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FORWORD BY: PROFESSOR NL MITRA

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FOREWORD

(by Prof. N.L. Mitra)

This inaugural publication of the Journal on Corporate Law and Commercial Regulations is proposed to be published by the National Law University of Mumbai. The most interesting feature of this first appearance is that it creates a niche investigative journal framework to bring out as the joint enterprise of serious law students of Universities and the legal professionals of leading law firms. To be exact, 8 legal professions of future years and 7 professionals of the present generation participated in simulation of their intellectual product. There is no presentation by any academicians, this is the specialty though a bit out of the way. There are 5 articles, one of which is co-authored by one of the senior legal professionals of the country, Mr. Sandeep Parekh, the Managing Partner of a leading Law firm. Sandeep has a wide experience on the capital market regulatory system for quite some time as the Executive Director in charge of Legal Affairs of Security Exchange Board of India. He regularly contributes in various journals and economic

dailies on Security Market. I suggest all students aspiring to become capital market lawyers to read his writings on capital market functioning in various journals and economic dailies to broaden the frontiers of knowledge in Law, Financial Management and Accounting systems. Naturally a journal the inaugural copy of which is led by him as the joint author of the first article, did raise high expectation from all those who are in the field of Corporate and Commercial Laws.

Personally, I look forward to read articles on the assessment of the Liability of Payment Aggregators and Demystifying Shadow Banks both authored by legal professionals of coming generation. One can easily foresee the sea-change in the financial sector legal environment for several reasons, especially due to impact of technology, data science operation, and evidence-based multidisciplinary interaction of the domain knowledge before appropriately applying principles of law and justice. Money and Capital market regulators shall have to face new challenges in the seamless global integration of economies of tomorrow. In that context, the molding of

the thought of new generations of legal professionals shall require involvement of multidisciplinary, integrated approach to develop new epistemic basis of administration of law and justice on sound domain knowledge to analyze critical facts. A cooperation on day-to- day basis will be required between the academic professionals and practicing professionals. Corporate and Commercial activities will have new innovations and start- ups in varieties fields. Some such innovative start-ups have already appeared in Indian screen, especially in the field of space science on account of commercialization and privatization of space world.

I really thank Dr. Kiran Rai, the Head of the Department of Corporate & Commercial Laws of the National Law University, Mumbai to initiate such a journal and give birth to this new bubbling idea. I hope she may add to this inaugural issue with her erudite editorial note. I anticipate that she shall regularly water this plant so that one day in near future this baby shall become a journal of repute! I thank all those experienced and young legal professionals of Law Firms and young students who authored their

articles and case comments and dared to enter this special field of knowledge mixing financial, technology and legal complexes dealing with financial regulatory system management in an integrated global economic platform. This is a fertile ground of a new legal order as well as innovation of avenues of market manipulation! A new generation of young legal professionals (solicitors and advocates) will be required to be the army to fight for rule of law and justice through a dialectic legal atmosphere in a participatory democratic social fabric.

~ Professor N. L. Mitra
Former Director, National Law School, Bangalore
Founder Vice Chancellor, National Law University, Jodhpur
Former Chancellor, KIIT University
Former Senior Partner, Fox Mandal Associates, Bangalore
Professor Emeritus, KIIT University

PREFACE

(by Prof. (Dr.) Dilip Ukey)

I am pleased to know that Maharashtra National University Mumbai's Centre for Training & Research in Commercial Regulations (CTRCR) is coming out with the first edition of the Journal on Corporate Law and Commercial Regulations (CLCR). This journal is yet another milestone in MNLU Mumbai's endeavour to conduct novel research on contemporary issues in the legal field. The contributions of our faculty members and students in this regard is significant and noteworthy.

The Centre's vision is to be a pivot for discussion, training, and research in commercial law and related disciplines. I am glad that the Centre has been able to execute its goals through various workshops, conferences and certificate courses. There is little doubt that the launch of such qualitative academic literature devoted to commercial laws is a source for pride and delight. Along with my sincere congratulations to the players of this endeavour, I wish to humbly highlight the truth that publications, like other types of pedagogical initiatives, may be thrilling to ponder upon but are invariably

difficult to produce. This wise advice will serve as a reminder to them to always work harder and go the extra mile in order to uphold the calibre and credibility of this publication. At the same time, I have full faith in the entire team that they shall make this endeavour a resourceful one and of the finest calibre.

In my opinion, the first edition of the journal has been a successful attempt at exploring various aspects of corporate governance and regulations, and displays the outstanding capability of our expert Peer-review panel and student editorial board.

I heartily congratulate the student team and all contributors for their laudatory initiative. I once again extend my heartfelt congratulations to the Editorial Board of the Journal and the Faculty-in-charge of CTRCR, Dr.Kiran Rai, her entire team at CTRCR and CLCR, advisors and all dear readers for bringing the journal to life and hope to see their continued enthusiasm and skills in future as well.

~ Prof. (Dr.) Dilip Ukey
Vice Chancellor
Maharashtra National Law University Mumbai

NOTE FROM THE STUDENT EDITORIAL BOARD

Dear Readers,

We are immensely delighted to present the first edition of the student run double peer-reviewed, bi-annual periodical, 'Journal on Corporate Law and Commercial Regulations'. The Journal aims to play an instrumental role in commercial law and allied areas by contributing towards research on contemporary developments and analysis of long-standing issues. It has been established with the vision to make the knowledge of these disciplines accessible and envisions becoming a comprehensive literature of the discourse surrounding corporate laws.

We express our sincere gratitude to this Journal's contributors for their invaluable submissions, which brought this Journal to fruition.

We also thank the Hon'ble Patron for this Journal, Prof. (Dr) Dilip Ukey Sir, for his constant and enabling support in helping this new initiative of the Centre gain traction. Dr Kiran Rai, Asst. Prof., and the Faculty Coordinator of

the Centre, for being a persistent source of encouragement. The initiative of Journal would not have been possible if the Centre would have been bereft of her learned advice. Further, we express our appreciation to the eminent Board of Advisors who have shown a keen involvement in this Initiative. Moreover, we are grateful to the Peer Review Panel who have meticulously shaped the submissions according to the Journal requirements.

We are proud that for our inaugural edition, the submissions received represented myriad of contemporary and crucial issues and developments in the field of commercial law. Mr. Sandeep Parekh and Ms. Rashmi Birmole opined how the green bond market is poised to mobilise capital for sustainable projects while generating fixed returns for investors, in their article ***Beyond the Green Label: Evaluating the Proposed Green Bond Framework Vis-À-Vis Greenwashing in India***'. Mr. Jatin Arora analysed the recent case *Genpact India Pvt. Ltd. v. Union of India and others,* in his article '***BPO service provider not be considered as an "Intermediary" for the purposes of IGST Ac***t', shedding

light on the conditions that fall within the scope of "intermediary service" and explaining why subcontracting services are not eligible for intermediary services. In another case comment, Ms. Smriti Yadav, Mr. Shwetank Tripathi and Mr. Abdul Hannan in their article titled '***Criminal Liability gets stringent in Copyright violation cases***' examine the unique case of *Knit Pro International v. The State of NCT of Delhi* which revolves around trademark infringement. On a multi-jurisdictional viewpoint, Mr. Ratul Roshan compares at length the differences in regulations governing pre-paid instruments in India and UAE in his article titled '***Pre-Paid Instruments: A Comparative Analysis Between India and The United Arab Emirates***'. Ms. Vyshnavi Praveen and Ms. Ananya Soni also examine the RBI guidelines on the regulation of Payment Aggregators and Payment Gateways 2020, in their article titled, '***An Assessment of the Liability Of Payment Aggregators in India under the RBI Guidelines*'.** Ms. Deepanjali Jain and Mr. Prateek Khandelwal take up a holistic perspective on the doctrine of public policy and its utilization by the Indian judiciary while enforcing arbitral awards in their article titled, '***The***

Doctrine of Public Policy: Backdoor Strategy to Review Foreign Arbitral Award or Necessary Evil?' Mr. R S Kailas Nath and Mr. Sikha George Sohan in their article titled, '***Demystifying Shadow banks as a substitute to the Banking Sector: A Critical Study***' examine the historical development of the NBFCs in India, their role in credit supply, potential triggers for the 2018 financial crisis, and the successive formulation of the 2022 Regulations. In the article titled ***Parity obligations in the online hotel booking Industry: Critically analyzing CCI's order against MMT-GO***', Mr. Bharat Manwani and Ms. Adya Desai analyzed the recent order passed by the Competition Commission of India against MakeMyTrip and Oravel Stays Private Limited and critiqued the order, highlighting concerns such as the 'special responsibility' on dominant firms in relevant markets.

For this Journal, the students have been the backbone, meticulously devoting their time and efforts in enabling this Journal to see the light of day. There is always scope for improvement and we look forward to implementing

your feedback as the Journal progresses and achieves greater heights.

Bearing this in mind, we welcome the readers for an insightful reading experience.

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BEYOND THE GREEN LABEL: EVALUATING THE PROPOSED GREEN BOND FRAMEWORK VIS-À-VIS GREENWASHING IN INDIA

Sandeep Parekh[*] *and Rashmi Birmole*[**]

ABSTRACT: *It is no secret that sustainable investing has long crossed the boundaries of a niche practice and is changing the face of finance as we know it. With the conversation around climate change and the transition to a low-carbon economy gaining pace, the wide financing gap in meeting India's climate targets and international commitments has become apparent. Having witnessed rapid growth in recent years, the green bond market is poised to mobilize capital for sustainable projects while generating fixed returns for investors. However, the integrity and development of the green bond market faces*

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[**] Associate at Finsec Law Advisors, Mumbai.

the risk of compromise on account of greenwashing practices, i.e., overstatement of positive environmental impact or use of proceeds towards projects with little or no environmental impact. These concerns were recently addressed by the Securities and Exchange Board of India in a Consultation Paper on Green and Blue Bonds as a mode of Sustainable Finance. Through this article, the authors attempt to critically analyze the proposals in the consultation paper from the lens of mitigating greenwashing practices in India. In doing so, the authors also put forth recommendations that may be considered regarding the proposals.

KEYWORD: *Green Bonds, Greenwashing, Sustainable Investing, SEBI, Regulatory Framework*

I. INTRODUCTION

Often termed the real growth story of the 21st century,[1] the transition to a low-carbon economy has been a fast-emerging priority and shared vision for countries across the globe since the Paris Agreement was adopted in 2015. Recently, in the 26th session of the Conference of Parties held in Glasgow, India submitted its Long-Term Low Emission Deployment Strategy to the United Nations Framework Convention on Climate Change, crystallizing key measures and setting out India's roadmap towards achieving the rather ambitious goal of achieving net zero emissions by 2070.[2] Like most things, the potential low-carbon transition comes at a cost and monumental investment needs.[3] The need to meet the existing

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[1] Srijana Mitra Das, *A clean economy is the 21st century's real growth story – India is central to this*, THE TIMES OF INDIA, (Nov 19, 2022), https://timesofindia.indiatimes.com/a-clean-economy-is-the-21st-centurys-real-growth-story-india-is-central-to-this/articleshow/95611519.cms.

[2] Press Release, Ministry of Environment, *Forest and Climate Change, India delivers National Statement at COP27* (Nov 15, 2022), https://pib.gov.in/PressReleasePage.aspx?PRID=1876119.

[3] MINISTRY OF ENVIRONMENT, FOREST AND CLIMATE CHANGE, INDIA'S LONG-TERM LOW-CARBON DEVELOPMENT STRATEGY, at 55, (2022), https://unfccc.int/sites/default/files/resource/India_LTLEDS.pdf.

financing gap and infrastructure deployment needs is considerable,[4] with the estimated expenses exceeding INR 11 lakh crores per year for India alone.[5] An innovative instrument within the sustainable finance ecosystem that rapidly bridges this gap and forms the focus of this article is the 'green bond'.

The Securities and Exchange Board of India ("**SEBI**") recently released a Consultation Paper on Green and Blue Bonds as a mode of Sustainable Finance ("**Consultation Paper**"),[6] to review the existing regulatory framework on green bonds. The Consultation Paper also focuses on the need

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[4] *Financing Climate Action*, UNITED NATIONS, https://www.un.org/en/climatechange/raising-ambition/climate-finance.

[5] Khanna N., Purkayastha D., Jain S., *Landscape of Green Finance in India*, CLIMATE POLICY INITATIVE (August 2022), https://www.climatepolicyinitiative.org/wp-content/uploads/2022/08/Landscape-of-Green-Finance-in-India-2022-Full-Report.pdf https://www.climatepolicyinitiative.org/publication/landscape-of-green-finance-in-india-2022/#:~:text=Green%20finance%20flows%20must%20increase,Net%2DZero%20emissions%20by%202070.

[6] THE SECURITIES AND EXCHANGE BOARD OF INDIA, CONSULTATION PAPER ON GREEN AND BLUE BONDS AS A MODE OF SUSTAINABLE FINANCE (Aug 2022), https://www.sebi.gov.in/reports-and-statistics/reports/aug-2022/consultation-paper-on-green-and-blue-bonds-as-a-mode-of-sustainable-finance_61636.html.

to tackle the practice of channeling proceeds from green bonds to activities with minimal or negligible environmental impact, termed as 'greenwashing', to increase the overall accessibility of the green bond market to issuers and investors alike. Through this article, the authors attempt to analyze the proposals set out in the Paper from the perspective of mitigating greenwashing concerns and put forward recommendations that may be considered before implementation.

II. GREEN BONDS - AN EXPLAINER

Akin to regular bonds, green bonds are fixed-income instruments which provide risk-adjusted returns and raise debt capital for sustainable projects with favorable climate and environmental impact. As the name suggests, the proceeds of a green bond offering are earmarked for financing green projects and are popularly known as 'use for proceeds' bonds. Unlike regular vanilla bonds issued to finance the general working capital requirements of the issuer, the proceeds from green bonds are ring-fenced for allocation to green projects or assets. Regarding credit risk, green bonds are backed by the issuer's entire balance sheet, preventing investors from being

directly exposed to the project's financial risks or assets financed by the green bond.[7]

III. EXISTING REGULATORY FRAMEWORK

Green bonds were initially viewed as innovative instruments in the infrastructure financing space. They were considered to fall within the ambit of debt securities governed under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 ("**ILDS Regulation**s") as reflected in the Concept Paper on Issuance of Green Bonds ("**Concept Paper**"), released by SEBI on December 03, 2015.[8] The Concept Paper proposed the inclusion of enhanced disclosures for green bond issuances in addition to the existing requirements under the ILDS Regulations. These enhanced disclosures largely mirrored the Green Bond Principles ("**GBP**"),[9] a globally recognized best

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[7] Aaron Maltais & Björn Nykvist, *Understanding the role of green bonds in advancing sustainability*, 11 JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT 1, 1 (2021).

[8] THE SECURITIES AND EXCHANGE BOARD OF INDIA, CONCEPT PAPER FOR ISSUANCE OF GREEN BONDS, (Dec, 2015), https://www.sebi.gov.in/reports/reports/dec-2015/concept-paper-for-issuance-of-green-bonds_31167.htm

[9] INTERNATIONAL CAPITAL MARKETS ASSOCIATION, GREEN BOND PRINCIPLES, (June 2021), https://www.icmagroup.org/assets/documents/Sustainable-

practice for promoting transparency and disclosure in green bond issuances, published by the International Capital Markets Association.

The proposals set out in the Concept Paper aligned with the critical components of the GBP, i.e., disclosures relating to the use of proceeds, the process for project evaluation and selection, management of proceeds and reporting requirements. The framework governing green bonds was further formalized through the SEBI circular on Disclosure Requirements for the Issuance and Listing of Green Debt Securities on March 30, 2017.[10] The said Operational Circular subsequently superseded the Circular for the Issue and Listing of Non-Convertible Securities (NCS), Securitised Debt Instruments (SDI), Security Receipts (SR), Municipal Debt Securities and Commercial Paper (CP) ("**Operational Circular**"),[11] read with Regulation 26 of the SEBI (Issue and

finance/2022-updates/Green-Bond-Principles_June-2022-280622.pdf.

[10] Securities and Exchange Board of India, Circular on Disclosure Requirements for Issuance and Listing of Green Debt Securities, CIR/IMD/DF/51/2017 (Issued on Mar 30, 2017).

[11] Securities and Exchange Board of India, Operational Circular for Issue and Listing of Non-Convertible Securities (NCS), Securitised

Listing of Non-Convertible Securities) Regulations, 2021 ("**NCS Regulations**"), which collectively form the existing framework governing green bonds in India.

The NCS Regulations set out the categories of projects or assets in respect of which green bonds may be issued and are supplemented by the Operational Circular, which prescribes disclosure norms in relation to offer documents for the issuance of green bonds in respect of, *among other things* the decision-making process underlying the determination of eligible projects and details of selected projects, environmental objectives of the proposed investment and internal procedures for tracking the deployment of proceeds. Additionally, issuers are also required to abide by continuous disclosure norms, which necessitate the inclusion of additional disclosure alongside the annual report and financial results in respect of, *among other things,* the utilization of the proceeds of the issue, details of unutilized proceeds, list of projects to

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Debt Instruments (SDI), Security Receipts (SR), Municipal Debt Securities and Commercial Paper (CP), SEBI/HO/DDHS/P/CIR/2021/613 (Issued on Aug 10, 2021).

which funds have been allocated, and performance indicators of environmental impact.

IV. GREENWASHING CONCERNS

While the size of the Indian green bond market has witnessed massive growth since the issuance of the first green bond by Yes Bank in 2015, a majority of the assignments are comprised of green bonds which target foreign investors and are listed in offshore markets on account of favorable pricing.[12] It is common knowledge that considering the magnitude of India's commitments and consequent financing requirements, the need to scale up domestic avenues to supplement international capital is evident. This knowledge raises a fundamental question - how can the domestic green bond market be made more accessible to investors? In the authors' view, the answer lies in reducing the risk perception around low-carbon investments[13] and effectively creating a sense of comfort and

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[12] Bhattacharya S., Kumar N., Lonikar P., *India Sustainable Debt State of the Market Report*, CLIMATE BONDS INITIATIVE (May, 2022), https://www.climatebonds.net/files/reports/cbi_india_sotm_2021_final.pdf.

[13] Kumar N., Vaze P., Kidney S., *Moving from growth to development: Financing green investment in India*, OBSERVER RESEARCH FOUNDATION (April, 2019),

familiarity around green bonds within the investor community. However, what is considered seemingly the most fundamental risk of investing in green bonds is the possibility of overstating environmental impact[14] or making false or misleading claims regarding the 'greenness' of the project and its projected impact on climate change and the environment.[15]

Greenwashing can lead to reputational risks for issuers seeking to raise capital to fund sustainable projects and information asymmetry for investors seeking to diversify their portfolios by investing in environmentally-linked financial instruments. The diversion of the proceeds of green bonds to projects with minuscule or questionable environmental impact also directly influences the perception of green bonds as 'safe' instruments and is, in turn, viewed as one of the biggest challenges to the

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https://www.orfonline.org/research/moving-from-growth-to-development-financing-green-investment-in-india-49420/.

[14] Suk Hyun, Donghyun Park, Shu Tian, *The price of frequent issuance: the value of information in the green bond market*, ECONOMIC CHANGE AND RESTRUCTURING (2022).

[15] Patrick Henry, *What are green bonds and why is this market growing so fast?,* WORLD ECONOMIC FORUM, (Oct 26, 2021), https://www.weforum.org/agenda/2021/10/what-are-green-bonds-climate-change/.

development of the green bond market by regulators across the world.

V. ANALYSIS OF PROPOSED CHANGES

Through the proposals in the Consultation Paper, SEBI has attempted to tackle the challenge of greenwashing by seeking to equip investors with the information necessary to evaluate the sustainability and environmental impact of their investments in green bonds on a holistic basis. While the Consultation Paper deals with a slew of proposals in respect of the existing framework on green bonds, the analysis in the subsequent paragraphs has been limited to recommendations concerned with monitoring requirements for tracking the utilisation of proceeds, disclosures in connection to the refinancing of projects and use of standards, certifications, or taxonomies for identification of eligible projects and impact reporting.

A. TRACKING THE UTILISATION OF PROCEEDS

Monitoring the utilization of proceeds from a green bond issuance is the foundational principle of the green bond market. It serves as a strong signalling tool to investors

regarding aligning their investment with environmental objectives.[16] The Operational Circular spells out material requirements concerning monitoring the utilization of proceeds in a twofold manner, i.e. *firstly,* the pre-issuance disclosure of internal processes to be employed for tracking the deployment of profits in the offer document, and *secondly,* the post-issuance ongoing reporting of the actual utilization of proceeds as per internal tracking carried out by the issuer, along with the submission of the annual report and financial results. The latter is also required to be verified by an external auditor. Moreover, the issuer must disclose any unutilized proceeds from the issuance. Through the Consultation Paper, SEBI has also proposed to include disclosures on the intended types of temporary placement for the balance of unallocated net proceeds.

Investment in green bonds is motivated mainly by the investors' knowledge that their investment shall be used for financing projects which will contribute to the green agenda. Thus, reporting on the processes to be put in place for internal

[16] *Supra* note 6.

tracking of the funds and utilization of proceeds from the green bond issuance, right from the stage of the offer document and as a continuous disclosure measure, is instrumental in providing clear assurance to investors regarding the deployment of funds to appropriate projects and critical from the standpoint of mitigating greenwashing concerns.

Once fundraising is complete, it is equally important to have clear visibility on the availability of any unallocated proceeds to a specific project, on allocation. This ready availability can be ensured by disclosing the intended types of temporary placement of unallocated proceeds, as proposed in the Consultation Paper. The said disclosure is a standard practice followed across the globe and can be viewed as a step forward towards attuning the domestic green bond framework with international conventions. To ensure that the funds raised are not deployed towards non-green projects pending allocation to suitable environmental objectives, the proposed framework may incorporate indicative guidelines on the nature of assets or instruments into which the unallocated proceeds can be parked. These instruments may be highly liquid, well-rated,

short-term instruments such as cash, government bonds, commercial paper, and other money market instruments.

B. REFINANCING OF PROJECTS

It is generally used to use the proceeds from green bond issuance to refinance assets or projects with a longer operating life than the bond's tenure.[17] Refinancing existing projects through the proceeds of a green bond issuance comes to the aid of issuers who cannot identify a significant pipeline of new eligible green projects in the given financial year and is a key enabler of green investment.[18] While doing so, it is crucial to provide a potential investor with necessary information regarding the existing projects which may be refinanced. An attempt to enhance the disclosure requirements for refinancing

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[17] Igor Shishlov, Romain Morel, Ian Cochran, *Beyond transparency: unlocking the full potential of green bonds*, INSTITUTE FOR CLIMATE ECONOMICS (June, 2016), https://www.cbd.int/financial/greenbonds/i4ce-greenbond2016.pdf.

[18] Ghosh A., Chawla K., Jaiswal A., Kwarta S., Connolly M., Kaur N., Deol B., Mance A., Smis D., Dougherty S., Schub J., & Youngs R., *Greening India's Financial Market: How Green Bonds Can Drive Clean Energy Deployment,* COUNCIL ON ENERGY, ENVIRONMENT & WATER (April, 2016), https://www.ceew.in/sites/default/files/ceew-research-how-green-bonds-can-drive-renewable-energy-deployment-india.pdf.

projects through green bonds has been made under the Consultation Paper. It is proposed to include additional disclosures on the project details in which the proceeds will be utilized for refinancing purposes, the per cent share of financing and refinancing, and the look-back period for determining the eligibility of such refinanced projects. A look-back period essentially refers to the time frame used to determine the eligible existing projects which may be refinanced from the proceeds of green bond issuance.

Regarding refinancing of projects, it is also pertinent to discuss the 'additionality' factor, which assumes relevance while directing the proceeds of green bond issuance to exist projects or assets. While the term additionality is yet to be circumscribed by a clear definition, it can be broadly understood to mean the flow of capital to green assets or projects which would not otherwise be financed.[19] It is widely believed that for a green bond to demonstrate additionality, it must contribute to scaling up activities which, in the absence

[19] Sean Kidney, *Green Bond Additionality: The Big Picture*, BONDS & LOANS, (Dec 24, 2018), https://bondsloans.com/news/green-bond-additionality-the-big-picture.

of financing conditions offered by the green bond proceeds, would otherwise not occur.[20] From the standpoint of existing projects which have originated several years before the refinancing, it has been observed that the additionality of an investment is low or downright questionable,[21] and issuers may market their green credentials under an existing project without further contributing to sustainable operations,[22] leading to an overall impression of greenwashing. Moreover, when a portion of the proceeds is used for refinancing, a lower additionality is generally assigned to existing projects selected through a more extended look-back period.[23]

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[20] UNITED NATIONS ENVIRONMENT PROGRAMME FINANCE INITIATIVE, ALIGNING FINANCE FOR THE NET-ZERO ECONOMY: NEW IDEAS FROM LEADING THINKERS, (April, 2021), https://www.unepfi.org/wordpress/wp-content/uploads/2021/03/5-Green-Bonds.pdf.

[21] Dion Bongaerts & Dirk Schoenmaker, *Working paper: The next step in green bond financing* (Rotterdam School of Management, April 2020), https://www.rsm.nl/fileadmin/Faculty-Research/Centres/EPSVC/WP-Green_Bond_Financing.pdf.

[22] Manual Adamini and Krista Tukiainen, *the Impact Bond Market*, *in* RESPONSIBLE INVESTMENT IN FIXED INCOME MARKETS (Joshua Kendall & Rory Sullivan ed., October 2022).

[23] Eugenia Jackson & John Ploeg, *Filtering Shades of Green Through our Green Bond Framework*, PGIM FIXED INCOME (June, 2021), https://cdn.pficdn.com/cms/pgim-fixed-income/sites/default/files/Filtering%20Shades%20of%20Green%20Through%20our%20Green%20Bond%20Framework.pdf.

The framework proposed in the Consultation Paper notes that while the issuer's disclosure of a look-back period has been proposed, the maximum permissible extent of such period has not been defined. The absence of a precise look-back period in the regulatory framework gives rise to the possibility of issuers using green bonds as a refinancing tool for older projects that may have existed for as long as ten years.[24] To avoid the risk of such green bonds from being construed as an attempt at greenwashing, it may be prudent to specify an upper limit for the look-back period in the regulatory framework for determining the eligibility of projects which may be refinanced through proceeds from green bonds. While setting the upper limit, it is equally important to retain the issuer's discretion to determine the exact look-back period. It is also recommended that the time elapsed since the project was last financed be included in the disclosures to enable informed decision-making by the investors.

C. USE OF COMMON STANDARDS

[24] Rosl Veltmeijer, *Stimulating Change or Just Cheap Financing*, TRIDOS INVESTMENT MANAGEMENT (Oct 10, 2019), https://www.triodos-im.com/articles/2019/green-and-social-bonds.

There is a growing consensus over the need to adopt common globally accepted standards, certifications, or taxonomies in selecting projects financed through green bonds and post-issuance impact reporting. Under the existing framework as set out in the Operational Circular, an issuer is required to, *among other things,* disclose the process followed for the determination of eligible projects, performance indicators of the environmental impact of the project, and any globally accepted standards used for identification of eligible projects and impact reporting. Under the Consultation Paper, it is proposed that, in addition to the existing disclosure requirements, an issuer shall disclose any taxonomies, standards or certifications (from now on collectively to as "**standards**") and information regarding the alignment of the selected projects with the said standards or taxonomies, if referenced during project selection. Similarly, issuers shall disclose the project's environmental impact in the offer document and as a continuous disclosure. Further, any standards or taxonomies used during such impact reporting may also be disclosed optional.

Let us first consider the upside of the proposals set out in the preceding paragraph. The proposed disclosure of standards used when identifying eligible projects and impact reporting is a step ahead in supporting investors to make environmentally conscious investment decisions. The disclosure of such measures is also integral to demonstrating the 'greenness' of a selected project and minimizing instances of greenwashing. Moreover, reporting information pertaining to project-specific impact in the offer document and as a continuous disclosure measure is also instrumental in demonstrating the 'additionality' of investment and enabling investors to assess their assets in a timely fashion regularly. In light of the same, it would be prudent to mandate the use of such standards by issuers during project selection and impact reporting to ensure the legitimacy of the green label.

However, without the introduction of harmonized standards in the Indian green bond market, the purpose that the proposed disclosures intend to serve would be precluded. Given the variety of standards available, merely requiring issuers to disclose their bar of choice can lead to possible overlap,

divergence and uncertainty in the market.[25] Moreover, given investors' lack of familiarity with green bonds, and the scarcity of tools required to distinguish between a green and a non-green asset, the presence of multiple taxonomies may cause further confusion. Thus, it is crucial to harmonize the standards used to identify eligible projects and impact reporting to rule out plural interpretations. Conflicting practices and, in turn, reduce the risk of investing in non-green projects under the green bond label.[26] Developing a list of reasonable and commonly accepted standards tailored to suit the nuances of the Indian green bond market is the need of the hour to address investors' concerns about greenwashing and deepen market penetration. Further, it is recommended that the issuer may be permitted to choose from the specified list of

[25] Jun M., Kaminker C., Kidney S., Pfaff N., *Green Bonds: Country Experiences, Barriers and Options*, ORGANISATION FOR ECONOMIC CO-OPERATIONS AND DEVELOPMENT, INTERNATIONAL CAPITAL MARKETS ASSOCIATION, CLIMATE BONDS INTIATIVE AND GREEN FINANCE COMMITTEE OF CHINA SOCIETY FOR FINANCE AND BANKING (2017), https://www.oecd.org/environment/cc/Green_Bonds_Country_Experiences_Barriers_and_Options.pdf.

[26] Renita D'Souza, *Perspectives on a green taxonomy for India*, OBSERVER RESEARCH FOUNDATION (Nov 11, 2021), https://www.orfonline.org/expert-speak/perspectives-on-a-green-taxonomy-for-india/.

standards while identifying eligible projects and reporting on impact to maintain flexibility.

VI. CONCLUDING REMARKS

At a time when environmental, social and governance themes are gradually taking centre stage in the investor landscape, the domestic green bond market is at a crossroads. Taking note of the scale of capital required to achieve India's nationally determined contributions and net zero emission commitments, the steps taken hereon to address critical market challenges, such as greenwashing, shall dictate the growth trajectory of the domestic green bond market in the time ahead. Dispelling the risks associated with greenwashing is pivotal to increasing accessibility and facilitating a low-risk perception, and in turn, fueling greater participation by issuers and investors in the domestic green bond market. Regulation, at this juncture, needs to be market-driven and must consider the introduction of harmonized standards and taxonomies for evaluation of eligible projects and impact reporting, detailed monitoring requirements for utilization of proceeds, clear definitions and a cohesive market ecosystem, all the while striking a balance

between regulation and high compliance cost for issuers. While the proposals set out in the Consultation Paper appear to make some headway in this regard, the ability of the framework to cater to the nuances of the green bond market shall determine its course in the time ahead.

PRE-PAID INSTRUMENTS: A COMPARATIVE ANALYSIS BETWEEN INDIA AND THE UNITED ARAB EMIRATES

Ratul Roshan[*]

ABSTRACT: *The author in this paper tries to emphasise on how differently detailed the regulations established by India and the UAE are. This is further attributed to the discussions about payment regulation in general and digital payment regulation in particular, which have been going on in India since 2007, if not earlier. In 2007, the Indian Payment and Settlement Systems Act (the "PSSA") was published. In contrast, the UAE's Stored Value Facilities Rules (also known as the "SVFR"), which are the PPIs' equivalent, were published in September 2020. This difference, its implications and the laws regulating prepaid instruments (PPIs) in India and the United Arab Emirates (UAE) are compared in this paper. The author has*

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elaborated on key premises and compared one jurisdiction to another using cases that were addressed in that jurisdiction.

KEYWORDS: *Pre-paid instruments, PSSA, SVFR, UAE, India*

I. INTRODUCTION

This paper compares the laws governing prepaid instruments ('PPIs') in India and the United Arab Emirates ('UAE'). It further fleshes out distinct touchpoints and uses cases addressed in one jurisdiction, comparing it to the other.

At the outset, the author highlights that the granularity of regulations issued by India and the UAE vary substantially. This is owed to the fact that the conversation on regulating payments generally, and digital payments specifically, has been ongoing in India since 2007, if not earlier. The Indian Payment and Settlement Systems Act,[27] ('PSSA') was released in 2007. Compared to this, the UAE released the first regulations on stored value facilities – the equivalent of PPIs – in September 2020 through the Stored Value Facilities Regulations ('SVFR').[28] With time, the author anticipates the SVFR to be refined and cover specific use cases, much like its Indian counterpart.

[27] Payment and Settlement Systems Act, 2007, No. 51, Acts of Parliament, 2007 (India).
[28] Stored Value Facilities Regulation, C.B.U.A.E (2020).

II. THE GROWTH OF DIGITAL PAYMENTS

The growth and resultant regulation of PPIs is a consequence of, in part, the increasing popularity of non-bank-led payment solutions. Africa and Southeast Asia have been of particular interest to PPI issuers given low banking penetration[29]. Financial technology service providers ('FinTechs') have moved quickly to fill in this void by providing front-end payment applications[30]. Typical examples can be seen in emerging markets such as India, Kenya, the Philippines, and Vietnam[31]. In emerging markets, noncash retail payment transactions increased at a compound annual growth rate of 25% between 2018 and 2021[32]. The growth of e-commerce, improved investor appetite for digital payments, global government initiatives towards digital payments, and of course

[29] Reet Chaudhuri, Carolyne Gathinji, Gustavo Tayar, and Evan Williams, *Sustaining digital payments growth: Winning models in emerging markets*, MCKINESY & COMPANY (Oct. 13, 2022), https://www.mckinsey.com/industries/financial-services/our-insights.
[30] *Id.*
[31] *Id.*
[32] *Id.*

the covid pandemic have all had their roles to play in the emergence of digital payments[33].

Within digital payments, the increased popularity of PPIs is the story in emerging markets where the payments infrastructure is still developing, along with the absence of regulatory restrictions on non-banking entities providing such facilities[34]. Furthermore, simplified KYC and easy client onboarding procedures have facilitated the quick adoption of PPI solutions[35]. This is not to say that economies with developed financial services infrastructure have not been quick to roll out wallet solutions. DBS Bank's PayLah is an example of a successful PPI solution co-existing with matured payment systems.[36]

The convergence of high volume-low value payments, the possibility of increased penetration, and the layered potential of non-core services integrated into PPIs have led to monetary regulators moving swiftly to regulate these solutions.

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[33] *Id.*
[34] *Id*, at 25.
[35] *Id.*
[36] *Id.*

Simultaneously exist policy considerations of anti-money laundering, liquidity, and technological risks, safeguarding account requirements, and pool money deployment. A deep exploration of these factors is not within the scope of this article.

III. REGULATIONS (INCLUDING NOMENCLATURE) AND REGULATORS

The regulatory framework in India is layered. The regulation of PPIs falls within the regulation of payment systems. The principal governing law is the PSSA, administered by the Reserve Bank of India (RBI) which is the Indian monetary regulator. A 'Payment System' is defined as "…a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange".[37] Payment Systems include 'Electronic Fund Transfer Systems' and 'Gross Settlement Systems',[38] both of which are defined in the PSSA. Consequently, the PSSA also regulates these payment systems. Section 18, PSSA governs the power of the

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[37] *Supra* note 27, § 2(1).
[38] *Id.* § 2.

RBI to give directions generally. Additionally, section 10 of PSSA governs the power of the RBI to determine standards. Sections 18 and 10 (2) of the PSSA were leveraged by the RBI to issue the 'Master Direction on PPIs' (MD-PPIs). The MD-PPIs were last amended in November 2021.

The Federal Decree-Law No. 14 of 2018 on the Central Bank and the Organisation of Financial Institutions and Activities (Federal Decree 14 of 2018)[39] governs the ambit and operation of the Central Bank of the UAE (CBUAE). It also governs financial institutions, both licensed and otherwise.[40] Article 65 of the Federal Decree 14 of 2018 lists the financial activities subject to the CBUAE's licensing and supervision. This includes the provision of stored value facilities as well. Leveraging Articles 67 through 71 of the Federal Decree 14 of 2018, the CBUAE issued the SVFR and it also administers the same.

KEY OBSERVATIONS

[39] Federal Decree 1 (2020).
[40] Federal Decree 1 § 1 (2018).

Note that the SVFR is a standalone principal regulation for governing SVFs, as opposed to being a sub-regulation under another law, as the MD-PPI is issued under the PSSA. Furthermore, as opposed to having a unified law on payments, such as the PSSA, the CBUAE has issued distinct regulations to regulate distinct payment systems leveraging its law-making powers in the Federal Decree 14 of 2018. Examples include the Retail Payment Services and Card Schemes Regulations, 2021; the Large Value Payment Systems Regulation, 2021; and the Retail Payment Systems Regulation, 2021. On occasion, this has led to a conflict in definitions, especially in relation to Virtual Assets, which have been defined differently under the SVFR and the Retail Payment Services and Card Schemes Regulations, 2021.

IV. DEFINITIONAL CONTOURS

The MD-PPI defines PPIs as "Instruments that facilitate the purchase of goods and services, financial services, remittance facilities, etc., against the value stored therein".[41] The MD-PPI

[41] Reserve Bank of India, Master Directions on Prepaid Payment Instruments, RBI/DPSS/2021-22/82 (Issued on August 27, 2021).

further notes that "PPIs that require RBI approval/authorisation prior to issuance are classified under two types viz. (i) Small PPIs, and (ii) Full-KYC PPIs". Small PPIs and Ful-KYC PPIs are explored in greater depth below in the article.

As opposed to the MD-PPI, the SVFR defines more aspects of the process of issuing PPIs and defines several related components as well. The SVFR defines an SVF as:

> "*A facility (other than cash) for or in relation to which a Customer,*[42] *or another person on the Customer's behalf, pays a sum of money (including Money's Worth such as values, reward points, Crypto-Assets or Virtual Assets) to the issuer, whether directly or indirectly, in exchange for: (a) the storage of the value of that money (including Money's Worth such as values, reward points, Crypto-Assets or Virtual Assets), whether in whole or in part, on the facility; and (b) the "Relevant Undertaking*". *SVF includes Device-based Stored*

[42] Stored Value Facilities Regulation, C.B.U.A.E (2020).

Value Facility and Non-device-based Stored Value Facility."[43]

KEY OBSERVATIONS

We observe a more descriptive definition of SVFs under the SVFR than for PPIs under the MD-PPI. Specifically, the definition excludes cash, includes the possibility of another person acting on behalf of a customer, extends and clarifies the definition of value to include Money's Worth, and introduces the concept of a Relevant Undertaking. Money's Worth is defined as "value-added onto an SVF by the Customer; value received on the Customer's SVF account; and value redeemed by the Customer include not only "money" in the primary sense." Therefore, the value may be of any nature, including monetary consideration, values, reward points, and, importantly, Crypto-Assets[44] or Virtual Assets"[45] may be

[43] *Id*, art. 1(27).
[44] *Id*. art. 1(8); SVFR defines Crypto-Assets as "*cryptographically secured digital representations of value or contractual rights that use a form of distributed ledger technology and can be transferred, stored or traded electronically*".
[45] *Id.* art. 1(30); SVFR defines Virtual Assets as "*…digital tokens (such as digital currencies, utility tokens or asset-backed tokens) and*

stored on an SVF. This is absent in the MD-PPI. For a facility to qualify as an SVF it must present a Relevant Undertaking. The SVFR states:

> "*In relation to an SVF, Relevant Undertaking means an undertaking by the Licensee that, upon the use of SVF by the Customer as a means for payment for goods and services (which may be or include money or Money's Worth) or payment to another person, and whether or not some other action is also required, the Licensee, or a third party that the SVF Issuer has procured to do so, will, in accordance with the Operating Rules: (a) supply the goods or services; (b) make payment for the goods or services; or (c) make payment to the other person, or as the case requires.*"[46]

Therefore, the Relevant Undertaking can be about payment for goods and services as well as payment to another person. The use of the term 'payment', as opposed to 'transfer', raises questions on whether the payment must be against a payment

any other virtual commodities, Crypto Assets and other assets of essentially the same nature."

[46] *Id,* at 31, art. 1(29).

obligation or whether this can include peer-to-peer transfers simpliciter. The author interprets it as the latter since the former is likely to be covered by sub-points (a) and (b) in the definition of a Relevant Undertaking. Additionally, it is unclear whether an SVF can be used to conduct a cross-border fund transfer. This is stipulated as being permitted under the MD-PPI. Cross-border fund transfers are a distinct activity under the Retail Payment Services and Card Schemes Regulations, 2021. This indicates that such clients working at the intersection of both these financial services must procure both licenses, and securing one is unlikely to obviate the need for the other.

V. CATEGORISATION OF PPIS

The MD-PPI currently bifurcates PPIs into two heads – Small PPIs and Full-KYC PPIs.[47] Small PPIs are defined as:

> "*Issued by banks and non-banks after obtaining minimum details of the PPI holder. They shall be used only for purchase of goods and services. Fund transfer*

[47] Reserve Bank of India, Master Directions on Prepaid Payment Instruments, RBI/DPSS/2021-22/82 (Issued on August 27, 2021).

> *or cash withdrawal from such PPIs shall not be permitted. Small PPIs can be used at a group of clearly identified merchant locations/establishments which have a specific contract with the issuer (or contract through a payment aggregator/payment gateway) to accept the PPIs as payment instruments*”.[48]

Small PPIs are further split into PPIs up to ₹ 10,000 (with cash loading facility) and PPIs up to ₹ 10,000 (with no cash loading facility). The only difference is that in that latter facility, loading may only be done from a bank account/credit card / full-KYC PPI.[49] The remaining features are the same. Small PPIs can only be used for payment for goods and services and not for cash withdrawals or money transfers.[50] The Master Direction for KYC issued by the RBI specifies that a mobile number verification via One Time Password and a self-declaration of name and unique identity /identification number of any "mandatory document" or "Officially Valid Document" recognised in the directive are the bare minimums necessary

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[48] *Id.*
[49] *Id* at 33, 9.1(ii).
[50] *Id*, 9.1.

to obtain a Small PPI.[51] Loading limits are ₹ 10,000 monthly, and ₹ 1,20,000 annually. Further, monthly spending cannot exceed ₹ 10,000.[52] Small PPIs can only be issued once to a person and must be converted to Full KYC PPIs within 2 months from the date of issuance.[53]

Full-KYC PPIs are defined as those "Issued by banks and non-banks after completing Know Your Customer (KYC) of the PPI holder. These PPIs shall be used for purchase of goods and services, funds transfer or cash withdrawal." Video Customer Identification Process is specifically stated to be allowed for obtaining Full-KYC PPIs or for converting Small PPIs to Full-KYC PPIs.[54] This is subject to the Master Direction for KYC issued by the RBI. The amount outstanding cannot exceed ₹ 2,00,000 at any point.[55] Monthly fund transfer limits have been prescribed for pre-registered beneficiaries (₹ 2,00,000) and otherwise (₹ 10,000).[56] In the case of bank and non-bank-

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[51] *Supra* note 47
[52] *Id.*
[53] *Id.*
[54] *Id,* at, 34 9.2.
[55] *Id.*
[56] *Id.*

issued Full-KYC PPIs,[57] cash withdrawals are permitted, subject to some limits.

This is a shift from India's earlier categorisation of PPIs,[58] namely including (i) Closed System PPIs, (ii) Semi-closed System PPIs, and (iii) Open System PPIs. Closed System PPIs could be used to purchase goods and services from the entity which has issued the PPI and did not permit cash withdrawals.[59] Think of a Marks & Spencer gift card. These did not require approval/ authorisation from the RBI since they did not qualify as payment instruments. Semi-closed System PPIs may be used to purchase goods and services, as well as financial and remittance services, from a group of clearly identified merchants who have agreed to accept the PPIs as payment instruments in a specific contract with the issuer.[60] Also, cash withdrawals were not permitted. Open System PPIs could only be issued by banks and could be used to purchase products and services from any merchant, including financial

[57] *Id.*
[58] *Id,* ¶ 2.8.
[59] *Id,* at 36.
[60] *Id.*

services and remittance facilities, amongst other services.[61] Cash withdrawals were permitted using these PPIs at ATMs, Points of Sale devices, and Business Correspondents.[62] This classification has been amended to promote interoperability between PPIs and with the Unified Payments Interface operating in India and to simplify the regulatory landscape.

The SVFR does not provide a categorisation of SVFs but does mention Closed Loop Payment Schemes and Single-purpose Stored Value Facilities. The SVFR defines a Closed Loop Payment Scheme as "a payment scheme, which is limited in terms of where it can be used to purchase goods and services from an issuing retailer or entity".[63] Further, a Single-purpose SVF is defined as:

> *"a facility that in respect of which the issuer gives an undertaking that, if the facility is used as a means of making payments for goods or services (not being money or Money's Worth) provided by the issuer, the issuer will provide the goods or services under the*

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[61] *Id.*
[62] *Id.*
[63] *Supra* note 28, art. 1(8).

> *rules of the facility. A Closed Loop Payment Scheme is a typical Single-purpose Stored Value Facility".*[64]

The SVFR lists some exemptions from licensing requirements as well. These are bonus and cash reward scheme SVFs, SVFs for digital product purchases, SVFs usable within a limited group of goods or services providers, and SVFs with an aggregate float below AED 500,000 and total users lesser than 100.

KEY OBSERVATIONS

Single Purpose SVFs envisaged under the SVFR could be seen as a parallel to Closed System PPIs defined under MD-PPIs. The exemptions listed in the SVFR also appear to be similar in nature to Closed System PPIs. This indicates that there is a common understanding across these two jurisdictions that PPIs that can be used to purchase goods or services only from the issuer of the PPI or only within a closed ecosystem, will fall outside the ambit of the relevant regulator. This may be to recognise that such PPIs do not qualify as payment systems

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[64] *Id,* at 27 art.1(25).

per se, and do not pose the risks associated with other kinds of PPIs that can be used for multiple purposes.

The categorisation parameter in the MD-PPI is the level of KYC undertaken on a user before issuing a PPI to him/her. This accommodates the multiplicity of payment systems available in the Indian context that must be driven toward interoperability. Interoperability brings higher risks, which must be contained by instituting stronger user identification mechanisms. Furthermore, a KYC-level-based division of SVFs allows PPI issuers in India to start operations swiftly, with KYC requirements being fulfilled in due course. Contrarily, the SVFR states that electronic KYC methods are sufficient, but does not split SVFs basis the level of KYC undertaken.

VI. RECOGNITION OF VIRTUAL ASSETS

The MD-PPI does not accord recognition to virtual assets. Under MD-PPI, to achieve interoperability, the guidelines recognise that PPIs can be issued in the form of wallets and cards (physical or virtual), however, does not include virtual assets as a payment method/ asset class. The definition of

Money's Worth under the SFVR includes Virtual Assets/Crypto-Assets as seen earlier.[65]

There is something to be about the Retail Payment Services and Card Schemes Regulations, 2021 ("RPSCS"). The RPSCS defines Payment Tokens as "a type of Crypto-Asset that is backed by one or more Fiat Currencies, can be digitally traded and functions as (i) a medium of exchange; and/or (ii) a unit of account; and/or (iii) a store of value, but does not have legal tender status in any jurisdiction".[66] This indicates that Payment Tokens are a limited set of Crypto-Assets that are secured by one or more fiat currencies, and that they also meet the other requirements in the definition.

KEY OBSERVATIONS

The SVFR's broad definition of Money's Worth to include Virtual Assets and Crypto-Assets creates an interesting conundrum. This may be read to indicate that Virtual Asset wallets may be licensed under the SVFR. However, this conflicts with other regional regulations, which indicate that

[65] *Supra* note 46.

[66] *Id,* at 39 art. 1(73).

the license required to issue a Virtual Asset wallet is that of providing custodial services. This is common across the regulations issued by the UAE's Securities and Commodities Authority,[67] the Financial Services Regulatory Authority(the financial regulator of the Abu Dhabi Global Market),[68] and the Dubai Financial Services Authority (the financial regulator of the Dubai International Financial Centre). This requirement is derived from the fact that an important aspect of providing virtual asset wallets is providing or facilitating the custody of the private keys which may be used to access that wallet. The author's experience in the region also indicates that the SVFR is also not leveraged to provide virtual asset wallet solutions in the region. Instead, the relevant custodial service license is used. The RPSCS lists a license category called 'Payment Token Services', which includes 'Custodian Services'. Even here, the author understands this to be the license required to issue wallets that hold Payment Tokens, as opposed to the SVFR.

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[67] The Chairman of the Authority's Board of Directors' Decision No. (23/ Chairman) of 2020 Concerning Crypto Assets Activities Regulation issued by the SCA

[68] The Guidance – Regulation of Virtual Asset Activities in ADGM issued by the FSRA

As noted above, the MD-PPI does not make such accommodations. This distinction in the regulatory approach to virtual assets in these two jurisdictions reflects the overarching positions that the respective governments have taken regarding virtual assets. While India has proceeded cautiously, the UAE intends to become a hub of all things crypto.

VII. Who can apply?

Section 5(1) of PSSA stipulates that "Any person desirous of commencing or carrying on a payment system may apply to the Reserve Bank for an authorisation under this Act". PSSA places the authority on RBI to authorise who can commence or continue with payment systems under the Act. RBI's MD-PPI provides that banks and non-banks can issue PPIs. However, the non-banks must be regulated by any of the financial sector regulators[69]. All entities, including both banks and non-banks, who are regulated by any of the financial sector regulators and seek approval/ authorization from the RBI under the PSSA, have to apply to the Department of

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[69] *Supra* note 42, ¶ 4.

Payment and Settlement Systems (DPSS), RBI, Central Office, Mumbai along with a 'No Objection Certificate' from their respective financial regulator, within 30 days of obtaining such clearance, to apply to RBI for authorisation.[70] Banks and NBFCs can issue PPIs after obtaining authorisation from RBI, they must have NOC from the Department of Payment Settlement and Systems of RBI, as a part of their eligibility criteria.

The non-bank PPI issuers must be companies incorporated in India and registered under the Companies Act, 1956 or the Companies Act, 2013.[71] Non-banking entities have to ensure their compliance with the applicable guidelines, and in addition to these compliances, in addition, RBI examines a number of essential factors, such as customer service and efficiency, technical and related requirements, such as safety and security, etc.[72] After satisfaction with these checks, these entities are granted 'in-principle' approval. The 'in-principle' approval is valid for a period of six months, and within these

[70] *Supra* note 42, ¶ 3.1; ¶ 4.1.
[71] *Id,* at 42 ¶ 4.2.
[72] *Id*, ¶ 5.3.

six months, the entities are required to submit a satisfactory System Audit Report (SAR) to RBI.[73] All entities can operate a payment system for issuing PPIs to individuals/ organisations after obtaining authorisation from RBI. However, RBI creates a distinction between Bank and non-Bank entities by restricting the systems they can operate. After receiving RBI's approval, semi-closed and open system PPIs may be issued by banks that meet the eligibility requirements, including those stipulated by RBI's respective regulatory department.[74] On the other hand, non-Bank entities can only issue semi-closed system PPIs.[75]

As per Article 65 of the Federal Decree 14 of 2018, the provision of SVF is a licensed financial activity and, therefore, is subjected to the CBUAE’s licensing and supervision in accordance with the provisions of the Federal Decree 14 of 2018. In accordance with this, an Applicant must satisfy the licensing requirements set by the CBUAE for SVF issuance,

[73] *Id,* ¶ 5.4.
[74] *Id,* at 43, ¶ 3.1.
[75] *Id*. ¶ 3.2.

and continue to do so on an ongoing basis.[76] SVFR prohibits anyone to issue or operate an SVF without a prior license except if the issued SVF is a Single-purpose SVF.[77] As per Article 3(2), an applicant for an SVF license "must be a company incorporated in the State, including free zones but excluding Financial Free Zone". An applicant must comply with or demonstrate that the applicant will comply with the requirements set out in Articles 7 to 14 of the SVFR. For licensed banks, by nature of them being licensed, they are deemed to be authorized to issue SVFs. However, they are required to notify the CBUAE in writing that they plan to issue an SVF and carry out the SVF business.[78] The concerned licensed bank is required a "No Objection" letter from the Central Bank before it can commence the SVF business.[79]

KEY OBSERVATIONS

In both jurisdictions, banking entities are permitted to issue PPIs. The requirements for banks are also lesser compared to

[76] *Id,* 34, art. 3.1.
[77] *Id*. art. 2.2.
[78] *Id,* at 14, art. 4.1.
[79] *Id,* art. 4.1.

those for non-banks. This may be because banks are already subject to higher levels of scrutiny and more frequent audits.

The treatment for non-banks seems to be slightly different between jurisdictions. In the UAE any entity can approach the CBUAE with an application to issue an SVF if they meet the requirements listed in the SVFR. The requirement under the MD-PPI indicates that the non-banking entity must first be regulated by some other financial regulator before making an application to the RBI. This inserts a preceding layer of scrutiny on the potential applicant, whom their existing financial regulator vets before seeking to be licensed by the RBI.

VIII. Capital requirements

At the time of application, all non-bank entities seeking RBI authorization under the PSSA must have a minimum positive net worth of 5 crore as per their most recent audited balance sheet. RBI processes the application based on this net worth which the non-bank entities must maintain at all times. Thereafter, by the end of the third financial year from the date of receiving final authorisation, the applicant should have

achieves a minimum positive net worth of ₹15 crore which would be maintained at all times.[80] The Memorandum of Association (MoA) of the non-bank entity is required to cover the proposed activity of PPI issuance.[81] For non-bank PPI entities having Foreign Direct Investment (FDI)/Foreign Portfolio Investment (FPI)/Foreign Institutional Investment (FII), these entities must satisfy the capital requirements as applicable under the current Consolidated FDI policy guidelines of the Government of India.[82] Authorised non-bank PPI issuers are required to submit a net-worth certificate every year to evidence compliance with the applicable net-worth requirement as per the audited balance sheet of the financial year within six months of completion of that financial year.[83] Non-bank PPI issuers are also guided by the DPSS circular on Investment in entities from FATF non-compliant jurisdictions.[84]

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[80] *Supra* note 42, ¶ 4.5.
[81] *Id*. ¶ 4.4.
[82] *Id,* at 36, ¶ 4.3.
[83] *Id,* ¶ 4.7.
[84] *Id.* ¶ 4.9.

The SVFR states that an entity is not permitted to carry on any other licensed financial activity without obtaining a license from the relevant authority and if the licensee wishes to conduct any secondary or ancillary businesses, the licensee is required to seek approval from the CBUAE before undertaking such activity.[85] The licensee is required to maintain paid-up capital of at least 15,000,000 AED or an equivalent amount in any other currency approved by the CBUAE and aggregate Capital Funds (as defined in the SVFR) must be at least 5% of the total Float received from the customers.[86] Aggregate Capital Funds must be calculated exclusive of accumulated losses and goodwill.[87]

The CBUAE must be provided with adequate details on the source of funds that will be used to support the licensee's proposed business activities. The licensee must demonstrate that its financial resources are sufficient for implementing its business model in a safe, efficient, and sustainable manner,

[85] *Id*. art. 7.3.
[86] *Id,* at 47, art. 7.4.
[87] *Id*, art. 7.6.

without compromising the customers' interests.[88] The CBUAE can impose a higher financial resources requirement on the licensee if taking into account the scale and complexity of a licensee's business if the CBUAE considers this necessary to ensure that the licensee concerned can fulfil its regulatory obligations under the SVFR.[89] An unconditional irrevocable bank guarantee for the full paid-up capital amount in favour of the CBUAE paid upon first demand shall also be submitted to the CBUAE with the application of the License. Such a guarantee should be renewable before expiry or based on the CBUAE's demand.[90] The licensee must demonstrate that it can maintain sufficient financial resources to facilitate an orderly wind-down of its SVF business, including a smooth refunding process.[91]

KEY OBSERVATIONS

The capital commitments under the SVFR are more onerous than those under the MD-PPI. This is exacerbated by the fact

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[88] *Id.* art. 7.7.
[89] *Id*. art. 7.10.
[90] *Id,* at 48, art. 7.10.
[91] *Id.* art. 7.9.

that under the SVFR, in addition to the minimum paid-up capital requirement, there is a simultaneous requirement to maintain an irrevocable bank guarantee. In the author's experience, this has been a major consideration for applicants looking to issue an SVF in the UAE. Instead, many non-banking players have collaborated with banks to leverage their exemption under the SVFR to issue co-branded PPIs in the UAE.

IX. Conclusion

As noted at the beginning of this article, the UAE regulations are nascent compared to their Indian counterparts. We can hope for the UAE regulations to evolve and become more sophisticated. This is the need of the hour for the UAE to maintain its position as a leader in the fintech space in the MENA region, a badge it already wears with great pride. The development of fintech regulations indicates that it's a fertile market, and that more such FinTech firms are to arrive at the horizon. It is, hence, recommended that the government and the companies work together towards the development of the same.

THE DOCTRINE OF PUBLIC POLICY: BACKDOOR STRATEGY TO REVIEW FOREIGN ARBITRAL AWARD OR NECESSARY EVIL?

Deepanjali Jain[*] & Prateek Khandelwal[**]

ABSTRACT: *Arbitration falls within one of the laws which were initiated with the reason to respect the parties' decision to opt for an alternative course to resolve their disputes outside the courts. International arbitration is usually chosen by the parties for the expertise of the institutions to deliver effectively enforceable decisions. In arbitration, the intention of the parties to pursue an arbitration is given the highest regard. But this intention for arbitration has been tested by the Indian courts on several occasions during the enforcement of such foreign*

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awards. The doctrine of public policy has been discussed and cited as the reason to deny the enforcement of these awards.

The Indian statutory act determines that it is the duty of the Indian courts to prevent any gross infringement of the basic rights of Indian citizens and hence, the courts possess the power to deny the enforcement of foreign awards. A test has been laid down for the satisfaction of the 'public policy' doctrine which states that the award should not be contrary to the fundamental policy of Indian law, the interests of India, justice or morality, among others as well.

This article aims to study the doctrine of public policy and to determine if it has been developed as a tool to escape the arbitration mechanism, once the decision rendered by the arbitrator has not favored the party approaching the courts. This would include a

detailed review of the landmark judgments on the doctrine of public policy to gather the parameters considered while denying the enforcement of foreign awards and discover patterns in other judgments as well as determine the ways other courts have been interpreting such landmark judgments to understand the position of Indian Judiciary on the utilization of the doctrine.

KEYWORDS- *ADR, Arbitral Awards Section 34, Public Policy, Enforcement of Arbitral Awards*

I. INTRODUCTION

In India nowadays, arbitration is the standard form of dispute settlement for business disputes. In fact, the Indian government acknowledged that improving arbitration and enforcement process efficiency was a way to boost its standing in the World Bank's Doing Business rankings. India's standing for 'Enforcing Contracts' in the World Bank Report on Doing Business 2018 rose multiple ranks, even reaching 163 in 2019. In terms of general ease of doing business, India advanced 23 places in 2019.[92]

However, the implementation of arbitral awards in India has been one of the main worries for parties. The concept of Public Policy in the Arbitration and Conciliation Act of 1996[93] as an exception to the execution of arbitral awards, thereby making arbitration one more stage in the adjudication process in India. Since the party in whose favour an award is passed have to essentially re-litigate the conflicts before an Indian court in

[92] *World Bank's Doing Business Report Bank*, THE WORLD BANK, (Sept 10, 2022) https://pib.gov.in/newsite/PrintRelease.aspx?relid=193994.

[93] Arbitration and Conciliation Act, No. 26, 1996 (India).

order to seek enforcement of such an award, this discussion raises significant concerns in the minds of individuals who have agreed to arbitration provisions as a dispute-resolution tool. Thus, this article aims to discuss the provision of Public Policy at length through the judicial Lens and discuss bad seeds of jurisprudence which can be used by the parties to re-litigate the whole process and escape arbitral awards, which includes the Phulchand fiasco and the re-evaluation of evidence approach.

II. PUBLIC POLICY

Public policy implies a situation involving the common benefit or the common interest. Therefore, any behaviour that has a potential to be nefarious enough to harm the interests of the state or the public is said to be against public policy or the law. What is good for the public, in the public interest, or occasionally damaging or injurious is what is meant by 'public policy'. Its meanings are incredibly broad and all-encompassing. Any action that undermines general agreement is against public policy.

Public policy is not defined in either the Arbitration Act or the Indian Contract Act as it cannot be precisely defined. It depends on shifting social mores, moral standards, and financial circumstances. The notion of public policy is flexible, which theoretically gives judges a justification to void any contract they don't like. In light of this risk, judges have occasionally criticised the concept. The courts' current stance constitutes a compromise between the necessity for clarity in business dealings and the flexibility ingrained in the idea of public policy. The concept has a rather open-textured and flexible nature, and this nature has led to judicial criticism. Two of these come to mind. It first fluctuates with the social and cultural ideals of many countries and within each country from generation to generation. Second, it has been described in a variety of ways by judges and jurists.

Section 34 of the Arbitration and Conciliation Act of 1996[94] specifies grounds for challenging an arbitral award, such as Incapacity of the party, proper notification not provided, inarbitrable subject matter, etc. Section 34 (2)(b)(ii) of the

[94] *Id*, at 54, § 34.

Arbitration and Conciliation Act of 1996[95] states that an arbitral award can be set aside by the court if it is in conflict with the public policy of India.

III. JUDICIAL CONTRIBUTION TO PUBLIC POLICY

A. AGAINST FUNDAMENTAL POLICY OF THE INDIAN LAW

The Supreme Court of India established the parameters of public policy pertaining to the implementation of a foreign award and used a narrow construction of public policy.[96] The court ruled that the phrase "public policy" in Section 7(1) (b) (ii) of the Foreign Awards Act[97] must necessarily be interpreted in the sense of the theory of public policy as applied in the area of private international law because the Foreign Awards Act is concerned with the recognition and enforcement of foreign awards that are regulated by the principles of private international law. Therefore, enforcing a

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[95] *Id*, at 56, § 34 (2)(b)(ii).
[96] Renusagar Power Co Ltd v. General Electric Co 1994 Supp (1) SCC 644.
[97] Foreign Awards Act, No. 28, 1961 (India), § 7(1)(b)(ii).

foreign award may be refused on the grounds that doing so would be against public policy if doing so would violate:

- The fundamental policy of Indian law
- Interest of India
- Justice, or morality.

The Court further clarified 'fundamental policy of Indian law' and gave three crucial points of consideration. Firstly, for the award to be rejected enforcement, it must allege more than just a breach of Indian law, secondly, must be a violation of economic interests of India, thirdly, the court's orders must be followed.

B. PATENT ILLEGALITY

The Supreme Court introduced the concept of 'patent illegality' for setting aside domestic awards under the head of public policy.[98] In accordance with Section 34 of the Arbitration and Conciliation Act of 1996[99], domestic arbitral

[98] Oil & Natural Gas Corporation Ltd Vs Saw Pipes Ltd (2003) 5 SCC 705.
[99] *Supra* note 95.

awards made in India were challenged in this instance on the grounds of public policy. A consideration of the merits of the underlying issue was partially required to determine patent illegality. It concluded that, while defining patent illegality, "illegality must go to the source of the matter, and if the illegality is of insignificant nature, it cannot be maintained the award is against public policy." Award may also be revoked if it horrifies the Court's conscience by being so unfair and irrational. Such an award must be declared void since it violates public policy.

C. JUSTICE AND MORALITY

Supreme Court, in the case of Associate Builders v. Delhi Development Associates[100], explored the terms ‘Justice and Morality’ in interpreting public policy. They ultimately refused to interfere with the arbitral award on the reasons that firstly, only the reasons listed in Section 34 of the Arbitration and Conciliation Act of 1996 may be used to contest an arbitral

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[100] Associate Builders v. Delhi Development Associates [2015] AIR 620 SC.

judgement and held that the merits of the award may only be examined in the general context of public policy.

They discussed all the four elements of public policy, including, fundamental Policy of Indian Law, Interest of India, Justice and morality and patent illegality. Fundamental Policy of Indian law to include certain factors, firstly, disregarding instructions from higher courts, secondly, usage a judicial method instead of an arbitrary approach, thirdly, natural justice principles must be applied and lastly, it must be ensured that an arbitrator's decision is not bizarre and unreasonable in the sense that no sensible person would reach the same conclusion.

The "Interest of India" was defined as relating to India's standing in the international community and its relationships with other countries.

The term ‘against justice and morality’ includes: firstly, the award should not be such that it shocks the conscience of the court, secondly, morality was limited to the scope of sexual immorality only, lastly, with respect to an arbitration, it would be a valid ground when the contract is not illegal but against

the moral standards of the society and will only be applicable when it shocks the conscience of the court.

In addition, the Supreme Court ruled that "Patent Illegality" would include: firstly, fraud or corruption, secondly, a violation of substantive law, which gets to the heart of the matter thirdly, an arbitrator's legal error, fourthly, a violation of the Act itself, fifthly, when the arbitrator disregards the terms of the contract and customs of the trade as required by Section 28 (3) of the Arbitration and Conciliation Act of 1996[101], and lastly, if the arbitrator gives an arbitrary decision or the reasoning behind the decision.

The Supreme Court ruled that an arbitrator is the only judge of the quality and quantity of the facts, and as a result, an award cannot be overturned based only on the lack of sufficient evidence or poor quality of the evidence. The Supreme Court also ruled that when a court evaluates an arbitration award using the "public policy" standard, it does not serve as an appeals court and, as a result, "errors of fact" cannot be

[101] Supra note 95, § 28(3).

addressed unless the arbitrator's decision-making process is arbitrary or capricious.

D. FUNDAMENTAL POLICY OF INDIAN LAW 2.0

The Supreme Court in the decision of Ssangyong Engg. and Construction Co. Ltd. v. National Highways Authority of India[102] provided an in-depth commentary on the situation following the 2015 amendment to the Arbitration and Conciliation Act of 1996. The Court determined that, in light of the 2015 amendment to the Arbitration and Conciliation Act of 1996, the broad interpretation of 'fundamental policy of Indian law' advanced in the judgments of Western Geco[103] and Associate Builders[104] would be inappropriate.

The Court used the 246th Law Commission Report in establishing that the interpretation of the subhead 'Fundamental policy of Indian law' would henceforth be

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[102] Ssangyong Engg. and Construction Co. Ltd. v. National Highways Authority of India (2019) 15 SCC 131: 2019 SCC OnLine SC 677.
[103] Oil & Natural Gas Corporation Ltd v. Western Geco International Ltd, (2014) 9 SCC 263.
[104] *Supra* note 101.

consistent with Renusagar[105]. It went on to say that this subhead would now imply that firstly, a decision which opposes a law defending national interests of the country, secondly, a decision that blatantly rejects superior court orders, and thirdly, a decision that egregiously violates principles of natural justice.

Thus, it is clear that the Court has eliminated the ground of non-adoption of a judicial approach, rightly anticipating that this would require an entry into the merits of the decision, which is clearly forbidden by the legislative intervention.

The Court then evaluated distinct aspects of Indian public policy, concluding that the phrase 'interest of India' must not be considered as part Indian jurisprudence. However, in accordance with Associate Builders[106], the head 'justice or morality' was maintained and the reason behind it was that this head would be regarded as a contradiction with the 'most basic notions of morality and justice'. Thus, this ground will only be applied to arbitral rulings that shock the Court's conscience.

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105 *Supra* note 97.

106 *Supr*a note 101.

The Court subsequently revised the subhead "patent illegality" in light of its statutory recognition through the addition of Section 34 of the Arbitration and Conciliation Act of 1996, establishing that it must appear on the face of the award and must indicate that such an illegality goes to the heart of the problem while eliminating an incorrect application of the law by the Tribunal.

The Court then discussed certain scenarios where patent illegality might apply. Firstly, if an arbitrator does not back the award with suitable logical reasoning then it would be in violation of Section 31(3) of the Arbitration and Conciliation Act of 1996[107]. Secondly, if an arbitrator takes a view so unbelievably impossible to interpret the contract, then it will attract patent illegality. Thirdly, if the arbitrator steps outside his jurisdiction while delivering the award, then it shall be considered as patent illegality. Lastly, if the arbitrator reached an erroneous conclusion based on a lack of evidence, the omission of material evidence, or the use of documents as evidence without properly notifying the parties.

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[107] *Supra* note 95, § 31(3)

IV. THE PHULCHAND FIASCO

One of the first fiascos with the public policy in the arbitration arena is the 2011 case of Phulchand Exports Ltd. vs. O.O.O. Patriot.[108] There was a disagreement between the appellant, an Indian corporation, and respondent, a Russian business. The Respondent demanded that the Appellant furnish him with a particular quantity of polished rice on a cost, insurance and cargo basis pursuant to a secret arrangement they had created. The respondent placed a rice order with the appellant, but no rice was ever delivered. As a result, the respondent brought an action against the appellant before a Russian arbitral tribunal, seeking payment of the agreed-upon sum. The panel finally rejected the appellant's defence while thinking it was strong. The respondent then requested arbitration from the Bombay High Court. It asked that the Act's award be implemented.

The enforcement of an arbitral decision may be rejected under section 48 (2) of the Arbitration and Conciliation Act of 1996[109], if the Court determines that (a) the dispute cannot be

[108] Phulchand Exports Ltd. v. O.O.O. Patriot, (2011) 10 SCC 300

[109] *Supra* note 95, § 48(2).

resolved via arbitration under Indian law; or (b) the implementation of the decision would be against Indian public policy. The issue in this case was the enforceability of foreign awards if they were "patently illegitimate" and against Indian public policy.

The court determined that, firstly, with regard to the claim that risk was conveyed to the purchasers, the SC's interpretation of the terms of the Goods Act determined that the risk of loss for the items remained with the seller until the buyer acquired ownership of the goods. However, the caveat to Section 26 of the Indian Sales of Goods Act, 1930[110] expressly specifies that if products are delayed owing to either party's fault, the goods are at the risk of the defaulting party. The Appellant did break the terms of the contract by shipping the goods late and on a vessel without a definite commitment to make Novorossiysk the first port of discharge. As a result, they were responsible for making up the loss in accordance with the rules of the Indian Goods Act, 1930. The Respondent was able to draw on the contractual provisions for compensation.

[110] Sale of Goods Act, No. 3, 1930 (India), § 26.

The argument that the aforementioned contractual condition is invalid and punitive in character is similarly unsupportable since the Contract Act's provisions do not in any way make it illegal to award liquidated damages. The contract's reimbursement clause is not in the type of a penalty or an in terrorem clause, therefore it cannot be seen as damages. Depending on how the transaction is structured, public policy can be determined in a contract. Due to the fact that the object/consideration is neither unlawful, dishonest, immoral, nor contrary to public policy, the aforementioned provision cannot be deemed invalid under Section 23 of the Contract Act, 1872[111]. As the condition for reimbursement or payback is not irrational nor unfair, and the Respondent was only compelled to pay for half of the sum paid, the judgement in this instance is not patently illegal or against Indian public policy.

The Supreme Court cited the Saw Pipes Ltd.[112] decision in holding that the award could be overturned "if it is patently illegal" and that the phrase "public policy of India" used in

[111] Indian Contract Act, No. 9, 1872 (India), § 23.
[112] *Supra* note 99.

Section 48 (2)(b) of the Arbitration and Conciliation Act of 1996[113] must be given a wider interpretation.

A. CRITICISM

The Phulchand case is said to have opened the floodgates for the rejection of enforcement of arbitral awards applications. The wider interpretation given to the phase of Public Policy was heavily criticized. This increased the chances of judicial intervention in international commercial arbitration, which has time and again been frowned upon by the Indian Supreme Court themselves. But wisely, this case was shortly overturned through the Shri Lal Mahal judgment[114].

B. REDEMPTION

The questions considered in the case of Shri Lal Mahal[115] of whether the enforcement of the awards could be refused on the grounds asserted by the Appellant arose regarding the meaning and interpretation of the term "public policy," which is provided as a cause to refuse enforcement of a foreign award

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[113] *Supra* note 95, § 48(2)(b).
[114] Shri Lal Mahal Ltd v Progetto Grano Spa (2014) 2 SCC 433.
[115] *Id.*

under section 48 (2) (b) of the Arbitration and Conciliation Act of 1996. Another question was whether "public policy" had the same definition and intent under Sections 34 (2) (b) (ii) and 48 (2) (b) of the Arbitration and Conciliation Act of 1996.

In overturning the Phulchand ruling, the Supreme Court ruled that section 48 of the Arbitration and Conciliation Act of 1996 definition of "public policy" was more limited than section 34 of the Arbitration and Conciliation Act of 1996. The Court, citing Renusagar[116], made the crucial point that there is a small line between applying the rule of public policy in a situation covered by domestic laws and one that involves a conflict of laws, as is the case in the majority of international commercial arbitrations. In cases involving conflicts of laws and proceedings with a foreign element, such as an arbitration with a foreign seat, the court noted that the theory of public policy's applicability is rather limited and that courts would not be naturally inclined to rely on it.

The court additionally noted that ONGC dealt with an instance where an application to withhold implementation of a

[116] *Supra* note 97.

judgement under section 48 of the Arbitration and Conciliation Act of 1996 was made as contrasted to one where the arbitral award was being challenged under section 34 of the Arbitration and Conciliation Act of 1996. According to a statement made, the phrase "public policy of India" under section 34 of the Arbitration and Conciliation Act of 1996 must be understood in the context of the court's jurisdiction where the legitimacy of the judgement is contested before it becomes final and executable, as opposed to when the award is enforced after it becomes final. Thus, it became clear that any "patent illegality" for putting aside the verdict would fall under the definition of public policy under Section 34 of the Arbitration and Conciliation Act of 1996.

The court determined that Section 48(2)(b) of the Arbitration and Conciliation Act of 1996 only provided for the suspension of implementation of a foreign award if doing so would go against the fundamental principles of Indian law, national interests, justice, or morality. When an objection is made to the enforcement of the foreign award under Section 48(2)(b) of the Arbitration and Conciliation Act of 1996, the more wider definition of "public policy of India" found in Saw

Pipes'[117] Section 34(2)(b)(ii) of the Arbitration and Conciliation Act of 1996 does not apply.

The court additionally stated that section 48 of the Arbitration and Conciliation Act of 1996 does not provide a reassessment of the foreign award during the enforcement stage. The court reaffirmed that section 48 of the Arbitration and Conciliation Act of 1996 does not provide for a reconsideration of the merits of the judgement and that procedural flaws during a foreign arbitration do not automatically render the result invalid.

V. THE EVIDENCE ON RECORD APPROACH: THE SUBTLE INTERFERENCE

A. NATIONAL AGRICULTURAL COOPERATIVE MARKETING FEDERATION OF INDIA (NAFED) V. ALIMENTA[118]

NAFED, the appellant, was an Indian government authorised canalising agency and made a deal with the

[117] *Supra* note 99.

[118] National Agricultural Cooperative Marketing Federation of India (NAFED) v. Alimenta (2020) SCC OnLine SC 381.

respondent, Alimenta S.A., for the season's supply of Indian groundnut. However, NAFED was unable to provide the agreed upon amount due to crop damage. As a result, both sides agreed to two revisions to provide the remaining amount in the following year. NAFED contacted the Government to request authorization to carry forward the export obligations from the prior year, but this request was denied due to material changes in the commodity's price. Alimenta characterized NAFED's disclosure of its impossibility due to the Government's prohibition as a breach of contract and thereafter referred the matter to arbitration. After a round of litigation over the suspension of the arbitration, the arbitral tribunal issued its decision ordering NAFED to compensate Alimenta for damages.

The Supreme Court refused to enforce the award, ruling that in the absence of the Government's consent, NAFED was justified in not supplying the item and so could not be ordered to pay any damages to Alimenta. In reaching its decision, the Court relied on clause 14 of the contract and determined that section 32 of the Indian Contract Act, 1872 applied because the contract between the parties was dependent on the

Government's export policy. Additionally, the Court ruled that the contract was null and void and carried no further duties as the government declined to issue the approval. The Court came to the conclusion that allowing the enforcement of the arbitral award amounted to ordering NAFED to perform an impractical act, which would have violated India's public policy as defined in section 7 of the Foreign Awards Act, 1961.

B. SOUTH EAST ASIA MARINE ENGINEERING AND CONSTRUCTIONS LTD. V. OIL INDIA LIMITED[119]

For the aim of well drilling in Assam, SEAMEC Ltd. came into a contract with Oil India based on a tender document. Although the contract's term limit was initially set at two years, the parties later agreed to two additional extensions of one year each. But, High Speed Diesel, a crucial raw material for drilling, has seen a significant price hike since the deal was signed. Later, clause 23 of the contract was triggered as SEAMEC demanded the stated price from Oil India, which was rejected and led SEAMEC Ltd. to invoke the arbitration clause.

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[119] South East Asia Marine Engineering and Constructions Ltd. v. Oil India Limited (2020) SCC OnLine SC 451.

The central issue considered in this judgment was whether the Tribunal's interpretation of the contract, in the award, was reasonable and fair according to the Section 34 of the Arbitration and Conciliation Act of 1996. The Court then examined the said interpretation of the contract and questioned if such interpretation could have been reasonably adopted by the tribunal. But, they ended up subjecting a wider test of reasonability to the arbitral award.

There were different approaches taken by the tribunal and High court, where Clause 23 of the contract was interpreted liberally by the tribunal, and it was decided that change in prices will come under the scope of 'change in law' and on the other hand, the High Court defined the 'Change in Law' clause as a case of force majeure. Disagreeing with both the interpretations, SC claimed that Tribunal failed to interpret clause 23 in its entirety while considering all the clauses of the contract. Ultimately, the Supreme Court ruled, based on evidence and contentions, that arbitral tribunal had unreasonably interpreted the contract and was perverse.

C. MMTC V. M/S VEDANTA LTD[120]

Invoking the arbitration provision in the contract between M/s Vedanta Ltd. (Respondent) and MMTC Ltd. (Appellant), the Respondent demanded payment for products it had sold to Hindustan Transmission Products Ltd. through the Appellant. The Arbitral Tribunal ordered the Appellant to pay the Respondent's claims in full, plus interest.

The Supreme Court re-examined the pre-existing legal position regarding the scope of interference with an arbitral award in India under Sections 34 and 37 of the Arbitration and Conciliation (Amendment) Act, 2015 when examining the issue of the arbitrability of the disputes between the Appellant and the Respondent. The Supreme Court concluded that judicial meddling cannot go beyond the parameters outlined in Section 34 after examining the extent to which courts can replace the decision reached by the arbitral tribunal with their own conclusion. It was made clear that in order to exercise its authority under Section 37, the Court need only confirm that the High Court had not gone beyond the bounds of the law by

[120] MMTC Ltd. v. Vedanta Ltd., (2019) 4 SCC 163

exercising its authority under Section 34. Therefore, it was determined that the Court is unable to conduct a fair evaluation of the award's merits.

The Supreme Court further noted that it must proceed with extreme caution and take its time to overturn findings that have already been made in an appeal under Section 37 after an arbitral award has been upheld under Section 34. The Award was determined to be a reasonable view based on a rational construction of the Agreement and after taking into account the material on record regarding the issue of the arbitrability of the disputes. The Supreme Court decided against interfering with the Award as a result.

D. ANALYSIS

The tendency of the Supreme Court of judicial overarching is visible through the judgments discussed above. In the instances of Public Policy exception, the court goes ahead and start analysing the evidence presented in the case and interpretation of documents as if they are acting as the court of facts and not acting in the appellate jurisdiction or the court of law.

Unfavourable opinions to the courts can exist on an arbitral tribunal. Simply holding an opinion that differs from the courts cannot be regarded as shocking the court's conscience. In the case of NAFED[121], we can observe that court states does not state the reason of how the arbitrator was unjustified in ruling in favour of Alimenta. It just states that economically NAFED could not deliver the supply and the export policy of government. There was no conduct on the part of Arbitrator or the award that shocked the conscious of the court or was delivered without a logical explanation. The court even delves further into contractual provisions and investigated the dispute's factual components to reach the conclusion that the government's approval was appropriate to deliver their final verdict. Additionally, this judgment also broadened, the otherwise narrow, scope of 'public policy' while refusing enforcement of the foreign award.

In the case of South East Asia Marine Engineering and Constructions Ltd. v. Oil India Limited[122], the judgement made by the tribunal was based on a perverse reading of the

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[121] *Supra* note 119.

[122] *Id*.

contract, according to the Court, which reinterpreted the contract in question and applied a broader definition of what is reasonable. In order to properly interpret clause 23, it has also relied on the evidence to determine the parties' intentions when they entered into the contract. But this was the ultimate fallacy made on the part of the court. They went ahead and stepped in the shoes of the tribunal and made judgment as if their nature was of a factual court and not an appellant court. The role of the Supreme Court is just to observe and make sure a gross injustice has not been committed on the part of the tribunal and not to examine evidences and make remarks about the interpretations taken into account by the tribunal.

In the *MMTC case*[123], contract interpretation may not need the analysis of any evidence to determine the parties' intentions. Although the Supreme Court's ruling may be supported by reasons, it is unclear if the narrow parameters of Section 34 of the Arbitration and Conciliation Act of 1996 are exceeded by such a thorough investigation of the contract in order to determine that an interpretation is irrational.

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[123] *Id,* at 77.

These judgments have towed away from the 'pro-enforcement' approach of the courts and the overall arc of discouraging re-evaluation of merits or errors, of fact or law at the stage of enforcement of foreign award, made by the arbitrator.

VI. CONCLUDING REMARKS

The public policy test has a long history. In arbitration law, Indian courts have, with the few notable exceptions, been slowly narrowing the scope of public policy. While the Judgments like ssa Pipe, Renusagar, etc. have given us great and precise precedents detailing possible aspects for enforcement and exceptional instances to restrain such enforcement in the interest of Public Policy, we have also encountered bad precedents such as Phulchand case, NAFAED case, MMTC case, etc. where scrutiny of arbitral awards have been much more than required, therefore, giving parties additional opportunities to turn the outcomes in their favour. This not only is a harmful practice for the opposing parties but for the arbitration jurisprudence as well.

But as talked about through the course of this article, there have been many incidents of bad precedents which leaves loopholes, some overruled and some still valid and applicable. This can assist many parties as a tool to escape arbitration and misuse the judicial recourses for personal benefits. The practice of stepping into shoes of an arbitrator to evaluate the evidence or minute details of commercial transaction or giving a wider interpretation to the recourse exception of public policy can become fatal for the parties, and set bad precedents.

The public policy test has to be applied with more rigour. It must be emphasised that an award must always be upheld unless extraordinary circumstances call for a different course of action. Courts must be extremely cautious when voiding or declining to uphold an award. To reduce any "play in the joints," it is necessary to tighten and increase the objectivity of the public policy exam. This is especially true for awards resulting from international commercial arbitration, whether it is sitting in India or abroad.

AN ASSESSMENT OF THE LIABILITY OF PAYMENT AGGREGATORS IN INDIA UNDER THE RBI GUIDELINES.

*Vyshnavi Praveen** & *Ananya Soni***

ABSTRACT: *The digital banking sector is one of the fastest developing sectors with millions of users worldwide. The pandemic and demonetisation have been some of the crucial accelerating factors in aiding this boost. Payment aggregators are one such digital asset hat has been invaluable in connecting merchants and customers by bridging the technological gap. With digital banking growing so much in terms of popularity in such a short span, it is no doubt that there have been increased instances of fraud, scams and theft which has raised some security related questions. In an age when more*

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individuals are opting for digital payment methods, there is a dire need to ensure that there is a safe and sound financial, technological infrastructure network present in the country and this resulted in the RBI coming up with the first ever concrete guidelines for payment aggregators: The Guidelines on the regulation of Payment Aggregators and Payment Gateways in March, 2020.These guidelines bring about a new era in Payment aggregation business by providing for mandatory licensing, dispute resolution mechanisms and verification. Although these guidelines have been a commendable step towards the advancement of the online payment and banking sector- how do these guidelines prefect in terms of comprehensiveness and adequacy while imposing liability?

Keywords: *Payment Aggregator, Payment Gateway, RBI, Digital Banking, Liability*

I. HISTORY OF PAYMENT AGGREGATORS IN THE INDIAN BANKING SCENARIO

In order to completely understand and analyse the current position of payment aggregators, it is vital to take a look at the history of payment aggregators and the evolution of the payment aggregator history in India. By tracing the history of these intermediaries one will be able to understand the improvements to the area and analyse the various shortcomings with regards to the existing legislations.

Payment methods in India have most certainly evolved to a great extent since its inception. Online banking has perhaps been one of the biggest successes of Indian history and has become more widely accepted with each passing day. In 1980, the Central bank of India released the first ever credit card in India, which was followed by MasterCard in 1988 and many other such banks by 1990.

Online Banking was first introduced in India by the Industrial Credit and Investment Corporation of India ('**ICICI**') Bank in 1996, and other banks quickly followed suit. This marked the

beginning of the digital banking era in India.[124] Following this, in 2008 the National Payment Cooperation of India ('**NPCI**') was launched by the Reserve Bank of India ('**RBI**') to help develop and expand the online payment infrastructure in India. The NPCI did just that by bringing about innovations in retail payment systems. Some retail payments products brought about by NPCI include Immediate Payment Service ('**IMPS**'), RuPay card scheme, Unified Payments Interface **('UPI'**), National Automated Clearing House ('**NACH**'), Aadhaar-enabled Payments System ('**AePS**'), and Bharat Bill Payment System ('**BBPS**').

The NPCI did much with regards to improving the state of digital India and some of the major contributions made include:

1. Banking cards: Under the NPCI much was improved in terms of the quality of cards and the services they offered. Prepaid cards were brought about and new

[124] *Digital payments and their impact on the Indian economy,* INDIA BRAND EQUITY FOUNDATION, (Sept 10, 2022) https://www.ibef.org/research/case-study/digital-payments-and-their-impact-on-the-indian-economy#:~:text=In%201996%2C%20Industrial%20Credit%20and,Citi%20launched%20online%20banking%20facilities.

safety features such as Personal Identification Number ('**PIN**') and One Time Password ('**OTP**') were introduced. Apart from this, NPCI made the process of online payments easier.

2. Unstructured Supplementary Service Data ('**USSD**') channel: This was an innovative feature that enabled banking services to take place using a mobile interface even without the use of internet which revolutionised the payment game in India.

II. UNDERSTANDING THE NATURE OF PAYMENT AGGREGATORS

Payment Aggregators ('**PA**')' thought not a completely new concept to the Indian markets, are relatively a little more complex to understand. Before going into the various intricacies of the concerns associated with PAs, the liability and the future scope, one needs to understand the true nature of the concept of payment aggregation.

A. WHO ARE PAYMENT AGGREGATORS AND WHAT DO THEY DO?

According to the Guidelines on Regulation of Payment Aggregators and Payment Gateways put out by the RBI in

March, 2020, Payment Aggregators are defined as entities that facilitate e-commerce sites and merchants to accept various payment instruments from the customers for completion of their payment obligations without the need for merchants to create a separate payment integration system of their own.[125]

Essentially, PAs act as intermediaries by providing the required technological infrastructure and help bridge the gap between the online merchant, buyer and the payment instruments to facilitate the transfer of funds without actually handling the funds themselves. By being the bridge between consumers at one end, and merchants at the other end, these service providers play a role in processing and completion of the payment transactions. They could be engaged by a bank, a merchant, or a biller. As to the various services offered by PAs, they broadly include:

- Providing the necessary interface for the fund transfer/payment.
- Entering into agreements with the billers.

[125] Reserve Bank of India, Guidelines on Regulation of Payment Aggregators and Payment Gateways, DPSS.CO. PD. No.1810/02.14.008/2019-20, (Issued on Mar 31, 2021).

- Managing the various operational complexities that arise out of using various different payment instruments.
- Providing all the banks with a standard method of dealing with the bill data.
- Managing the various utility requirements, consolidated pay-outs and other various service delivery aspects.

Payment aggregators work by interacting with various entities to ensure that transactions are securely carried out between merchants and customers. The major steps involved are:

1. The PG runs a fraud check and encrypts the card details of the customers.
2. The acquiring bank collects relevant details.
3. The card network runs a fraud check.
4. Transactions are approved by the issuing banks.
5. The card company communicates either its approval or denial of the transaction.
6. This approval or denial is communicated to the customer via the PG.
7. Upon the approval, the acquirer requests money from the issuer.

In the present technology driven era, it is safe to say that payment aggregators have become indispensable given the heavy reliance by online retailers, which calls for an increased need to monitor and regulate these entities.

B. PAYMENT AGGREGATORS v. PAYMENT GATEWAYS

Payment aggregators and Payment Gateways (‘**PG**’) are often used interchangeably however they are not the same. PGs are essentially a software service that enable companies or merchants to process online payment transactions on their interface. They allow acceptance of payment in various forms such as UPI, debit card, or a credit card. A PA on the other hand, is a service provider that aggregates and provides various payment acceptance services to merchants. The major difference is the fact that while a gateway is for e-commerce websites/ apps, an aggregator digitises online and/or offline payment touchpoints[126].

[126] Chaitali Bhatia, *what differentiates a Payment Aggregator from a Payment Gateway?* EZETAP BY RAZORPA, (Sept 10, 2022), https://corp.ezetap.com/blogs/what-differentiates-a-payment-aggregator-br-from-a-payment-gateway.

While PAs are largely owned by fintech players such as RazorPay and RuPay, PGs are owned by public and private banks, vendors and even other PAs. PGs typically deal with data on the front-end whereas PAs are capable of going through the underwriting process of the concerned banks.

PGs in India permit payments on the website/app only using a few select options but there is a wider choice offered by PAs including UPI, cards etc. The bottom line is that while PAs are the payment interface, PGs are simply the payment intermediaries.

III. C. PAYMENT AGGREGATORS IN THE CONTEXT OF BANKS: HOW DO THEY DIFFER?

Now that it has been established that PAs are merely the interface that helps merchants collect funds, it brings us to the next question: how do these aggregators differ from traditional banks in terms of functions and duties?

Traditionally speaking, in order to be classified as a bank, an organization/ institution has to perform certain core functions including: Take deposit amounts, take current accounts, issue and pay cheques and collect cheques both crossed and uncrossed from their customers. This was elaborated in Sir John Paget’s definition of banking. Furthermore, under the

Banking Regulations Act, 1949 "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise[127] and additionally a banking company is one that provides banking services.[128] From the definition of payment aggregators, it is clear that they perform features including acceptance of funds on behalf of merchants which is a crucial element of banks however this is applicable in the most limited sense. In the context of banks, PAs are more on the lines of an intermediary that supports transfer of funds between one bank account (customer) to another bank account (vendor).

Looking at the definitions relating to who is a banker and what are baking services in the Indian context, it appears that PAs do not fit the definition of a banker by providing banking facilities for a few reasons:

1. There in an absence of the cheque deposit and issuance feature

[127] Banking Regulation Act, § 5(b), No. 10, Acts of Parliament, 1949 (India).

[128] *Id,* § 5(c).

2. The deposited funds are not payable upon demand and have to follow certain channels
3. They are not open to the general public and only apply to a merchant and customer scenario.

In order for an entity to be held as a bank/ banker, these banking services need to be the primary business of the organization and these banking functions (including accepting deposits form general public and offering loans) need to be done for the main aim of profit making[129]. Payment aggregators typically charge merchants based on each transaction that is carried out and this amount may be fixed or varied. The differentiating factor here is the fact that the primary service is not that of banking but rather providing the financial technology to enable payments. Just because the PAs accept funds on behalf of the merchants does not mean that they may be called banks.[130] Interestingly enough, more and more banks owing to the popularity of such payment systems have introduced their own PAs.

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[129] *Id,* at 90, § 7.
[130] *Ramalingam Pillai v. Sankara Iyer and Ors* [1964] 1964 Mad 424.

IV. THE GUIDELINES ON REGULATION OF PAYMENT AGGREGATORS AND PAYMENT GATEWAYS

As discussed previously, PAs and PGs essentially form the backbone of the modern banking sector in the retail space and the increased number of upcoming PAs has pushed the RBI to release guidelines relating to the functioning of such intermediaries. The increased traffic in this area caught the eyes of regulatory bodies such as the RBI which stepped in and decided to introduce certain measure to ensure increased scrutiny and to regulate the actions of the many aggregators that came about. This resulted in the RBI, with its powers from the Payments and Settlement Systems Act,[131] introducing the Guidelines on Regulation of Payment Aggregators and Payment Gateways in March 2020.[132] The guidelines were brought about in a bid to ensure that more such aggregators come within the purview of the RBI and to increase scrutiny to prevent rising instances of data breach and fraudulent

[131] The Payment and Settlement Systems Act, § 3, No 51, Acts of Parliament 2007 (India).
[132] *Supra* note 126.

activities. While there are banking and non-banking PAs, these guidelines only apply to the non-banking entities.

A. WHY THE NEW GUIDELINES?

As new as the concept sounds, PAs have actually been around for a while and are not a new concept. For example, BillDesk was one of the first and most comprehensive PAs to have been introduced all the way back in 2003.[133] Despite PAs having existed for so long, there was little to no regulation regarding their activities which emerged as a cause for concern. PAs and PGs were mostly unregulated until the RBI released directions for opening and operation of accounts and settlement of electronic payment transactions involving intermediaries in November 2009.[134] Under these guidelines, PAs were treated as intermediaries who were required to maintain a nodal bank

[133] *Shaping the ways payments are made and accepted,* BILLDESK, (Sept 12, 2022), https://www.billdesk.com/web/about_us#:~:text=Over%20the%20next%20decade%20and,stage%2C%20governments%20and%20financial%20institution*s*.

[134] Reserve Bank of India, Directions for opening and operation of Accounts and settlement of payments for electronic payment transactions involving intermediaries, RBI/2009-10/231 DPSS.CO. PD. No.1102 /02.14.08/ 2009-10. (Issued on Nov 24, 2009).

account and comply with the Information Technology Act of 2008[135]. However, these guidelines didn't provide a comprehensive framework for the operation of Pas, and had no mandatory licensing requirements which resulted in the PAs continuing to remain vastly unregulated.

The use of these new and unregulated PAs did not help the general consumer population as indicated by a Global Tech Support Scam Research report put out by Microsoft in July 2021, suggesting that 31% of Indians using online payment and indulging in online retails had lost money to scams, which was a 238% increase as compared to 2018[136]. This is clearly shows a positive correlation between and higher instances of frauds and scams, as a result of increased reliance on PAs

Perplexed by this growth, the RBI decided to introduce the guidelines relating to PAs and PGs in 2020. The new guidelines calling for mandatory licensing of non-bank PAs

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[135] The Information Technology Act, No 13, Acts of Parliament, 2008 (India).

[136] *Global Tech Support Scam Research Report,* MICROSOFT, (Jul 2021), https://news.microsoft.com/wp-content/uploads/prod/sites/45/2021/07/Microsoft-India-Tech-Support-Fraud-Survey-2021.pdf.

came as a solid move in the direction towards the regulation of these PAs. In 2022, RazorPay, Pinelabs and Stripe were amongst some of the first few entities to have received this license from the RBI.[137]

B. NEW GUIDELINES, NEW STAKES: INCREASED LIABILITY?

It is no doubt that a lot will change with the new guidelines in place. Firstly, the new guidelines specifically state that PAs shall have a minimum net-worth of ₹15 crore at the time of application for authorisation and shall attain a net-worth of ₹25 crore by the end of third financial year of grant of authorization and this ought to be verified by a Chartered Accountant (**'CA'**). Under these guidelines, all PAs who are unable to comply with the capital requirement within the prescribed period will mandatorily be required to close up their aggregation business. It is interesting to see that in this case,

[137] Subrata Panda, *RBI clears payment aggregator licence for Razorpay, PineLabs & Stripe,* BUSINESS STANDARD, (Sept 14, 2022) https://www.business-standard.com/article/finance/rbi-clears-payment-aggregator-licence-for-razorpay-pinelabs-stripe-122070800873_1.html

the liability has been placed on the nodal accounts/escrow accounts to monitor and report compliance with this regard. [138]

In the case where a non-bank entity carries out an aggregation business that they will be required to maintain an account with a bank (escrow/nodal) indicates a banker customer relationship between the PA and the bank. The liability of ensuring compliance in terms of the capital stipulation as per the guidelines appears to fall almost entirely upon the banks with no apparent regulatory or supervisory body in place. Additionally, the guidelines make no mention of what is to happen in the event that banks themselves fail to comply with these provisions. It is rather strange that from the guidelines, no liability seems to be imposed on the PAs in this case. There are several issues with leaving this compliance aspect upon banks: Firstly, owing to the customer and banker relationship between these PAs and banks, there appears to be no actual motive or benefit from banks and hence there is no benefit that actually comes of banks wanting to alter the terms of their relationship with these PAs which would also mean loss of

[138] *Supra* note 128.

business to the bank. Additionally, there is no guarantee that banks will be held liable in the case of any irregularity to this regard. The lack of accountability and a proper reporting channel along with a lack of clarity as to the authority vested to banks remains uncertain. The mention of "monitor and report" compliance here remains largely ambiguous with regard to the level of scrutiny that banks have to undertake, the rights and powers granted to them in this regard and also the proper channel of reporting that ought to be followed.

The guidelines mention that the Know Your Customer ('**KYC**') Directions[139] as updated from time to time will apply to PAs.[140] As per the directions of the KYC circulars, all regulated entities are required to undertake KYC measures for the customers as soon as there is the creation of an account-based relationship. It remains rather unclear from the guidelines as to whether PAs providing services to various merchants will have to undertake these KYC measures with every merchant even if there might not be an account-based

[139] Reserve Bank of India, Master Direction - Know Your Customer (KYC) Directions, RBI/DBR/2015-16/18 (updated on May 10, 2021).

[140] *Id*.

relationship. Another point to note is that while opening accounts with their respective banks, merchants, and customers would have already gone through the KYC process. With these requirements already in place, it seems rather frivolous to require PAs to additionally carry out this KYC process with merchants. Furthermore, considering these guidelines apply to non-banking PAs and seeing how the funds are maintained in an escrow account, there is no direct relationship between the account and the merchant, thus it comes off an unnecessary step. There are however arguments that favour this KYC requirement as it might serve as an additional layer of security and verification, which might curb online merchant fraud.

With regards to the entire governance system, a major concern of even the users of such PA systems has been with regards to the lack of transparency. The guidelines state that agreements should be entered between PAs, merchants, acquiring banks with regards to handling refund/failed transactions, return policies and customer redressal.[141] This clause fails to

[141] *Id,* at 97.

uniformly affix liability upon one particular party. In the case of banks themselves, a clear picture painting the liability of both customers and the bank has been painted by the RBI Circular on Customer protection, [142] and backed by various cases over the years.[143] In most of these cases, liability is established based on contributory actions, depending on the degree of involvement of the customers in transactions.

Additionally, this circular seems to discount the fact that more parties are involved in such online payment methodologies using PAs as opposed to direct use of banking features. It becomes extremely complicated to identify the parties considering the chain that ensues post approval of payment. In such a circumstance, by requiring the involved parties to decide amongst themselves the level of liability that each entity assumes only results in increased hesitation and as a result, more inconvenience for the users of such facilities. This method further allows for more deadlock situations where parties are unwilling to negotiate and come to consensus.

[142] Reserve Bank of India, Customer Protection – Limiting Liability of Customers in Unauthorised Electronic Banking Transactions, RBI/2017-18/15, (issued on Jul 6, 2017).

[143] *Punjab National Bank and Anr. v. Leader Valve* (2020) CPJ 92 (NC).

Further, this also leads to lack of uniformity relating to liability amongst various PAs, undermining the very purpose of these guidelines. In 2016, the RBI issued a master circular relating to the reporting of fraud by commercial banks and a few select financial institutions, which doesn't include PAs. Resultantly, there is a lack of a properly laid down framework for the reporting of fraudulent instances by PAs and other intermediaries. [144]

Further, with regard to the process of merchant onboarding, the circular dictates that PAs are required to carry out background and antecedent checks to verify the authenticity of the merchant.[145] The guidelines specifically require all PAs to verify the authenticity of the merchants, however makes no mention of the extent of this power or its limitations. Furthermore, these PAs are required to carry out security audits to ensure that merchants do not save the details of customers however there is no clarification provided by the RBI or any other regulatory body as to the mode of conducting

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[144]Reserve Bank of India, Classification and Reporting by commercial banks and select FIs, RBI/DBS/2016-17/2, (Updated on Jul 3, 2017)

[145] *Id*.

such audit and the specifics of the same, which might lead to breach of data.

Further, the guidelines do not mention whether this requirement extends to PAs in instances when the PA provides its services to an e-commerce entity (who onboards sub-merchants), and whether they will be required to undertake KYC for the sub merchants as well, since the delivery of goods and services is by the sub-merchants. The guidelines also fail to address what ought to be done in the event where a merchant employs the services of a PA solely for collection of amounts from customers where the actual transactions are conducted offline. In addition to this, PAs will be required to ensure whether or not the terms and conditions have been listed on the website of the merchant. Additionally, merchants may have availed listing services from third parties and might not be in a position to carry out these listing requirements. The RBI has issued no clarification as to the powers and authority of PAs in carrying out this compliance.

The guidelines (clause 7.3) also require the PAs to check Payment Card Industry-Data Security Standard (‘**PCI-**

DSS'[146]) and Payment Application-Data Security Standard ('**PA-DSS**')[147] compliance of the infrastructure of the merchants on-boarded. However, the guidelines also dictates that merchant sites are not to save date related to customer card , and that the PA may carry out security audit of the merchant to check compliance, as and when required[148]. It is an interesting requirement considering how merchants are not permitted to store card related data. Additionally, PA-DSS and PCI-DSS may prove to be rather onerous on new, small and medium business entities which is another concern regarding these guidelines.

The guidelines also call for a strong risk management system to be put in place with PAs with the help of the Baseline Technology Related recommendations. However, these are mere recommendations and have no binding value. Adding on,

[146] PCI, *Payment Card Industry Data Security Standard,* (Sept 14, 2022) https://listings.pcisecuritystandards.org/documents/PCI-DSS-v4-0-SAQ-D-Merchant.pdf
[147] PCI, *Payment Application-Data Security Standard*, (Sept 14, 2022) https://listings.pcisecuritystandards.org/minisite/en/docs/PA-DSS_v3.pdf.
[148] *Id*.

there exists no regulatory body ensure that PAs comply with these regulations.

V. A LIABILITY ASSESSMENT

Now that we have understood the key areas of change relating to the new guidelines along with the concerns associated with them, we need to move on to the next issue: What is the actual extent of liability of PAs and who regulated this liability?

There are several concerns that may be associated with an online PA business including data privacy and security of the customers, acquiring bank and unauthorized transactions etc. Data privacy has perhaps been one of the most pressing issues especially in recent times. The primary concern remains that given the existence of multiple parties, who should be held liable for breach? The answer depends upon who handles the data, the nature of the data, and as to who processes or collects this data. As per the guidelines released by the RBI, PAs and the merchants would not be allowed to store any data. Considering the PA works by providing the technological infrastructure, it is natural that there are degrees of liability towards the various parties involved.

A. LIABILITY TOWARDS CUSTOMERS

As already evidenced by the way PAs work, they are a vital player in facilitating online transactions between merchants and customers. That being said, there is an implied and express liability that the PA has towards the customers

Firstly, banks are liable as per the new guidelines to ensure that there is a comprehensive grievance redressal and dispute management framework including the appointment of a nodal officer to handle customer grievances and so on. It is evident that the liability in the event of customer grievances relating to the disputes lies almost entirely upon the PA. It is also the liability to ensure that all details pertaining to this dispute redressal mechanism is properly published on the merchant's website It appears that the burden of ensuring the success of payments and transactions is on the PAs and rightly so considering the fact that it is due to this technological infrastructure that transactions are carried out. However, while looking at the entire issue from the customers' point of view, it appears that in most cases a customer would be more comfortable dealing with the merchant directly relating to such

queries instead of the PA. This is due to the fact that while a customer enters into an agreement to purchase anything, they maintain a relationship only with the merchant. This is probably the reason why in several cases where merchants engage PAs, there is a collaborative effort to ensure that redressal services are offered to the customers in an easily accessible manner. Under the guidelines, the PAs will be liable for promptly initiating refunds and managing failed transactions in accordance with the prescribed RBI directions.[149] This measure ensures that customers are adequately protected against any possible mismanagement on part of the PAs and also have redressal under the Reserve Bank - Integrated Ombudsman Scheme, 2021[150]

Although it is understood from reading the guidelines that this liability is vested upon the PA, there is ambiguity regarding the actual consequences and punishments in the case of non-compliance.

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[149] Reserve Bank of India, Harmonisation of Turn Around Time (TAT) and customer compensation for failed transactions using authorised Payment Systems, RBI/2019-20/67 DPSS.CO.PD No.629/02.01.014/2019-20, (issued on Sept 20, 2019).

[150] Reserve Bank of India, The Reserve Bank - Integrated Ombudsman Scheme, 2021, (Issued on Nov 12, 2021).

Similarly, with respect to fraud prevention and risk management, PAs are required to install good and secure technology infrastructure to ensure minimization of risk and the chances of fraud. The liability here is placed on the board to approve a security and safety policy.[151] Under the relevant guidelines, there is an effort to create a working relationship between PAs and the DPSS, RBI, Central Office, Mumbai and CERT-In (Indian Computer Emergency Response Team). This also indicates the accountability towards regulatory and vigilance bodies on part of the PA. Additionally, PAs are not permitted to store any of the personal data of any customer and are required to comply with the same standards as applicable to Payment System Operators (‘**PSO’**)[152].As per this, the PAs will be mandated to store data only in systems located within India, which is something enshrined in the GDPR as well[153]. Even in this instance, the PAs are liable to ensure compliance and report the same to the RBI. System Audit Reports (SAR)

[151] *Id,* at 105.
[152] Reserve Bank of India, Guidelines on Storage of Payment Data, RBI/2017-18/153 DPSS.CO.OD No.2785/06.08.005/2017-2018, (Issued on Apr 6, 2018),
[153] *Id*.

conducted by the CRET-In add an additional layer of liability on the PAs and ensure that there is mandatory compliance and increased accountability. When there is data stored there invariably also is data sharing and data processing. Brings us to the question of when will the PA be bound to disclose any shared data if any? While there is no explicit provision that outlines this, we may apply the same rationale behind banks and their data sharing. Typically, data may be shared: when there is prior consent, when there is legal compulsion or if there exists a greater public duty. Legal compulsion might perhaps be one of the most solid grounds for such PAs having to disclose information E.g., Sec 131 of the Income Tax Act, 1961[154]. The Indian courts too have on multiple occasions upheld the banks duty to disclose information where there is a legal compulsion. [155]

B. LIABILITY TOWARDS REGULATORY AUTHORITIES

[154] The Income Tax Act, § 131, No 43, Acts of Parliament, 1961 (India).
[155] *Shankarlal Agarwalla v. State Bank of India And Anr*, AIR 1987 Cal 29.

Just as PAs are liable towards customer, there are also certain liabilities towards the Merchant. Escrow account management and settlement periods are perhaps the most crucial part of this relationship. It is understandable that defaults on the part of PA to settle up due amounts can result in major losses to the merchants. As evidenced from the guidelines, non-bank PAs are to maintain an escrow account where the funds ae collected and later transferred to the merchant on a tp+0t +1 basis.[156] The settlement period depends upon whether the merchant (Td+1) [Td'- date of confirmation by the merchant to the intermediary about delivery of goods to the customer.] or the PA(Ts+1) [Ts' – date of intimation by the merchant to the intermediary about shipment of goods]is responsible for the delivery of goods/services. The PAs are further able to facilitate all refund processes only via the escrow account unless otherwise agreed upon by the merchant and customer.

Apart from this, the PAs are, required to take on liability relating to customer management and grievance redressal as already discussed above. It becomes rather clear that by

[156] *Supra* note 126.

engaging the services of the PA, merchants are to a large extent absolved of substantial liability and duty towards the customers. With the PAs being responsible to ensure the authenticity and veracity of these online merchants, it appears that there is a great onus of liability that is being shifted from merchants to PAs. This in itself is an interesting position wherein an intermediary even with respect to ensuring that pay-outs are made timely, it is the duty of the escrow bank to ensure that these funds maintained are used solely for paying the merchants and not to issue loans etc.[157]

All in law, the entire regulatory framework relating to PAs and their liability seems to be highly inter-linked and inter-related where liabilities of the various parties are affixed on one and another.

VI. FINDINGS, SUGGESTIONS AND CONCLUSION

Undoubtedly, India has come a long way with respect to the adaptation and promotion of digital payment methodologies and other FinTech developments. The entire PA business was

[157] Reserve Bank of India, Master Directions on Prepaid Payment Instruments (PPIs), RBI/DPSS/2021-22/82, (updated on Feb 10, 2023).

perhaps one of the most revolutionary inventions of all time that brought us closer to a modern, digitally friendly India. The introduction of Guidelines on Regulation of Payment Aggregators and Payment Gateways by the RBI was truly a revolutionary step and was one of the most critical steps towards a more digitally sound and secure India. The guidelines released in 2020 proved to be a positive step in the direction of establishing a clear framework for the operation of PAs and PGs and surely did open up avenues. The RBI citing concerns over the models of PAs and their operation pushed for these guidelines [158] The RBI has been extremely cautious while handing out these licenses to non-banking PAs and this has resulted in an increased number of pending applications[159]

[158] Manojit Saha, *Payment platforms under RBI scrutiny*, BUSINESS STANDARD, (Mar 25, 2022), https://www.business-standard.com/article/economy-policy/data-breach-business-models-of-payment-platforms-under-rbi-scrutiny-122032401531_1.html.

[159] Arti Singh, *RBI returns a large number of payment aggregator license application,* (Jul 7, 2022), https://www.livemint.com/industry/banking/why-rbi-is-wary-of-payment-aggregators-11657126296607.html

Considering the ease that PAs offer, more and more corporates are coming forward with their own PA systems to eliminate external third parties and to shorten the bridge between the merchants and customers. [160] This marks a new era of digital payments. Although the Payment aggregator guidelines released by the RBI read along with the PSSA Act is a commendable entry into the arena of online payment regulation, there is much scope for improvement.

From our detailed discussion through the course of this paper, there have been a few key takeaways.

Firstly, we were able to understand that PAs are a lot more complicated than traditional banks owing to the nature of transactions and the parties involved. We cannot compare the nature of a traditional bank to that of a PA although some of the functions are the same. Additionally, we were able to discuss the various guidelines and regulations in place with

[160] Ashwin Manikandan, *From Amazon to Zomato, a big crowd at RBI doors for payment aggregator licence*, (Aug 19,2021*)* https://economictimes.indiatimes.com/tech/technology/a-big-crowd-at-rbi-doors-for-payment-aggregator-licence/articleshow/85439562.cms.

regards to such aggregators and a detailed reading of it suggests that while there is a significant improvement, there are several gaps that are to be filled and several nuances that enquire special attention. The government and the RBI ought to look into the complete functioning of such aggregators and come up with a legislation or bring it within the ambit of the Banking Regulations Act, 1949 to ensure maximum accountability and clarity. The existing norms though do suffice in terms of providing a general guidance, they lack clarity on several accounts such as intricacies of reporting, lack of fixed time frames, and confusion regarding the liability imposed. Interestingly enough, we were also able to identify that PAs do in fact have a high degree of liability imposed on them both from the regulatory bodies and from the merchants and are more or less responsible for ensuring authenticity of merchants, compliance, and to ensure that merchants are not engaged in any sort of fraudulent or suspicious activity. PAs have a very robust and vibrant future ahead of them and can completely revolutionize the online payment scene.

In terms of what can be done with regards to the existing condition relating to the PA system, there are a few suggestions.

1. The possibility of creating a sub-committee or another statutory body such as Security Exchange Board of India ('**SEBI**') specifically for monitoring all aspects relating to the functioning, compliance and reporting of PAs and all PAs would be required to directly comply with and report to these bodies on a periodic basis and the body in turn will report to RBI its findings. At present, the RBI has far too much under its authority.
2. There is a need for the Regulators to promote a cooperative reporting system between banks, merchants and PAs to provide complied reports of risk assessment, safety measures and performance.
3. There is a need for the regulatory bodies to come up with a set of security risks, payment issues, and other problems that may arise in the course of conducing such PA business and ensure that this is publicly available to all banks, PAs and merchants along with the customers.

4. Instead of imposing the liability of compliance on part of PAs on the banks, there could be devised a scenario where the new proposed regulatory body would be in charge of ensuring such compliance and further penalising any individuals found in violation. Furthermore, instead of asking PAs to verify the authenticity of merchants, similar to the PA license system, there may exist a Merchant license system as well. Only upon the receipt of such a license will merchants be allowed to carry out such online businesses and undertake the services offered by PAs. Only merchants with valid licences shall be permitted to engage the services offered by PAs

PAs have no doubt had a major impact on the banking sector of India and has revolutionised the way merchants and customers transact. As the banking systems evolve, there is a need for the relevant laws and guidelines to accommodate this change in technology. India has always managed to remain on top of technology but every once in a while, there is bound to be a gap and that just so happens to be the case with PAs. While the guidelines issued by the

RBI appear to be a great step in the right direction, there are several concerns that are yet to be addressed. We see that it is not just the private entitles but also government undertakings such as Indian Railway Catering and Tourism Corporation ('**IRCTC**') entering the market of the payment aggregation business.[161]

The upcoming years will see a boom in the online payment and PA business and when such a boom does come about, it is essential that the government, merchants, customers and the entities themselves remain prepared. By filling the existing gaps in the framework and through a system of constant monitoring and reporting, we will be able to ensure that our system is up to date with all the changes and hence is strong enough to withstand any challenge that may come about. Until then, there is a need for increased caution and compliance on part of all the parties engaged in such transactions.

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[161] Dhruvaksh Saha, *Payment aggregator licence may open avenues beyond rail-ticketing for IRCTC*, BUSINESS STANDARD, (Sept 19, 2022), https://www.business-standard.com/article/companies/payment-aggregator-licence-may-open-avenues-beyond-rail-ticketing-for-irctc-122091900694_1.html.

DEMYSTIFYING SHADOW BANKS AS A SUBSTITUTE TO THE BANKING SECTOR: A CRITICAL STUDY

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ABSTRACT: *Although there have been prodigious studies about various aspects of the banking industry, minimal efforts have been taken to intrinsically study the NBFC sector and document the structural issues they face. This paper examines the historical development of the NBFCs in India, their role in credit supply, potential triggers for the 2018 financial crisis, and the successive formulation of the 2022 Regulation. It attempts to comprehend the benefits and drawbacks of NBFCs' business models, as well as the factors that led to their recent rapid growth and difficulties. The latter part of the paper seeks to evaluate the emergence of Fintech companies as prominent players*

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within the Indian financial system alongside NBFCs and its subsequent impact on the credit landscape. Given the growing importance of NBFCs as a significant contributor to expanding India's monetary base, there is a substantial academic and research interest in their origins, development, and performance.

Keywords: - *NBFCs, Financial inclusion, Systemic effect, Asset mismatch, Credit regulations.*

I. INTRODUCTION

The advancement of the Indian economy is sustained by increasing the flow of credit, which could be primarily attributable to investments in the private sector. Owing to the 1991 Liberalization, Privatization, and Globalization ('**LPG**') reforms, there has been an influx in credit availability to the Indian economy.[162] For a long period of time, banks accounted for a predominant share of credit within the economy in comparison to other Non-Banking financial companies (**'NBFCs'**). Post the Fiscal year 2014, this trend underwent a significant shift due to the burgeoning NPA within the balance sheet of the banks, after which banks restricted the accessibility of credit to the public.[163] The consequent deficiency of credit was primarily compensated by NBFCs,

[162] Subhomoy Bhattacharjee, *How WB, IMF got India to adopt reforms in 1991,* THE INDIAN EXPRESS (Nov. 12, 2022), https://indianexpress.com/article/news-archive/web/how-wb-imf-got-india-to-adopt-reforms-in-1991/.

[163] Sunainaa Chadha, *Gross NPAs of the public sector banks doubles in the last seven years*, THE TIMES OF INDIA (Dec. 16, 2021) https://timesofindia.indiatimes.com/business/india-business/gross-npas-of-public-sector-banks-double-in-last-seven-years-sbi-tops-list/articleshow/88316357.cms.

who then emerged as key players within the financial sector.[164] Over time, Non-Banking financial institutions have broadened their scope, technological complexities, asset expansion as well as diversification in the range of products and services offered.[165] NBFCs are incorporated under the Companies Act of 1956. They are companies that carry out financial operations without holding a banking license. The history of NBFCs in India can be traced back to Muthoot Fincorp Ltd in the late 1880s when they started as a small lending company in Kerala.[166] These non-banking companies started as a humble supplement to Banks in the early 1960s. There has been a commendable growth of NBFCs in the last decade, therefore necessitating the regulation of these companies. To objectively examine how these companies operate, it is essential to comprehend the differences and similarities

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[164] Gautam Rohidekar, *NBFC Regulation: Mistakes of the Past and Challenges of the Future,* 10 STUDENT ADV 26, 27 (1998).

[165] THE WORLD BANK, https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/nonbank-financial-institution (Nov 16, 2022).

[166] Rajiv Singh, *The other Muthoot: True blue heirs*, FORBES INDIA (Nov. 14, 2022), https://www.forbesindia.com/article/boardroom/the-other-muthoot-true-blue-heirs/51265/1.

between NBFCs and banking institutions, with an emphasis on the regulatory framework and operational practices they are subject to.

The acceptance of deposits is where these two organizations primarily diverge. Demand deposits cannot be accepted by an NBFC, and expressly they cannot hold a savings account. Only NBFCs with specific Reserve Bank of India ('**RBI**') authorization and grade categorization are allowed to accept time deposits. On the other hand, banks can accept both time and demand deposits, which in turn gives them an upper hand in terms of accepting deposits. In addition to this, NBFCs are not permitted to provide all the transaction services which are provided by banks, such as issuing Demand Draft, cheques, and facilitating Fund transfers. It can be thus construed that they do not form a part of payment and settlement systems. Furthermore, they are not entitled to maintain a current account as opposed to banking companies.[167] Lastly and most importantly, Deposit Insurance and Credit Guarantee Corporation ('**DICGC**') provides insurance facilities to

[167] R. Kannan ET. AL, Non-Banking Financial Companies role in India's development, 84 (2019).

depositors in the case of banks, whereas this privilege is not extended to depositors of the NBFCs.

Another area of focus extends to the scope and application of the Insolvency and Bankruptcy code 2016 on these institutions. Matters such as bankruptcy, liquidation, and winding up of NBFC are governed by the provisions of this code, whereas banks are excluded from the ambit of the same. This is mainly because banks are considered to be the backbone of the economy, hence matters such as winding-up have grave implications for the financial stability of the country. Thus, independent legislations exist to separately govern banking and nonbanking entities. Amalgamation, Winding up, and liquidation of Banks, in instances of violation of the rules and regulations laid by RBI, and failure in meeting prescribed obligations such as repayment of public debts, are governed by sections 36 / 36AA /36AE /36AF /36AG /37 /38 of Banking Regulation Act 1941.[168] Section 270 of the Companies Act 2013 deals with the winding up of a company, either voluntarily or by an order of the National Company Law

[168] Banking Regulation Act 1949, §36, 36AA, 36AE, 36AF, 36AG, 37, 38, No. 10, Acts of Parliament, 1949(India).

Tribunal.[169] Since NBFC is recognized as a company, the aforementioned provision will be applicable. Interestingly, IBC invests rights to both debtors and creditors to file petitions to scrutinize insolvency resolutions. If the same is made applicable in cases of banking institutions, the public depositors, who are the creditors, will be empowered with the same rights which in turn would be detrimental to the aims and objectives of the RBI, as the chances for banks to get wound up as an alternative to reconstruction or rectification increases.

Since NBFCs are not allowed to undertake all of the bank's services, they are categorized into distinct categories to make it easier for them to operate. The different types of NBFCs are Asset Finance companies, Loan companies, Mortgage Guarantee companies, Investment companies, Core Investment companies, Infrastructure finance companies, Microfinance companies, and housing finance companies.[170] The rise in these financial institutions' importance in the

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[169] The Companies Act, 2013, §270, No. 18, Act of Parliament, 2013(India).

[170] RESERVE BANK OF INDIA, https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92 (Nov. 11, 2022).

economy motivated the RBI to frame more rules and regulations in order to contain the systemic risks that could be possibly caused by them. RBI recognizes that NBFCs cater to specific sectors and geographies and that their distinctiveness must be safeguarded to guarantee that their activities in the line of credit remain flexible.[171]

There have been profound ramifications of the Russian War on the NBFC Sector. Russia is India's 25th largest trading partner with the export of mobile phones, pharmaceuticals, import of crude oil, diamonds, and coal. Russia is the second largest oil producer, which mainly sells crude oil to European refineries, and the largest supplier of natural gas to Europe which accounts for almost 35%. At the Onset of the Russia-Ukraine War, the demand for crude oil in Russia increased, and which furthered price of crude oil. Although Russia is not the sole source from which India purchases crude oil, the others countries on which India is dependent for the same are supplied by Russia itself. Products that are directly tied to crude oil account for 9% of the wholesale price index. An

[171] *Nedumpilli Finance Co. Ltd. v. State of Kerala and Anr*., (2022) 7 SCC 394.

increase in the price of crude oil will spurs inflation in the economy because manufacturers and other intermediaries use petroleum products. International trade will also be impacted by the war as aviation fuel prices will also spike.[172] Since the import and export of goods will determine the value of the Indian currency, increased import expenditure will decrease the value of the Indian currency. Therefore, RBI should take necessary steps to accommodate this situation by providing substitutes for petroleum products like ethanol and dependence on electrical vehicles.[173]

II. THE 2018 IL&FS CRISIS AND ITS SYSTEMIC IMPACT ON NBFCS.

In India, a crisis was developing when Infrastructure leasing and financial services limited ('**IL&FS**') failed to make payments to its creditors in 2018, which coincided with the celebration of the tenth anniversary of the fall of Lehman

[172] RESERVE BANK OF INDIA, https://m.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1208, (Jun 30, 2022).

[173] RESERVE BANK OF INDIA, https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=21204, (Aug 18, 2022).

Brothers, a vital element in the 2008 recession.[174] IL&FS Ltd is a holding company of the IL&FS group which has more than twenty-four direct subsidiaries and more than 135 indirect subsidiaries. Infrastructure, finance, and environmental services comprise the firm's core business sectors. The business owed more than 91,000 crores in debt, and its debt-to-equity ratio exceeded 18, which was inimical.[175] Due to underperformance, the firm was unable to pay off its long-term and short-term loans in accordance with the terms previously agreed upon. As a result, other IL&FS group companies also fell behind on payments, which caused a significant decline in the share price on the stock market. With the approval of the National Company Law Tribunal (**'NCLT'**), the central government made the decision to replace the Board of Directors under Sections 241 and 242 of the Companies Act 2013.[176][177] It removed 12 of the existing board members and appointed Uday Kotak, Vineet Nayyar, GN Bajpai, GC

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174 Hans Tjio, *Securities and Financial Services Regulation*, 16 SALANNREV 615, 615-619 (2015).
175 Tanya Rathod ET. AL., *Analysis of Indian Laws in the Wake of IL&FS Crisis*, 3.2 JCLG 218, 222 (2020).
176 *Supra* Note 170, §241.
177 *Id* §242.

Chaturvedi, Malini Shankar, and Nanda Kishor as six newly elected members. Uday Kotak, the managing director of Kotak Bank, presided over the board.[178] This kind of rescue effort is being conducted by the central government for the first time after Satyam computer's scam.

Investors will be eager to participate in these debt products because the credit rating agency gave the firm a AAA credit rating for the debt instruments issued, making them the highest-rated instruments on the market.[179] IL&FS received loans from banks and NBFCs in the form of money market instruments, with bank loans being long-term and NBFC loans being short-term, respectively. Commercial paper, intercorporate deposits, repo rates, and reverse repo rates are some examples of money market instruments. They are given out for periods of time shorter than a year. The loans were provided on a short-term basis, and the NBFCs wanted payback. However, IL&FS invested the funds in term

[178] *Supra* note 176, 231.
[179] *Id*, 224.

infrastructure projects, which led to an assets-liability mismatch and payment default.[180]

One of the financial institutions that did not get its repayments was SIDBI, which prompted the institution to approach the central bank of India. Due to the default in payment, there was a sudden downgrade in the credit rating of the company. The reduction of credit rating resulted in the sale of these debt Instruments at heavily discounted rates, and the stock market took a hit of more than 1000 points. The default of payments by a mammoth company like IL&FS made a dent in the confidence of the investors and not only caused the investors to withdraw their money from the Debt market but also from the equity market and caused turmoil in both markets. The genesis of this issue started way back when the credit-rated agency gave AAA ratings for these debt instruments issued by the company as well as its subsidiaries. If the company whose debt instruments were given the highest rating in the market fails to repay its debt, investors will not rely on the ratings

[180] Jayshree P. Upadhyay, *Inside the audit lapses that led to IL&FS crisis*, (May 21, 2019), https://www.livemint.com/companies/news/inside-the-audit-lapses-that-led-to-il-fs-crisis-1558456079750.html.

given by the credit rating agency and will withdraw their shares from the market because there is no guarantee that a company which has BBB credit rating will honour its debt obligations and thereby affected the corporate Debt market, the aftermath of the situation caused other market players to pay high-interest rates on commercial paper as well as in the debenture market.[181] In addition, NBFCs lacked adequate funding since investors lost faith in them as a result of IL&FS's status as an NBFC. The RBI increased banks' lending credit to these entities from 10% to 15% in an effort to increase credit availability and help to stabilize the market.

The Ministry of Corporate Affairs included NBFCs under the scope of the IBC, 2016, and granted them a moratorium period during which no action could have been taken against them.[182]

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181 Shilpy Sinha, *IL&FS fiasco: Why rating agencies need a reform*, (Oct 26, 2018), https://economictimes.indiatimes.com/industry/banking/finance/ilfs-fiasco-why-rating-agencies-need-a-reform/articleshow/66340528.cms?from=mdr.

182 Anisha Shroff ET. AL., *NBFCs brought under purview of insolvency code,* (Jan. 20, 2022), https://law.asia/NBFCs-purview-insolvency-code/.

Looking back upon the 2018 financial crisis, there were a number of beneficial effects on the economy. NBFCs and the credit rating agency came into the limelight, and as a result, there is more transparency. The RBI, being one of the finest banking regulators in the world, helped in containing the situation, and IL&FS, with its new Board of Directors, was able to recover more than 90% of its debts and is expected to cover all before 2023.[183] Because NBFCs and banks are intertwined, as well as, considering that these financial institutions receive the majority of bank loans, any impact on NBFCs will have an impact on the economy as a whole. For example, in 2018, the IL&FS crisis caused shadow bank transactions to decline, which in turn led to a decline in the infrastructure and transportation industries.[184] Majority of the consumers in this sector rely on credit from these financial institutions since they are granted more easily.

III. NBFC 2022 AMENDED FRAMEWORK.

[183] Press Trust of India,*Govt reshuffles IL&FS board; Rajan becomes non-executive chairman, Business Standard* (Sept. 27, 2022).

[184] Beena Parmar, *Debt and defaults: What happened to IL&FS?* (Sept. 14, 2018) https://www.moneycontrol.com/news/business/companies/debt-and-defaults-what-happened-to-ilfs-2952381.html.

On 22nd January 2021, the RBI published a discussion paper for public comments with the title "Revised Regulatory Framework for NBFCs - A Scale-based Approach. "Upon the inputs received from the discussion paper, the central bank decided to bring a new scale-based regulatory system. Section I of this regulation classifies NBFCs into four categories on the basis of their size, risks involved and activities performed, namely Base layer (**'NBFC-BL**'), middle layer (**'NBFC-ML'**), the upper layer (**'NBFC-UL'**), and the top layer (**'NBFC-TL'**).[185] The 2018 NCLT crisis is one of the reasons for the enactment of the 2022 regulation. The primary classification of NBFCs will be the aforementioned NBFC-BL and NBFC-ML. The NBFC-UL and NBFC-TL are rather subjective categories, and the RBI has the sole discretion to assign NBFCs in these categories. Being placed in the top layer category requires receiving RBI clearance based on a predetermined set of rules, and there is no minimum number needed for it. These categories frequently include one or more of the top 10 NBFCs. Because they are run by the government,

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[185] *Revised Regulatory Framework for NBFCs - A Scale-based Approach*, RESERVE BANK OF INDIA - Publications (Nov. 18, 2022), https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=20316.

NBFCs that are owned by the government will not be classified. These categories frequently include one or more of the top 10 NBFCs. Because they are run by the government, NBFCs that are owned by the government will not be classified. [186] The top layer is nearly identical to the upper layer and should be left vacant, but if the RBI determines that the NBFC's systemic risk is rising, the top layer will be converted from the upper layer. The Net owned fund (**'NOF'**) was also altered by the modification.

The amendment also made changes regarding the NOF. All types of these Financial Institutions must expand their NOF, which were established at 2 crores, to 10 crores by 2027, which would lead to an expansion of the sale and purchase market of NBFCs.[187] These categories frequently include one or more of the top 10 NBFCs. Because they are run by the government, NBFCs that are owned by the government will not be classified. Further Non-performing assets (**'NPA'**) norms were

[186] Siddhi Anand, *Revised Regulatory Framework for NBFCs- A Scale-Based Approach*, TAXGURU, 7-8 (2021), https://taxguru.in/rbi/revised-regulatory-framework-NBFCs-scale-based-approach.html.
[187] *Supra* Note 171.

amended. For an asset to be considered NPA, the default made should be for more than 180 days. This has to be eventually reduced to 150 days, 120 days, and 90 days by 2024, 2025, and 2026 respectively. The amount of NPAs in the economy will rise as a result of this. This can be beneficial or detrimental to the economy. Detrimental because the increase in NPAs will lower the credit scores leading to a reduction in the economy's ability to obtain credit, and beneficial because NPAs can be recovered much more quickly with the help of the Debt Recovery Tribunal (**'DRT'**).[188] Another provision that this amendment brought about was regarding the board of directors. NBFCs should have at least one member with experience in the banking or Non-banking Financial sector.[189] The newly amended regulation made it compulsory for even non-systemically important NBFCs to have a Risk Management Committee. For a company to be included as systemically important it should have an asset size of more than 500 crores.[190] This would help the RBI to regulate NBFCs in a much more efficient manner. NBFCs uses prudence while

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[188] *Supra* Note 186.
[189] *Id.*
[190] *Id.*

dealing with their directors, senior officers, or any other associated parties in transactions or loans. This is performed to alleviate any corruption or bias. An increase in the document disclosure in Related Party Transactions makes this easier.[191] Section 2(76) of the Companies Act defines Related Parties.[192] The third change is in relation to Key Managerial Persons ('**KMPs')**. The Companies Act defines a KMP in Section 2(51).[193] Prior to the aforementioned amendment, a KMP of one company could hold an office in any other company (including an NBFC) as a Key Managerial Person. This is now forbidden. Existing KMPs have been given a transition period of two years. Additionally, a new position has been created by the framework, called the Chief Compliance Officer, who will act as an independent internal auditor.[194]

Furthermore, other changes brought by the aforementioned regulation are on the basis of:

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[191] *Id,* at 132.
[192] *Supra* Note 170, §2(76).
[193] *Id*, §2(51).
[194] RESERVE BANK OF INDIA, https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12290&Mode=0 (Nov 18, 2022).

- **Household Income Cap**: Prior to the amendment, the cap was 1,20,000/- and 2,00,000/- in the case of rural and urban areas, respectively, but now it has been increased to 3,00,000/-,[195]
- **Indebtedness:** The initial cap was 1, 25,000/- excluding the loans taken for educational and medical expenses, but now the loan can be granted up to 50% of the annual income of a household. To substantiate further, if a household has an annual income of 5,00,000/-, then 2,50,000 is the Indebtedness cap. If an NBFC had already lent 2,40,000, then the balance of money which could be availed by any other financial institution is 10,000/-. This amount is called the residual Indebtedness lim.[196]
- **Loan pricing:** Earlier, there was capping on loan pricing, but it has been removed, and the price will be fixed on the basis of competitiveness, which is one of the major advantages brought to the NBFCs by the amendment.[197]

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[195] *Supra* Note 186.
[196] *Id.*
[197] *Id.*

- **Penalty charges:** NBFCs were not allowed to charge penalty even when customers made default or what so ever the situation may be. As per the amendment, delay payment penalty can be now imposed.[198]
- **Qualifying Asset:** Up until the new regulation NBFCs were required to keep 85% of its net assets as qualifying assets however these thresholds were not applicable to any other entities like the banks. This threshold has been reduced to 75%.[199]
- **Registration:** Non-profit NBFCs having an asset size of more than 100 crores are required to be registered and need to adhere to the guidelines and norms.[200]

All these measures were brought in order to bring regulation in the functioning of NBFCs and to bring clarity amongst all the players on the field. The impact of this regulation will definitely increase the profit margins of NBFCs due to various factors like the removal of the cap on loan pricing and the permission to charge penalty charges. The old regulation

[198] *Id,* at 134.
[199] *Id.*
[200] *Id*

caused problems relating to operational feasibility, those borrowers who were considered to be earning too much (above the house hold income cap) in the perspective of NBFCs, were considered earning too little to be covered by banks, and hence they were unserved. With the amended regulation took care of this discrepancy which will bring financial inclusion in the economy.

IV. BENEFITS OF NBFC AND FINTECH PARTNERSHIP

Fintech companies, as the name suggests, are a combination of two words - Finance and technology. It aims at redefining the financial sector through the incorporation of technological innovation, multiformity in the products and services offered to the common public, and upgrading existing business models. It can be construed as the utilization of Information technology by the finance sector.

The principal difference between NBFCs and Fintech companies is in terms of the functions it undertakes. NBFCs aims at providing credit, and financial assistance to customers whereas Fintech companies, which comprise a particular

segment of NBFCs, focus explicitly on expanding efficacy and accessibility in customer service.[201]

NBFC is fundamental for credit outreach and partnership with the Fintech Companies can spur a revolution within the credit market system. Credit should be made accessible to the underserved in order to boost the economy, even though the majority of individuals cannot enter the mainstream due to a lack of capital. There is a lot of possibility for credit development and increased financial inclusion if the last mile is covered through the partnership model.[202] The pandemic has facilitated an increased partnership between the two entities. With NBFC'S model of decision-making (guidelines for asset-liability mismatch promulgated by the RBI for all financial

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[201] 'Fintech and NBFCs partnership can bring credit revolution in the country': PayPoint India MD Ketan Doshi at ASSOCHAM 8th National E-Summit, (Dec 31, 2022) https://www.business-standard.com/content/press-releases-ani/fintech-and-NBFCs-partnership-can-bring-credit-revolution-in-the-country-paypoint-india-md-ketan-doshi-at-assocham-8th-national-e-summit-121123100356_1.html.

[202] Prabhakar, Tarunima and Weber, Steven, *Alternative Lending in a Digital Age: A Comparative Case Study in Regulation Across India and the United States,* (May 19, 2020). Available at SSRN: https://ssrn.com/abstract=3956623 or http://dx.doi.org/10.2139/ssrn.3956623.

institutions irrespective of whether they accept public deposits or not)[203] and Fintech companies' model of payment, the costs for customer acquisition and on boarding can be significantly reduced as credit can be dispersed within a span of a few minutes (low manual operational costs).

The benefit of this partnership is to cater to customers in different geographies, especially ones in rural areas. The partnership follows a first loan default guarantee scheme, where a Fintech company and a regulated entity ('**RE**'), such as banks or NBFCs, enter into an agreement, whereby the Fintech Company pays, the regulated entity to some extent, in cases of default by the borrower.[204] The Co-lending model between NBFCs and Fintech partners is viable in this age of collaboration over competition. It stipulates sourcing the loan at a specified proportion (the ideal ratio is 80:20). Co-lending

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[203] RESERVE BANK OF INDIA, https://rbi.org.in/scripts/PublicationsView.aspx?id=20941 (Dec 28, 2021).

[204] Subrata Panda, *Digital lending norms: Fintech firms seek clarity on RBI's FLDG stance*, Business Standard (Saturday, Nov 19, 2022), https://www.business-standard.com/article/finance/digital-lending-norms-fintech-firms-seek-clarity-on-rbi-s-fldg-stance-122090601207_1.html.

necessitates an NBFC license for the Fintech companies. If a Fintech company does not have an NBFC license, then the Co-lending ratio would equate to 100:0. This denotes that a loan entirely or partly can originate from a Fintech partner, but 100 percent of the loan is written off in the balance sheets of the NBFC.[205]

The unique ability of Fintech partners is related to their distribution, deeper understanding of customers, and embedment into various other forms of ecosystems (payments ecosystem, e-commerce). NBFCs are limited to the extent of their own distribution, whereas Fintech companies help enhance distribution reach to serve multiple customer segments.[206] Notably, there has been an expansion of business

[205] Ishpreet Gandhi, Armaan Joshi,What Is Co-Lending And How Does It Work?, Forbes ADVISOR, https://www.forbes.com/advisor/in/business-loans/what-is-co-lending/ (Apr 17, 2022); Nidhi S Chugh, *With co-lending partnerships on rise, credit flow to enhance: Experts*, ETBFSI.com (April 05, 2022), https://bfsi.economictimes.indiatimes.com/news/NBFC/with-co-lending-partnerships-on-rise-credit-flow-to-enhance-experts/90638462.

[206] Rajeev Tomar, *Finance Industry Transitioning To A New Era Of FinTech – NBFC Collaborations,BUSINESSWORLD,* (November 19, 2022), https://www.businessworld.in/article/Finance-Industry-

in the Indian banking sector in the last few years,[207] but when analysed deeper, it can be found that the majority of the expansion is concentrated on the top 10% of the customers (constituting the top pyramid). This includes clients who own multiple credit cards and those who get multiple calls for bank loans. Others are not included in that top period because they do not have access to any form of formal credit from banks or other financial institutions. This can be linked to several factors, including a lack of data typically used for underwriting, accessibility issues, and banks' comfortability with providing high-ticket loans. This demonstrates that the possibility of credit innovation is sluggish. The necessity for the sector to be formalized is crucial because India accounts for the largest informal lending market. New age data can be used to collect digital footprints,[208] underwrite them, and

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Transitioning-To-A-New-Era-Of-FinTech-NBFC-Collaborations/26-10-2021-409870/.

207 RESERVE BANK OF INDIA, https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1209 (June 30,2022).

208 THE ECONOMIC TIMES, https://economictimes.indiatimes.com//markets/stocks/news/learn-with-etmarkets-why-a-digital-footprint-is-crucial/articleshow/53924552.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst (Aug 30, 2016).

understand the profile of the customers approaching the institutions.

To start a lending business, there are four broad pillars, first is Customer acquisition or sourcing, followed by underwriting, collection, and lastly, creation of capital.[209] There are different challenges with each of these parameters. Customer acquisition is presumed to be a herculean task because it is challenging to reach particular population segments, particularly those in rural areas, and inform them about the availability of small amounts of credit that can be accessed solely through mobile phones for medical and other emergencies. Since the market has become digitally literate, making on boarding customers is made simple. (That enables Fintech companies to become 100% digital). Underwriting and collections are sectors that need to be built eventually, during the course of time. It requires the need to build algorithms, create new data points, and test them across

[209] BUSINESS STANDARD, https://www.business-standard.com/content/press-releases-ani/fintech-and-NBFCs-partnership-can-bring-credit-revolution-in-the-country-paypoint-india-md-ketan-doshi-at-assocham-8th-national-e-summit-121123100356_1.html (Dec 31, 2021).

various cycles. Due to covid and other events that have occurred in the past few months, trust in the co-lending model has been generated as various transactions have been made possible in reality and not just at the superficial level. Capital Acquisition also requires reliance on various sources such as banks, and debt instruments and there are various procedural formalities that need to be followed.[210]

Reserve Bank of India V. Peerless General Finance and Investment Co. Ltd.[211] is a landmark judgment that dealt with the regulation of NBFCs in the country. In this case, the Supreme Court reiterated the power that RBI holds in monitoring this country's financial system. Under Section 45K and 45L of the RBI Act,[212] the RBI can collect information regarding deposits, including interest rates, and give directions on the same from NBFCs and financial institutions. The

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[210] Neel Juriasingani, *The opportunities & challenges for NBFCs catering to New to Credit Customers*, BFSI (Apr 14, 2020), https://bfsi.economictimes.indiatimes.com/blogs/the-opportunities-challenges-for-NBFCs-catering-to-new-to-credit-customers/4163.

[211] Reserve Bank of India V. Peerless General Finance (1992) SCC (2) 343

[212] The Reserve Bank of India Act, 1963, §45J, §45K No. 55, Act of Parliament, 1963(India).

Supreme Court, while upholding this power, held that NBFCs are recognised regulated entities.

A. WORKING OF AN NBFC-FINTECH-BASED PARTNERSHIP

Fintech have the capacity to focus on specific niche segments, which could be demography, profession, or geography related. Traditionally when it comes to unsecured personal loans banks and NBFCs have relied on civil data, and bank statements, as the primary way of underwriting. This becomes a bottleneck for the economy, as India is home to one of the largest unorganized, semi-formal sectors in the economy, and reliance on these variables will lead to the exclusion of a large segment of potential customers since they might not have access to these data.

Banks will take a longer time, owing to the regulatory framework, to experiment with the tons of data captured in SMS and other forms of transactions. NBFCs are more forthcoming in this regard, whereas Fintech can go two steps forward in acquiring the data owing to their technological

prowess, to address the market gaps in the economy.[213] Each entity can focus on each of their specialty and create an environment of coexistence within the financial sphere. The relationship between a Bank, an NBFC, and a Fintech company is symbiotic in nature. MSMEs, businesses run by women entrepreneurs, or in smaller locations, with minimal capital, remain the focus segments of the partnership since these units contribute to the country's GDP and create employment opportunities.[214]

If the partnership does not exist, there would be a sequential flow of capital. Banks will lend to an NBFC at a specific interest rate, and NBFC will further lend to a Fintech company with an increased margin. After the partnership, the credit flow structure takes a shift. Customers can directly acquire loans

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[213] Antonio Garcia Pascual, Fabio Natalucci, *Fast-Moving FinTech Poses Challenge for Regulators,* IMF Blog (April 13, 2022), https://www.imf.org/en/Blogs/Articles/2022/04/13/blog041322-sm2022-gfsr-ch3.

[214] Mr Marko Carevic; Col. Sarpreet Benipal; Mr Mahesh Thakkar; Mr Sanjeev Goel, (Jan. 9, 2020), *Session 1 — Can NBFCs fulfill India's Financial Inclusion goals? SCC Online.*

from banks or NBFCs.[215] The movement of capital will be reduced to two stages, so the margin loaded at every stage is reduced. Hence the cost of capital will decline and this benefit will be passed out to the customer. Fintech, apart from being a sourcing channel concentrates on new age kinds of business models (FLDG, AI-MI, Peer to Peer Lending, Payment Gateways, and Digital Models),[216] which is anchored on the concept of digitization. Due to this, they will be able to source loans at a lower cost in comparison to NBFC, since the cost of capital would lessen, a phenomenon which will encourage people to approach a Fintech based company. Organizations like Facebook are also partnering with NBFCs to channelize their data.

The Reserve Bank of India Act of 1934 regulates all NBFCs. As per the regulations, any organization facilitating Fintech services in India will have to be registered with RBI.

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[215] RESERVE BANK OF INDIA, https://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=11920 (June 24, 2020).

[216] Ayushi Doegar, *10 Innovative Fintech Business Models,* MOBCODER, (October 7, 2021), https://mobcoder.com/blog/fintech-business-models/.

Certificate of Registration from RBI is pre-requisite for NBFC for initiating Fintech business in India.

B. BREACH OF PRIVACY

This partnership is not entirely fool proof. Fintech heavily relies on technology and they amass sensitive and personal data of the customers. With access to such information, they become custodians or owners of such data, which is being given access by them. Whether the information is private or public in nature, these organizations are now responsible for preserving it, and this cannot be compromised.[217] Different systems and procedures must be implemented by the Fintech companies in order to guarantee confidentiality. Any violation of privacy by the company would be in contravention of the terms and conditions of the contractual relationship, which governs the distribution and use of sensitive data between two parties. In the event that sensitive personal information is

[217] Wanbil W. Lee, DBA, FBCS, FHKCS, FHKIE, FIMA, Wolfgang Zankl, Ph.D. and Henry Chang, CISM, CIPT, CISSP, DBA, FBCS, *An Ethical Approach to Data Privacy Protection*, Volume 6, ISACA Journal (2016), https://www.isaca.org/resources/isaca-journal/issues/2016/volume-6/an-ethical-approach-to-data-privacy-protection.

handled carelessly and someone suffers an unforeseen loss, Section 43A of the Information Technology Act, 2000 provides for payment of compensation by a body corporate.[218] According to section 72A of the Act, the intentional, knowing publication of information without the person's consent and in violation of the essentials of a valid contract, is now additionally punishable by up to three years in prison and a fine.[219] Fintech companies need to ensure data protection in order to encourage customer participation. This can be achieved by setting up an Incident Reporting Framework where instances of cyber threats and attacks can be reported, creating audit and quality management mechanisms where vulnerabilities within the system can be assessed or catered to, and most importantly adherence to the safe transaction principles which is mainly availability, confidentiality, and integrity. The only thing that regulators can do is adopt a practical strategy by creating credible cyber-attack scenarios and evaluating the defences put in place by digital firms. The fact that ongoing financial innovation is continually creating

[218] The Information Technology Act, 2000, No. 21 OF 2000, § 43A.
[219] *Id,* § 72A.

new avenues for assault makes this effort even more challenging.[220] The only way the regulators can hope to successfully carry out their duties is by gaining in-depth knowledge in this area. As per the RBI guidelines, every regulated entity should have a nodal officer to deal with grievances and redressal in relation to the operation of Fintech companies. The borrower has the option to file a complaint through the Complaint Management System portal under the Reserve Bank-Integrated Ombudsman Scheme, in cases where complaints made by the borrower against the lender or the Lending Service Provider ('**LSP**') employed by the lender are not resolved by them within the allotted time frame which is currently 30 days.[221]

V. CONCLUSION

In developing nations like India, where access to financing by banks remains difficult for a sizable portion of the population, NBFCs play a significant role. Other developing nations can

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[220] Reserve Bank of India, https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12382&Mode=0, (September 02, 2022).

[221] Team Finserv, *RBI Regulations on Digital Lending, VINOD KOTHARI CONSULTANTS, (August 10, 2022)*

learn a lot from the development of NBFCs in India and the crisis of 2018. Ultimately, capital (both equity and debt) must practice the required restraint, and capital providers must be more selective when supporting NBFCs. NBFCs can access finances more easily and with greater flexibility. They have been making significant contributions to key industries including infrastructure and the automobile industry, which are regarded as the engine of the nation's economic expansion and progress. It is recommended that the regulatory bodies analyse, recognize, and oversee the impact of NBFCs' risk-taking activities on their financial performance. They should also scrutinize or verify rigorously, and enforce new rules and regulations for their better and efficient performance, which can result in the development of the sectors of the economy in a good and profitable way.

BPO SERVICE PROVIDER NOT BE CONSIDERED AS AN "INTERMEDIARY" FOR THE PURPOSES OF IGST ACT

*Jatin Arora**

ABSTRACT: *The recent ruling of the Punjab and Haryana High Court in Genpact India Pvt. Ltd. v. Union of India and others, which pertains to the eligibility of Business Process Outsourcing (BPO) services providers to claim the unused Input Tax Credit (ITC) on zero-rated supplies. The article provides an in-depth understanding of the definitions of "intermediary" and "export of service" under Section 2(13) and Section 2(6) of the Indian Goods and Services Tax (IGST) Act, respectively. The case concerned Genpact, a BPO service provider, and Genpact International Inc. (GI), where Genpact*

* Partner, Phoenix Legal.

provided BPO services to GI's customers on its own account, rather than acting as a mediator between GI and its customers. The Joint Commissioner of CGST (Appeals) rejected Genpact's application for a refund, stating that the services provided by Genpact were "intermediary services," which the court overruled. The article sheds light on the conditions that fall within the scope of "intermediary service" and explains why subcontracting services are not eligible for intermediary services. Furthermore, it provides clarity on how the Court's ruling allows BPO service providers to benefit from the provisions of the IGST Act and claim refunds for the unused Input Tax Credit (ITC) on zero-rated supplies.

KEYWORDS: *Business Process Outsourcing (BPO), Input Tax Credit (ITC), Intermediary Service, Export of Service, Indian Goods and Services Tax (IGST) Act, Subcontracting Services.*

BPO SERVICE PROVIDER NOT BE CONSIDERED AS AN "INTERMEDIARY" FOR THE PURPOSES OF IGST ACT

I. INTRODUCTION

In the recent judgement of *Genpact India Pvt. Ltd. v. Union of India and others*, [CWP-6048-2021 (O&M)][222], the Punjab and Haryana High Court (**'P&H High Court'**), while quashing the order of the Joint Commissioner CGST ('**Appeals**'), clarified the proposition that the services, rendered by the Business Process Outsourcing ('**BPO**') providers, fall within the definition of "export of service" and maintained the eligibility of a registered person to claim the unused Input Tax Credit ('**ITC**') on zero-rated supply of such services. The court also stipulated the criteria for services covered under the ambit of "intermediary service."

Under the Indian Goods and Services Tax ('**IGST'**) Act, the terms "Intermediary" and "Export of Service" have the been defined.

[222] *Genpact India Pvt. Ltd. v. Union of India and others*, [CWP-6048-2021 (O&M)]

Section 2(13) of the IGST Act[223] defines an intermediary to mean,

> "*a broker, an agent, or any other person who arranges or facilitates the supply of goods or services or both, between two or more persons, but does not include a person who supplies such goods or services or both on his account.*"

In essence, the term "intermediary" pertains to a tripartite relationship involving the supplier of goods or services, the principal on whose behalf the supply is made, and the person who ultimately receives the supply (i.e., the principal's customer). However, the classification of an individual as an intermediary under Section 2(13) of the IGST Act is contingent upon the existence of an arrangement or facilitation of the supply of goods, services, or securities. Notably, the provision expressly excludes persons supplying goods or services on their own account from the purview of the term "intermediary".

[223] The Integrated Goods and Services Tax Act, 2017, § 2(13), No. 13, Acts of Parliament, 2017 (India).

It follows that for an individual to be deemed an intermediary, two supplies must occur simultaneously: the supply of goods or services between the principal and the third party, and the supply of the intermediary's own services (typically for a fee or commission) to the principal. This formulation accords with the ordinary meaning and intent of the term "intermediary", which implies a mediating role in facilitating the supply chain.

Export of Service is defined in Section 2(6) of the IGST Act.[224] It means the supply of any service when:

> *"(a) the supplier of service is located in India,*
>
> *(b) the recipient of service is located outside India,*
>
> *(c) the place of supply of service is outside India,*
>
> *(d) the payment for such service has been received by the supplier of service in convertible foreign exchange, and*

[224] *Id,* at 152, § 2(8).

(e) the supplier of service and the recipient of service are not merely establishments of a distinct person in accordance with Explanation 1 in Section 8 of the IGST Act."

Fundamentally, export of services entails the provision of services by an Indian service provider to a recipient situated beyond the geographical boundaries of India. To merit the nomenclature of export of service, the place of supply of such service must fall outside the territorial confines of India, and the consideration for the same must be received in a foreign currency.

II. FACTS OF THE CASE

In the instant case, Genpact India Pvt. Ltd., (**'Genpact'**), a BPO, entered a contract with Genpact International Inc., (**'GI'**) in the form of a Master Service Agreement (**'MSA'**), wherein, Genpact was engaged by GI, for the actual performance of BPO services and IT services to GI customers, as well as for acquiring new clients and maintaining relationships with current clients. The provisions of the MSA largely provided for the sub-contracting of services, wherein

the arrangement was made on a principal-to-principal basis. Further, The BPO services were provided by Genpact directly to the customers of GI, on Genpact's own account, and not as a facilitator between GI and its customers. The agreement also provided for Genpact's responsibility in providing the services, including any risk or reward that arises from the same.

Genpact sought to claim a refund of the unutilized ITC on the zero-rated supply of services as they asserted that the BPO services are an "export of services" in terms of Section 16(1) of the IGST Act.[225] The Joint Commissioner of CGST (Appeals), however, rejected the petitioner's application for a refund, on the ground that the services rendered by the petitioner are "intermediary services," in terms of Section 2(13) of the IGST Act.

Aggrieved by the commissioner's order, Genpact filed a writ petition in the Punjab and Haryana High Court.

III. PETITIONER'S CONTENTION IN THE HIGH COURT

[225] *Id*, at 154, § 16(1).

Genpact, as the Petitioner, argued that the services rendered by them would not be covered under the ambit of "intermediary services" as it did not facilitate any supply of service between GI and its customers, but provided the same "on their own account." The Petitioner also argued that the MSA is a subcontracting agreement and in terms of CBIC circular dated 21.09.2021,[226] "subcontracting services" do not qualify as "intermediary services".

The Petitioner also argued that they had been availing the refund of unutilized ITC during the pre-GST, wherein the definition of "intermediary service" is largely similar to that provided in the IGST Act. Therefore, the authority's view of the assessee in different periods, in terms of the definition of "intermediary services" under the Service Tax regime and the GST regime, should be consistent when the facts and circumstances are the same.

IV. REVENUE'S CONTENTION IN THE HC

[226] CBIC *vide* Circular No. 159/15/2021-GST

The Union of India (Department) argued that the petitioner satisfies every requirement for an "intermediary," as the services rendered by the petitioner are on behalf of the GI, as specified in the MSA. The department also argued that the relationship between GI and the petitioner is that of a principal-agent since one of them has authority over the other in terms of decision-making capacity. Further, in terms of the applicability of the pre-GST law related to availing of the ITC, the department argued that the principle of res judicata does not apply to tax-related matters, each assessment year is distinct from the last, whether the assessee was allowed to avail the unutilized ITC does not set a precedent for the similar matters post-GST.

V. OBSERVATIONS AND RULING OF THE PUNJAB AND HARYANA HIGH COURT

The P&H High Court made two key observations regarding the main issue: first, any person providing service on his "own account" is not considered an "intermediary" because there must be a "principal-agent relationship", "facilitation of service", and "mediation between the principal and the third

party". Second, the court noted that the definition of "intermediary" in the GST law is borrowed from the Service Tax regime and is broadly similar in scope, and as a result, the department cannot take different views in different periods. The Court upheld the consistency principle relying on the rulings of *M/s Radhasoami Satsang Soami Bagh, Agra v. Commissioner of Income Tax*[227] and *Bharat Sanchar Nigam Ltd. v. Union of India*.[228]

In respect of the observations made, the court ruled that the petitioner's BPO services are outside the ambit of "intermediary services" and rather constitute an "export of services" under section 16(1) of the IGST Act. The court also made reliance on the CBIC circular and upheld the petitioner's contention that the master-supply agreement was indeed in nature of a 'sub-contract' and therefore not an intermediary service.

VI. CONCLUSION

[227] M/s Radhasoami Satsang Soami Bagh, Agra v. Commissioner of Income Tax, (1992), 1 SCC 659.
[228] Bharat Sanchar Nigam Ltd. v. Union of India, (2006) 3 SCC 1.

BPO SERVICE PROVIDER NOT BE CONSIDERED AS AN "INTERMEDIARY" FOR THE PURPOSES OF IGST ACT

The Punjab and Haryana High Court's decision has opened a window of opportunities, for India has become a major international market for BPO service providers. The court eliminated any uncertainty regarding the definition of "intermediary" and "intermediary services". The recent judgement is good not only in terms of law but also in terms of business.

However, the applicability of the legal principle is conditional on the fact, that there aren't any expressed or implied provisions establishing a principal-agent relationship. The agreement should also include a subcontract-like structure. It is also very crucial that, the services are rendered on the service provider's "own account".

CRIMINAL LIABILITY GETS STRINGENT IN COPYRIGHT VIOLATION CASES

Smriti Yadav[*], *Shwetank Tripathi*[**], *Abdul Hannan*[***]

ABSTRACT: *Knit Pro International v. The State of NCT of Delhi is a case that revolves around trademark infringement. Knit Pro International, a UK-based company, manufacturing knitting needles and other related products registered the trademark "Knit Pro" in India. However, a company called "Vardhman Industries" was also using the same name and selling similar products in the Indian market, leading to confusion among consumers. Knit Pro International filed a lawsuit against Vardhman Industries, alleging that the latter was infringing on their trademark and causing harm to their*

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[***] Associate, Khaitan & Co.

business. The Delhi High Court in this case ruled in favour of Knit Pro International and ordered Vardhman Industries to stop using the name "Knit Pro" and any other mark similar to it.

The case is unique because it highlights the importance of trademarks and intellectual property rights in the business world, and the need for companies to protect their brand names and logos from infringement by competitors. In the article the author tries to critique and analyse the judgement and use the judgment as a warning and a caution to individuals and organisations to exercise utmost caution in IP matters. The judgment could be abused in a situation where top corporate employees are held legally responsible for the actions of a firm.

KEYWORDS: *Copyright Infringement, Trademark, Intellectual Property, cognizable, non-bailable.*

I. INTRODUCTION

In the matter of M/s *Knit Pro International v. The State of NCT of Delhi*[229][Criminal Appeal No 807 of 2022] (Appeal), the Hon'ble Supreme Court of India ('Supreme Court') vide judgment dated 20 May, 2022 ('Decision') held that the offence under Section 63 of the Copyright Act 1957[230] ('Copyright Act') is cognizable and non-bailable.

II. FACTUAL BACKGROUND

M/s Knit Pro International ('Complainant') filed an application under Section 156(3) of Code of Criminal Procedure, 1973[231] against Anurag Sanghi ('Accused') seeking registration of FIR for the offences under Sections 51, 63 and 64 of the Copyright Act[232] read with Section 420 of the Indian Penal Code 1860[233] ('IPC'), before the Court of Chief Metropolitan Magistrate ('Magistrate Court'). The Accused was primarily alleged to have committed infringement of

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229 *Knit Pro International v. State of NCT of Delhi and Anr.*, (2022) 10 SCC 221.
230 The Copyright Act, 1957, § 63.
231 The Code of Criminal Procedure, 1973, § 156(3).
232 The Copyright Act, 1957, §51, 63, 64.
233 The Indian Penal Code, 1860, § 420.

Complainant's copyright in respect of certain products. The Magistrate Court vide order dated 23 October, 2018 ('Magistrate's Order') directed registration of FIR against the Accused. The Accused challenged the Magistrate's Order in a criminal writ petition before the Delhi High Court ('Delhi High Court') and sought quashing of the FIR. During the arguments before the Delhi High Court, the Accused prayed for quashing of the FIR on the sole ground that the offence under Section 63 (which is punishable with imprisonment for term which shall not be less than 6 months but which may extend to 3 years) of the Copyright Act[234] is not a cognizable and non-bailable offence. The Accused relied upon a judgment of the coordinate bench of the Delhi High Court and the decisions of Supreme Court in *Avinash Bhosale v Union of India*[235] ('*Avinash Bhosale case*') and *Rakesh Kumar Paul v State of Assam*[236] ('*Rakesh Paul case*').

The Delhi High Court vide order dated 25 November, 2019 (**'HC Order'**) held that the offence under Section 63 of the

[234] *Supra* note 230.
[235] Avinash Bhosale v. Union of India, (2007) 14 SCC 325.
[236] Rakesh Kumar Paul v. State of Assam, (2017) 15 SCC 67.

Copyright Act[237] is not cognizable and non-bailable and quashed the FIR. The Complainant challenged the HC Order before the Supreme Court.

III. RIVAL CONTENTIONS

The provisions of Part II of Schedule 1 of CrPC[238] were deliberated by both the sides. It *inter alia* provides as follows:

(a) If the offence is punishable with imprisonment for three years and upwards: cognizable / non-bailable; and

(b) If the offence is punishable with imprisonment for less than three years: non-cognizable / bailable.

The Complainant *inter alia* contended that (i) since the offence under Section 63 of Copyright Act[239] is punishable with imprisonment which may extend to three years, the above clause (a) should apply; and (ii) Delhi High Court has not properly appreciated and misinterpreted the Supreme Court's decision in *Rakesh Paul case*.[240] In *Rakesh Paul case*, the Supreme Court had dealt with a phrase viz. *'punishable with*

[237] *Supra* note 230.
[238] The Code of Criminal Procedure, 1973, Part II, Sch. 1.
[239] *Supra* note 230.
[240] *Supra* note 237.

imprisonment for not less than 10 years' in Section 167(2) of CrPC[241] and observed that it only included offences which are punishable with a minimum punishment of ten years[242].

The Accused *inter alia* contended that the *Rakesh Paul case* was correctly applied in the HC Order, and hence, in the present case where offence is punishable with maximum imprisonment of three years, clause (a) above should not apply, i.e. the offences under Copyright Act ought not to be considered as cognizable and non-bailable.

IV. DECISION

After considering the rival contentions and the language of the provision in Part II of Schedule 1 of CrPC*,* the Supreme Court observed that the provision is clear and there is no doubt that under Section 63 of the Copyright Act[243], the maximum punishment that can be imposed is three years. In view of the same, the Supreme Court held that for the present matter, clause (a) above will be applicable. Accordingly, the Supreme

[241] The Criminal Procedure Code, 1973, § 167 (2).
[242] *Supra* note 237.
[243] *Supra* note 230.

Court held that offence under Section 63 of the Copyright Act[244] is cognisable and non-bailable.

V. COMMENT

The Decision did not consider the *Avinash Bhosale case*, which dealt with an offence under the Customs Act 1962 ('Customs Act')[245]. It is pertinent to mention that under Section 135 of the Customs Act[246], the punishment provision is similar to the Copyright Act and while deciding the *Avinash Bhosale case*, the Supreme Court held that an offence under the Customs Act which provides for punishment with imprisonment which may extend to three years, is a non-cognisable and bailable offence.

In any event, the Decision has put to rest the divergent views taken by some of the High Courts in India on this issue (for instance, Bombay High Court and Andhra Pradesh Court has taken a view that the offence under the Copyright Act is cognizable / non-bailable while the Delhi High Court has taken

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[244] *Id.*
[245] The Customs Act, 1962.
[246] *Id*, § 135.

a view that the offence is non-cognizable / bailable). The Decision has made the offences under Copyright Act cognisable and non-bailable across the country presently.

Though the Decision is specifically passed under the Copyright Act, it would apply in other IP laws as well viz Trade Marks Act 1999 (Sections 103, 104 and 107)[247]; The Geographical Indications of Goods (Registration and Protection) Act 1999 (Sections 39, 40 and 42)[248]; The Protection of Plant Varieties and Farmers' Rights Act 2001 (Sections 72 and 73)[249] and The Semiconductor Integrated Circuits Layout-Design Act 2000 (Section 56)[250] having similar punishment terms. The Decision is an alarm and reminder to the citizens / corporates to be extremely vigilant in IP matters. The Decision may also be prone to misuse where the senior personnel of the Companies may be exposed to criminal liability for the acts committed by a company.

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[247] Trade Marks Act, 1999, § 103, 104, 107.

[248] The Geographical Indications of Goods (Registration and Protection) Act 1999, § 39, 40 and 42.

[249] The Protection of Plant Varieties and Farmers' Rights Act 2001, § 72 and 73

[250] The Semiconductor Integrated Circuits Layout-Design Act 2000, § 56.

PARITY OBLIGATIONS IN THE ONLINE HOTEL BOOKING INDUSTRY: CRITICALLY ANALYZING CCI'S ORDER AGAINST MMT-GO

Bharat Manwani[*] *& Adya Desai*[**]

ABSTRACT: *On 19th October 2022, a Competition Commission of India ('CCI') bench headed by Chairperson Ashok Kumar Gupta levied hefty monetary and non-monetary penalties against MakeMyTrip ('MMT') and Oravel Stays Private Limited ('OYO'). This contribution comprehensively analyses the order passed by the CCI and proceeds to comment on its implications. The order has forced MMT to abandon parity obligations with their hotel partners, which calls for a review on the judicial and economic application of mind by the CCI bench. The economic justifications for*

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imposing parity obligations are central to our critique on the said order. In a growing economy where market players have emerged by virtue of their digital databases, their algorithms, and their unique business models, we argue that it is only economically efficient and pro-competitive to protect the interest of these platforms. Additionally, this contribution highlights several other concerns that arise out of this order, such as the 'special responsibility' on dominant firms in relevant markets. Altogether, we conclude that the CCI has erred in their judgement against MMT and OYO, which calls for them to reconsider their said assessment.

KEYWORDS: - *Parity Agreements, Competition Commission of India, MakeMyTrip – OYO dispute, Competition Laws, Online Hotel Booking Industry.*

I. INTRODUCTION

Recently, an order[251] by the CCI has directed MMT and Goibibo to abandon their parity obligations with hotel partners, which can have a lasting impact on the entire online hotel booking industry and the competition jurisprudence in India. This contribution carefully analyses the order passed by the CCI and comments on the relevant concerns and questions arising out of this order. It goes on to provide the economic justifications for imposing such parity obligations and discusses the potential impact of this ruling on the relevant market.

Parity obligations, derived from Across Platform Parity Agreements[252] (APPAs), are defined as impositions on suppliers that restrict them from selling a product or a service, at a price lower than what is being offered on any other sales channel. Parity clauses hence essentially mandate suppliers to

[251] Federation of Hotel & Restaurant Associations of India (FHRAI) and Anr. v. MakeMyTrip India Pvt. Ltd. (MMT) and Ors., (2022) Case 14 of 2019 & 01 of 2020 (CCI).
[252] Simon Constantine, "*OECD Hearing on 'Across Platform Parity Agreements', Competition Committee (28 Oct. 2015): Written Contribution from the Competition and Markets Authority*", 15 COMPETITION L.J. 33 (2016).

offer goods at the same prices as their competitors, so there remains 'parity' with regard to prices in the market. Such parity clauses are extremely prevalent with Online Travel Agencies and is presently an industry standard. MMT is a well-established Online Travel Agency ('OTA') which is engaged in the business of providing tourism related services across India, and more particularly facilitates the hotel bookings online via its platform. Goibibo (also engaged in the same business) was merged with MMT in 2017[253], and has since been a part of the same business group (herein after referred to as 'MMT-Go').

This case was initially filed by the FHRAI, which is a representative body of the hospitality industry in India, after which FabHotels and Treebo were also included as Informants. The said inclusion of the parties was necessitated by the substantial interest they have in the outcome of this

[253] Biswarup Gooptu, *Online travel portals MakeMyTrip and Goibibo announce merger*, THE ECONOMIC TIMES (Oct. 18, 2016) https://economictimes.indiatimes.com/small-biz/startups/online-travel-portals-makemytrip-and-ibibo-announce-merger/articleshow/54921415.cms?from=mdr.

proceeding. The following order[254] was passed by the CCI under Section 27 of the Competition Act 2002[255], which empowers the CCI to levy penalties on organizations that are observed to abuse whilst dominating the said market. On 28th October 2019, the Commission had ordered an investigation, against MMT, GoIbibo and OYO for contravening Section 3[256] and 4[257] of the Act. A CCI Bench headed by Chairperson Ashok Kumar Gupta delivered its order on 19th October 2022, after careful consideration of the Director General's ('DG') investigation report and objections/suggestions of the involved parties to said report.

II. ALLEGATIONS LEVIED AGAINST MMT-GO-OYO

The first allegation against MMT-Goibibo was that they had imposed parity obligations with their hotel partners, whereby these partners could not sell their rooms at any other platforms,

[254] Federation of Hotel & Restaurant Associations of India (FHRAI) and Anr. v. MakeMyTrip India Pvt. Ltd. (MMT) and Ors., (2022) Case 14 of 2019 & 01 of 2020 (CCI).
[255] Competition Act, 2002, § 27, No. 12, Acts of Parliament, 2003 (India).
[256] *Id*, § 3, at 3.
[257] *Id*, § 4.

for prices lower than what MMT was offering. In addition to such obligations, MMT reserved the discretion to fluctuate the prices for each room and that the parties i.e., the hotels, could not deny rooms, at a time when they were being offered on some other OTA. It has been further alleged that MMT-Go has been offering deep discounts, and hence their market performance is based upon their deep pockets, which consequently pushes the smaller OTAs out of the market. Lastly, an allegation has been levied against MMT-Go and OYO for having entered into a confidential commercial agreement, which denied Treebo and FabHotels of market access. Other miscellaneous allegations against MMT also included the misrepresentation of information across the relevant market.

III. DG'S INVESTIGATION REPORT

The Director General commenced his investigation report with observing the current post pandemic situation along with the increase in internet penetration across the country. He noted that the dependence of consumers on OTAs is bound to increase in the coming years. He has analyzed the ability of MMT-Go to create a distortion in the supply side of the

market, through their deep discounts. Since smaller players in the OTA market are not as dominant as MMT-Go, they cannot compete with comparable discount offers which further restrains new competitors in the same market. MMT-Go also possesses larger inventory data combined with a high customer outreach, which in turn creates network effects and gives them a competitive advantage. This essentially means that MMT-Go has been competing on deep pockets, which has enabled them to create entry barriers in the market. With regard to allegations surrounding the parity obligations, the DG has relied on international cases and foreign jurisprudence to observe that such obligations have been found to be anti-competitive. He nonetheless observed that imposing parity clauses is an industry practice, and that it is carried out by all OTAs in India. However, owing to MMT-Go's dominant position in the market, the anti-competitive impact of parity clauses is exacerbated. Consequently, the DG has found the parity clauses to have been violated Section 4(2)(a)(i) of the

Act.[258] He has also observed MMT's deep discounting strategies to be contravening Section 4(2)(a)(iii) of the Act.[259]

The commercial agreement between MMT and OYO was examined, as part of the DG's investigation report. The agreement contained a delisting clause, through which MMT-Go had removed FabHotels and Treebo Hotels from their platform. As concluded by the DG in his report, FabHotels and Treebo were driven out of the business of budget franchising hotels only as a consequence of such delisting. This commercial agreement restricted market access and did not let FabHotels and Treebo effectively compete with OYO, thereby hindering entry into the market. Observing that this agreement led to an appreciable adverse effect on competition, the DG held it to be violative of Section 3(4)(d) [260]read along with Sec 3(1)[261] of the Act. With regard to the misrepresentation of information allegations, MMT had labelled hotels to be 'sold out' on their platform, when in actuality they had been

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[258] *Id*, at 187, § 4(2)(a)(i), at 3.
[259] *Id*, § 4(2)(a)(iii).
[260] *Id*, § 3(4)(d).
[261] *Id*, § 3(1).

delisted. This had led to the creation of information asymmetry in the market, and that MMT's conduct had the potential to deny market access to those hotels.

IV. CCI'S FINDINGS

A. ON RELEVANT MARKET

The delineation of a relevant market is necessary to ascertain dominance in the present case, along with examining the conduct of MMT-Go for allegations pertaining to Section 4 of the Act[262]. The commission noted that all parties in this matter agree on the relevant geographic market being India. It further held that the online and offline hotel booking segment is not part of the same market, and even within the former segment, OTAs constitute a separate relevant product market. Hence, the commission held the "market for online intermediation services for booking of hotels in India" to be the relevant market in the present case.

B. ON DOMINANCE

[262] *Supra* Note, 257.

The scheme of the Act dictates that provisions under Section 4[263] are only attracted when the entity holds a position of dominance in the market delineated above. MMT-Go is alleged to be engaging in abusive conduct in contravention of Section 4 of the Act[264], and hence determining whether the MMT holds the dominant position in the said market is a key consideration in the present case. In the present circumstances, both consumers and hotels positively value the presence of more users on either side of the OTA platform, as it brings along wider consumer choices and higher visibility which transforms into sales for hotels. There is no doubt that network effects are essential in assessing the dominance of an entity, as they also have the potential to create entry barriers. The Commission has adjudged that the said contract between MMT and OYO has further increased the dominant position of MMT, as a huge amount of customer's book hotels on their OTA platform which consequently brings along a huge number of hotels willing to list themselves on the OTA. Considering the fact that MMT-Go has a market share of 63%

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[263] *Supra* Note, 257.
[264] *Id*.

in the online intermediation services for hotel booking, the CCI concluded that MMT-Go held a position of dominance in the abovementioned market.

C. ON THE ABUSE OF THEIR DOMINANT POSITION

The CCI has held that the price parity impositions, whereby hotel partners are restrained from offering lower prices to other OTAs possess the ability to limit price competition and create entry barriers for potential and existing players and are hence anti-competitive in nature. These obligations, in combination with the exclusivity conditions that MMT-Go has maintained with OYO, are violative of Section 4(2)(a)(i)[265] read along with 4(2)(c)[266], read with Section 4(1)[267] of the Act.

With regard to the allegation for misrepresentation of information, the CCI noted that consumers are strongly dependent on the results displayed on MMT-Go's platform as it dominates the OTA market. Once the consumer assumes that a hotel is 'sold out', however it is not the case in actuality, they

[265] *Supra* Note 258.
[266] *Id*, § 4(2)(c).
[267] *Id*, § 4(1).

are dissuaded from looking for rooms on alternative channels which consequently lowers the number of hotel bookings on other OTAs. The CCI concluded that such misrepresentation of information will eventually reduce competition among budget hotels registered on other OTAs, thereby leading to the exclusion of such hotels from the market.

The CCI as a market regulator is cast with a duty to ensure fair and healthy competition, and it is bound to ensure that all stakeholders get the opportunity to compete on a level playing field and get an equal chance to be part of digital commerce. The commission observed that the consequent impact that flowed from the exclusion of FabHotels and Treebo Hotels from MMT-Go's platform, has had a negative impact on competition and consequently on consumer welfare. Such delisting has gone on to create an artificial advantage for OYO's hotel partners, and hence the CCI held that this impugned commercial arrangement between MMT-Go and OYO has led to a denial of market access to aggrieved parties. The commission declared the abovementioned contract

between MMT-Go and OYO to be anticompetitive, as under Section 3(4)(d)[268] read with Section 3(1)[269] of the Act.

V. CCI'S ORDER

Given the present circumstances, the CCI found MMT-Go's conduct to be in contravention of provisions mentioned under Section 4(2)(a)(i)[270] and Section 4(2)(c)[271] read along with Section 4(1)[272] of the Act. Furthermore, the CCI held that the commercial arrangement between MMT-Go and OYO is in violation of Section 3(4)(d)[273] read along with Section 3(1)[274] of the Act. It is in this regard, that the CCI levied monetary penalties on MMT-Go and OYO worth Rs. 223.48 Crores and Rs. 168.88 Crores respectively. Apart from the said monetary penalties, the CCI held that it is imperative to establish a business environment with fair competition between the OTAs which in the long run will benefit the consumers and hotels.

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[268] *Id*, § 3(4)(d).
[269] *Supra* Note 261.
[270] *Supra* Note 258.
[271] *Supra* Note 266.
[272] *Supra* Note 267.
[273] *Supra* Note 268.
[274] *Supra* Note 261.

Toward this end, the CCI, inter alia, gave the below mentioned directions:

1. *MMT-Go is directed to modify its agreements with hotel partners to remove and abandon the parity obligations imposed with respect to other OTAs.*
2. *MMT-Go is directed to modify its agreements with hotel partners to remove and abandon all exclusivity conditions.*
3. *MMT-Go is directed to provide fair, transparent, and non-discriminatory access to its platform for all existing and potential hotel partners, through formulating listing conditions in an objective manner.*

This order passed by the CCI has however recently been stayed a by a ruling passed by the Hon'ble Delhi High Court. In the case of *MakeMyTrip (P) Ltd. v. Competition Commission of India*[275], the Hon'ble Delhi High Court through a Single Judge Bench decision passed by Justice Prathiba Singh, has stayed such penalty mentioned above. Moreover, it has also directed

[275] MakeMyTrip (P) Ltd. v. Competition Commission of India, 2022 SCC OnLine Del 4440.

that there shall be no recovery of Rs. 223.48 Crores of penalty amount which was supposed to be paid by MMT.

VI. CONCERNS ARISING OUT OF THE ORDER

There are several concerns and questions arising out of this order passed by the CCI. Firstly, it is important to note that for the brief period where hotel partners of FabHotels and Treebo were delisted from the MMT-Go platform, the economic performance of both entities displayed consistent growth[276] and increased revenues[277]. Parity obligations are an industry standard and the only reason why MMT-Go was penalized is due to the 'special responsibility' it has owing to its dominant position in the market. This special responsibility principle has often come under scrutiny of various economists and legal

[276] ET Bureau, *Budget hotel chain FabHotels eyeing 30% revenue growth,* THE ECONOMIC TIMES, (Aug. 14, 2018) https://economictimes.indiatimes.com/industry/services/hotels-/-restaurants/budget-hotel-chain-fabhotels-eyeing-30-revenue-growth-through-loyalty-program/articleshow/65404866.cms?from=mdr.

[277] Aarzoo Mittal, *Treebo revenues surge 64% in FY19; closes fresh round from BCCL at Rs 580 Cr valuation*, DAILYHUNT, (Jan. 2, 2020) https://m.dailyhunt.in/news/india/english/entrackr epaperdha0c45e177cb249ba912e81e32e331e54/treebo+revenues+surge+64+in+fy19+closes+fresh+round+from+bccl+at+rs+580+cr+valuation-newsid-n156832294.

scholars, and regarded as a "burden on dominant firms, a political choice, and an unhelpful and unclear concept which prevents competition on merit."[278] Secondly, the CCI in the present case has failed to analyse the nature of conduct by MMT-Go, wherein the end consumer only benefited from the commercial agreement with OYO, as it expanded the inventory of hotels being offered on the platform leading to greater network effects. Moreover, this order encroaches upon the MMT-Go group's fundamental freedom to contract and commercial wisdom. They have also submitted to the commission that preferring OYO over its competitors was purely a commercial decision and condition precedent to forging a business relationship with OYO. Lastly, the Commission has ignored the fact that Booking.com and Expedia Inc. are global giants in terms of revenues and finances[279], which are also MMT-Go's direct competitors in

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[278] Phumudzo S. Munyai, *A Critical Review of the Treatment of Dominant Firms in Competition Law - A Comparative Study*, (Doctoral Thesis, University of South Africa 2016) https://uir.unisa.ac.za/bitstream/handle/10500/21908/thesis_munyai_ps.pdf?isAllowed=y&sequence=1

[279] Inti Pacheco, *Two Travel Giants Raised $4 Billion to Ride Out the Pandemic. Only One Needed It*, THE WALL STREET JOURNAL (NOV.

the Indian OTA industry. These hefty penalties levied on MMT-Go would send a chilling effect on their ability to compete against such huge global conglomerates and further concentrate the industry.

VII. THE ECONOMIC JUSTIFICATIONS FOR PARITY OBLIGATIONS

The CCI observes that the available literature on parity clauses indicate that it harms competition, however, the imposition of such clauses also possesses the ability to generate economic efficiencies under the right circumstances[280], such as the Indian OTA market. These clauses have been justified in specifically safeguarding investments and prevent 'free riding' or 'showrooming' actions.[281] Parity obligations have been the standard industry practice in both domestic and international OTA markets, and the impositions of such clauses have been exercised by all competitors in the Indian OTA market including Booking.com, Expedia, Cleartrip and Agoda. Such

21, 2021) https://www.wsj.com/articles/two-travel-giants-raised-4-billion-to-ride-out-the-pandemic-only-one-needed-it-11605954601.

[280] Jonathan B. Baker & Fiona Scott Morton, "*Antitrust Enforcement against Platform MFNs*", 127 YALE. L. J. 2176 (2018).

[281] *Id,* at 199.

clauses are economically justified for the protecting the investment sustained by the OTA platform in furtherance of establishing a reliable database and prevent instances of 'free riding'.[282] Consumers could make use of the OTA platform and extract information hotels, but subsequently conduct a transaction via a channel which offers a lower price for the same hotel. Without imposing such parity obligations, the OTA platform will find it difficult to recover their investments or improve the quality of their services, which is better known as the 'hold-up problem'.[283] This is all the more necessitated owing to the price sensitivity and the nascent stage of the Indian market. Furthermore, there is also a significant reduction in transaction costs involved in bargaining and searching for the availability of lower prices on other distribution channels. In fact, the antitrust jurisprudence in the United States of America considers such parity clauses as pro-

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[282] 7 MARGHERITA COLANGELO, *Competition Law and Most Favoured Nation Clauses in Online Markets*, in "NEW DEVELOPMENTS IN COMPETITION LAW & ECONOMICS, ECONOMIC ANALYSIS OF LAW IN EUROPEAN LEGAL SCHOLARSHIP" (Springer 2018).

[283] *Id.*

competitive.[284] Moreover, the Competition and Markets Authority (the competition regulator for the United Kingdom) concluded that parity obligations are necessary to safeguard the credibility of price comparison websites and prevent free riding by consumers.[285]

VIII. CONCLUSION

Consumer databases and algorithms are the very essence of business models of platforms that connect consumers to hotel owners. This ruling seems to be a landmark decision taken by the CCI and will contribute to the evolution of the competition jurisprudence in India. By holding MMT-Go's conduct and commercial arrangement with OYO to be in contravention of Section 3 and 4 of the Act, it will go on to adversely influence their dominant position in the relevant market for providing such online intermediation services for the booking of hotels in India. In light of this order, OTA players in the relevant

[284] Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic, (1995) 65 F.3d 1406.

[285] Competition and Market Authority, *Private motor insurance market investigation*, (Sep. 24, 2014) https://assets.publishing.service.gov.uk/media/5421c2ade5274a1314000001/Final_report.pdf.

market will restrain themselves from entering into similar commercial agreements with hotel chains and possibly update their policies regarding parity obligations. This ruling must be critically examined from an economic perspective as it lacks sufficient reasoning to depart from international standard practice and antitrust norms of major economies like USA and UK. It is imminent that the abandonment of parity clauses will have a negative impact on the economic efficiencies that MMT-Go previously benefitted from, however, its impact on the competition in OTA markets remains a test of time. In this respect, the recent Delhi High Court ruling has corrected the erroneous interpretation made by the CCI, which has only strengthened the economic justifications for parity obligations.