023) <<https://indiacorplaw.in/2022/05/the-promise-of-private-enforcement-of-competition-law-in-india.html>> accessed 8 January 2024.

32. Herbert J, ‘A Primer on Antitrust Damages’ (2011) U. Penn. L. R. 1846; Urs Schweizer, ‘Damages for infringements of competition law’ (2022) 53 European J. of Law and Econ, pp. 353-377.

33. Commission of European Communities, ‘White Paper on Damages Actions for Breach of the EC Antitrust Rules’ (COM, 2 April 2008) 165.

compensation would not be just for the loss suffered but also of the lost profits and interest.

For enforcing false advertising claims, the compensatory model is most suitable because it will place the injured competitor in the same position as he was in before the infringement occurred. However, to recover for the injury suffered properly, the claimant would have to present sufficient evidence. The compensatory principle can be followed as long as the harm caused can be ascertained.³⁴ If the true amount of harm caused is unascertained, then compensation may not be ordered. This model strongly rejects overcompensation.

Secondly, upon receiving a private claim against false advertisement, a preliminary enquiry should be court-ordered instead of party-initiated to curb the misuse of the law. A preliminary enquiry would be ordered only when the plaintiff has discharged his burden by proving either of the two things; that the anticompetitive conduct was targeted against a new entrant or, that actual monetary harm was caused.³⁵

In the first case, if a monopolist or an attempted monopolist is destroying the market of a new entrant, it would be an exclusionary practice and would qualify as abuse of dominance. So, a new beer company like Bira engaging in false advertising targeting other big competitors in a highly concentrated beer market would not give rise to a claim of false advertising under such a framework. The second factor would be measured by examining whether the injured firm was prevented from expanding its market share. For instance, in the above example of Dabur's coconut oil, Parachute would be successful in its claim if it could prove that the sales of its product marked a decrease after Dabur's advertisement. This further shows that stimulating fair competition is an equally important goal under this framework.

VI. CONCLUSION

In the apprehension of being deluged with false advertising claims, courts have adopted a counterproductive approach by making it almost impossible to bring false advertising claims within the bandwidth of antitrust.

34. John H. Andrew, 'The Civil Penalty Provisions of California's False Advertising and Unfair Competition Laws: Time for Review' (1992) 1 W St U Consumer LJ 103.

35. Daniel A. Crane, 'Optimizing Private Antitrust Enforcement' (2010) 63 Vand L Rev 673.

The argument that most of these claims don't violate competition law has led to a total abandonment of antitrust analysis, even in cases where monopolists or attempted monopolists are indulging in such unfair conduct. Most horizontal agreements don't contravene the competition law either, but courts still acknowledge its relevance when it is used to sustain one's monopoly.

This essay argues that it is incorrect to hold that false advertising cannot lead to an adverse effect in the market by placing reliance on the market of 'lemons' analogy. Further, the essay also contends that while advertising might have some pro-competitive effect, it is crucial to also recognize the anticompetitive effect. Thus, balancing the pro-competitive and anti-competitive effects by analyzing false advertising claims on a case-by-case basis is suggested as the way forward.

In the end, the author has proposed a framework for injured competitors to seek total compensation, including lost profits caused by false advertisements. The framework further permits for a preliminary enquiry, which would be conducted only when the plaintiff has satisfied the court about the gravity of the infringement with proper evidence. Such a framework will also keep false claims in check and conserve the limited resources with the competition authorities.

Sailing the Ship of Liabilities: Redefining Limited Liabilities for NBFCs in India

—Deepanshu and Digvijay Singh Maavi*

ABSTRACT

Non-banking financial companies (NBFCs) have become the favoured choice for corporate financial needs. Despite a decade of commendable growth, the NBFC sector faced a setback in 2018 with the collapse of Infrastructure Leasing & Financial Services, prompting a critical re-evaluation of company laws. Examining lessons from the 2018 Non-Banking Financial Company (NBFC) crisis and the Global Financial Crisis that affected NBFCs on Wall Street, this Author will suggest that the current regulations set forth by the Securities and Exchange Board of India and the Reserve Bank of India do not adequately tackle issues leading to banking failures. The author contends that the conventional concept of limited liability, deemed fundamental to corporate structures, is unbecoming for the NBFC sector. The research advocates for diluting limited liability and reintroducing a form of multiple liability. In examining limited liability, the author extrapolates potential civil and criminal liabilities in India. The author, by highlighting the importance of reform, will recommend modifying the strategy of holding individual directors and managers accountable under civil law to improve the efficacy of penalising collective negligence. The study also illuminates the distinctive features of NBFCs, often comprising relatively small and decentralised firms that equity investors actively manage. The author argues that limited liability in such cases may incentivise investors to take excessive risks, heightening systemic risk. Proposing a redesign of limited liability to align investor and societal interests better, the paper calls for reassessing the regulatory framework governing NBFCing firms.

* The authors are students at Indian Institute of Management, Rohtak.

Throughout the paper, the author seeks to extract lessons from jurisdictions like the United Kingdom and the United States.

I. INTRODUCTION

In the contemporary economic landscape, significant financial backing for expansive initiatives and undertakings no longer exclusively emanates from conventional financial institutions. A considerable proportion of the credit is derived from entities commonly identified as Non-banking Financial Companies (NBFCs). This phenomenon is particularly conspicuous within the United States (US), where a multitude of NBFCs conduct operations on Wall Street. Essentially, these entities are corporate entities that mirror conduct and furnish services akin to those offered by traditional banks, including deposit-taking, loan provision, and insurance services, among other functionalities. Nevertheless, they operate outside the boundaries of NBFC statutes and regulations. In India, NBFCs serve as counterparts to their Wall Street actors.¹ Enterprises such as Bajaj Finserv and Muthoot Finances proffer an extensive array of financial services, mirroring the repertoire of services delivered by conventional banks.

All well-known NBFCs have chosen limited liability as their status under the Act. NBFCs have this option.² The fundamental rationale behind this choice lies in affording shareholders the capacity to confine their financial exposure in the event of default. Nevertheless, this liability framework introduces a quandary, conspicuously highlighted by the Wall Street upheaval in 2008. Essentially, the issue arises from the fact that limited liability incentivises managers and directors to embark upon exceedingly precarious business decisions. In instances where these strategies prove successful, the ensuing profits are substantial. Alternatively, if these businesses experience failure and enter into default, the directors and management can find solace in knowing that their individual responsibility is restricted to the extent of their share ownership.

The significance of the NBFCs is poised to ascend in a post-COVID epoch. In India, various sectors of the economy are infused with substantial

1. Roy Girasasa, *Shadow Banking: The Rise, Risks, and Rewards of Non-Bank Financial Services*, (Springer 2018).

2. Laura E Kodres, 'What Is Shadow Banking?' (IMF) <www.imf.org/external/pubs/ft/fandd/2013/06/basics.htm> accessed 11 December 2023.

sums of NBFC capital, propelling further expansion and advancement.³ The quantum of lending facilitated by NBFC in India already eclipses that of other major economies.⁴ Given the marked economic downturn in India, resuscitating it is anticipated to necessitate substantial funds.⁵ As a result, Non-Banking Financial Companies (NBFCs) are expected to play a crucial role in providing essential loans to stimulate economic activity, which was significantly disrupted by the COVID-19 pandemic.

Recent information points to a decline in borrowing prices for several NBFCs. Given the unstable state of many well-known banks, particularly those in the public sector, businesses are more likely to turn to NBFCs for financial support.⁶ Given this economic backdrop, it becomes essential to scrutinise the legal standing of these entities. The heightened concern primarily arises from significant defaults observed within major NBFCs of late.

II. INDIA'S OWN LEHMAN CRISIS AND ITS REGULATIONS

In 2018, the default of Infrastructure Leasing & Finance Corporation (*IL&FS*) can be interpreted as “India’s own Lehman Crisis”, also known as “the Great Indian NBFC Crisis” (*the NBFC crisis*), triggered a significant market upheaval reminiscent of the “Lehman Crisis” or “the Global Financial Crisis” (*GFC*),⁷ echoing the familiar financial turmoil associated with large-scale banking failures.⁸ Auspiciously, the Government of India took decisive action to tackle the NBFC crisis, implementing

3. ‘About \$63 Billion of Stalled Residential Projects Across Country: Report - ET RealEstate’ (ETRealty.com) <<https://realty.economicstimes.indiatimes.com/news/industry/about-63-billion-of-stalled-residential-projects-across-country-report/71437142>> accessed 12 December 2023.

4. Global Shadow Banking Monitoring Report 2017 (FSB, Financial Stability Board 2018).

5. Divya Patil and Anil Poonia, ‘Borrowing Costs Ease for NBFCs After RBI Pumps More Cash in Credit Market’ (Business Standard, 19 November 2020) <www.business-standard.com/article/economy-policy/borrowing-costs-ease-for-nbfc-after-rbi-pumps-more-cash-in-credit-market-120111900164_1.html> accessed 12 December 2023.

6. *Ibid.*

7. Andy Mukherjee, ‘Bloomberg - Are You a Robot?’ (Bloomberg, 13 September 2018) <www.bloomberg.com/opinion/articles/2018-09-13/india-s-il-fs-is-facing-a-lehman-moment> accessed 12 December 2023.

8. ‘India’s Shadow-Bank Bust Has a Lehman Echo Banks and Mutual Funds Are on the Hook for IL&FS’s \$12.5 Billion Debt’ (Bloomberg, 13 September 2018) <www.bloomberg.com/view/articles/2018-09-13/india-s-il-fs-is-facing-a-lehman-moment> accessed 12 December 2023.

effective measures.⁹ The Reserve Bank of India (*RBI*) assumed control of IL&FS's day-to-day operations, backed by multiple public sector banks providing financial aid to facilitate the company's business revival.

The challenges faced by the RBI in managing the IL&FS default were substantial. One year later, Dewan Housing Finance Corporation (*DHFC*) missed payments on its debt. RBI was compelled to replicate the entire process, which included taking control by removing the Board of Directors in order to revive the company. The sequential occurrence of these defaults underscored the potential strain on the RBI.¹⁰ This led to both defaults occurring simultaneously, doubling the workload for the RBI.

The IL&FS failure was marked by numerous regulatory lapses. Several Indian Administrative Service (*IAS*) officers entrusted with scrutinising the company's financial records and operations were found engaged in collusion.¹¹ Furthermore, credit rating agencies assigned an 'AAA' rating to IL&FS's long-term and short-term borrowings. Notably, this rating was adjusted only on the eve of IL&FS's default, indicating a failure on the part of these agencies to assess the looming crisis accurately.¹² The RBI, aiming for greater oversight, designated IL&FS as a 'Systemically Important NBFC.' Despite this classification, the regulatory body could not avert the default and subsequent collapse of the NBFC. This raises concerns about the effectiveness of the regulatory oversight in place.¹³

After this, considerable enhancements are imperative in financial laws and regulations to rectify the deficiencies that led to the setbacks of

9. Anil Poonia and Divya Patil, 'Shadow Banks Ride out the Crisis while Virus Ravages India' (Bloomberg Quint, 16 Sept 2020) <<https://www.bloomberquint.com/business/shadowbanks-are-riding-out-the-crisis-while-virus-ravages-india>> accessed 5 October 2020.

10. Shayan Ghosh, 'RBI Takes Over DHFL Board; R Subramaniakumar Appointed as Administrator' (Business Today, 20 November 2019) <www.businesstoday.in/latest/corporate/story/rbi-takes-over-dhfl-board-r-subramaniakumar-appointed-as-administrator-238613-2019-11-20> accessed 12 December 2023.

11. Sucheta Dalal, 'IL&FS: SFIO Investigation Throws up new leads on Insolvent Bank's Dealings' (The Wire, 5 April 2018) <<https://thewire.in/banking/ilfs-mess-sfio-investigation-new-dirt>> accessed 12 December 2023.

12. Anjan Basu, 'IL&FS and the La-La Land That Is Indian Credit Rating' (The Wire, 7 October 2018) <<https://thewire.in/business/ilfs-moodys-fitch-care-icra-rating-companies>> accessed 12 December 2023.

13. Kavaljit Singh, 'How Should India Resolve the Fault Lines in Its Shadow Banking System?' (The Wire, 16 June 2019) <<https://thewire.in/banking/india-shadow-banking-system-fault-lines>> accessed 12 December 2023.

IL&FS and DHFC. As was already said, NBFCs provide a large portion of project financing, and in the wake of the COVID-19 outbreak, this dependence is expected to increase. The framework of financial regulation establishes the parameters for various stakeholders in financial markets, encompassing consumers, banks and other entities.¹⁴ It delineates the rules to which all participants must adhere while conducting their activities in the financial and banking sectors.

In response to the NBFC crisis, efforts have predominantly concentrated on regulatory measures. This approach involves formulating additional rules and guidelines to augment oversight and monitoring by the RBI.¹⁵ Yet, the efficacy of this strategy is dubious. Marketplaces are dynamic and in a perpetual state of evolution, frequently surpassing and circumventing regulations, irrespective of their stringency.¹⁶ Consequently, expecting the RBI and other regulators to consistently enforce new guidelines effectively might be unrealistic.

Intellectuals in the US have acknowledged a shift in focus within legal scholarship, notably following the GFC.¹⁷ The diminished confidence in the ability of financial regulation to avert crises has prompted a redirection of attention toward broader realms within company and financial law.¹⁸ The prevailing viewpoint asserts that altering the legal framework governing investment banks holds greater promise for effectively overseeing banking activities. Notably, the presence of “Moral hazard” is ingrained in managers’ compensation structure, wherein incentives for taking substantial risks to boost profits are heightened.¹⁹ Consequently, legal reforms must address such dimensions of banking practices.

14. H Kronke, J Benjamin, *Financial Law* (Oxford University Press 2007).

15. Editorial Team, ‘RBI’s Welcome Steps to Reform HFCs’ (Times of India Blogs, 16 July 2020) <<https://toiblogs.indiatimes.com/blogs/et-editorials/rbis-welcome-steps-to-reform-hfcs/>> accessed 12 December 2023.

16. Steven Schwarcz, ‘Disclosure’s Failure in the Subprime Mortgage Crisis’ (2008) *Utah Law Review* 1109.; Andrew R Keay, ‘The Duty to Promote the Success of the Company: Is It Fit for Purpose?’ (2010) University of Leeds School of Law, Centre for Business Law and Practice Working Paper.; Hans-Werner Sinn, ‘Risk Taking, Limited Liability and the Competition of Bank Regulators’ (NBER, December 2001) <www.nber.org/papers/w8669> accessed 12 December 2023.

17. Steven Schwarcz and Iman Anabtawi, ‘Regulating Systemic Risk: Towards an Analytical Framework’ (2010) UCLA School of Law, Law-Econ Research Paper No. 10-11.

18. *Ibid.*

19. Lucian A Bebchuk and Holger Spamann, ‘Regulating Bankers’ Pay’ (2010) 93(2) *Gerogetown law Journal*.

III. DEVELOPMENTS

The era of limited liability did not always prevail in the common law jurisdiction. The UK maintained a system of unlimited liability for banks until approximately 1879. However, this approach saw a substantial shift after the Glasgow Bank collapsed.²⁰ Similarly, the US²¹ maintained a concept of twice and thrice the liability for banks until the era of the GFC. In both cases, the departure from numerous liabilities stemmed from the onerous liabilities it imposed on everyday shareholders not actively engaged in the governance of banks, notably the obligation placed on them to compensate creditors for defaults.

A. Liabilities under the British Raj

The evolution of Indian company law closely resembles the development of the British Raj, although it diverged earlier, notably in the transition from unlimited liability. This departure occurred sooner in India, driven partially by the unique dynamics of the colonial economy. A pivotal moment unfolded in 1848 when the Union Bank of Calcutta (*UBC*), operating with unlimited liability, faced a major banking failure.²² The repercussions reverberated throughout the entire share market, prompting bankers to engage in discussions about the viability of maintaining this liability standard.

During the following ten years, the Indian legislative scene showed significant respect for academic and legal viewpoints originating from Britain. After limited liability started to make sense for British banks in 1858,²³ the colonial administration swiftly adopted the same just two years later.²⁴ Notably, the inception of limited liability for banks in India coincided with the emergence of the first significant economic bubble.²⁵

20. Matthew Willison, 'Were Banks Special? Contrasting Viewpoints in Mid-Nineteenth Century Britain' (2018) Bank of England Working Paper No. 755.

21. National Banking Act, 1863 12 U.S.C 38.

22. Jonathan R. Macey and Geoffrey P. Miller, 'Double Liability of Bank Shareholders: A Look at the New Data' (1993) 28 Wake Forest L. Rev. 933.; Acheson Graeme G, Hickson Charles R and John Turner, 'Does Limited Liability Matter? Evidence From Nineteenth-Century British Banking' (2010) 6(2) Review of Law & Economics 247.

23. Charles Northcote Cooke, *The Rise, Progress, and Present Condition of Banking in India* (Bengal Print. Co. 1863).

24. *Ibid.*

25. Shyam Rungta, *The rise of business corporations in India, 1851-1900* (Cambridge University Press 1970).

This economic surge was propelled by the booming cotton industry in Bombay,²⁶ stimulated by a disruption in the cotton supply from the Southern US due to the American Civil War.²⁷ Over the ensuing half of the decade, while the US was traditionally the primary source for Britain in the cotton business and was embroiled in conflict, Bombay's mills enjoyed unprecedented profitability. The financial sector flourished as a result of this unexpected financial windfall.

Upon the Confederacy's defeat and the subsequent resumption of cotton production in the Southern States, the abrupt and substantial decrease in demand precipitated a severe economic downturn in Bombay.²⁸ In 1866, the Bank of Bombay encountered the formidable task of refunding a mere Rs. 100 against a Rs. 5,000 investment in paid-up shares, illustrating the disruptive consequences of the speculative bubble during that period.

Several potential reasons have proved why re-evaluating liability standards did not occur in the aftermath of that period. As previously mentioned, Indian administrators tended to follow the legal course set by Britain without much independent thought. The stability of the British financial situation during those years, periodically supported by cotton from either Bombay or the Southern US, provided no compelling reason to re-open discussions. Another perspective dismissed the Bombay boom and bust as an isolated incident, with economic revitalisation already underway, particularly through the tea industry.²⁹ Essentially, the Indian economy was primarily seen as a means to fulfil the evolving needs of the British.

What stands out is the relative obscurity of this period of debate on limited liability in contemporary discussions on business laws. It was 'irksome' to think of unlimited liability, and it was a little odd to ignore the 1857 Act's limited liability for banks without taking into account the lengthy deliberations that took place at the time.³⁰ This oversight has resulted in a lack of literature scrutinising the application of limited liability to NBFCs and the potential benefits of modifying this aspect of

26. Joint Stock Companies Act, 1857 (19 of 1857) s 1.

27. *Ibid.*

28. Dinshaw Edulji and Wacha, *A Financial Chapter in the History of Bombay City* (Cambridge University Press 1910).

29. *Ibid.*

30. Dwijendra Tripathi, *The concise Oxford history of Indian business* (Oxford University Press 2006).

the law to enhance regulation. In the next sub-section, we will delve into this inquiry, echoing the considerations of colonial lawmakers nearly two centuries ago.

B. NBFC's Limited Liability under the Indian regime

In the examination of the uncertainties surrounding the inevitability of limited liability, a critical analysis of the imperative for India to embrace a more stringent liability framework for NBFCs is imperative.³¹ This sub-section delves into the nuanced operations and significance of NBFCs, highlighting the distinctive scenario that limited liability presents, particularly within the realm of NBFC banking.³²

Limited liability not only allows the management of NBFCs to utilise external funds for investments but also affords them the privilege of spending beyond the value of their shares,³³ all while safeguarding their personal finances. This regulatory paradigm gives rise to a 'moral hazard,' where irresponsible behaviour is inadvertently endorsed through a corporate structure that shields such actions.

The consequences of this limited liability regime manifest in three distinct market crashes:

1. Information Failure,
2. Agency Failure, and
3. Limited Liability and Information Failure.³⁴

The two key ideas are revealed in the context of accountability failure.

Firstly, the decentralisation that accompanies the expansion of NBFCs creates an information imbalance across different segments of the company. Power tends to concentrate among primary investors/shareholders, propelling management towards substantial risks for outsized profits. Limited liability, serving as a safeguard, caps financial losses in the event

31. Lucian A Bebchuk and Holger Spamann, 'Regulating Bankers' Pay' (2010) 93(2) *Gerogetown law Journal*.; Claire A Hill and Richard W Painter, 'Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability' (2010) 33 *Seattle University Law Review*.

32. *Ibid*.

33. Kraakman and Hansmann, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100(7) *Yale Law Journal* 1879.

34. Steven Schwarcz, 'The Governance Structure of Shadow Banking: Rethinking Assumptions About Limited Liability' (2014) 90 *Notre Dame Law Review* 1.

of insolvency, shedding light on the reticence of prominent investors like “LIC” and “HDFC Bank” before the 2018 collapse of IL&FS.³⁵

Secondly, the strategy of intermediation contributes significantly to the challenges faced by NBFCs. The prevalent approach of securing short-term financing for projects with extended timelines, prevalent in both India and the US,³⁶ harbours inherent risks, exemplified by the IL&FS case.³⁷ Despite regulatory oversight, the flawed financing strategy resulted in default and insolvency, emphasising the limitations of regulatory mechanisms.³⁸

The heightened risk within NBFCs, categorised as systemically important by the Reserve Bank of India (RBI), stems from the critical nature of their intermediary portfolio entrenched in vital sectors.³⁹ This precarious scenario presents the potential for contagion, where the failure of a single NBFC entity could adversely impact the entire economy and financial markets, as witnessed in the aftermath of the dissolution of IL&FS.

The larger NBFCs face heightened concerns, especially those publicly listed and traded on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).⁴⁰ The substantial magnitude and diverse areas of investment expose a significantly larger number of ordinary investors to the risk of a downturn in their investments,⁴¹ implying that defaults could propagate across multiple sectors of the economy.⁴²

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35. Hemindra Hazari, ‘Behind IL&FS Default, A Board that Didn’t Bark when it was supposed to’ (*TheWire* 17 September 2018) <<https://thewire.in/business/behind-ilfs-default-a-board-that-didnt-bark-when-it-was-supposed-to#:~:text=The%20IL%26FS%20episode%20shows%20the,maya%2C%20all%20was%20an%20illusion.>> accessed on 12 December 2023.
36. Schwarcz, ‘Regulating Shadows: Financial Regulation and Responsibility Failure’ (2013) 70(3) *Washington & Lee Law Review*.
37. Gurbachan Singh, ‘How can we discourage IL&FS and Other Shadow Banks from Relying on Short-Term Funding?’ (*The Wire*, 17 October 2018) <<https://thewire.in/banking/ilfs-short-term-funding>> accessed 12 December 2023.; Andrew Crockett and Benjamin Cohen, ‘Financial Markets and Systematic Risks in an Era of Innovation’ 2002 4(1) *International Finance* 127.
38. RBI, Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company Directions, 2016.
39. Iman Anabtawi and Steven Schwarcz, ‘Regulating Ex Post: How Law Can Address the Inevitability of Financial Failure’ (2013) 92 *Texas Law Review* 75.
40. *Ibid.*
41. ABC, ‘Largest, NBFC by Net Profits’ (Latest Control) <<https://www.moneycontrol.com/stocks/marketinfo/netprofit/bse/finance-nbcc.html>> accessed on 12 December 2023.
42. RBI, ‘Master Direction -NBFC-Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Direction’, 2015; RBI, ‘Master

While recognising that limited liability extends beyond the confines of the NBFC system,⁴³ its application within this context is particularly noteworthy due to its heightened likelihood of yielding systemic repercussions.⁴⁴ This heightened risk is attributed to two main factors: the decentralised nature of NBFC entities and the amplification of systemic consequences through disintermediation.⁴⁵

Decentralised structures increase the likelihood of managers in limited liability NBFC firms taking greater risks compared to their counterparts in other limited liability enterprises.⁴⁶ Smaller entities within the NBFC system are often directly supervised by their principal investors, who exhibit robust motivations to partake in risk-taking activities.⁴⁷ The safeguard provided by limited liability shields investor managers from potential losses exceeding their initial invested capital, presenting a notable contrast to the incentives prevalent in non-NBFC firms.⁴⁸

Managers overseeing limited liability NBFC entities are more inclined to undertake risks, heightening the probability of failure. The heightened risk is further intensified by the characteristics of NBFC financial intermediation. Similar to conventional banks, NBFCs increase the liquidity risk by engaging in short-term funding for long-term projects.⁴⁹

The potential consequences of the failure of an NBFC are more likely to pose systemic implications compared to those of a conventional firm. Due to the high level of interconnectedness among all financial intermediaries, the failure of an NBFC firm could trigger a chain reaction,

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- Direction- NBFC- Companies Prudential Norms (Reserve Bank) Directions, 2007, 2007.
43. Stacy Collins, 'Valuation of Hedge Fund Businesses' [2008].; Richard M. Hynes, 'Securitization, Agency Costs, and the Subprime Crisis' (2009) 4 Virginia Law and Business Review 231.
 44. Mercer Bullard, 'Regulating Hedge Fund Managers: The Investment Company Act as a Regulatory Screen' (2008) 13 Stan. J. L. Bus. & Fin. 286.
 45. Steven Schwarcz, 'Understanding the Subprime Financial Crisis' (2009) 60(3) University of Chicago law Review.
 46. Robert Boldin and Keith Leggett, 'Bank Dividend Policy as a Signal of Bank Quality' (1995) 4(1) Financial Services Review.; Nikola Spatafora, 'Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risks, in the global financial crisis' (2009) 1753 PLI/Corp 319.
 47. Claire A. Hill, 'Is Secured Debt Efficient?' (2002) 80 TEX. L. REV. 1117.
 48. Henry T.C. Hu, 'Risk, Time, and Fiduciary Principles in Corporate Investment' (1990) 38 UCLA Law Review.
 49. Steven Schwarcz, 'Collapsing Corporate Structures: Resolving the Tension Between Form and Substance', (2004) 60 The Business Lawyer.

impacting other financial intermediaries and manifesting as a systemic event.

Moreover, engaging in the practice of securing short-term funding for long-term projects not only amplifies the rate of failure for an NBFC but also exacerbates the systemic ramifications associated with such a failure. Correlated failures, as exemplified during the GFC, pose a systemic risk attributed to the lack of solvency regulation, a feature notably absent in traditional banking institutions.

The legal system, with a specific focus on tort law, functions as a means to internalise externalities associated with a firm. Nonetheless, the application of limited liability presents practical hurdles for conventional banking institutions, as individuals adversely affected by even non-systemic issues may encounter difficulties in seeking compensation for damages. For NBFC firms, the consequences are qualitatively different, especially concerning systemic harm. Injured third parties in systemic cases have minimal chances of recovering damages that internalise the harm due to the unique challenges posed by the unpredictability and widespread nature of systemic harm.

The analysis highlights that investors with limited liability in NBFCs may not have sufficient incentives for monitoring, which could lead to their involvement in actions that pose systemic risks. Additionally, conventional legal remedies are unlikely to effectively address and internalise the systemic externalities associated with NBFC activities.

C. Re-wiring the Companies Act 2013

There has been criticism asserting that financial regulations are ineffective in preventing the failures of NBFCs. The RBI had put rules on IL&FS after classifying it as “Systemically Important,” believing that this would be enough to prevent banking failures.⁵⁰ However, as the sequence of events unfolded, it became evident that this confidence was misplaced. It is to be stated by the chairperson of RBI that the issue at hand is not necessarily a lack of regulatory measures but rather a deficiency in

50. RBI, ‘List of Non-Deposit taking Systemically Important (NBFCND-SI) companies registered with RBI’ (RBI Bulletin) <<https://rbidocs.rbi.org.in/rdocs/content/PDFs/NBFCsandARCs10012023.PDF>> accessed 11 December 2023.

supervisory capabilities.⁵¹ This means that RBI and the Securitization and Exchange Board of India (*SEBI*) should effectively supervise the warrant compliance.⁵²

The observation was that IL&FS effectively concealed its non-performing loans by shuffling funds within its network of over 300 companies.⁵³ Additionally, it has been pointed out that there is no mention of IL&FS in the RBI's Financial Stability Report (*FSR*), even in the 2018 edition released just before the collapse of the NBFC.⁵⁴ The RBI acknowledged in the *FSR* 2019 the failure of IL&FS had been able to evade its inspection for over half of the bad debt that dated back decades.⁵⁵ This highlights that the Regulatory bodies have consistently struggled to keep pace with such evasive practices as the majority bank engaged in concealing its activities will invariably devise creative methods to do so.⁵⁶

Continuing to obsess over these regulatory controls by the SEBI and RBI risks losing sight of the bigger picture. However, it appears that the RBI intends to address the problems through regulatory means. The RBI's discussion paper about the NBFCs suggests a four-tier ranking with varying regulatory obligations for each tier.⁵⁷ Notably, the bottom layer, comprising 9,209 out of 9,429 NBFCs, will face minimal additional regulatory controls. The third tier's inclusion of the top 30 NBFCs and its application of capital, exposure, and provisioning regulations similar to those of well-established banks is a good development. Nevertheless,

51. Arvind Subramanian, *Of Counsel: The Challenges of the Modi-Jaitley Economy*, (Penguin Books 2018).

52. *Ibid.*

53. Arvind Subramanian, 'RBI's Regulatory failure created IL&FS mess' (*Economics Times*, 29 November 2018) <<https://economicstimes.indiatimes.com/news/economy/policy/rbis-regulatory-faliure-created-ilfs-mess-says-arvind/articleshow/66866097.cms?from=mdr>> accessed on 12 December 2023.

54. Arvind Subramanian, 'RBI's reports never mentioned possible IL&FS crisis: Arvind Subramanian' (*Financial Express*, 12 July 2019) <<https://www.financialexpress.com/policy/economy-rbis-reports-never-mentioned-possible-ilfs-crisis-arvind-subramanian-1642510/>> accessed on 12 December 2023.

55. Reuters, 'IL&FS may not have disclosed bad loans for 4 years' (*Business Today*, 15 August 2019) <<https://www.businesstoday.in/latest/economy-politics/story/ilfs-may-not-have-disclosed-bad-loans-for-4-years-rbi-report-222299-2019-08-15>> accessed on 12 December 2023.

56. Lee Buchheit, 'Did We Make Things Too Complicated?' (2008) 27(3) *International Financial Law Review*.; Steven Schwarcz, 'Disclosure's Failure in the Subprime Mortgage Crisis' (2008) *Utah Law Review* 1109.

57. RBI, 'Discussion Paper on Revised Regulatory Framework for NBFCs - A Scale Based Approach', 2021.

the introduction of cash reserve and liquidity ratios is absent. It appears to be an attempt to balance regulation and economic growth, walking a tightrope.⁵⁸

However, excessively focusing on the exact scope of regulations without significantly improving actual supervision is likely to cause future banking crises. Changing the incentive structure for management staff in NBFCs is the favoured and long-term answer.

IV. CIVIL AND CRIMINAL LIABILITY

The contingent obligations predominantly pertain to individuals at managerial echelons, specifically senior and middle-level executives, who concurrently possess varying degrees of company shares. While this may be applicable to various small-to-medium-sized NBFCs, it is not the same for the largest ones, regardless of whether they are private, public, or listed. Given the current circumstances, an alternative strategy for addressing the improprieties linked with NBFCs involves the enforcement of sanctions, encompassing both civil and criminal measures. Even in the aftermath of the subprime mortgage crisis in the US, only one banker, Kareem Serageldin, was arrested.⁵⁹ It did not belong to senior management but fell within the ‘secondary management’ category.⁶⁰ The public’s disappointment and indignation at witnessing the majority of shareholders and top managers escape only with fines, or sometimes none at all, was evident.⁶¹

Conversely, the Serious Fraud Investigation Office (*SFIO*) has been diligently conducting investigations into IL&FS, albeit with a narrow

58. ‘The Hindu Business Line, ‘Regulating NBFCs’ (Business Line, 27 January 2021) <www.thehindubusinessline.com/opinion/editorial/regulating-nbfc/article33677923.ece> accessed 12 December 2023.

59. Peter J Boyer, ‘Did Obama Sell Out?’ (Newsweek, 6 May 2012) <www.newsweek.com/why-cant-obama-bring-wall-street-justice-65009> accessed 5 January 2024.; Marian Wang, ‘Why No Financial Crisis Prosecutions? Ex-Justice Official Says It’s Just Too Hard’ (ProPublica, 6 December 2011) <<https://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-its-just-too-hard>> accessed 6 January 2024.

60. Jesse Eisinger, ‘Why Only One Top Banker Went to Jail for the Financial Crisis’ (The New York Times, 30 April 2014) <<https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html#:~:text=Serageldin%20lied%20about%20the%20value,that%20should%20have%20been%20reported.>> accessed 6 January 2024.

61. Ben Hallman, ‘Too Big to Jail: Wall St. Execs Unlikely to Face Criminal Charges, Source Says’ (HuffPost, 8 September 2012) <www.huffpost.com/entry/criminal-charges-wall-street_n-1857926?ri18n=true> accessed 12 December 2023.

emphasis on a small number of persons within the organisation.⁶² In spite of this, there have only been two high-management arrests, for which criminal investigations are still pending. Nevertheless, no clear regulations in India holding directors personally accountable for group liability is a matter of concern. Now, the topic of whether criminal or civil penalties are more suited to deal with corporate wrongdoing emerges, as well as how the particularities of the NBFC industry affect the result. It is suggested that civil liability should consider the senior management group rather than focusing on individual actions, particularly in cases where the way a bank operates or the collective carelessness of its policies raises the risk of default.

A. Civil Sanctions for Directors in Indian NBFCs

Civil charges can be invoked under Section 447.⁶³ Although this provision has been applied sporadically since its inception, it has recently gained prominence in addressing fraud allegations arising from the Bhushan Steel Insolvency.⁶⁴ Notably, these charges are of a criminal nature. However, a notable limitation of these standalone provisions is the absence of a mechanism to hold entire groups accountable.

There exists a common misconception regarding Indian law, suggesting that it permits the collective liability of a group of directors. This assumption is, in fact, incorrect. To comprehend the distinction between group and individual liability, it is insightful to turn to US jurisprudence.⁶⁵

Group liability entails holding a collective entity accountable at the group level, rendering individual conduct irrelevant. The approach is employed in instances where fiduciary duties, including the duty of care, have been breached, resulting in a no-fault liability for the entire Board concerning a specific failure.⁶⁶

62. Abc, 'Banking News: Read Today's Banking News, Banking Latest Updates | the Economic Times' (The Economic Times) <<https://economictimes.indiatimes.com/industry/banking/finance>> accessed 13 December 2023.

63. The Companies Act 2013, s 447.

64. Serious Fraud Investigation Office v Neeraj Singhal [2018] Criminal appeal no. 1114/2018.; Serious Fraud Investigation Office v Nittin Johari [2019] Criminal appeal no. 1381/2019.

65. Darian M. Ibrahim, 'Individual or Collective Liability for Corporate Directors?' (2008) Arizona Legal Studies Discussion Paper No. 06-25.

66. Smith v Van Gorkom [1985] Del. 488 A2d 858.

The rationale behind group liability lies in the complexity of determining the specific director responsible for negligence or failure of due care. The entire Board is held accountable when a corporation suffers as a result of such negligence, such as when a bank collapses as a result of dangerous policies. Significantly, the liability extends to all board members, irrespective of their direct involvement in the decision-making process or their responsibility for implementing the policy. On the other hand, the concept of individual liability for distinct directors is reserved for disloyalty or fraud cases, where the actions are individually scrutinised.⁶⁷

Moreover, the fiduciary obligations outlined in Section 166 of the Act⁶⁸ are distinctly delineated for each director, lacking a collective approach regarding the Board's responsibility, a contrast to the jurisprudence in the United States where the group liability principle has found application. Notably, Section 166 focuses on individual directorial duties without explicit reference to the Board's joint liability.

Despite the absence of supportive case law on this aspect, singling out specific directors or managers for accountability fails to adequately address the underlying concerns. Directors often assert that decisions were influenced by individuals with greater knowledge, such as the Managing Director (*MD*), thereby deflecting responsibility. The contention that group decisions were made can be undermined by asserting the lack of accurate information. Furthermore, the subjective nature of evaluating whether a particular policy is optimal for the company complicates matters, as it is not an objective determination. In the absence of a no-fault liability provision, directors possess various avenues to evade accountability.

The IL&FS board faced criticism for its failure to intervene when senior management actions began adversely affecting the company. The Act outlines negligence-based liability for directors; however, no efforts have been made to enforce it against them thus far.⁶⁹ The challenge in holding them accountable lies in the absence of a no-fault group liability option. Certain directors have faced criminal sanctions, leaving the rest

67. *Ibid.*

68. The Companies Act 2013, s 166.

69. The Companies Act 2013, ss. 2(60), 166(3).

unaffected. Section 166 offences are compoundable, enabling individual directors to admit guilt and pay fines.

The same also arise during the piercing of the corporate veil doctrine. Though fraud can trigger personal liability for a director, the cumbersome court enforcement process renders it essentially redundant post-default.⁷⁰ Investigating a company's operations comprehensively is challenging, particularly given the intricacies of NBFC. This complexity hampers the doctrine's effectiveness, and addressing specific directors does not resolve the highlighted issues.⁷¹ The doctrine's usefulness is further diminished by the complex ways in which NBFCs operate and the challenges associated with obtaining important information after large-scale corporate crime. Only a few situations, including breaking the Prevention of Money Laundering Act (*PMLA*), provide the SFIO and Enforcement Directorate with the authority to take direct legal action against the IL&FS administration.

When assessing the appropriateness of imposing civil liability to address fraud or other transgressions committed by directors, a prevailing view suggests that criminal penalties are deemed excessively severe.⁷² Advocates argue that given the nature of these offences predominantly involving financial misconduct, a commensurate financial penalty represents a more fitting response.⁷³ In the Indian context, the practice of entering into settlements with offenders, particularly in cases of listed companies' regulatory violations, is widespread. These payments frequently prevent the SEBI from doing additional research.⁷⁴

70. Estate Officer v. Esys Information [2016] CIVIL APPEAL NO. 3765/2016; S. Sukumar v Institute of Chartered Accountants of India, Supreme Court of India [2019] Civil Appeal No.2422/2018 .

71. Moshen Manesh, 'The Case Against Fiduciary Entity Veil Piercing' (2016) 72 Business Lawyer (Winter 2019-2017).; Colin P. Marks, 'Piercing the Fiduciary Veil' (2014) 19 Lewis & Clark Law Review.

72. Christine Hurt, 'The Undercivilization of Corporate Law' (2008) 33 Journal of Corporation Law.

73. Ibid.

74. Abc, 'Four Individuals Settle Insider Trading Case With Sebi' (*The Economic Times*, 26 June 2020) <<https://economictimes.indiatimes.com/markets/stocks/news/four-individuals-settle-insider-trading-case-with-sebi/articleshow/76645800.cms?from=mdr>> accessed 14 December 2024.

Moreover, the “Business Judgment Rule” (*BJR*), although not widely embraced in India,⁷⁵ shields managers from liability by affording them considerable discretion in the company’s operational decisions.⁷⁶ In distinct criminal proceedings, civil suits frequently face dismissal, especially in the jurisdictions where the rule has undertaken more utilitarian legal examination.⁷⁷ Beyond this, challenges associated with navigating the intricate internal workings of financial institutions and pinpointing liability contribute to the inclination towards settlement. In contrast, settlement remains an unavailable recourse in criminal proceedings.

In addition, the process of proving civil claims in court still presents difficulties even though it has a lower standard of proof than criminal law. Fundamentally, the claims pose a hypothetical financial jeopardy for executives/directors rather than an absolute one.⁷⁸ Directors possess various legal defences, such as proximate cause, remoteness of specific harm, absence of causation, *BJR* and others, to safeguard their interests. These collections of defences significantly diminish the risk of being held liable during adjudication, leveraging the extensive legal and financial resources typically available to these individuals. Directors have a strong incentive to adopt a bullish approach to taking substantial risks in investment strategies, as any potential penalty, if imposed, is likely to constitute a modest fraction of their newly accumulated wealth. Crucially, such ambitious behaviour does not lead to fraud, necessitating the *mens rea* or the intent, which is not present in these instances. Rather, the violation in these situations results from a failure to use reasonable caution or from negligence in accordance with the NBFC’s regulations. Recognising collective liability under the Act would alleviate this issue in the Indian context.

75. *Gimbel v Signal Cos*, Court of Chancery of Delaware [1974] Del. 316 A.2d 599.; *John F. Dodge and Horace E. Dodge v. Ford Motor Company et al* [1919] Mich. 204 Mich. 459.

76. Martin Petrin, ‘Circumscribing the ‘Prosecutor’s Ticket to Tag the Elite’ – A Critique of the Responsible Corporate Officer Doctrine’ (2011) Vol. 84 Temple Law Review (Winter 2012).

77. *Cede & Co v Technicolor* [1994] Del. 634 A2d 345.; *Aronson v Lewis* [1984] Del. 473 A2d 805.

78. Jennifer Chawla, ‘Criminal Accountability and Wall Street Executives: Why the Criminal Provisions of the Dodd-Frank Act Fall Short’ (2014) Law School Student Scholarship.; Lisa Fairfax, ‘On the Sufficiency of Corporate Regulation as an Alternative to Corporate Criminal Liability’ [2011] 41 Stetson Law Review.

There is a widespread perception, which is also true in the US, that while civil law may punish, its ability to serve as a deterrent is dubious.⁷⁹ The ability to effectively mitigate penalties or fines through assertive litigation, often resulting in negotiated settlements with regulatory authorities, minimises the possible consequences of breaching civil regulations to a mere ‘cost of doing business,’ as opposed to a definitive guilty finding.⁸⁰ This fact is demonstrated by the recurring problems that Wall Street faces on a regular basis. Notably, bankers after the GFC would have found reassurance in the negligible likelihood of imprisonment and the robust defences available against civil actions.⁸¹ It has been extensively informed that the IL&FC’s Board was careless, and several members of the Board and management received significant bonuses. You might apply a similar story to Yes Bank.⁸² However, very few people have been prosecuted by SFIO or SEBI for criminal fraud or other infractions. However, the vast majority have not yet been subject to punishment.

B. Criminal Accountability in NBFC’s Governance

The significance of criminal liability plays a crucial role in serving as an effective deterrent against misconduct by management. Despite extensive literature exploring the impact of imprisonment and its potential as a deterrent,⁸³ the stringent criminal law has largely undermined its effectiveness. The difficulties in determining the prerequisites for a successful prosecution. In the realm of corporate fraud within NBFCs, the existing laws in India and other jurisdictions prove to be largely ill-suited.⁸⁴

79. Lisa Casey, ‘Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud’ (2010) 35(1) Delaware Journal of Corporate Law.

80. Ibid.

81. Subrata Panda, ‘Former IL&FS Directors Got Lucrative Paychecks Even as Firm Collapsed’ (*Business Standard*) <www.business-standard.com/search?q=article> accessed 14 December 2023.

82. Shrimi Choudhary, ‘YES Bank Loan Fraud: CBI Charges Rana Kapoor With Criminal Conspiracy’ (*Business Standard*, 25 June 2020) <www.business-standard.com/search?q=article> accessed 13 December 2023.

83. Paul H. Robinson, ‘Strict Liability’s Criminogenic Effect’ [2017] All Faculty Scholarship.; Raymond Paternoster and Sally Simpson, ‘Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime’ (1996) 30(3) Law & Society Review.

84. Katalin Ligeti, Wolters Kluwer and Angelo Marletta, *Punitive Liability of Heads of Business in the EU: A Comparative Study* (Wolters Kluwer 2019).

While the Indian Penal Code (*IPC*) includes provisions addressing fraud, the demanding burden of proof diminishes their practical utility.⁸⁵ In a similar vein, Section 447 of the Act may be used for the same objective but is subject to strict requirements for proof.⁸⁶ Before a director can be charged in India, the legal system requires conclusive proof of their involvement as well as evidence of their illegal intent.⁸⁷ Before any director can be taken before a court as an accused person, the Indian legal system requires conclusive proof of their involvement as well as their illegal intent.

The operational nature of NBFC inherently supports arguments claiming that defaults were not reasonably foreseeable. It becomes extremely unlikely to prove criminal intent when managers claim that their decisions were made using the best information available at the time and in line with accepted market wisdom.⁸⁸ In an organisation, the effective implementation of such a high standard proves to be exceedingly difficult.

The sole alternative available within the framework of Indian law, aside from the standard mentioned, is the provision for vicarious liability when sanctioned by the relevant statute. Although the Act, through various provisions, allows for the imposition of vicarious liability on directors and other high-ranking individuals within an organisation, this is applicable solely to breaches of the Act's provisions.⁸⁹ The action of an NBFC engaging in activities that may pose a threat to the company and its creditors does not seem to *prima facie* fall within the purview of this Act. Similarly, the SEBI Act confers authority upon the regulatory authority to attribute liability to individuals in charge of a company. However, this authority is constrained to violations falling under the ambit of its

85. The Indian Penal Code, 1860(45 of 1860) ss 421-424.

86. Molla Hasan and Bharat Vasani, 'Corporate Frauds – Emerging Legal Architecture & Judicial Trends' (India Corporate Law, 13 October 2020) <<https://corporate.cyrilamarchandblogs.com/2020/10/corporate-frauds-emerging-legal-architecture-judicial-trends/#:~:text=Corporate%20Frauds%20-%20Emerging%20Legal%20Architecture%20&%20Judicial%20Trends,-By%20Bharat%20Vasani&camp;text=Corporate%20scandals%20and%20frauds%20in,fraud%20of%20the%20independent%20India.>> accessed 15 December 2023.

87. *N.K. Wahi v Shekhar Singh & Ors* [2007] Criminal appeal no. 83-85/2004; *Sunil Bharti Mittal v Central Bureau of Investigation* [2015] Criminal appeal no. 34/2015.

88. Peter J. Henning, 'Dim Prospects for Financial Crisis Prosecutions' (New York Times, 29 May 2012) <<https://archive.nytimes.com/dealbook.nytimes.com/2012/05/29/dim-prospects-for-financial-crisis-prosecutions/>> accessed 18 December 2023.

89. The Companies Act 2013, s 128.

provisions. Additionally, the SEBI Act provides an avenue for a defence based on reasonable care and due diligence in such matters.⁹⁰

The exacting standards within criminal law have frequently allowed individuals to evade accountability or seek refuge within the framework of corporate entities. One notable example of this difficulty is the first attempt to prosecute senior management in the US during the GFC. The highly publicised 2009 acquittal of Bear Stearns executives due to the strict requirements made the Securities and Exchange Commission less eager to pursue comparable lawsuits.⁹¹ This hesitancy ultimately turned into a deliberate choice not to prosecute bankers criminally unless there was a high level of assurance that they would be found guilty.⁹² Consequently, the focus shifted towards seeking civil remedies,⁹³ a trend underscored by the Dodd-Frank Act, notable for its absence of new provisions facilitating the application of criminal charges.

It is evident that, despite the potential of criminal law, many jurisdictions hesitate to dilute the typically stringent standards required for prosecutors. The intricate nature of corporate structures, coupled with their often-veiled operations, poses challenges to prosecution despite SEBI disclosure obligations. Given the complexities involved, one might question the effectiveness of the strategic choice made by the US Department of Justice (*DOJ*) to primarily pursue civil claims against Wall Street bankers, opting to avoid criminal prosecutions.

The present situation is an apparently free choice when there is no real alternative, considering the drawbacks of exclusively relying on civil charges. Nevertheless, when weighed against the challenges of securing a criminal conviction, the US *DOJ*'s decision to pursue a purely civil course of action seems reluctantly sensible. Given this context, potential adjustments to the legal framework exist that could enhance its efficacy

90. The Securities Exchange Board of India Act 1992, s 27.

91. DOJ, 'More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage"' (Department of Justice, 19 June 2008) <www.justice.gov/archive/opa/pr/2008/June/08-odag-551.html> accessed 14 December 2023.

92. Reed Albergotti and Elizabeth Rappaport, 'U.S. Not Seeking Goldman Charges' (Wall Street Journal, 9 August 2012) <<https://www.wsj.com/articles/SB10000872396390443537404577579840698144490>> accessed 15 December 2023.; Reuters, 'US Will Not Prosecute Goldman Sachs, Employees for Abacus Deal' (Reuters, 10 August 2012) <www.reuters.com/article/idUSL2E8J995F/> accessed 16 December 2023.

93. Barry Ritholtz, 'October 2016 - The Big Picture' (The Big Picture, 1 October 2016) <<https://ritholtz.com/2016/10/>> accessed 15 December 2023.

in delivering justice, even if limited to monetary sanctions alone. While the effectiveness of this compromise may not match the deterrent effect typically associated with criminal sanctions, it has the potential to foster a collaborative approach towards civil liability.

V. CORPORATE MISBEHAVIOUR AND CIVIL REMEDY

A. Redefining Negligence in NBFC Regulations

The foundation for establishing civil liability in cases of corporate misconduct within the NBFC sector should prioritise a negligence standard.⁹⁴ In the context of NBFCs, it is crucial to acknowledge that a considerable number of practitioners frequently overlook the potential adverse consequences of their actions. This oversight is often rooted in unwarranted optimism or excessive confidence in their investment strategies.⁹⁵ The allure of significant profits during specific periods frequently leads bankers to be swayed without adequate consideration. To mitigate the potential drawbacks associated with such behaviour, it is advisable to adopt a legal approach that centres on negligence. This approach underscores the importance of considering how a prudent and vigilant individual would have prudently moderated their actions, exercising due diligence to thoroughly assess the potential ramifications of their transactions. Effectively implementing this approach requires a recalibration of the BJR, which traditionally involves significant deference to business choices and strategies.⁹⁶

In the US, the Board of directors is acknowledged to bear a duty of care, signifying a recognised responsibility.⁹⁷ Despite the acceptance of group liability, the standard of due care has undergone a reduction. Presently, directors are mandated to exercise due diligence, ensuring compliance with laws but not necessarily delving into scrutinising the business strategies of their companies. After the GFC, the court, in the case of

94. Jeffrey Gordon and John Armour, 'Systemic Harms and Shareholder Value' [2014] 6(1) *Journal of Legal Analysis*, Oxford University Press.

95. Steven Schwarcz and Iman Anabtawi, 'Regulating Systemic Risk: Towards an Analytical Framework' (2011) 86 *Notre Dame Law Review*.

96. John Armour and Jeffrey N Gordon, 'Systemic Harms and Shareholder Value' *Columbia Law and Economics Working Paper No. 452*.

97. *Re Caremark Int' Inc. Derivative Litig* [1996] Del. 698 A.2d 959.

Re: Citigroup,⁹⁸ clarified that responsibilities did not extend to investigating business strategies, and negligence in anticipating potentially harmful policies would not be condemned. This standard, as established in the Citigroup case, has been both acknowledged and constrained by subsequent decisions. While the concept of a ‘duty of care’ is acknowledged, breaches are limited to situations where the Board has either ‘knowingly failed’ or ‘completely failed.’⁹⁹ In the IL&FS case, the actions of the Board may indeed meet this standard. Nevertheless, there are concerns about the general appropriateness of this standard, as it predominantly concentrates on the most severe and overt shortcomings, occurrences that are infrequent and frequently susceptible to clarification during the adjudication process.¹⁰⁰ Hence, the efficacy of the negligence-based standard of liability relies on two essential prerequisites,

1. It is imperative for managers and directors to not only adhere to formal obligations in preventing legal violations but also to conscientiously align with the business strategy of an NBFC. The limited use of the BJR in India proves advantageous in this context, as it eliminates a potential mitigating factor;
2. In the present regulations in India for insider trading, the criterion for identifying a breach should be predicated on a ‘preponderance of probabilities’. This approach, while intensifying monitoring efforts by management and the Board, necessitates a crucial shift from scrutinising the actions of individual directors. Instead, the assessment of fault should prioritise an examination of how the bank operates to identify systemic faults. The forthcoming section will primarily centre on an in-depth examination of the second component of the civil liability standard.¹⁰¹

B. Art of Shared Liability

The primary focus should shift from individual culpability to the broader corporate system. Highlighting the systemic operations of a financial

98. Re Citigroup Inc Shareholder Derivative Litig [2009] Del. 964 A2d 106.

99. Stone v Ritter [2006] Del. 911 A.2d 362.

100. V.K. Kaul Vs. Adjudicating Officer (SAT) [2012] Securities Appellate Tribunal, Appeal No. 55/2012.

101. Mousam Singha Roy v State of West Bengal [2003] Criminal appeal no. 231-234/2002.; The Chairman, SEBI v Shriram Mutual Fund Anr [2006] civil appeal no. 9523-9524/2003.

institution is consistent with an approach centred on due diligence. In cases of a banking institution experiencing default, ascribing the responsibility solely to an individual is a misjudgement. Instead, it signifies a systemic breakdown implicating various participants or passive contributors. Existing checks and balances often prove inadequate in detecting the underlying dangers, ultimately leading to the collapse of the bank. Blaming individuals in such cases risks overlooking the systemic issues at play.

Formulating a legal doctrine that can effectively confront instances of widespread negligence, specifically attributable to senior management and the BOD, is imperative. These particular groups are generally well-equipped to mitigate instances of such organisational breakdowns. Several European nations have implemented proactive measures to address instances of corporate misconduct. Illustratively, the UK has enacted the Corporate Manslaughter Act (*CM Act*) and the concept of ‘Senior Management Mens Rea’.¹⁰² These legal frameworks concentrate on how a company functions rather than singling out individual actions within the company. It is crucial to note that these legal measures are intricately connected to criminal law, aiming to allocate criminal liability to the company as a whole.

However, the *CM Act* and his proposal to shift the focus onto senior management as a collective rather than individuals presents intriguing possibilities.¹⁰³ An essential element of his analysis focuses on the corporation’s function, particularly within our context, where an NBFC, as an employer, defines the prescriptive boundaries of behaviour.¹⁰⁴ In instances where a bank either explicitly encourages misconduct or consistently conceals such behaviour, the likelihood of eventual insolvency significantly increases. The decision to permit or even endorse such behaviour originates from upper management, representing a top-down approach.¹⁰⁵ The ultimate determination regarding the establishment of a particular

102. George Skupski, ‘The Senior Management Mens Rea: Another Stab at a Workable Integration of Organizational Culpability into Corporate Criminal Liability’ (2011) 62(1) *Case Western Reserve Law Review*.

103. Luke Price, *Finding Fault in Organisations – Reconceptualising the Role of Senior Managers in Corporate Manslaughter* (Cambridge University Press 2018)

104. RH Coase, ‘The Nature of the Firm’ (1937) 4(16) *Economica*.

105. Charles R. P. Pouncy, ‘Reevaluating Corporate Criminal Responsibility: It’s All About Power’ (2011) 41(1) *Stetson Law Review*.

corporate structure and culture renders the senior management group collectively accountable for the ensuing consequences.

Several justifications support this perspective:

1. Acknowledging the large-scale failures leading to events like manslaughter often result from systemic failures rather than individual lapses during company activities.
2. Mitigating the tendency of senior leadership to avoid accountability and shift blame onto middle management or frontline staff in the event of failures is crucial. This is especially pertinent in the context of NBFCs, where top-level executives typically do not directly participate in securities trading. As a result, they may shield themselves by asserting their non-involvement in the design of securities or the direct negotiation of trades.
3. Acknowledging that individual managers or board members may not individually bear substantial culpability to justify significant liability, a situation reminiscent of the circumstances faced by Wall Street bankers post the GFC.

While legislation primarily addresses corporate criminal liability at the organisational level, Price's proposal fundamentally suggests a framework that can be applied to impose civil liability on senior management and bank directors on a personal level. The evaluation of the senior management collective would hinge on their negligence in adequately overseeing risky investment strategies that could jeopardise the company's stability. Those individuals knowingly involved in such practices could be singled out for allegations of outright fraud. During legal proceedings, individuals who conscientiously objected to these policies may present their dissent as a defence against culpability.

An additional complexity arises in defining senior management's precise boundaries or scope. While Section 128(6) may be considered a potential alternative for this objective, avoiding relying on such substitutes is recommended. A more favourable solution involves implementing a designation and certification of a management system for all senior personnel, akin to the model adopted in the UK.¹⁰⁶

106. Oonagh McDonald, *Holding Bankers to Account: A Decade of Market Manipulation, Regulatory Failures and Regulatory Reforms* (Manchester University Press 2019).

The aforementioned proposal balances the civil and criminal penalties' effectiveness and relevance. Given that the concept of lowering the threshold of criminal liability for corporate misconduct is not widely embraced in most jurisdictions, and its implementation raises various concerns,¹⁰⁷ the most viable approach is to enhance and fortify the framework of civil sanctions. Analysing the organisational structure and culture is essential for engaging the entire cohort of senior managers. Enhancing accountability across the group can be facilitated by adopting a negligence-based standard aligned with the company's overarching business strategy rather than concentrating solely on individual members.

VI. REDESIGNING THE LIMITED LIABILITY

In the realm of the NBFC system, an elevation in responsibility failure underscores the need to reconsider limited liability. If the advantages of such a redesign outweigh the associated costs, this section explores how this can be achieved.

A. Establishing Goals for the Restructuring of Limited Liability

Any re-evaluation of the limited liability should incorporate its conventional justifications. The "efficiency" rationale aims to stimulate broad investor engagement in equity ownership by minimising risk aversion. Redesigning limited liability should seek to mitigate investor risk aversion, making them comfortable that potential gains outweigh potential losses.¹⁰⁸ This could involve implementing caps, such as double liability, and aligning liabilities and incentives effectively. Other traditional justifications, like reducing monitoring costs and promoting the shares being transferred freely, should be reassessed in the context of the NBFC system.

B. Evaluating Redesign Proposals against Goals

Various redesign proposals are examined against predefined goals. Compensation-based tests, pro rata unlimited investor liability, and

107. Eyvindur G. Gunnarsson, 'Criminal Proceedings in the Wake of the Icelandic Banking Crisis' (2019) Vol 21(1) *European Business Organization Law Review*.

108. Steven Schwarcz, 'The Inherent Irrationality of Judgment Proofing' (1999) 52 *Stanford Law Review*.

control-based liability regimes are critiqued. While each proposal has drawbacks, the need to effectively address systemic risk is emphasised. A potential solution involves coupling increased limited liability with a privatised systemic risk fund, encouraging responsible management and mitigating systemic harm.

C. Practical Implementation

Practical guidance for redesigning limited liability is provided, considering costs and benefits. Key recommendations include:

1. Increasing limited liability exclusively for investor-managers in the NBFC system, particularly those designated as systemically important financial institutions (*SIFIs*).
2. Defining “investor-managers” as equity investors with significant control over the firm and a substantial share of profits.
3. Enhancing the structure of limited liability incentivises investor managers in actively monitoring and mitigating systemic risk, possibly through establishing it as a multiple of the initial investment.
4. Imposing an upper liability limit, such as double liability, to balance the need for increased liability without unduly discouraging investment.
5. Minimising costs by discouraging cross-investor monitoring through independent liability for each investor-manager.
6. Introducing a mechanism, like a privatised systemic risk fund, to internalise systemic costs and hold investor managers accountable for contributions.
7. Mitigating the challenge of cross-border capital flight requires the implementation of federal legislation and fostering international collaboration to address the collective action problem effectively.

By putting these factors in the Indian context, it can be agreed that the proposed redesign of limited liability in the NBFC system demonstrates a comprehensive understanding of the complexities associated with this financial sector. The document appropriately identifies traditional justifications for limited liability, such as reducing investor risk aversion and minimising monitoring costs. Moreover, the acknowledgement that conflicting goals may arise during the redesign process, such as the tension

between increasing investor liability and potential discouragement of investment, reflects a nuanced consideration of the challenges involved.

The analysis of various redesign proposals reveals a keen awareness of their strengths and weaknesses. For instance, the critique of compensation-based tests and pro rata unlimited investor liability shows a discerning approach, highlighting potential shortcomings in targeting investor managers and discouraging investment. The suggestion of a control-based liability regime appears promising but is rightly scrutinised for its potential to deter investment due to the absence of a liability cap.

The emphasis on addressing systemic risk through a privatised systemic risk fund is a commendable proposition. By tying investor liability to contributions to the fund, the proposal introduces a mechanism that aligns investor managers' interests with the broader financial stability goals. However, the acknowledgement of the associated costs and political considerations demonstrates a realistic understanding of the challenges in implementing such a mechanism.

VII. CONCLUSION

In conclusion, the examination of limited liability within the framework of NBFCing entities, particularly NBFCs, reveals inherent challenges that necessitate a re-evaluation of existing legal structures. The conventional acceptance of limited liability at the firm level may not be optimal for entities shaping the NBFCing system, motivating investor managers to undertake risks that amplify systemic risk without effective legal mitigation.

The proposed redesign of limited liability for investor-managers of NBFCing firms, as discussed in this article, advocates for a balanced approach. This involves increasing liability to mitigate systemic risk while avoiding discouragement of investment and minimising costs related to cross-investor monitoring. One suggested solution is coupling redesigned limited liability with a privatised systemic risk fund, requiring contributions from systemically risky NBFC firms. This approach encourages investor managers to monitor and control their firm's behaviour, linking personal liability to insufficient capital contributions. The empirical success of any redesign hinges on a cost-benefit analysis considering the real-world impact on risk-taking and investment.

In recent years, NBFCs have played a pivotal role in addressing the credit needs of the Indian commercial sector, particularly in the wake of standard banks' reluctance. The importance of NBFCs, especially in segments like real estate, underscores their significance for economic recovery post-COVID and beyond. Notably, failures in NBFCs, particularly in the construction sector, pose challenges that require a robust and healthy NBFCing sector for proper recovery.

The NBFC crisis, though impactful, was somewhat mitigated by its ownership structure and absence of public deposits. However, the central role of NBFCs in critical economic segments highlights the importance of ensuring their health to facilitate a comprehensive recovery. The NBFC crisis also underscores the need for ongoing vigilance and reform in the regulatory framework governing NBFCs, emphasising the delicate balance between financial innovation, risk mitigation, and safeguarding public interests.