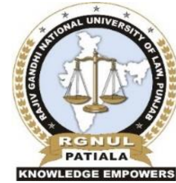

RGNUL FINANCIAL AND MERCANTILE LAW REVIEW

PEER REVIEWED

Volume VIII Issue II

2021

RAJIV GANDHI NATIONAL UNIVERSITY OF LAW, PUNJAB

RGNUL FINANCIAL AND MERCANTILE LAW REVIEW

[Mode of Citation: Vol. 8(2) RFMLR <Page Number> (2021)]

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December 2021

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EDITORIAL NOTE

Dear Readers,

On behalf of the Editorial Board of the RGNUL Financial and Mercantile Law Review (RFMLR), we wish all authors, patrons, and readers a prosperous year.

The pen is mightier than the sword. This phrase may be found at the heart of the legal profession as writing allows the readers to highlight challenges plaguing the current world and offer solutions that may impact law and policy as we know it. RFMLR has always endeavored to present quality legal research to the readers and to contribute substantially to the existing discourse on pertinent issues in the realm of various business and commercial laws.

The sudden onset of the second wave of COVID-19 this year put our continued determination to the test. Amidst these challenging times, the efforts of the Editorial Board continued uninterrupted, with the journal expanding its horizons and increasing its impact. The Editorial Board has continued to promote discourse with its virtual academic initiatives.

During this academic session, the Editorial Board organized the RGNUL-SAM Conclave on Arbitration in Practice in collaboration with Shardul Amarchand Mangaldas. Singapore International Arbitration Centre supported the event as an Associate Partner and Bar and Bench joined as the Media Partner. The Conclave was extremely successful in initiating a discourse on contemporary issues of practical aspects of arbitration in India.

It witnessed wide participation from leading experts, academics, and students from across the country for a paper presentation session and an expert discussion. The paper presentation session saw participants presenting novel solutions to challenges faced by various stakeholders in the field of arbitration, and the expert discussion brought together leading experts who shared practical insights into the evolving opportunities and persisting hurdles likely to shape arbitration in the coming years.

Curating RFMLR has always been an outcome of the entire Board's synergy. It encompasses an intricate process, beginning from the stage of finalizing the call for papers, reviewing the manuscripts received from authors across the country, and culminating to the final stage of compiling the peer-reviewed manuscripts as a biannual issue of the journal. We are elated to release the Second Issue of Volume VIII of RFMLR which is an upshot of the professionalism and dedication of all the Senior Editors, Associate Editors, Junior Editors, Citation Editor, Copy Editors, Digital Editors, and Editorial Assistants. The success of this issue was only possible with the constant support of our esteemed Peer Board consisting of renowned practitioners working across different practice areas, including Capital Markets, Intellectual Property Law, Arbitration, Insolvency, Mergers and Acquisitions, Banking and Finance and Technology Law.

In this issue of RFMLR, the fifth to be published during the COVID-19 pandemic, we are pleased to present a comprehensive and insightful analysis on a vast array of contemporary issues such as trade distortions due to cross-subsidization during the pandemic, positive aspects of Bad Bank in India, jurisdictional issues of antitrust and privacy concerns, Information

Technology Rules 2021, bid-rigging in insolvency resolution applications, the proposed ownership structure for Stock Exchanges in India, Group Insolvency, the judicial undermining of parliamentary supremacy in light of Section 40(a)(ia) of the Income Tax Act, 1961, revamped reassessment procedure and the quandary of corporate governance in light of the Tata-Mistry Saga.

We assure all our contributors and readers that the Board is constantly endeavoring to enhance the visibility and impact of the journal. All the issues of RFMLR are already indexed on SCC Online and the journal is one of the most accessed law reviews in their database. The Editorial Board has initiated efforts to get indexed on other Indian and international legal databases soon.

We look forward to hearing from you and receiving your submissions for our future issues.

Happy reading!

Akshat Jain
Ayushi Goel
Managing Editors
(On Behalf of the Editorial Board)

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I. REVAMPED REASSESSMENT PROCEDURE: AN EXAMINATION OF THE EXTENT OF CHANGE AND AREAS OF CONCERN

- Prashant Meharchandani*

ABSTRACT

The Finance Act, 2021 claims to have introduced a completely new regime for reassessments. A first look at the amended provisions makes it evident that in addition to the changes introduced in the limitation for issuance of notice and the reassessment procedure, changes have also been made in the language of the jurisdictional pre-conditions. The Memorandum indicated that the objective of the Bill is to result in less litigation and would provide ease of doing business to taxpayers as there is a reduction in time limit by which a notice for assessment or reassessment or re-computation can be issued. The legal framework governing reassessment has always been a highly litigated area of the tax laws. It has been frequently amended in the past, including changes in its jurisdictional pre-conditions. However, despite several amendments, Courts have time and again reaffirmed certain basic principles surrounding the concept of reassessment which are integral to it and any attempt to interpret the legal provision otherwise will amount to misuse of the power to reasseess. This article is an attempt to understand the scope of the new regime, examine how should the assessees expect the department to proceed under the amended provisions and figure out the trigger points that an assessee should keep in mind to immediately litigate and protect themselves against any illegal reassessment proceeding under the new regime.

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I. INTRODUCTION

The Finance Act, 2021 has introduced a new regime for law relating to reopening of assessments under the Income Tax Act, 1961 (**"Act"**). The Explanatory Memorandum to the Finance Bill 2021 (**"Memorandum"**) indicated that the Bill proposes a completely new procedure of assessment, reassessment or re-computation of income escaping assessment. The Memorandum indicated that the objective of the Bill is to result in less litigation and would provide ease of doing business to taxpayers as there is a reduction in time limit by which a notice for assessment or reassessment or re-computation can be issued. The Budget Speech also highlighted that "it is proposed to completely remove discretion in re-opening and henceforth re-

opening shall be made only in cases flagged by system on the basis of data analytics, objection of C&AG and in search/survey cases."[1]

The legal framework governing reassessment has always been a highly litigated area of the tax laws. It has been frequently amended in the past, including changes in its jurisdictional pre-conditions. However, despite several amendments, Courts have time and again reaffirmed certain basic principles surrounding the concept of reassessment which are integral to it and any attempt to interpret the legal provision otherwise would amount to misuse of the power to reassess.

The Finance Act, 2021 claims to have introduced a completely new regime for reassessments. A first look at the amended provisions makes it evident that in addition to the changes introduced in the limitation for issuance of notice and the reassessment procedure, changes have also been made in the language of the jurisdictional pre-conditions. This article is an attempt to understand the scope of the new regime, examine how should the assessees expect the department to proceed under the amended provisions and figure out the trigger points that an assessee should keep in mind to immediately litigate and protect themselves against any illegal reassessment proceeding under the new regime.

---

[1] Nirmala Sitharaman, Minister of Finance, Address at the Budget Announcement (Feb. 1, 2021), *in* Speech of Nirmala Sitharaman, Budget 2021-2022, Annex B at 28-33.

II. JURISDICTIONAL PRE-CONDITIONS FOR REASSESSMENT

A. Reassessment Regime prior to the Finance Act, 2021

To examine the changes introduced in the jurisdictional pre-conditions by the new regime, it is important to broadly understand the earlier regime of reassessment. As per Section 147 of the Act, as it existed prior to the amendments introduced by the Finance Act, 2021, the jurisdictional pre-condition for reassessment was that the Assessing Officer (**"AO"**) shall have a reason to believe that income chargeable to tax has escaped assessment. The key phrase here is 'reason to believe'. Prior to the substitution of Section 147 of the Act by the Direct Tax Laws (Amendment) Act, 1987 w.e.f. 1-4-1989, the jurisdictional pre-condition for reassessment was that in consequence of information in his possession, the AO shall have reason to believe that income chargeable to tax has escaped assessment.[2] The key phrases here are 'information in his possession' and 'reason to believe'.

These phrases underwent judicial scrutiny from time to time and broadly, the settled law as on date is as follows:

'Information':

i. Information is an indispensable ingredient which must exist before the section can be availed of;[3]
ii. Information shall mean not only facts or factual material but also includes information as to the true and correct state of the law;[4]

---

[2] Income Tax Act, 1961, § 147 *(Prior to Direct Tax Laws (Amendment) Act, 1987),* No. 43, Acts of Parliament, 1961.
[3] Indian & Eastern Newspaper Society v. CIT, (1979) 2 Taxman 197 (SC).
[4] Maharaj Kumar Kamal Singh v. CIT, (1959) 35 ITR 1 (SC).

iii. When 'information' as to law is referred to, what is contemplated is information as to the law created by a formal source;[5]

iv. Reason to believe shall be based on a fresh tangible material (information) which came to the knowledge of the AO subsequent to the initial assessment;[6]

v. Information is an instruction or knowledge derived from an external source concerning facts or particulars, or as to law, relating to a matter bearing on the assessment".[7]

'Reason to Believe':

i. AO must have a reason to believe that income chargeable to tax has escaped assessment;

ii. The reason to believe shall not be based on a change of opinion;[8] The AO cannot review or rectify its order under the guise of reassessment.[9]

iii. When a regular order of assessment is passed in terms of the said sub-section (3) of Section 143, a presumption can be raised that such an order has been passed on application of mind. If it be held that an order which has been passed purportedly without application of mind would itself confer jurisdiction upon the AO to reopen the proceeding without anything further, the same would amount to giving premium to an authority exercising quasi-judicial function to take benefit of its own wrong.[10]

---

[5] Indian & Eastern Newspaper Society v. CIT, (1979) 2 Taxman 197 (SC).
[6] CIT v. Kelvinator of India Ltd., (2002) 123 Taxman 433 (Del).
[7] CIT v. A. Raman & Co., (1968) 67 ITR 11 (SC).
[8] CIT v. Kelvinator of India Ltd., (2010) 187 Taxman 312 (SC).
[9] CIT v. Kelvinator of India Ltd., (2002) 123 Taxman 433 (Del).
[10] CIT v. Kelvinator of India Ltd., (2002) 123 Taxman 433 (Del).

iv. AO must record reasons for proposing to initiate reassessment proceedings;

v. The reasons recorded by the AO must demonstrate a live link between the fresh tangible material (information) and escapement of income;[11] and

vi. The satisfaction to be recorded for reopening shall not be a borrowed satisfaction. The satisfaction shall be of the AO itself.

It is evident that despite dropping the word 'information' from Section 147 of the Act post 01.04.1989, the above judicial principles have continued to apply with equal force. Fresh tangible material/information continues to be the primary basis which must exist for assuming jurisdiction for reassessment. However, the jurisdiction is not obtained by merely having the information. The jurisdiction to reassess is obtained only when the AO uses such information/material and forms a reason to believe that income chargeable to tax has escaped assessment. Therefore, while existence of a 'fresh tangible material/information' is an objective step to obtain jurisdiction, 'reason to believe' is the subjective and equally important step of obtaining jurisdiction to reassess.

B. New Reassessment Regime as introduced by the Finance Act, 2021

The statutory provision laying down the jurisdictional pre-conditions for reassessment in Section 148 reads as hereunder:

> 148. Before making the assessment, reassessment or recomputation under section 147, and subject to the provisions of section 148A, the Assessing Officer shall serve on the assessee a notice, along with a copy of the order

[11] CIT v. Kelvinator of India Ltd., (2010) 187 Taxman 312 (SC).

> passed, if required, under clause (d) of Section l48A, requiring him to furnish within such period, as may be specified in such notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed, and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under Section 139:
>
> Provided that no notice under this Section shall be issued unless there is information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment in the case of the assessee for the relevant assessment year and the Assessing Officer has obtained prior approval of the specified authority to issue such notice.

Further, an exhaustive meaning has been given defining as to what information with the AO means which suggests that income chargeable to tax has escaped assessment and the same is reproduced hereunder:

> Explanation 1. For the purposes of this Section and Section l48A, the information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment means, -
>
> any information flagged in the case of the assessee for the relevant assessment year in accordance with the risk management strategy formulated by the Board from time to time,
>
> any final objection raised by the Comptroller and Auditor-General of India to the effect that the assessment in the case of the assessee for the relevant assessment year has not been made in accordance with the provisions of this Act.

C. Areas of Concern in New Reassessment Regime with respect to Jurisdictional Pre-conditions

In the new regime, the Finance Act, 2021 proposes to completely remove discretion in re-opening by allowing reopening only in cases flagged by the system on the basis of data analytics and on the basis of objection of the Comptroller & Auditor General (**"CAG"**) and in search/survey cases.

In order to understand what to expect from the new provisions, it is important to examine the phrases used in the new provisions and understand as to what extent has the discretion been removed.

I. Scope of Information forming basis for Reassessment

The jurisdictional pre-condition requires that the AO should have information which suggests that income chargeable to tax has escaped assessment. The re-introduction of the word 'information' in itself is not of much significance as even in its absence in the statute between 1989 and 2021, the existence of a fresh tangible information/material was still a mandatory pre-requisite which served as the basis for the AO to form its 'reason to believe'.

Further, the information will still continue to be either information as to facts or information as to the correct position of law (as created or interpreted by a formal source) as the new regime doesn't restrict the definition of information to either of the above.

Which information can be considered for the purpose of reassessment? Earlier, the statute did not answer this question and it was left to the discretion of the AO. The Finance Act, 2021 takes away this discretion from the AO who

will now consider reopening of the assessment only on such information as is flagged in the case of an assessee in accordance with the Risk Management Strategy (**"RMS"**) determined by the Central Board of Direct Taxes (**"CBDT"**) or on the basis of the final objection raised by the CAG.

From Clause (i) of the Explanation 1 to the proviso to Section 148 of the Act, it is evident that the discretion to choose information has been transferred to the final report of the CAG and also to a computer-based system which will flag information every year in accordance with the RMS of the CBDT. Therefore, the scope of information to be considered for reassessment is majorly in the hands of the CBDT which may, from time to time, amend the factors in its RMS.

II. Applicability of Concepts of 'Fresh Tangible Material' & 'Change of Opinion'

Whether the AO will be allowed under the new regime to use such information, as flagged by the system or as pointed out by the CAG report, which was already available with the AO and was examined by it in the initial assessment proceedings? Whether the concepts of 'fresh tangible material' and 'change of opinion' continue to apply under the new regime as well?

These two concerns relate to the settled principle of law that the AO does not have the power to review under the garb of reassessment proceedings. The Hon'ble Supreme Court has time and again interpreted the word 'reassess' and has distinguished the same with 'review'. The Apex Court has throughout maintained its stand that if the AO is allowed to re-appraise and change its opinion on the same information which existed with the AO at the time of the initial assessment or which had in fact been examined by the AO in the initial

assessment proceedings, it will amount to review of the assessment and the AO has the power to reassess and not the power to review. The Apex Court has held as follows:[12]

> We must also keep in mind the conceptual difference between power to review and power to re-assess. The Assessing Officer has no power to review; he has the power to reassess. But reassessment has to be based on fulfilment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of re-opening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1-4-1989, Assessing Officer has power to reopen, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief.

It is evident from the above findings of the Apex Court that its findings go to the core of the concept of reassessment. It is not based upon the interpretation of the phrase 'reason to believe' or 'information', etc. Therefore, this well settled principle of law governing reassessment shall still apply with full force under the new regime as well. The concept of 'change of opinion' will have to be treated as an in-built test under amended provisions as well.

III. Requirement to demonstrate live link between information and escapement of Income?

The realisation that income has escaped assessment used to be covered by the phrase 'reason to believe' (now replaced with the phrase 'which suggests' in the new regime), and such realisation follows from the

[12] CIT v. Kelvinator of India Ltd., (2010) 187 Taxman 312 (SC).

"information" received by the AO. The information is not the realisation of escapement of income, the information merely gives birth to such realisation.[13]

Therefore, the phrase 'which suggests' in the new regime signifies that merely having the information will not suffice. A live link or a causal connection will still have to be demonstrated between such information and escapement of income. The requirement in law relating to reassessments is very simple and logical – that, in the reasons for reopening, the AO cannot simply record a factual position. The AO must record how such facts have led to the escapement of income. The law does not require a final finding on escapement of income from the AO at this stage. But at the same time, the minimum requirement is that the AO must record how the facts recorded by the AO have any connection or causal nexus or live link with the escapement of income.[14]

The Income Tax Department may come up with an interpretation that Explanation 1 to the proviso to Section 148 of the Act does not merely define 'information' but it defines the entire phrase 'information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment'. Applying this interpretation, the Department can argue that the information flagged by the system as per the RMS formed by the CBDT and the final objection from the CAG report are by themselves information that suggest that income has escaped assessment and hence, no further exercise has to be undertaken by the AO on such information except for taking an approval from the specified authority to initiate proceedings u/s 148A of the Act. This

[13] Indian & Eastern Newspaper Society v. CIT, (1979) 2 Taxman 197 (SC).
[14] G.S. Engineering & Construction Corporation v. DDIT, Circle 1(2), International Taxation, New Delhi & Ors, (2013) 357 ITR 335.

interpretation also finds support to some extent by the following paras from the Memorandum to the Finance Bill, 2021:

> (iv) It is proposed to provide that any information which has been flagged in the case of the assessee for the relevant assessment year in accordance with the risk management strategy formulated by the Board shall be considered as information which suggests that the income chargeable to tax has escaped assessment. The flagging would largely be done by the computer based system.
>
> (v) Further, a final objection raised by the Comptroller and Auditor General of India to the effect that the assessment in the case of the assessee for the relevant assessment year has not been in accordance with the provisions of the Act shall also be considered as information which suggests that the income chargeable to tax has escaped assessment.

Therefore, if this interpretation is considered, it will imply that even the requirement to demonstrate the live link between information and escapement of income has been shifted from the AO to the computer-based system and the final report of CAG.

However, it is not understood how the information obtained from a computer-based system or from the final report of CAG will deal with the concepts of 'change of opinion' or requirement of a 'fresh tangible material'. These concepts have been fundamental to the power of reassessment as they have been crucial to check the abuse of power by the AO in order to ensure that an unbridled power of review is not resorted to by the AOs. These concepts do not lose their importance even today when a computer based system is being introduced to remove subjectivity from a human exercise. A certain level of subjective exercise by the AO upon the objective factors of 'change of opinion' and 'fresh tangible material' will still be imperative to

ensure that the AO does not assume a power of review which has never been the intention of the legislature.

The alternative interpretation is that Explanation 1 to the proviso to Section 148 of the Act merely defines 'information' that can be used to reopen assessments. It merely fulfils the requirement of information in the jurisdictional pre-condition that the AO should have information which suggests that income chargeable to tax has escaped assessment. Therefore, in the alternative view, it will be the AO who will apply such 'information' on the facts of an assessee's case and determine whether such information provided by the system or by the final objection from the CAG report 'suggests' that income has escaped assessment.

These possible alternative interpretations will be prone to litigation and the assessees must file appropriate objections in following cases, *inter alia*:

1. Where the AO merely mentions the information flagged by the computer-based system and does not demonstrate how such information suggests that income has escaped assessment in assessee's case;
2. Where the information flagged by the system or the information in the form of the final objection in the CAG report is with respect to an issue which has already been examined by the AO in the initial assessment proceedings.

D. Additional Conditions in case of Reopening beyond 3 years but before 10 years

The earlier regime allowed reopening of assessment upto 4 years from the end of the relevant assessment years if the AO had reason to believe that income escaped assessment. However, if the income escaping assessment was above INR 1 lac and there was a failure on behalf of the assessee to disclose fully and truly all material facts, the AO was allowed to reopen assessments upto 6 years from the end of the relevant assessment year. There was an additional limitation of upto 16 years for escapement of income in relation to foreign assets which is now governed by the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

The new regime has revised the timelines for reopening of assessment as follows – (i) within 3 years from the end of the relevant assessment year and (ii) beyond 3 years but within 10 years from the end of the relevant assessment year. The jurisdictional pre-conditions for reassessment upto 3 years have already been discussed hereinabove in this article. Section 149(1)(b) of the Act prescribing additional conditions for the 3-10 years' timeline for initiating reassessment proceedings reads as hereunder:

> 149. (1) No notice under Section 148 shall be issued for the relevant assessment year,
>
> if three years have elapsed from the end of the relevant assessment year, unless the case falls under clause (b),
>
> if three years, but not more than ten years, have elapsed from the end of the relevant assessment year unless the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income chargeable to tax, represented in the form of asset, which

> has escaped assessment amounts to or is likely to amount to fifty lakh rupees or more for that year:
>
> …
>
> Explanation - For the purposes of clause (b) of this sub-section, "asset" shall include immovable property, being land or building or both, shares and securities, loans and advances, deposits in bank account.

In addition to the conditions already discussed in this article above for reassessment, the amended provisions have prescribed following additional jurisdictional conditions for initiating reassessment proceedings beyond 3 years:

i. The AO must have in his possession either books of accounts or other documents or evidence which reveals that income chargeable to tax has escaped assessment;
ii. Income escaping assessment shall be represented in the form of an asset; and
iii. Income escaping assessment shall be or likely be INR 50 lacs or more for that year.

It is evident from a mere reading of Section 149(1)(b) of the Act that the above 3 additional conditions must co-exist. And looking at the nature of these conditions imposed by the legislature, it is very likely that these conditions will be prone to litigation. Therefore, it is very important for the assessees to understand each condition in detail because the non-existence of any one of the conditions takes away the jurisdiction from the AO to reopen assessment beyond a period of 3 years.

I. AO must have books of accounts or documents or evidence which reveal escapement of income

'Books of account' has been defined under the Act under Section 2(12A) as follows: **"**(12A) "books or books of account" includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device;**"**

Document has been defined under the Act under Section 2(22AA) as follows: **"**(22AA) "document" includes an electronic record as defined in clause (t) of sub-section (1) of Section 2 of the Information Technology Act, 2000 (21 of 2000);**"**

Evidence is not defined under the Income Tax Act but the same has been defined under the Indian Evidence Act, 1872 as follows:

> Evidence means and includes —
>
> 1. all statements which the Court permits or requires to be made before it by witnesses, in relation to matters of fact under inquiry; such statements are called oral evidence;
>
> 2. all documents including electronic records produced for the inspection of the Court; such documents are called documentary evidence.

Therefore, for reopening assessment beyond 3 years, merely having information which suggests that income has escaped assessment is not sufficient. The law requires that the AO shall have in his possession either books of accounts or documents (which include electronic documents) or evidence (which includes oral as well as documentary evidence) which shall reveal that income has escaped assessment. The use of the word 'reveal' for

reopening assessment beyond 3 years instead of the word 'suggests' by itself indicates that the law requires the AO to have a higher amount of certainty of escapement of income and such revelation should either come from the books of accounts or some document or evidence.

As per the Cambridge Dictionary, the word 'reveal' means 'to make known or show something that is surprising or that was previously secret' or 'to allow something to be seen that, until then, had been hidden' Therefore, the use of the word 'reveal' also indicates that such books of accounts or the document or the evidence that now reveals escapement of income was not disclosed by the assessee to the AO in the initial assessment proceedings. This is an additional safeguard for the assessee which can be used to object to the reassessment in case the AO seeks to reopen on the basis of any document, evidence or books of accounts which was specifically disclosed by the Assessee during the initial assessment and was examined by the AO or can be presumed to have been examined on the basis of any specific questionnaire.

II. Income escaping assessment shall be represented in the form of an asset

For reopening assessment beyond 3 years under the new regime, it is mandatory that the income which has allegedly escaped assessment shall be represented in the form of an asset. The phrase 'represented in the form of an asset' indicates that the assessee has held or used to hold such income escaping assessment in the form of an asset.

While the provision provides that the income escaping assessment must be or must have been held by the assessee in the form of an asset but it does not require that at the time of the initiating reassessment proceedings, the

assessee should still be holding such asset. If the books or documents or evidence reveal that any asset, which was once held by the assessee, and has now been converted or transferred, represents any income that has escaped assessment, this condition will be satisfied.

III. PROCEDURE FOR INITIATING REASSESSMENT PROCEEDINGS

A. Procedure under the Reassessment Regime prior to Finance Act, 2021

In the reassessment regime prior to the Finance Act 2021, the legislature provided the following steps for initiating reassessment proceedings:

Step 1: AO shall have a reason to believe that income has escaped assessment.

Step 2: AO to take approval of the specified authority under Section 151 of the Act on the reasons for reopening.

Step 3: AO issues notice for reassessment requiring the assessee to file return for reassessment.

Step 4: AO to issue notice under Section 143(2) and pass reassessment order.

Between Step 3 and Step 4, the following procedure was introduced by the Hon'ble Supreme Court to be followed mandatorily by the assessee and

the Department in cases the assessee wishes to know the reasons for reopening: 15

Step 3.1: On receipt of notice, assessee files the return of income and seek reasons for reopening.

Step 3.2: AO to present reasons for reopening to the assessee within a reasonable time

Step 3.3: Assessee to file objections with the AO, if any.

Step 3.4: AO to dispose off the objections by way of a speaking order before proceeding with the reassessment.

Under this regime, following principles were laid down by the Courts time and again with respect to the procedure for initiating reassessment proceedings in order to prevent the abuse of the process by the Department:

i. The reasons for reopening must be recorded prior to taking the approval of the specified authority and prior to issuance of the notice.[16] Reasons for reopening, as approved by the specified authority, is the pre-requisite for issuance of a notice for reassessment. The reasons to be presented to the assessee during the reassessment proceedings must be reasons already recorded by the assessee before initiating such proceedings.

[15] GKN Driveshafts (India) Ltd. v. ITO, (2003) 259 ITR 19 (SC).
[16] Rajoo Engineers Ltd. v. DCIT, (2008) 218 CTR 53; CIT v. S.R. Constructions, (2002) 257 ITR 502 (MP).

ii. The approval of the specified authority for reassessment does not mean paper approval. The approval must indicate due application of mind.[17]

iii. Approval of the specified authority is a mandatory pre-condition for issuance of a notice for reassessment and in absence of such approval, the AO will lose jurisdiction for reassessment.[18]

B. Procedure under the New Reassessment Regime introduced by the Finance Act, 2021

In the new reassessment regime introduced by the Finance Act, 2021, in principle, the procedure introduced by the Supreme Court in *GKN Driveshafts*[19] has been made part of the legislative scheme under Section 148A of the Act with higher safeguards requiring approval of the specified authority at every stage in order to reduce litigation and improve ease of doing business. The procedure now gives the option of a pre-notice enquiry to the AO. The procedure also encompasses a mandatory show cause notice and option to object to the reasons and requirement to pass a reasoned order disposing off such objections even before issuance of a notice for reassessment. The procedure is as follows:

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[17] German Remedies Ltd v. Dy. CIT, (2006) 287 ITR 494 (Bom); CIT v. Suman Waman Chaudhary, (2010) 321 ITR 495 (Bom); CIT v. S. Goyanka Lines & Chemical Ltd., (2016) 237 Taxman 378 (SC); My Car (Pune) (P.) Ltd. v. ITO, (2019) 263 Taxman 626; United Electrical Company (P) Ltd v. CIT & Ors, (2002) 258 ITR 317 (Del); Asiatic Oxygen Ltd. v. Dy. CIT, (2015) 372 ITR 421 (Cal.); Maruti Clean Coal And Power Ltd. v. ACIT, (2018) 400 ITR 397 (Chhattisgarh); Central India Electric Supply Co. Ltd. v. ITO, (2011) 51 DTR 51 (Del).

[18] Anil Jaggi. v. CIT, (2018) 168 ITD 599 (Mum) (Trib.); ITO v. Ashok Jain, 2018 SCC OnLine ITAT 2201.

[19] GKN Driveshafts (India) Ltd. v. ITO, (2003) 259 ITR 19 (SC).

Step 1: AO shall have information which suggests income has escaped assessment. Additional conditions to be met in case of reassessment beyond 3 years.

Step 2: AO has the option to conduct an enquiry, if required, but with prior approval of the specified authority under Section 151 of the Act. This is an optional step.

Step 3: AO to issue a show cause notice to the assessee as to why a notice for reassessment shall not be issued on the basis of the information which suggests income has escaped assessment and on the basis of the results of the enquiry conducted, if any. A period of minimum 7 days and up to 30 days (extendable on request) to be provided to the assessee to reply. Such show cause notice shall also be issued only with prior approval of the specified authority.

Step 4: AO to consider the reply of the assessee furnished, if any, in response to the show cause notice.

Step 5: On the basis of the material available on record including the reply of the assessee, AO to decide and pass an order within one month from the end of month in which reply is received and in case of no reply, within one month from the end of the month in which the period to file response expired. Order to be passed with prior approval of the specified authority.

Step 6: If the objections of the assessee have been rejected, AO to issue notice for reassessment after taking approval from the specified authority requiring the assessee to file return of income.

Step 7: AO to issue notice under Section 143(2) and pass reassessment order.

C. Areas of Concern under the New Reassessment Regime with respect to Procedure

I. When should the AO satisfy the jurisdictional pre-condition of having information which suggests income has escaped assessment?

With the addition of the procedure for a pre-notice enquiry by the AO, the first area of concern is as to when should the AO satisfy the jurisdictional pre-condition of having 'information which suggests that income chargeable to tax has escaped assessment'. Can the AO take recourse to the provision for pre-notice enquiry under Section 148A(a) for obtaining information which suggests that income has escaped assessment?

Having information which suggests that income has escaped assessment is a mandatory pre-requisite to initiating the entire reassessment proceedings. Therefore, the requirement of having such information shall be satisfied by the AO at the very outset. The AO cannot take recourse to the provision for pre-notice enquiry under Section 148A(a) of the Act for obtaining such information for the following reasons:

i. The requirement to have information which suggests that income has escaped assessment is a mandatory jurisdictional pre-requirement for initiating reassessment proceedings while the pre-notice enquiry is an optional exercise that the AO may opt to undertake. The law will not provide an optional enquiry procedure to satisfy a mandatory jurisdictional pre-condition;

ii. The option of pre-notice enquiry envisaged under Section148A(a) is for carrying out an enquiry 'with respect to the information which suggests that the income chargeable to tax has escaped assessment'. When the enquiry itself is about the information which suggests that income has escaped assessment, then it is obvious that such information should exist prior to making the decision to undertake such enquiry or not.

iii. The use of the phrase 'if required' under Section 148A(a) also makes it evident that such information shall exist prior to the AO exercising the option to make such enquiry or else there will be no other way for the AO to determine whether the enquiry is required or not.

iv. Further, Section 148A(a) requires the AO to take prior approval of the specified authority to undertake enquiry. If an approval has to be taken for undertaking an enquiry, there must be some subject matter for such enquiry. The approval from the specified authority cannot be made for a fishing and roving enquiry. Hence, even the requirement for approval suggests that the information suggesting escapement of income must exist prior to exercising the option to undertake a pre-notice enquiry.

It is evident from the above that the AO cannot use the provisions for pre-notice enquiry as a tool to obtain information which suggests income escaping assessment. Initiating an enquiry without having any information suggesting income escaping assessment will clearly amount to undertaking fishing and roving enquiries where the AO may or may not find any information suggesting income escaping assessment. Once the AO has such information, the AO can resort to the enquiry in case he/she thinks it fit to obtain certain additional details with respect to such information.

Even in case of reassessment beyond 3 years, the AO must satisfy the additional pre-conditions laid down by Section 149(1)(b) of the Act at the very outset before taking the permission for undertaking a pre-notice enquiry. The AO cannot resort to a fishing and roving enquiry under Section 148A(a) to obtain the books of accounts or documents or evidence in order to reveal income escaping assessment. The AO cannot assume jurisdiction to initiate the reassessment proceedings, unless he is already in possession of such books of accounts or documents or evidence revealing income, represented in the form of asset, amounting to INR 50 lacs or more, escaping assessment.

From the discussion above, it is evident that Section 148A(a) has the highest potential to be misused by the Department for conducting fishing and roving enquiries. Therefore, the approval of the specified authority under Section 148A(a) becomes very crucial to determine whether the jurisdictional pre-conditions were satisfied prior to obtaining such approval and whether the approval has been granted by the specified authority on the basis of information with the AO which suggests income escaping assessment or books of accounts/documents/evidence revealing escapement of income, as the case may be. As a matter of litigation strategy, in cases where enquiry has been undertaken by the AO, the assessee should always formally seek a copy of the approval obtained for such enquiry or conduct a formal inspection of the record. If found that the AO conducted fishing and roving enquiries for satisfying jurisdictional pre-conditions, this goes to the root of the matter and invalidates the reassessment proceedings.

II. Order to be passed u/s 148A(d) of the Act

The amended provisions require the AO to consider the objections filed by the assessee in reply to the show cause notice and the material

available on record and decide the objections by passing an order with prior approval of the specified authority.

The use of the phrase 'consider the reply of assessee furnished' under Section148A(c) and use of the phrase 'decide, on the basis of the material available on record including the reply of the assessee' make it evident that the AO must pass a reasoned order after considering all the objections raised by the assessee and after considering the material available on record.

This part of the reassessment procedure will be highly prone to litigation. Therefore, the assessees must give great attention to such orders. If an order fails to consider and decide any objection which is crucial to the case of the assessee will be violative of Section 148A(c) and 148A(d) and will be in violation of the principles of natural justice. Such orders will be liable to be set aside. However, if the assessee's challenge to such order is limited to non-disposal of a certain objection, then, in a writ jurisdiction, the assessee should expect only an order of remand back to the AO to pass a reasoned order.

III. Approval of the Specified Authorities u/s 151 of the Act

The new regime requires approvals to be taken from even higher authorities than what the earlier regime required. For reassessment within 3 years, the amended Section 151 of the Act requires approval to be obtained from Principal Commissioner or Principal Director or Commissioner or Director. For reassessment beyond 3 years, approval has to be obtained from Principal Chief Commissioner or Principal Director General or Chief Commissioner or Director General.

The amended provisions require such approvals to be obtained at every stage obviously in order to ensure higher safeguards for the assessees. This by

itself indicates that such approvals should not be reduced to empty formalities or be mere paper approvals. The specified authorities must give approvals after duly applying their mind.

Further, it is a settled principle that if the law requires the approval to be obtained from a particular authority, the approval has to be obtained from the mentioned authority only. Approval either from superior or sub-ordinate authority does not amount to a valid approval.[20]

Approvals taken from specified authorities for issuance of notice for reassessment is a mandatory pre-requirement for obtaining jurisdiction to issue such notice. Therefore, this is another area of the reassessment procedure which the assessees should closely examine. Any irregularity in the approvals renders the entire reassessment proceedings invalid. Therefore, as a matter of litigation strategy, the assessee should always formally seek a copy of the approval obtained for such an enquiry or conduct a formal inspection of the record.

IV. CONCLUDING REMARKS

The new reassessment regime introduced by the Finance Act 2021 is a welcome step for the following reasons:

i. It has considerably reduced the limitation for reopening from 6 years to 3 years for normal cases;

[20] Ghanshyam K. Khabrani v. ACIT, (2012) 346 ITR 443 (Bom); DSJ Communication Ltd. v. DCIT, (2014) 222 Taxman 129 (Bom); Purse Holdings India P. Ltd. v. ADDIT(IT), (2016) 143 DTR 1 (Mum); Yum! Restaurants Asia Pte Ltd v. Dy. DIT, (2017) 397 ITR 639 (Del); CIT v. Aquatic Remedies Pvt. Ltd., (2018) 406 ITR 545 (Bom).

ii. Even for cases which are otherwise cases of non-disclosure and severe tax evasion but where the income escaping assessment is below INR 50 lacs, the limitation for reopening has been limited to 3 years;

iii. The cases covered by the 10 years limitation have been subjected to additional jurisdictional conditions and a monetary threshold of INR 50 lacs to focus only on cases of severe tax evasion and non-disclosures;

iv. Smaller individual taxpayers and businesses have been relieved from a longer period of uncertainty of assessment;

v. Despite the procedure laid down by the Supreme Court in *GKN Driveshafts,*[21] it was still not being followed by many AOs. Making such procedure a mandatory part of the legislative scheme ensures higher level of safeguards for the assessees;

vi. Further, approvals from very senior authorities have been made mandatory in the legislative scheme and that too at every stage of the reassessment procedure. This evidences the commitment of the legislature to ensure highest level of protection to the taxpayers against any illegal reopening of assessments or reassessments without any application of mind.

However, there are several areas of the amended provisions, as indicated at various places in the article, which are highly prone to litigation and which the assessees should closely examine while being subjected to reassessment proceedings. Despite being principally similar to the earlier regime, since there has been a major overhauling in the new reassessment regime, the assessees should expect major variations in Department's

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[21] GKN Driveshafts (India) Ltd. v. ITO, (2003) 259 ITR 19 (SC).

interpretation of the amended provisions and hence, should be extra cautious during the entire reassessment proceedings, examine each stage closely and object to anything which appears in variance with the legislative scheme.

II. SIMPLIFYING THE QUANDARY OF CORPORATE GOVERNANCE IN LIGHT OF THE TATA-MISTRY SAGA

- Mr. Janak Panicker*

ABSTRACT

The Hon'ble Supreme Court in the recent case of Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd., explored various issues of corporate governance such as the duties of the nominee directors, the role of independent directors in Indian companies and whether they are actually required, the applicability of invoking the remedy of oppression and mismanagement, and the legality of affirmative voting rights. Even though the case largely revolved around the claims of oppression and mismanagement and did not substantially delve into other issues, the Supreme Court's opinion on issues pertaining to corporate governance has still raised many concerns. This paper seeks to analyse this decision and evaluate the stance of the apex court on the aforementioned issues relating to corporate governance. The authors have revisited the basics of corporate governance, extensively analysed the fiduciary duties of the directors, both in India and the UK, and explored some scenarios in which the fiduciary duties might be subject to change. Further, in light of the judgment, the authors argue for the need of independent directors in the Indian corporate governance regime. Lastly, the authors discuss the remedies available with the shareholders and explain the cases in which these remedies can be invoked.

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I. INTRODUCTION

A. Contextual Background

Recently, the Hon'ble Supreme Court (**"SC"**) in the case of *Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd.*,[1] (**"judgment"**) primarily dealt with the claims of oppression and mismanagement initiated by the Cyrus Investments Pvt. Ltd. (minority shareholder) under Section 241 and 242 of the Companies Act, 2013 (**"CA 2013"**),[2] against the majority shareholders for carrying out the affairs of the company in a manner that was detrimental to the interests of the minority shareholders and contravening the company's Articles of Association (**"AoA"**). However, the SC also delved into many questions with respect to the corporate governance mechanisms in India such as *inter alia,* the role and relevance of Independent Directors **("IDs")**, the legality of Affirmative Voting Rights (**"AVRs"**), and the fiduciary duties of the directors.[3] The *prima facie* dictum of the SC pertaining to certain issues of corporate governance has resulted in some eminent scholars[4] questioning the veracity of the SC's opinion on these issues, especially in light of the existing laws and precedents.[5] In furtherance, this has

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[1] Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd., 2021 SCC OnLine SC 272 [hereinafter *Tata Consultancy*].
[2] *Id.*, ¶ 1.4.
[3] *Id.*, ¶¶ 19.23, 19.30.
[4] *See* Umakanth Varottil, *Supreme Court on Directors' Duties in the Tata/Mistry Case: A Critique*, IND. CORP. L. BLOG (Mar. 29, 2021), https://indiacorplaw.in/2021/03/supreme-court-on-directors-duties-in-the-tata-mistry-case-a-critique.html.
[5] *Id.*

also induced us to re-visit the basics of the concept of corporate governance, the existing law, and take assistance from the foreign laws in order to find conclusive answers to the questions raised pursuant to the judgment.

B. Corporate Governance: The *Tabula Rasa* Analysis

The OECD Principles of Corporate Governance[6] define corporate governance as the principles governing the relationship, and regulating the accountability between the management and all the stakeholders of a corporation. Thus, the principles of corporate governance suggest that the affairs of the corporation should be carried out in consonance with the best interests of the corporation and all of its stakeholders.[7] In this regard, the concept of fiduciary duties[8] is important to understand. The fiduciary duties of the directors are a means to secure the interests of the company, and consequently, the interests of its beneficiaries.[9] In a catena of judgments, most prominently in the English judgment of *Regal (Hastings) Ltd. v. Gulliver & Ors.*,[10] it was held that a director holds the position of a trustee of a company and equity prohibits the trustee from making profits at the cost of the company and its stakeholders. Further, in the case of *M/S Paliwal Hotels Pvt. Ltd & Ors. v. Sanjay Paliwal*,[11] the Delhi High Court upheld that the directors are entrusted with a responsibility to carry out their duties with utmost good faith,

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[6] OECD, *G20/OECD Principles of Corporate Governance* (2015), https://www.oecd-ilibrary.org/docserver/9789264236882en.pdf?expires=1622406635&id=id&accname=guest&checksum=540119BDA124EF42ACCD1B5DD38FEBD4.
[7] *See* Charles Handy, *What is a Company For?*, 1 CORPORATE GOVERNANCE 14, 14 (1993).
[8] Companies Act, 2013, §166, No. 18, Acts of Parliament, 2013, [hereinafter "CA 2013"].
[9] Gautam Sundaresh, *In Whose Interests Should a Company be Run? Fiduciary Duties of Directors During Corporate Failure in India: Looking to the West for Answers*, 8 MICH. BUS. & ENTREPRENEURIAL L. REV. 291, 294 (2019).
[10] Regal (Hastings) Ltd. v Gulliver & Ors., (1942) l All ER 379.
[11] M/S Paliwal Hotels Pvt. Ltd & Ors. v Sanjay Paliwal, 2012 SCC OnLine Del 258.

care and diligence for the benefit of the company. Thus, in furtherance, the fiduciary duties of directors is a great tool to uphold and promote the principles of corporate governance.[12]

The judgment extensively deliberated on the fiduciary duties of directors, especially the conflict of duties arising in the case of nominee directors,[13] who are nominated by the shareholders or other stakeholders such as the creditors.[14] The nominee directors face a precarious situation as they have to act in the best interests of the company, in accordance with the provisions laid down in the CA 2013, and at the same time, they are also "contractually bound" to advance the interests of their nominators.[15] This brings to the fore the issue of affirming the ambit of the directors' duties and determining in whose interests should they carry out their duties. The next section of the paper shall delve into the same.

II. IN WHOSE INTERESTS DO THE DIRECTORS CARRY OUT THEIR DUTIES?

There has been a persistent conundrum on the issue of fiduciary duties of directors and to whom exactly do they owe this duty.[16]

Further, the Courts have also provided varied opinions on this issue in the past. In this section, the authors shall firstly, analyse the diverse opinions

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[12] Vijay P Singh, *Directors' Fiduciary Duties to the Company: A Comparative Study of the UK and Indian Companies Act*, 6 TRUSTS & TRUSTEES 1,1 (2021).
[13] *Tata Consultancy,* ¶ 19.30.
[14] Varottil, *supra* note 4.
[15] *Id.*
[16] Mihir Naniwadekar & Umakanth Varottil, *The Stakeholder Approach Towards Directors' Duties Under Indian Company Law: A Comparative Analysis,* NUS LAW WORKING PAPER NO. 2016/006 (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2822109.

on the fiduciary duties of the directors. Secondly, the authors shall also endeavour to explore various scenarios in which the directors may face a conflict while carrying out their fiduciary duties.

A. Fiduciary Duties of Directors: To whom do they owe these duties?

As mentioned above, there have been conflicting opinions regarding this question. The English precedents, in this regard, have established a very clear approach. In the case of *Percival v. Wright*,[17] it was explicitly upheld that the directors only owe their fiduciary duties to the company itself and not to any individual shareholders. Further, in the case of *Peskin v. Anderson*,[18] it was settled that the directors do not owe a general duty to shareholders, and any duty that may arise between them, would only be in exceptional circumstances, and/or if a special relationship is established between them.

Per contra, the picture seems to be hazy under Indian law. The Hon'ble SC, initially in the case of *M/S. Harinagar Sugar Mills Ltd. v. Shyam Sundar Jhunjhunwala & Ors.*,[19] held that the directors owe their fiduciary duties not only towards the company but also towards every shareholder of that company. In the case of *Globe Motors Ltd. v. Mehta Teja Singh*,[20] it was explicitly held that the directors occupy the position of a trustee towards "the company", and consequently they should exercise this duty in the best interests of the company. In furtherance, in some cases, such as *Sangram Singh P.*

[17] Percival v. Wright, [1902] (2) (Ch.) 421.
[18] Peskin & Anr. v. Anderson & Ors., [2001] 1 BCLC 372.
[19] M/S. Harinagar Sugar Mills Ltd. v. Shyam Sundar Jhunjhunwala & Ors., AIR 1961 SC 1669.
[20] Globe Motors Ltd. v. Mehta Teja Singh, (1984) 55 Comp. Cas 445.

Gaekwad & Ors. v. Shantadevi P. Gaekwad (Dead) thr. Lrs. & Ors.,[21] and *Kamal Kumar Dutta v. Ruby General Hospital Ltd.*,[22] the SC upheld the view adopted in the English precedent of *Peskin*,[23] and opined that ideally the directors only owe their fiduciary duties towards the company itself, and cases in which the directors owe any duties towards the individual members is an anomaly rather than the norm.

However, this stance was modified by the SC in the case of *Dale & Carrington Invt. Pvt. Ltd. v P.K. Prathapan*,[24] in which the SC observed that the directors acting as the trustees of a company are duty-bound to carry out their activities with due care and for the benefit of the company. Furthermore, the directors while carrying out the functions of the company need to disclose all important details regarding the pertinent matters of the company to the shareholders. The SC further held that "in a limited sense," the directors "are also trustees for the shareholders of the company."[25]

Therefore, keeping Section 166 of the CA 2013 in mind, it can be safely concluded that the directors of a company primarily owe their fiduciary duties only towards the company; however, at the same time, they need to be considerate of the interests of the shareholders of that company.[26] Nonetheless, this settled position of law regarding the fiduciary duties of directors might come in conflict in some instances. The prime example of such a situation is

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[21] Sangram Singh P. Gaekwad & Ors. v. Shantadevi P. Gaekwad (Dead) & Ors., (2005) 11 SCC 314 [hereinafter *"Gaikwad"*].
[22] Kumar Dutta v. Ruby General Hospital Ltd., (2006) 7 SCC 613 [hereinafter *Kumar Dutta*].
[23] Peskin & Anr. v. Anderson & Ors., [2001] 1 BCLC 372.
[24] Dale & Carrington Invt. Pvt. Ltd. v P.K. Prathapan, (2005) 12 SCC 212 [hereinafter *Dale & Carrington*].
[25] *Id.*
[26] Naniwadekar & Varottil, *supra* note 16.

the company being insolvent or when the company is likely to face insolvency. In such a situation, the directors need to re-evaluate the prioritization of the interests of various stakeholders, like the creditors of the company.[27] Further, as evinced by the judgment, the position of nominated directors can also lead to a conflict. The next segment shall deal with these two situations and identify whether the directors' fiduciary duties shift towards other parties.

B. Fiduciary Duties during Insolvency and the "Twilight Zone"

Under Indian law, it has not been explicitly mentioned whether in insolvency the directors owe their duties towards the creditors. In this context, the authors rely on the landmark English case of *West Mercia Safetywear v. Dodd*.[28] In this case, it was clarified that the directors owe their duties towards the company; however, in insolvency or its vicinity, undoubtedly the duties of the directors are altered in such a manner that the directors are required to "at minimum"[29] "have proper regard for the interests of the creditors."[30] The legal position in the USA is also similar to this stance. In the case of *North American Catholic Educational Programming Foundation Inc. v. Gheewalla,*[31] it was held that at all times the directors owe their fiduciary duties only towards the corporation. Thereby, in insolvency or its vicinity, the duties of the directors become more creditor-oriented.[32] The rationale behind such a model of fiduciary duties is to preserve the assets of an insolvent company or a company

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[27] *Id.*
[28] West Mercia Safetywear v. Dodd, (1988) 4 BCC 30.
[29] Kristin van Zwieten, *Director liability in insolvency and its vicinity*, 38 OX J. OF L. STUD. 382, 383 (2018).
[30] Bilta (UK) Ltd (in liquidation) & Ors. v. Nazir & Ors. (No 2), [2016] AC 1, ¶ 123.
[31] North American Catholic Educational Programming Foundation Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (U.S.)
[32] Zwieten, *supra* note 29.

that is likely to face insolvency, for the interests of the creditors and to preclude the directors from undertaking investments in risky ventures/projects, which might be favoured by the shareholders.[33] Although it is not explicitly clear as to the time period for the directors to make their approach more creditor-oriented, the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) suggests that the directors need to start weighing in the interests of the creditors as soon as it is reasonably foreseeable by the directors that a Corporate Insolvency Resolution Process **("CIRP")** is inevitable.[34] Therefore, the directors are required to maintain their creditor-oriented approach when the company enters into the "Twilight Zone", which connotes a time period from the point where CIRP becomes inevitable and its actual initiation.[35] Thus, in a nutshell, during or in the vicinity of insolvency, the directors owe their duty only to the company, but instead of prioritizing the interests of the shareholders, their priority shifts towards preserving and advancing the interests of the creditors.[36]

C. The Mysterious Case of Nominee Directors

As mentioned above, the judgment discussed the nominee directors and their fiduciary duties. The appointment of nominee directors is not an anomaly, especially where one company has invested in another and wants to

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[33] *Id.*; *See also* William B. Bratton, *Bond Covenants and Creditor Protection: Economics and Law, Theory and Practice, Substance and Process*, 7 EBOR 39, 7 (2006).
[34] Insolvency and Bankruptcy Code, 2016, § 66(2), No. 31, Acts of Parliament, 2016.
[35] Vaneeta Patnaik, *Directors in the Twilight Zone V*, INSOL INTERNATIONAL (2013), https://www.insolindia.com/uploads_insol/resources/files/directors-in-the-twilight-zone-v-1034.pdf.
[36] Zwieten, *supra* note 28.

maintain a system of checks and balances by nominating a director.[37] However, the nominee directors might face a conflict in cases where the interests of their nominators are not aligned with the interests of the company.[38] In such a scenario, both English[39] and Indian[40] cases staunchly propound that the directors should have their "undivided loyalty" towards the company while owing their duties specifically to the shareholders only in exceptional circumstances.[41] In the judgment, the SC acquiesced to the legality of the AVRs exercised by the nominee directors,[42] and held that it would largely be determined by the nature of the nominating company. In this case, the nominating company was a public trust company, which was a driving factor for the SC to legalize the AVRs.[43] However, the exercise of AVRs by the nominee directors is impliedly indicative of the fact that the SC prioritized the interests of the nominating shareholders rather than the company on whose board the directors were nominated, which contravenes past precedents and is likely to add confusion with regards to the directors' fiduciary duties in the future.[44]

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[37] Arjun Anand & Arushi Gupta, *Nominee Director- the Tug of War between Duty to Company and Nominator*, SINGHANIA & PARTNERS (Jul. 2, 2020), https://singhania.in/blog/nominee-director--the-tug-of-war-between-duty-to-company-and-nominator.

[38] Varottil, *supra* note 4.

[39] Boulting v. Association of Cinematograph Television and Allied Technicians, 1963 (2) Q.B. 606.

[40] *Gaikwad,* ¶ 42.

[41] *Dale & Carrington*, at 230.

[42] *Tata Consultancy,* ¶ 19.30.

[43] *Id.*

[44] Varottil, *supra* note 4.

III. THE REQUIREMENT AND RELEVANCE OF INDEPENDENT DIRECTORS: A BONE OF CONTENTION?

The judgment also evaluated the importance and the requirement of IDs in a company.[45] The SC opined that "if all Directors are required under Section 166(3) to exercise independent judgment, we do not know why there is a separate provision in Section 149(4) for every listed Public Company to have at least 1/3rd of the total number of Directors as independent Directors."[46] The stance taken by the SC pertaining to the IDs diverges from the popular opinion that expresses the necessity of IDs in order to maintain robust corporate governance mechanisms. Furthermore, this becomes interesting in light of the recent consultation paper issued by the Securities and Exchange Board of India (**"SEBI"**) which tightened the scrutiny on the IDs for a listed company.[47] This section shall provide a brief analysis on the concept of IDs, their role, requirement and relevance in the Indian corporate governance regime.

A. Does the Indian corporate governance regime really require IDs?

Pursuant to the CA 2013, IDs can essentially be defined as non-executive directors that do not possess any material or pecuniary relationship with the company.[48] Thus, the provisions of the CA 2013 ascribe immense importance to the appointment of the IDs for ensuring transparency in the

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[45] *Tata Consultancy,* ¶ 19.23.
[46] *Id.*
[47] SEBI, *Consultation Paper on Review of Regulatory Provisions Related to Independent Directors*, (Mar. 1, 2021), https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html [hereinafter "Consultation Paper"].
[48] CA 2013, § 149(6).

affairs of the company.[49] In furtherance, SEBI in its consultation paper highlighted the importance of IDs for the corporate governance framework as they act as a bridge between the interests of the promoters and the minority shareholders of the company.[50] Further, SEBI emphasised the importance of overseeing the appointment, removal and resignation of the IDs so that the independence of the IDs remain intact, and there is no external influence by the promoters of the company.[51]

The appointment of IDs safeguards a more balanced composition of the board of directors and has been considered one of the most effective instruments of ensuring compliance of principles of corporate governance by the directors.[52] The requirement of IDs for the corporate governance framework and protecting the rights of the minority shareholders is also highlighted by the fact that in India, the proportion of companies where the promoters own more than 50% of the shareholding increased to 66% in 2018.[53] Thus, the requirement of IDs for the maintenance of a robust corporate governance framework cannot be underestimated and is heavily emphasized upon by SEBI's consultation paper. Consequently, the authors believe that the SC's opinion on the role and requirement of IDs contravenes the legislative intent behind the inclusion of provisions relating to the installation of the IDs in various corporations,[54] and ignores their relevance for preserving the

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[49] *Id.*, § 149(4). *See also* Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, § 16(1)(b).
[50] Consultation Paper, ¶ 2.1.
[51] *Id.*
[52] Pranav Mittal, *The Role of Independent Directors in Corporate Governance*, 4 NUJS L. REV. 285, 287 (2011).
[53] OECD, *Ownership structure of listed companies in India*, (2020), https://www.oecd.org/corporate/ownership-structure-listed-companies-india.pdf.
[54] Varottil, *supra* note 4.

interests of the minority shareholders in an environment where the interests are skewed towards the promoters.

IV. ANALYSING THE REMEDIES FOR SHAREHOLDERS

The central dispute of the judgment was the claims of oppression and mismanagement initiated by the minority shareholders of the corporation against the exercise of AVRs by the nominee directors.[55] In light of this, it becomes pertinent to understand the available remedies for the shareholders in the Indian corporate governance regime. This section shall deal with the two most commonly adopted remedies by the shareholders against the abuse of power by the management i.e., oppression and mismanagement and the shareholder's derivative action.

A. Statutory Remedy of Oppression and Mismanagement

The CA 2013 provides a remedy to the shareholders to initiate an action against the controlling shareholders/management if the affairs of the company are being conducted in a manner that is prejudicial to the interests of the company, its members or the public at large.[56] Section 241 of the CA 2013 provides the right to any member to file an application before the National Company Law Tribunal (**"NCLT"**). This remedy is not exclusive to Indian jurisprudence and is largely but not entirely similar[57] to the "oppression" remedy provided in the statutes of other common law jurisdictions such as the

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[55] *Tata Consultancy,* ¶ 19.23.

[56] CA 2013, § 241(1).

[57] Vikarmaditya Khanna & Umakanth Varottil, *The Rarity of DAs in India: Causes and Consequences,* THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH (Cambridge University Press, Dan W. Puchniak et al. (eds.), 2012).

UK[58] and Singapore[59] in cases where there has been "unfair prejudice" to the minority shareholders.[60]

The SC, in the case of *Shanti Prasad Jain v. Kalinga Tubes Ltd.*,[61] upheld that where the conduct of the majority shareholders has been continuously abusive and detrimental to the interests of the company and/or the minority shareholders, the minority shareholders, in those instances, are justified to invoke the remedy of oppression and mismanagement.[62] The question of what constitutes oppression and mismanagement shall depend on the facts of each case.[63] The concept of oppression and mismanagement was also discussed in the case of *Needle Industries (India) v. Needle Industries Newey (India)*,[64] whereby it was held that where the directors act without probity and transparency, the shareholders have the right to exercise this remedy. However, oppression and mismanagement is not the only remedy that the shareholders possess. Another mechanism of corporate governance in India is the common law remedy of a shareholder's derivative action. The next section shall provide a brief analysis of the shareholder's derivative action, the cases in which it can be exercised, its possible applicability to the judgment, and the differences between the two remedies.

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[58] Companies Act, 2006, § 994 (United Kingdom).
[59] Companies Act, 1967, § 216 (Singapore).
[60] Khanna & Varottil, *supra* note 57.
[61] Shanti Prasad Jain v. Kalinga Tubes Ltd., AIR 1965 SC 1535 [hereinafter *"Shanti Prasad"*].
[62] *Id.*, ¶ 20.
[63] Mcdonald's India Private Limited v. Vikram Bakshi & Ors., 2016 SCC OnLine Del. 3949.
[64] Needle Industries (India) v. Needle Industries Newey (India), AIR 1981 SC 1298.

B. Shareholder's Derivative Action

The remedy of derivative action was laid down for the first time in the landmark English case of *Foss v. Harbottle,*[65] and was also adopted and recognized as a valid remedy in Indian jurisprudence by the case of *Dr. Satya Charan Law v. Rameshwar Prasad Bajoria*.[66] Derivative actions can be initiated by the shareholders in cases where the directors/wrongdoers are in control of the company[67] and have committed either a fraud on minority,[68] or violated the requirement of a special resolution,[69] or where the wrongdoers have carried out an *ultra vires* transaction.[70]

Even though the two remedies of oppression and mismanagement under Section 241, and a shareholder's derivative action have been equated,[71] they are not the same. Apart from the fact that oppression and mismanagement is a codified, statutory remedy and derivative action is a common law remedy, the biggest and the most fundamental difference between the two remedies is that in oppression and mismanagement, the shareholders initiate a direct action against the wrongdoers for claiming relief in their personal capacity.[72] Whereas, in a shareholder's derivative action, the shareholders can only initiate an action on behalf of the company for the benefit of the company.[73] This essentially implies that in a shareholder's derivative action, the relief will not be provided to the shareholder in the individual capacity, but to the

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[65] Foss v. Harbottle, [1873] 2 Hare 461.
[66] Dr. Satya Charan Law v. Rameshwar Prasad Bajoria, AIR 1950 FC 133.
[67] BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai, 1993 SCC OnLine (Bom.) 17, ¶ 18.
[68] Onyx Musicabsolute.com Pvt. Ltd. v. Yash Raj Films Pvt. Ltd, 2008 (6) Bom. CR 418.
[69] Darius Rutton Kavasmaneck v. Gharda Chemicals Ltd., 2014 SCC OnLine (Bom.) 1851.
[70] N.V.R. Nagappa Chettiar & Anr. v. The Madras Race Club, (1949) 1 MLJ 662.
[71] ICP Investments (Mauritius) Ltd. v. Uppal, 2019 SCC OnLine (Del.) 10604.
[72] Khanna & Varottil, *supra* note 57.
[73] *Id.*

company as a whole, which would have the effect of remedying the injuries suffered by the company, and consequently, the shareholders.[74]

In the judgment, the minority shareholders preferred to adopt the statutory remedy of oppression and mismanagement, raising the question of whether the minority shareholders could have chosen to initiate a claim of a derivative action in this case. Pertinently, the usage of AVRs is not illegal or oppressive in itself to either the company or to the minority shareholders *per se*.[75] Further, considering that a shareholder's derivative action can be initiated only in the aforementioned specific cases, and since none of them seems to be *prima facie* fulfilled in the judgment, it was not a viable remedy. In comparison, the statutory remedy of oppression and mismanagement has been invoked more often than the shareholder's derivative actions due to several procedural impediments, high thresholds to fulfil the requirements and the lack of awareness pertaining to the latter.[76]

V. CONCLUSION

The judgment addressed some pertinent issues relating to corporate governance in India, the most prominent of them being the issue of deciding whether the exercise of AVRs amounts to oppression and mismanagement. However, while arriving at the conclusion, the SC also delved into the discussion regarding the fiduciary duties of the directors, and the need and relevance of IDs. It is still unclear whether these observations were a part of

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[74] *Id. See also* Umakanth Varottil, *The Continued Influence of Foss v. Harbottle in India,* IND. CORP. L. BLOG, (Mar. 9, 2021), https://indiacorplaw.in/2021/03/the-continued-influence-of-foss-v-harbottle-in-india.html.
[75] Varottil, *supra* note 4.
[76] Khanna & Varottil, *supra* note 57.

the *ratio decidendi* of the judgment, and consequently, have over-reaching implications on the future jurisprudence on these issues, or whether these were merely the *obiter dicta* of the judgment. Since the central issue before the SC was to determine the nexus between the exercise of AVRs and oppression of the minority shareholders, there is an immense likelihood that all the other observations made by the SC are the *obiter dicta*.[77] Nevertheless, the judgment and the observations made by the SC, stimulated the inquisitiveness of the authors to observe and re-visit the certain basic precepts of corporate governance.

The authors have endeavoured to resolve the confusion relating to the fiduciary duties of the directors and explained the situations in which the directors may face a conflict in deciding the entity to whom they actually owe their duties. These situations include the company's insolvency/the verge of insolvency, popularly known as the "twilight zone", and the case of nominee directors, which was also discussed by the judgment. The nominated directors face the conflict between fulfilling their duties of promoting the interests of their nominators on one hand, and on the other hand, fulfilling their duties towards the company. Contrary to the judgment's analysis, the precedents and the CA 2013 suggests that the directors always owe their fiduciary duties towards the company; nonetheless, they need to weigh the interests of the stakeholders of the company as well.

Further, since the judgment questioned the requirement of IDs for corporate governance in a corporation, the authors have also addressed the importance of IDs to preserve and promote the framework of corporate

[77] Varottil, *supra* note 4.

governance in India, especially where the affairs companies are mostly controlled by the promoters.[78] The authors have also highlighted that the requirement of IDs for corporate governance is also manifested by the recent SEBI consultation paper which sought to regulate the appointment, removal and resignation of the IDs to ensure that they can carry out their roles in an independent manner.

Lastly, since the dispute revolved around the claims of oppression by minority shareholders, the authors have highlighted the two most commonly adopted remedies available to the shareholders in the corporate governance regime of India. Moreover, the authors have also provided an explanation regarding the non-usage of the remedy of derivative action in the judgment in particular and the lack of usage of this remedy in general. However, at the same time, it has been contended by the authors that there is a lack of awareness regarding this remedy, and this certainly needs to change for increasing transparency in the conduct of the directors/management and ensuring constant evolution in corporate governance in India.

Since the judgment has decided on such a high-profile, long-drawn dispute, with each intricate issue raised and addressed by the judgment, there is bound to be extensive deliberation and discourse around it. Further, since the judgment has certainly reinvigorated some questions and concerns regarding the corporate governance regime in India, which were seemingly settled, it is bound to be recognized as a landmark judgment. Whether it has any sweeping effects on the jurisprudence relating to corporate governance in the future is yet to be seen.

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[78] OECD, *supra* note 53.

III. THE GOODNESS WITHIN THE BAD BANK IN INDIA

- Kirthana Singh Khurana[*]

ABSTRACT

A bad bank is an entity that purchases distressed assets from a bank at sizeable discounts to book value and then searches for buyers for those assets. A proposal to establish a bad bank was outlined in the Indian Union Budget 2021-22. In this paper, an attempt has been made to explore the advisability of having a bad bank in India. To begin with, the evolution of the existing Indian legal framework for bad debt resolution is examined. This is followed by a discussion on the various features of a bad bank, particularly about how it can prove to be an effective tool to ameliorate a stressed banking sector. An analysis of the mounting bad debts in India is undertaken to appreciate how a bad bank can turn out to be a revolutionary initiative. The author also reviews the growth of bad banks established in various countries and weighs the potential of a similar experiment in India. Based on the experience of existing asset reconstruction companies in India, an evaluation of the potential impediments to the Indian bad bank is also made. The author proposes recommendations for the successful functioning of the bad bank and indicates areas for necessary legal and systemic interventions. It is also emphasised that a bad bank in isolation may not give the desired outcome and an overhaul of the Indian banking sector is the need of the hour. The paper is concluded by making a strong case for establishing a bad bank in India.

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I. INTRODUCTION

In her 2021 Union Budget speech, the Finance Minister of India, Mrs Nirmala Sitharaman, announced the setting up of an Asset Reconstruction Company (**"ARC"**), heralding a paradigm shift in the government's approach towards cleaning up the banking sector. The proposed ARC, also called a 'bad bank' in the financial world parlance, shall be mandated to take over and restructure the existing stressed assets of the Indian banks, principally the state-run banks, and eventually sell them to various funds or investors to realise a fair value.[1]

Assets of an ordinary bank comprise the loans extended by it and the investments made by it. The quality of a bank's assets is reckoned in terms of how much of the loans taken are paid back by the borrowers by way of interest and principal. A loan on which either the interest or principal remains unpaid by the borrower within the specified period is called a Non-Performing Asset (**"NPA"**) or a bad loan.[2] Thus, the asset quality of a bank can be measured in terms of the NPAs existing on its books. The distressed asset situation across the Indian banks has worsened over the past many years because of factors ranging from undercapitalised projects, viability issues, global slowdown, delayed recognition of stressed assets by Indian banks and the consequent debt trap and mal-governance and policy paralysis at the banks' level. Needless to overstate, a distressed banking system impacts the overall economy of the state and retards the envisaged growth plans. The proposed bad bank is a path-

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[1] Ministry of Finance, Government of India, Budget 2021-2022, Speech of Nirmala Sitharaman (Minister of Finance) (Feb. 1, 2021).

[2] Reserve Bank of India, *Master Circular- Prudential Norms on Income recognition, Asset Classification and Provisioning pertaining to the Advances Portfolio*, DBOD No. BP.BC/ 20 /21.04.048 /2001-2002 (Issued on September 1, 2001).

breaking step by the Indian government, to identify such distressed assets and put them under the care of a specialised agency, manned by experts, to ameliorate these assets by mainstreaming them back into the financial system and thereby, reviving the Indian economy.

In this paper, the author aims to explore the advisability of having a bad bank in India. In Part II, the evolution of the existing legal framework for bad debt resolution in India is examined, and its versatility to aid in the success of the bad bank is also assessed. In Part III, various features of a bad bank are discussed. Part IV analyses how in the given scenario of mounting bad debts in India, a bad bank can turn out to be a revolutionary initiative. In Part V, the bad banks established in various countries are reviewed to appreciate how such an experiment could fare in the Indian circumstances. Part VI evaluates the various impediments likely to be faced by a bad bank in India in view of the experience of the existing ARCs functional in India. The author proposes certain recommendations for the successful functioning of the bad bank in India and indicates areas for necessary calibrations. It is also emphasised that a bad bank in isolation may not give the desired outcome and a comprehensive overhaul of the Indian banking sector is the need of the hour.

II. THE EVOLUTION OF THE LEGAL FRAMEWORK FOR BAD DEBTS RESOLUTION IN INDIA

India has a robust mechanism, at present, in the form of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) for bad debts resolution. However, before this 2016 legislation, there were four major laws that dealt with this problem:

(i) The Companies Act, 1956 did have specific provisions to deal with bad debts.[3] However, the major problem was that the regular courts were not well equipped to handle matters requiring business valuation or to suggest appropriate rehabilitation plans. Later, Section 271 of the Companies Act, 2013 provided for the winding up of companies by court orders for non-payment of loan dues. This provision also remained in the statute without being notified till as late as November 2016, when the IBC became functional. Thus, till November 2016, the provisions of the Companies Act, 1956 remained relevant in this context.

(ii) Sick Industrial Companies Act (**"SICA"**), 1986 addressed the deficiency in rehabilitation and gave the authority to the managing committee and board of directors to come up with a plan to rejuvenate the business. SICA failed because the companies took advantage of the protection provided by it without any successful scheme for rehabilitation.

(iii) Another attempt towards the resolution of bad debts was the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

(iv) Before the year 2002, banks could not sell the pledged assets (pledged by borrowers while securing loans) to recover the due money without a competent court's order. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (**"SARFAESI"**) Act, 2002 changed that and authorised banks to sell assets without the court's intervention. This act also brought in ARCs that were to be registered under this Act and with the RBI.

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[3] Companies Act, 1956, §391-394, No. 1, Acts of Parliament, 1956.

Post-2014, the present NDA government, after securing a decisive mandate, gave impetus to the debt resolution process. It made two serious debt resolution attempts in this regard –firstly, the Statutory Debt Restructuring (**"SDR"**), which permitted the creditors to take over the firms that were unable to pay and sell them to new owners.[4] Secondly, the Sustainable Structuring of Stressed Assets of 2016 (**"S4A"**) permitted creditors to take up to 50% haircut to restore the financial viability of firms.[5] The above two attempts did not yield the desired results. The SDR suffered because the Reserve Bank of India (**"RBI"**) specified that the SDR route is not to be taken for all the defaults but only in those cases where the change in ownership is likely to increase the economic value of the entity and better its recovery. This caused confusion and later disillusionment with the initiative. In contrast, under the S4A, the lender banks had to convert a part of their loan into equity. This conversion had to take place at face value or the fair value of the share, whichever was higher. This translated into huge mark-to-market losses to lenders right at the inception. Additionally, the RBI's conditions required the concerned entity to be functional, generating cash and the total loans to the entity to be INR 500 crore or more. For the loans to be eligible under the scheme, at least 50% of the loan needed to be sustainable.[6] The fact that not many borrowers could meet this requirement became a testimony of the graveness of the bad debts problem.

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[4] Reserve Bank of India, *Strategic Debt Restructuring Scheme*, RBI/2014-15/627 (June 8, 2015).
[5] Reserve Bank of India, *Scheme for Sustainable Structuring of Stressed Assets*, RBI/2015-16/422 (June 13, 2016).
[6] *Id*.

The IBC mechanism which came into existence in the year 2016 is an umbrella legislation for insolvency resolution for all categories of entities, corporate as well as individual. This trailblazing economic measure is aimed at aligning India's insolvency infrastructure with global standards and providing greater coherence in law applicable to stakeholders affected by business failure or their inability to fulfil the debt obligations. For the above purpose, IBC has made amendments to many existing laws including the Companies Act, 2013, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the SARFAESI Act, 2002, to address their shortcomings and promote a time-bound resolution of insolvency matters through the newly codified legislation.[7] The mechanism follows the following four steps –

(i) Application to National Company Law Tribunal (**"NCLT"**) – A company becomes insolvent when its debts or losses are more than its net worth. Financial creditors, operational creditors and corporate debtors of the company can submit an application to the NCLT to start the insolvency process, which is called the Corporate Insolvency Resolution Process (**"CIRP"**). The NCLT has to accept or reject the application within 14 days of the filing of the application.[8]

(ii) CIRP Process – The board of directors is suspended, and management is placed under the control of an Interim Resolution Professional (hereinafter "**IRP**"). The management loses control of the company and is brought under

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[7] *Understanding the IBC Key Jurisprudence and Practical Considerations: A Handbook,* INSOLVENCY AND BANKRUPTCY BOARD OF INDIA & INTERNATIONAL FINANCE CORPORATION (2020), https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf.
[8] Insolvency and Bankruptcy Code, 2016, § 7, No. 31, Acts of Parliament, 2016 [hereinafter "IBC, 2016"].

a moratorium.[9] Within thirty days of the initiation of CIRP, the IRP has to form a committee of all the financial creditors called the Committee of Creditors (**"COC"**).[10] The COC appoints a Resolution Professional (**"RP"**), which may be the same as IRP, depending upon the discretion of the COC.[11]

(iii) Resolution Plan and its execution – Within one hundred and eighty days of the start of the CIRP, a resolution plan is required to be prepared and approved by the creditors and the NCLT. NCLT could extend this time by ninety more days. The resolution needs to be prepared by any person, including former management creditors or RP or a third party, provided it gets approved by the NCLT. Once approved, the plan is binding on all the parties.[12] If no plan is approved within the stipulated time, NCLT shall order for the liquidation of the company. However, in July 2019, in order to ensure the resolution of much larger number of cases within the stipulated time, the government made a few amendments to the IBC to beef up the infrastructure and also revised the resolution time limit to three hundred and thirty days.[13] The rationale behind this was to grant more time for the resolution plan to be firmed up. The Insolvency and Bankruptcy Board of India (**"IBBI"**), the regulator for IBC proceedings, which came into existence in October 2016, is mandated to oversee the timely submission of the resolution plan.[14]

(iv) Liquidation process – Failure to reach resolution leads to liquidation. The RP is assigned the role of the liquidator unless the IBBI appoints someone else

[9] IBC, 2016, § 13.
[10] IBC, 2016, § 18(c).
[11] IBC, 2016, § 24(4).
[12] IBC, 2016, § 31.
[13] IBC, 2016, § 12(3).
[14] Ministry of Corporate Affairs, S.O. 3110(E) (Oct. 1, 2016).

explicitly. Liquidator sells the assets of the company one by one through a method of auction. Section 53 of the IBC, 2016 indicates the order in which the proceeds of the liquidation shall be distributed.

Under the IBC, NCLT benches have been functional since June 1, 2016. There is, at present, one Principal Bench at New Delhi and benches at thirteen other locations distributed across the whole country. Appeals against the NCLT decision go to the National Company Law Appellate Tribunal (**"NCLAT"**) in New Delhi. Appeals against the NCLAT judgments are filed before the Supreme Court of India.

Thus, the statutory wherewithal to fight the menace of mounting bad debts is very much there, and the IBC mechanism holds the advantages of Insolvency Professionals (**"IPs"**) leading the campaign backed by IBBI, a regulator to perform legislative, executive, and quasi-judicial functions with respect to such IPs. This infrastructure, if put to optimal use, can be a major device to secure lasting and sustainable resolutions in the insolvency space in India.

III. INTRODUCTION TO THE CONCEPT OF A BAD BANK

A bad bank is an entity similar to a special purpose vehicle that purchases distressed assets from a bank at significant discounts to book value and then finds buyers for those assets. A bad bank helps the stressed banks in two ways – firstly, it relieves the banks of their bad loan burden by setting up an ARC and transferring the NPAs to the ARCs. This way, the banks can concentrate on their core banking functions without having to bother for the

resolution of their bad loans.[15] Secondly, it augments the bank's balance sheet by freeing it from provisioning requirements against bad loans and enhances its ability to lend to the productive sectors of the economy to spur growth.[16] Needless to overstate, a cleaner balance sheet improves the prospects of raising fresh capital also. A bad bank normally takes up stressed assets of a multitude of financial institutions instead of a single bank to spread its risks. Once the buyers are found, the assets are sold, ideally at a profit. When all the bad loans are sold, the bad bank liquidates itself and returns money to its shareholders.

Bad banks are normally set up in difficult times when financial institutions are fighting to emerge out of trying situations to protect their reputation and prevail over the financial stress. In any country, the success of a bad bank hinges principally on the choices made by the banks in terms of which assets to be transferred, the structure and portfolio strategy of the bad bank, its operating structure, and above all, the role played by the government. In some countries, the governments have gone to the extent of considering the establishment of a national bad bank, but generally, it is not accepted everywhere that the governments need to support such initiatives. Thus, the

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[15] *Are bad banks effective options to tackle non-performing assets?*, DELOITTE (2021), https://www2.deloitte.com/in/en/pages/tax/articles/are-bad-banks-effective.html (last visited Sep 5, 2021).

[16] Akiko Terada-Hagiwara & Gloria Pasadilla, *Experience of Asian Asset Management Companies: Do They Increase Moral Hazard? - Evidence from Thailand*, Working Paper Series No. 55, ASIAN DEVELOPMENT BANK - ECONOMICS AND RESEARCH DEPARTMENT (2004), https://www.adb.org/sites/default/files/publication/28188/wp055.pdf.

ecosystem in which a bad bank operates varies from nation to nation that decides its success.[17]

IV. THE NEED FOR A BAD BANK IN INDIA

India sits on the legacy of burgeoning bad debts, which have piled up due to adverse market conditions, global slowdown, and incidence of lax underwriting standards in some banks, primarily the public sector banks. However, at present, the pandemic-hit Indian economy faces a twin problem – anaemic credit growth because the industry is taking time to recover and piling bad debts resulting from their delayed resolution. A glance at the present status would be appropriate.

The RBI's Financial Stability Report of January 2021[18] indicates that the Indian banking sector's gross NPAs may rise from 7.5% of advances in September 2020 to between 13.5% to 14.8% of advances by September 2021, which could be the highest in twenty-two years and has the potential to ruin not just the banking sector but the entire economy. The above situation is over and above the INR 8.8 lakh crores of assets that have been written off by banks between Financial Year (**"FY"**) 2014-15 to FY 2019-20. In addition, two hundred large Non-Banking Financial Companies (**"NBFCs"**) may also see their NPAs rise to between 6.8% to 8.4% of advances by September 2021. So, in aggregate, we may be staring at a figure between INR 26.7 lakh crore to INR 28.8 lakh crore as NPAs – this translates to between 13.7% to 14.8% of

[17] Gabriel Brenna, Thomas Poppensieker & Sebastian Schneider, *Understanding the bad bank*, MCKINSEY & COMPANY (2009), https://www.mckinsey.com/industries/financial-services/our-insights/understanding-the-bad-bank (last visited Aug 15, 2021).
[18] Reserve Bank of India, *Financial Stability Report 2021* (January 2021).

our GDP in FY 2020-21.[19] The enormity of the problem calls for unprecedented steps, hence the pressing need for a bad bank.

We need to address the above unprecedented financial problem urgently to reinvigorate our economy. A reason why establishing a bad bank in present times shall be the most prudent is that over time the net value of NPAs has gone down substantially. The banks have made provisions for these loans in their balance sheets, which means setting aside a prescribed percentage of the bad loans, year after year, bringing the net book value of these NPAs very low. Thus, putting these NPAs into the bad bank resolution process shall cost lesser today than before. Besides, freeing up banks from bad loans can help them participate in the economic recovery, which is becoming visible now with the COVID-19 pandemic impact tapering. Moreover, so far the resolution of large cases has only happened through debt recovery tribunals and the IBC mechanism. With the bad bank in the lead, resolutions across loan types can become possible following an ARC route.[20]

Another very potent argument in favour of the proposed ARC stems from the effect of the RBI guidelines for loan provisioning.[21] The lenders, not being in a strong position to resolve the bad debts, shall see rising loan provisioning and a leaking balance sheet in short. Instead, if the loan is sold at a fair price, some cash (15% of the asset sold at present, in the ARCs

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[19] Ananth Narayan, *How to make India's bad bank workable*, LIVEMINT (Feb. 22, 2021), https://www.livemint.com/industry/banking/how-to-make-india-s-bad-bank-workable-11613911668500.html.

[20] Amarnath Yadav & Pallavi Chavan, *ARCs in India: A Study of their Business Operations and Role in NPA Resolution*, RBI BULLETIN APRIL 2021, 2021, https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=20203.

[21] Reserve Bank of India, *Automation of Income Recognition, Asset Classification and Provisioning processes in banks*, RBI/2020-21/37 Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 (Sept. 14, 2021).

functioning) accrues to the lender, which can be channelised meaningfully.[22] The ARC being a competent forum, rarely encounters a situation where it must sell the assets at a loss and bear the whole loss itself. Normally the ARCs are able to secure a good deal, and for every asset sold at a price higher than the one at which it was bought, the lender gets 80% of the price difference. ARC stands to gain because, besides the 20% retention, it also gets an annual fee of 1.5% to 2% of the total loans transferred from the lender.[23] Thus, it leads to a near win-win deal for ARCs, without a doubt.

Though the Indian Finance Minister in her FY 2020-21 Union Budget speech did not mention the term bad bank as such, however, she did declare the Indian government's resolve to bring in an ARC or an Asset Management Company (**"AMC"**) mechanism to tame the menace of bad debts. The critics lost no time in questioning the advisability of a bad bank with the IBC mechanism already in place. Their criticism stemmed from the stand that without fundamental reforms to solve the NPA problem, a bad bank shall only mean shifting the problem from one place to another. They also saw a moral hazard problem in the banks as the bad bank could appear as a permit for them to continue with irresponsible lending. Besides, the fact remains that the market for stressed assets is not adequately developed in India. A bad bank can work efficiently only when a developed debt market with a large number of participants facilitates adequate price discovery.[24] They also referred to the

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[22] EY & ASSOCHAM, *ARCs – at the crossroads of making a paradigm shift* (2016), http://www.arcindia.co.in/assets/img/EY-ARCs-at-the-crossroads-of-making-a-paradigm-shift.pdf.

[23] *Id.*

[24] Nupur Anand & Aftab Ahmed, *ANALYSIS-Indian ARC may only give banks respite from toxic debt flood*, NASDAQ (2021), https://www.nasdaq.com/articles/analysis-indian-arc-may-only-give-banks-respite-from-toxic-debt-flood-2021-02-01 (last visited Sep 5, 2021).

twenty-eight private ARCs functional in the country as duly registered entities under the SARFAESI Act, 2002 and suggested that the government be well advised to strengthen them instead of floating a new entity.

IBC is an excellent piece of legislation and carries a lot of promise. It has been able to establish a robust mechanism for settlement, resolution, liquidation and withdrawal of cases. The Economic Survey in 2020 indicated that the IBC has improved resolution processes compared to the earlier mechanism. For the first four years, it was able to clock recovery of 42.5% of the debt amount involved compared to 14.5% under the SARFAESI Act, 2002.[25] Similarly, the resolution time under the IBC averaged about 340 days compared to about 4 years and 3 months under the earlier system.[26] The IBC has suffered from various impediments also in this period. The various NCLT benches have not been able to run with full capacity as vacancies at various levels have always remained. The resolution period, which was 180 days, to begin with, now stands extended to 330 days. Besides, overall, the facilitative process for resolution has not been as productive as it was envisaged at the inception of IBC. Yet, in view of the COVID-19 pandemic, when NPAs are set to balloon even further, much of the resolution has to take place outside the IBC framework through a one-time clean-up.

As for the existing ARCs, they started getting bad loans aggressively only from 2013-14, owing majorly to the Security Receipts (**"SRs"**) route

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[25] Ministry of Finance Department of Economic Affairs, Government of India, Economic Survey 2019-2020 (Volume I) (January 2020).

[26] PTI, *Economic Survey: IBC reduces resolution time to 340 days from 4.3 years*, BUSINESS STANDARD (2020), https://www.business-standard.com/article/pti-stories/ibc-reduces-resolution-time-to-340-days-from-4-3-years-earlier-eco-survey-120013101463_1.html (last visited Aug 15, 2021).

taken. Against about INR 10,000 crore of bad loans in the year 2012-13, the same rose sharply to around INR 50,000 crore in the years 2013-14 and 2014-15. However, in August 2014, RBI raised the upfront cash payment by ARCs from 5% to 15%, which brought down the bad debt sales to about INR 20,000 crore.[27] The ARCs have not regained momentum after that instance. The ground reality is that the deals between the banks and the ARCs have slowed down in the recent past due to disagreement over the realisable value of an asset. Besides, the 28 odd ARCs with a tiny, aggregated capital are in no position to cater to a bad loans market of over INR 8 lakh crore, which is mushrooming further.[28]

With the government expressing its willingness to back its efforts in a significant way, the proposed bad bank or national ARC, as it is likely to be christened, stands out as the perfect fit in the given circumstances.

V. BAD BANKS – A GLOBAL PERSPECTIVE

When we search for global parallels, we find almost all the successful bad banks have dealt majorly with housing loans. Some examples are the Resolution Trust Corporation, which dealt with the US savings and loan crises in the 1980s, Grant Street National Bank, also called the Mellon Bank of the US in 1988, Securum and Retriva in Sweden in the 1990s, Arsenal and Sponda in Finland in 1990s and UK Asset Resolution Company which took over the bad loans of Bradford & Bingley and Northern Rock in 2008. The reason why

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[27] EY and ASSOCHAM, *supra* note 22.

[28] Vishwanath Nair, *India's Asset Reconstruction Companies Dealing in "Monopoly Money", Says Kotak's Srini Sriniwasan*, BLOOMBERG QUINT (2021), https://www.bloombergquint.com/business/indias-asset-reconstruction-companies-dealing-in-monopoly-money-says-kotaks-srini-sriniwasan (last visited Aug 15, 2021).

housing loans' bad bank succeeded was because such loans are small in value, relate to a single asset, mortgages are uncomplicated and entirely contained within a clearly saleable property.

But unlike the above, Indian stressed assets are mostly complexly hypothecated corporate fixed assets involving a consortium of lenders, typically to finance large industrial or infrastructure projects. Till now, bad banks have never worked in cases where industrial, corporate, and conglomerate level bad loans predominate. The fundamental cause for this is that such loans are normally large in size, are linked to global business cycles and often take years for the projects to get completed, exposing them to further risks. Such large loans are also linked to complex mortgages where the collaterals may also be exposed to market uncertainties. Some efforts made in Mexico, Brazil, South Korea, Thailand and of course India bear testimony of the same.[29]

Nearer home, the Danaharta of Malaysia is a great example of the carrot and stick model, which romped home with spectacular success. Established in 1998, this bank clocked an admirable 58.7% asset recovery and was wound up in 2005 after a successful stint. The bank was manned by seasoned debt specialists and renowned industry experts. The Malaysian government supported the bank strongly by ushering in structural reforms and accountability. But the inspiration stops beyond this point as the Danaharta was solely owned by the Malaysian government, something that the Indian Finance Minister has already expressly ruled out.

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[29] Omkar Goswami, *The ABCD of Bad Banks*, THE ECONOMIC TIMES (Feb. 12, 2021).

The Indian experiment is going to be a tight rope walking with the government, indicating no actual participation but, of course, the readiness to tweak the ecosystem favourably.

VI. POSSIBLE IMPEDIMENTS TO BE FACED BY THE BAD BANK

As a concept, the most salient advantage of a bad bank lies in the fact that the entity taking a decision on the sale price of an asset is entirely different from the entity accepting that price. This not only leads to avoidance of conflict of interest, but this avoidance is discernible enough to instil confidence in the indulgent parties. Yet, in practice, the bad bank shall have to respond to daunting challenges like an absence of a developed debt market in India and the legacy burden of deteriorating bad debts situation. Its most prominent tests shall relate to the following:

(i) Structure of the Bad Bank: The foremost challenge is likely to be about the structure of the Bad Bank, which is still in the works. Yet, as indications suggest, the bad bank shall comprise an ARC which shall be the holding company of an AMC. Banks will sell these assets to the ARC, which in turn shall be managed by the seasoned professionals at the AMC.[30]

(ii) Ownership Pattern: The next hurdle is likely to be the ownership pattern, for which the views are as divergent as –

a) if the equity comes from the public sector banks, the inability of the public sector banks' chiefs to take bold decisions shall persist;

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[30] *Bad Banks in India,* DELOITTE (2020), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/finance/in-fa-bad-bank-note-noexp.pdf; David Woo, *Two Approaches to Resolving Nonperforming Assets During Financial Crises,* IMF WORKING PAPER WP/00/33 (2000), https://www.imf.org/external/pubs/ft/wp/2000/wp0033.pdf.

b) if the equity comes from the private sector, allegations of crony capitalism are likely to spring up; and
c) if the government is to subscribe to the equity, should it rather not capitalise the banks in question?

It would not be out of place to mention that, unlike the private banks, the public sector banks, in their functioning, are not only subject to the RBI's control but are also accountable to the Department of Financial Services in the Ministry of Finance, Government of India. The public sector banks are covered by the definition of 'State' under Article 12 of the Indian Constitution. These are also subject to the jurisdiction of the three Cs – Central Bureau of Investigation, Central Vigilance Commission, and Comptroller and Auditor General of India. Critics argue that the fear of being drawn into investigations by the above agencies has deterred the public sector banks' chiefs from taking bold and pragmatic decisions. Thus, the bad bank as a public sector entity shall mean shifting the reluctance to act from the public sector banks to the new bad bank.[31] Moreover, it is problematic to have the public sector banks as sellers of bad loans and also as the equity holders of the entity buying them.

In a first, nine banks, comprising seven public sector banks and two private sector banks, and two non-banks are likely to jointly invest INR 7000 crore as initial capital in the proposed bad bank. The non-bank lenders could be Power Finance Corporation and Rural Electrification Corporation.[32] In light of the marquee foreign investors like KKR, Blackrock and Brookfield etc.,

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[31] RAGHURAM RAJAN, I DO WHAT I DO (1st ed. 2017).
[32] Joel Robello, *Nine banks, two non-bank lenders to infuse Rs 7,000 crore in bad bank*, ECONOMIC TIMES, March 1, 2021, https://m.economictimes.com/industry/banking/finance/banking/nine-banks-two-non-bank-lenders-to-infuse-rs-7000-crore-in-bad-bank/articleshow/81264978.cms.

also evincing their interest, RBI, along with the Securities and Exchange Board of India, shall need to carry out necessary changes in the relevant regulations.[33] With the bad bank having become operational in July 2021, there is a community of experts who have strongly voiced their preference for a privately owned bad bank. It is felt that the expertise of the private management, free from the government control, can be employed to manage the assets in innovative ways like bundling of assets, brokerage services and better price discovery. In contrast, entrusting the public sector to lead the bad bank could mean that the inertia among banks to take pragmatic as well as tough decisions shall continue.[34] Besides, as discussed above, it could lead to a moral hazard problem in the banks to keep extending loans as earlier.

(iii) Functioning: The next challenge shall be as regards the functioning of the proposed ARC. As it appears, the bad loans of over INR 500 crores and with 100% provisioning shall be transferred to the new entity.[35] The partly provided loans can continue to be handled by the other existing ARCs. The SRs issued by the national ARC (bad bank) are likely to be backed by the Indian government for a few initial years, but not for their whole tenure. It is expected that RBI is likely to issue guidelines in this regard. The banks holding SRs may, in all likelihood, be made to pay an annual fee to the national ARC,

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[33] Dheeraj Tiwari, *BlackRock, KKR, Brookfield and others may join government's proposed "bad bank,"* ECONOMIC TIMES, March 2, 2021, https://economictimes.indiatimes.com/industry/banking/finance/blackrock-kkr-brookfield-and-others-may-join-governments-proposed-bad-bank/articleshow/81285014.cms?from=mdr.

[34] Sunny Verma & George Mathew, *Explained: The arguments for and against a bad bank*, THE INDIAN EXPRESS (2021), https://indianexpress.com/article/explained/npa-bad-bank-balance-sheet-loan-rbi-shaktikanta-das-7151841/ (last visited Aug 15, 2021).

[35] Anup Roy, *Bad bank may follow Swiss challenge method for price discovery of assets*, BUSINESS STANDARD (2021), https://www.business-standard.com/article/finance/bad-bank-may-follow-swiss-challenge-method-for-price-discovery-of-assets-121022500062_1.html (last visited Aug 15, 2021).

which could range from 1.5% to 2% of the loans transferred, in line with the prevailing practice among the existing ARCs at present.[36]

(iv) Development of a functional market for dud loans: Another aspect requiring serious consideration is the development of a functional market for dud loans.[37] Though after the enactment of the SARFAESI Act, 2002, many private ARCs emerged, but as India lacks a developed debt market and there are not many investors for stressed assets, not many bidders came forth and resultantly, most ARCs have come a cropper. In this regard, one recent development needs mention. As a first step towards building a secondary debt market in India, ten Indian banks, including the leading players like State Bank of India, the HDFC Bank and ICICI Bank, came together in the first week of August 2021 to set up the Secondary Loan Market Association.[38] This body has been set up as a self-regulatory body following the recommendations of the RBI's Task Force on the Development of Secondary Market for Corporate Loans.[39] The secondary debt market helps larger borrowers widen their lending base, avoid funding uncertainties and gain better access to market participants with different risk appetites. Such reforms can prove to be game changers for the success of the bad bank in India and can help it succeed in cases where the existing ARCs could not progress too well.

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[36] EY and ASSOCHAM, *supra* note 22.

[37] Narendra Kumar, *Function of Asset Reconstruction Companies & RBI Regulation for ARC*, ENTERSLICE (2017), https://enterslice.com/learning/function-asset-reconstruction-companies/ (last visited Mar 21, 2021).

[38] Gopika Gopakumar, *SLMA launched to help secondary loan market*, LIVEMINT (2021), https://www.livemint.com/industry/banking/banks-set-up-secondary-loan-market-association-11628689998479.html (last visited Sep 5, 2021).

[39] Reserve Bank of India, *Report of the Task Force on the Development of Secondary Market for Corporate Loans* (2019), https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/DSMCLOANSBB7C3EDF738D4038B734E909AC054D68.PDF.

A daunting challenge shall come in the form of the pricing of the assets to be transferred. The bad bank shall not buy a bad loan at book value; how would it make a profit then? It will insist on discounts, depending upon the asset and its saleability. Now, is the bank management protected if it sells loans at discounts? And if the eventual buyer is in the private sector, how would the allegations regarding favouritism and crony capitalism be handled? Similarly, if the loans are sold at too high a price, it would entail very slim chances of a resolution. It would be worthwhile to cite the IDBI Bank's experiment of Stressed Assets Stabilization Fund (**"SASF"**), which was not successful. In the year 2004, when the erstwhile IDBI Ltd. converted itself to a bank, the government went ahead with the setting up of a SASF with 636 stressed loan cases worth nearly INR 9,000 crore and extended a loan of INR 9,000 crore to the fund with a tenure of 20 years. The SASF failed to resolve most large cases and had to settle with part success in some small cases. The learning from this case was that not only the price discovery was faulty, in the beginning, the SASF was also ill-prepared to run the show with a very small team of experts.[40] Thus, the subset of India's present challenge, as regards the bad bank, is to improve price discovery and address the transparency-related problems given that state-owned banks are going to sell loans to a state-backed bad bank. Shall the bad bank be capable of crafting a miracle? One hopes so.

Another caveat to be encountered by the bad bank is the failure of the four major bank recapitalisation attempts in our country since 1992-93. Nothing much was achieved in terms of efficiency, return on equity and assets,

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[40] Vishwanath Nair, *Lessons from IDBI's experiment with a bad bank-like structure*, LIVEMINT (2016), https://www.livemint.com/Industry/cM5Rb5szBMFPAyYMNiVq1N/Lessons-from-IDBIs-experiment-with-a-bad-bank.html (last visited Aug. 14, 2021).

or in creating a modern banking structure.[41] The country can ill afford another failure in the series.

VII. RECOMMENDATIONS FOR THE SUCCESSFUL FUNCTIONING OF A BAD BANK IN INDIA

Why the bad bank took so long to arrive could remain a puzzle, but prudence demands that it should be turned into a huge opportunity to handle the challenges posed by bad debts; and hurriedly also, before the pandemic-hit economy releases the fresh flow of bad loans.[42]

We have seen the ARCs working in our country for over eighteen years, majorly in the private sector. Though these ARCs were well received and were highly successful in the beginning, the going got tougher after the RBI tightened their working norms. To add to their woes, the air around the true value of the assets became murky, and the absence of a market for bad loans started hitting harder. For the proposed bad bank to be a success, it is highly imperative to improve the ecosystem for resolutions and remove all the anomalies hurting it presently. Ideally, the bad bank should have a focussed mandate putting NPA resolution to timelines, backed by a supportive legal infrastructure catering to bankruptcy and personal property laws and a strong political will to make it a success.[43]

A conducive environment shall not only facilitate faster resolutions by the bad bank but shall be a shot in the arm for the existing ARCs. Since such

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[41] Goswami, *supra* note 29.

[42] Deloitte, *supra* note 30; Prathamesh Mulye, *The second wave of Covid-19 will deepen the bad loan crisis at Indian banks*, QUARTZ INDIA (2021), https://qz.com/india/1996804/indian-banks-bad-loans-will-rise-as-lockdowns-hurt-businesses/ (last visited Sept. 5, 2021).

[43] Yadav and Chavan, *supra* note 20.

resolutions are going to come through legal proceedings or otherwise, it would be worthwhile to see the performance of the IBC mechanism in the last few years.

Under the IBC, various NCLT benches had admitted 4008 cases until the second quarter of FY 20-21, after which it was stopped from initiating a fresh corporate insolvency process until March 24, 2021 due to the COVID-19 pandemic. Out of the 4008 cases, 277 ended up as resolved cases till the end of September 2020 (firms continue as going concerns), while 1025 cases resulted in liquidation. For the resolved cases, the total claim was INR 10.48 lakh crore, out of which the realisable amount is INR 2.2 lakh crores, a haircut of INR 8.30 lakh crore. This translates to a debt recovery of 20.9% and a haircut of 79.1%. Out of the INR 18,917 crore that went into liquidation, the recovery was only INR 280 crore, meaning recovery of 1.5% and a haircut of 98.5%. The greater concern is as regards the pending cases where the ageing of a very high percentage of cases is over 270 days. The situation becomes of much larger concern when one factors the likely addition of nearly 4000 fresh cases every year, in view of the COVID-19 impact.[44]

Therefore, in view of the fact that the structural faults of the resolution mechanism have already caused massive value destruction of profitable or potentially profitable businesses, for a successful bad bank to usher, the following are a few must-do steps requiring immediate action.

First and foremost, the NCLT mechanism needs a thorough revamping and fine-tuning. The NCLT benches need to be increased tremendously. All the vacancies in such benches should be filled on a war footing. The presence

[44] Narayan, *supra* note 19.

of technical or non-judicial members in the NCLT or the NCLAT needs to be increased.[45] Most matters before them seek a commercial or subject-matter appreciation more than the judicial one. The Supreme Court of India should proactively frame rules for the accountability of NCLT judges/benches as regards meeting resolution timelines and follow the prescribed procedure for the same.

Since bad loan cases emerge out of economic distress or financial distress, for the successful resolution, a clear differentiation at the end of the NCLT is essential to see where lies the incentive – in liquidation (most cases of economic distress) or in revival (most cases of financial distress). A company is economically distressed when the present value of its expected profits is less than the total assets of the company, and the prevailing economy also does not seem to be offering it any hopes of recovery. Liquidation, normally, is the best option for them. In contrast, a company is financially distressed when it cannot service its debts. Such companies can be sustained either by effecting the restructuring of the board and bringing in competent persons to steer the firm or by selling it to investors with stronger financial muscle. NCLT should, therefore, employ an appropriate approach while handling resolutions. A one size fits all strategy cannot successfully work here.

[45] National Company Law Tribunal and Appellate Tribunal Bar Association v. Ministry of Corporate Affairs, 2021 SC 406; *See generally* Debayan Roy, *Supreme Court seeks response from Centre on plea to fill up vacancies at NCLT, NCLAT, asks to expedite President & Chairman's appointment*, BAR AND BENCH (2021), https://www.barandbench.com/news/litigation/supreme-court-notice-central-government-vacancies-nclt-nclat (last visited Sep 5, 2021). Arpan Chaturvedi, *240 Vacancies At 15 Tribunals Even As Tug-Of-War Continues On Tribunal Reforms*, BLOOMBERG QUINT (2021), https://www.bloombergquint.com/law-and-policy/240-vacancies-at-15-tribunals-even-as-tug-of-war-continues-on-tribunal-reforms (last visited Sep 4, 2021).

To make the resolutions smoother, the NPAs market needs structural flexibility to attract private participants from across the world. The mix of the cash and securities components also needs to align with demand and supply dynamics to get the best possible resolutions.

The NCLT as a forum has been following resolution as a default approach and keeping liquidation as a last resort. Needless to overemphasize that liquidation leads to a triple whammy – loss of the funds given as loan to the firm, loss of business which could have resulted from a successful firm, and loss of employment as a result of the shutting down of the business.[46] Quick resolution and disposal should be the guiding principle for the NCLT benches. For example, in the resolution of the cases like the INR 42,000 crores bad debt of Essar Steel, assuming the inflation rate to be 4%, the delay in a settlement shall cost INR 5 crores every day. So, judgments in NCLTs should be delivered in commercial time instead of judicial time.[47]

The final ownership pattern of the bad bank is yet to emerge, but for this entity to bear desired results, the ideal situation shall be to grant it private ownership. But short of private ownership, any structure which finally emerges should be allowed to function professionally and with optimum operational autonomy. The participation of the government, if at all, should be limited to issuing SRs to instil confidence in the system. Certain aspects of the

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[46] Prasanna Mohanty, *Rebooting Economy 65: IBC has failed; will a bad bank succeed?*, BUSINESS TODAY (2021), https://www.businesstoday.in/opinion/columns/rebooting-economy-65-ibc-has-failed-will-a-bad-bank-succeed/story/430537.html (last visited Mar 21, 2021).

[47] R Jagannathan, *Bankruptcy cases must account for the time value of money*, LIVEMINT (2021), https://www.livemint.com/opinion/online-views/opinion-bankruptcy-cases-must-account-for-the-time-value-of-money-1565111192615.html (last visited Mar 21, 2021).

resolution process like recovery rates and transparency in the whole mechanism shall remain very important.

Besides the above, the following steps can potentially arm the proposed ARC or the bad bank with much greater thrust and hope –

(i) Capital infusion of about INR 1 Lakh crore to support the purchase of about INR 2.5 to INR 3 lakh crore worth bad loans, assuming haircuts varying from 30% to 50%.

(ii) The ARC needs inspiring and acclaimed professionals to spearhead its operations.

(iii) The transfer of assets to the bad bank has to be at a goldilocks just-right price, neither too high nor too low.

(iv) The bad bank should have a pre-notified limited tenure. A fixed tenure shall bring a sense of urgency in its working and shall also send a loud message that this one-time exercise does not carry even an iota of invitation for perpetuating the evil cycle of bad assets.

(v) Most stressed assets belong to infrastructure, real estate, power and construction sectors, and a strong government policy action shall be imperative.[48]

Additionally, raising a bad bank alone shall not lead to sustainable results unless the government also unleashes a series of banking sector reforms.

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[48] Narayan, *supra* note 19.

Bank loan arrears have mounted in India over the decades because of the global slowdown, project viability issues, lack of focus and accountability in the bank management, slackness of the firms' auditors and protracted litigations heading nowhere. To improve the overall status of the public sector banks, the government would be well advised to consider Dr P. J. Nayak's report[49] outlining the much-needed reforms in the public sector banks' boards.

Public sector banks need a complete overhaul. Banks/financial institutions need to appoint an independent chief compliance/due diligence officer, who should report to the central regulator, the RBI, and not the firm's CEO. The credit underwriting department should be manned by personnel having relevant sectoral, legal, and due diligence backgrounds. This department should be energised to segregate the good from the not-so-good borrower and to timely identify the red flags.[50]

Public sector banks have to be provided with professional autonomy. Social obligations may remain a part of the banking system, but the government should address them through specific instruments and targeted transfers rather than leaning on such banks, which are commercial organisations answerable to their shareholders. Additionally, market-linked remuneration should replace the current repressed salaries of the public sector bank employees. Senior bankers' pay must be tied with larger components

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[49] Reserve Bank of India, *Report of The Committee to Review Governance of Boards of Banks in India* (2014).

[50] Jagriti Bhattacharya, *Will the proposed bad bank help?*, FINANCIAL EXPRESS (2021), https://www.financialexpress.com/opinion/will-the-proposed-bad-bank-help/2196737/ (last visited Mar 21, 2021).

linked to long term performance. This would attract better resources towards these banks.[51]

VIII. CONCLUSION

Starting with the Economic Survey, 2017, when the bad bank was first conceived in the form of a Public Sector Asset Rehabilitation Agency[52] and later through the Project Sashakt of 2018, which recommended a five-point plan for bad debts' resolution,[53] bad bank as an entity has attracted significant attention. Yet, the value destruction has continued over the years. In the last decade alone, bank loans of over INR 8,83,168 crores have been written off,[54] with nearly INR 2,37,206 crores written off in the year 2019 only.[55] Nobody shall relish squandering more good money over bad money.

Thus, the large overhang of non-performing assets in our banking sector ecosystem makes a strong case for a one time clean up through the proposed bad bank. A successful ARC shall also go a long way in contributing to the economic revival in the country. Mr Hari Hara Mishra, Director at UV ARC, very aptly remarked,[56]

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[51] Narayan, *supra* note 19.
[52] *Economic Survey 2016-17*, MINISTRY OF FINANCE, GOVERNMENT OF INDIA (2017) https://pib.gov.in/newsite/PrintRelease.aspx?relid=157805 (last visited Aug 12, 2021).
[53] PTI, *Sunil Mehta panel incorporates "Sashakt India AMC" for large NPAs*, THE ECONOMIC TIMES (2018), https://economictimes.indiatimes.com/industry/banking/finance/banking/sunil-mehta-panel-incorporates-sashakt-india-amc-for-large-npas/articleshow/66637519.cms?from=mdr (last visited Aug 12, 2021).
[54] Reserve Bank of India, *Report on Trend and Progress of Banking in India 2019-20* (2020).
[55] *Id.*
[56] ET Bureau, *Why Budget proposal for setting up of a bad bank is a good idea*, ECONOMIC TIMES (2021), https://economictimes.indiatimes.com/industry/banking/finance/banking/why-budget-proposal-for-setting-up-of-a-bad-bank-is-a-good-idea/articleshow/80639840.cms?from=mdr (last visited Mar 28, 2021).

> In COVID parlance, a bad bank is like setting up a jumbo quarantine centre for NPAs. However, the treatment it will require shall be a large number of ventilators which effectively are distressed debt funds with risk appetite to acquire these NPAs. Vaccine, or permanent cure, of course, lies in enhancing underwriting skills and oversight mechanism to arrest the deterioration of credit quality.

The long-awaited bad bank has finally taken shape with the National Asset Reconstruction Company Limited (**"NARCL"**), the name given to the bad bank, getting registered with the Registrar of Companies Mumbai in July 2021. Mr Padmakumar M Nair, a resolution expert from the State Bank of India, has been appointed as the managing director of NARCL.[57] This marks the beginning of India's march towards a strong stressed assets resolution regime and makes it a decisive step in the direction of India's dream of becoming one of the leading economies in the world.

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[57] *Daily News Digest by BFSI Board, ICAI*, , THE INSTITUTION OF COST ACCOUNTANTS OF INDIA (2021), https://icmai.in/upload/BI/DND_1407_21.pdf (last visited Sep 4, 2021). Vishwanath Nair, *Padmakumar M Nair Appointed As CEO Of National Asset Reconstruction Company*, BLOOMBERG QUINT (2021), https://www.bloombergquint.com/business/india-bad-bank-padmakumar-m-nair-appointed-as-ceo-of-national-asset-reconstruction-company (last visited Sep 4, 2021).

IV. RETROSPECTIVE OVERREACH: THE JUDICIAL UNDERMINING OF PARLIAMENTARY SUPREMACY IN LIGHT OF SECTION 40 (A) (IA) OF THE INCOME TAX ACT, 1961

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ABSTRACT

Legal stability forms a cornerstone of the common law system, yet discord among High Courts causes confusion among the public at large regarding certain parts of the law. The problem compounds itself when one narrows their scope to the field of tax law – as predictability of tax becomes paramount. The present study seeks to understand the current position of Section 40(a)(ia) of the Income Tax Act, 1961 which pertains to the non-deduction of certain expenditures while calculating the income of a business and expands into a more holistic analysis of the interpretation of tax statutes. In particular, the present paper focuses on the retrospective application of the second proviso of Section 40(a)(ia) and the possible consequences of such a decision – while exploring the arguments for and against the retrospective application of the provision. Additionally, the present paper scrutinises the six High Court decisions in this regard, and other allied judgements, to gauge the best possible reasoned interpretation of the provision. This dispute has gained contemporary relevance after the Apex Court, in the Shree Choudhary Transport Company case, enunciated that a substantial provision does not warrant retrospective operation merely because it is beneficial in nature. This strikes at the very core of the judgments delivered by various High Courts holding that the second proviso of Section 40(a)(ia) is retrospective in nature. While the appeals against these decisions of the High Courts are pending before the Supreme Court, the authors opine that the Apex Court is likely to hold that the proviso does not have retrospective operation, in light of the recent aforementioned case. The paper concludes with the opinion of the authors regarding the retrospective application of the said section, and tax statutes in general, while also putting forth recommendations that would bring uniformity in the interpretations of

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tax statutes across the judicial discipline – providing the greater good to the public in the form of enhanced stability of laws.

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I. INTRODUCTION

Tax deductions are crucial in incentivising the proliferation of productive businesses as the same lowers the taxable income of persons and thereby reduces the overall tax obligation of an individual or business. The same garners further importance by way of cultivating an entrepreneur-friendly climate as small businesses and start-ups which incur heavy outflows in capital expenditure would not be able to sustain themselves without tax deductions.

In light of the above considerations, Section 30 to 38 of the Income Tax Act, 1961 (**"Act"**) have been inserted – which lay down the business expenditures that are deductible while calculating the taxable income of a

person.[1] Nevertheless, Section 40(a)(ia) disallows certain deductions, provided the assessee fails to deduct the applicable Tax Deductible at Source (**"TDS"**) on the said payment. Section 40(a)(ia), before the 2012 Amendment,[2] laid down that the non-deduction of TDS would disallow the impugned expenditure on which TDS was not withheld in whole – thus increasing the tax liability of the assessee in that assessment year.

To appreciate the rigor of Section 40(a)(ia), it is important to understand the purpose of TDS provisions. The insertion of TDS provisions minimises tax evasion by partially or wholly taxing the income of a person at the time of generation, thus preventing assessees from evading taxes.

Neither the mandatory nature of TDS provisions nor their benefit to the revenue has been contended; however, a cleavage of opinion arises as to the retrospective application of the second proviso to Section 40(a)(ia) (**"Second Proviso"**). The second proviso reads as under:

> "where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of Section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso."[3]

The second proviso, in essence, allows the assessee to claim deductions even where he has not complied with the TDS provisions, provided

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[1] The Income- Tax Act, 1995, No. 43, Acts of Parliament, 1961, § 2(31) [Hereinafter *Income Tax Act, 1961*].

[2] The Finance Act, 2012, No. 23, Acts of Parliament, 2012, § 11 [Hereinafter *Finance Act, 2014*].

[3] Income Tax Act, 1961, § 40(a)(ia).

that the recipient of such income has paid tax on it and fulfilled other conditions laid down under § 201.[4] The conditions that ought to be met by the payee are as follows:

i. has furnished his return of income under Section 139;

ii. has taken into account the sum on which TDS was not deducted while computing his income;

iii. has paid, in whole, the tax due on the income so declared; and

iv. has furnished a certificate to this effect from an accountant to the assessee as prescribed under Rule 31ACB.[5]

Although the Amending act, i.e., the Finance Act, 2012, states that the second proviso shall come into effect from April 1, 2013, that same has been contested in several High Courts for the grant of retrospective application.

A. Present Judicial Stance

The absence of a Supreme Court decision is the primary cause of deviations between various High Court decisions concerning the second proviso. The Kerala High Court[6] is the sole constitutional court that has ruled in favour of the revenue in the present contention, i.e., against retrospective application of the second proviso whereas the Delhi,[7] Allahabad,[8] Bombay,[9]

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[4] Income Tax Act, 1961, § 201.
[5] Income Tax Rules (1962), GOVT. OF INDIA, Rule 31 ACB.
[6] Thomas George Muthoot v. CIT, (2016) 287 CTR (Ker) 101.
[7] CIT v. Ansal Landmark Township, (2015) 279 CTR 384.
[8] Commissioner of Income Tax v. Manoj Kumar Singh, (2014) 44 taxmann.com 362 (Allahabad).
[9] Perfect Circle India Ltd v. Assistant Commissioner of Income Tax, (2020) 423 ITR65 (Bombay).

Calcutta,[10] and the Punjab and Haryana High Court[11] have adjudicated the matter in favour of the assessee.

The Courts that have adjudicated the matter in the favour of the assessees[12] have observed that the insertion of the second proviso was curative and declaratory in nature as the same sought to cure unintended hardships caused by the language of Section 40(a)(ia) before the 2012 Amendment. These hardships include disallowance of business expenditure even where the tax had been paid by the recipient and the purpose of the provision was satisfied, *de facto*.

On the other hand, the Hon'ble Kerala High Court had ruled in favour of the revenue[13] as the second proviso conferred an additional benefit on the assessees and did not cure any unintended hardships, favouring prospective application in consonance with the literal interpretation of the statute. It is pertinent to note that the decisions given by the Delhi High Court and the Kerala High Court are already in appeal before the Hon'ble Apex Court and await a hearing.[14]

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[10] Commissioner of Income Tax v. S. K. Tekriwal, (2014) 46 taxmann.com 444 (Calcutta).

[11] Commissioner of Income Tax v. Shivpal Singh Chaudhary, (2018) 409 ITR 87 (Punjab and Haryana).

[12] CIT v. Ansal Landmark Township, (2015) 279 CTR 384; Commissioner of Income Tax v. Manoj Kumar Singh, (2014) 44 taxmann.com 362 (Allahabad), Perfect Circle India Ltd v. Assistant Commissioner of Income Tax, (2020) 423 ITR65 (Bombay); Commissioner of Income Tax v. S. K. Tekriwal, (2014) 46 taxmann.com 444 (Calcutta); Commissioner of Income Tax v. Shivpal Singh Chaudhary, (2018) 409 ITR 87 (Punjab and Haryana).

[13] Thomas George Muthoot v. CIT, (2016) 287 CTR (Ker) 101.

[14] Commissioner of Income-tax-1 v. Ansal Landmark Township (P.) Ltd., (2016) 73 taxmann.com 63 (SC); Principal Commissioner of Income-tax-6 v. Noida Software Technology Park Ltd., (2020) 113 taxmann.com 145 (SC); Principal Commissioner of Income-tax-8, Delhi v. Shivaai Industries (P.) Ltd., (2020) 113 taxmann.com 166 (SC); Thomas Muthoot v. Commissioner of Income-tax, (2020) 120 taxmann.com 317 (SC).

However, in the recent judgment of *Shree Choudhary Transport Company*,[15] the Hon'ble Supreme Court has conferred prospective operation to the 2014 Amendment[16] to Section 40(a)(ia) which restricted the amount of disallowance to 30% in case of failure to withhold or deposit tax at source.

In this article, the authors seek to put forth the stance that the decisions of Delhi,[17] Allahabad,[18] Bombay,[19] Calcutta,[20] and the Punjab and Haryana High Court,[21] holding that the second proviso is retrospective in nature and need to be revisited especially in light of the *Shree Choudhary Transport* judgement. The authors first establish that the second proviso must be presumed to be prospective in nature, and second, that it must be interpreted strictly due to its unambiguous language, and finally, the authors establish that the proviso is not curative or declaratory in nature.

II. PRESUMPTION IN FAVOUR OF THE PROSPECTIVE APPLICATION

The Hon'ble Apex Court has at multiple occasions held that the law must be presumed to be prospective in nature unless it has been given retrospective effect by the legislature either expressly or by necessary

[15] Shree Chaudhary Transport Company v. Income Tax Officer, [2020] 118 taxmann.com 47 (SC).
[16] Finance Act, 2014, § 14.
[17] CIT v. Ansal Landmark Township, (2015) 279 CTR 384.
[18] Commissioner of Income Tax v. Manoj Kumar Singh, (2014) 44 taxmann.com 362 (Allahabad).
[19] Perfect Circle India Ltd v. Assistant Commissioner of Income Tax, (2020) 423 ITR65 (Bombay).
[20] Commissioner of Income Tax v. S. K. Tekriwal, (2014) 46 taxmann.com 444 (Calcutta).
[21] Commissioner of Income Tax v. Shivpal Singh Chaudhary, (2018) 409 ITR 87 (Punjab and Haryana).

implication.[22] This position was reiterated by the Hon'ble Court in the recent decision of *CIT v. Vatika Township Pvt. Ltd*.[23]

The Apex Court, while relying upon *Phillips v. Eyre,*[24] elucidated in this case that the rule against the retrospective application is based on the imperative principle of fairness, since the law looks forward and not backward.[25] Hence, the Court should consider whether conferring retrospective application to a provision would defeat the reasonable expectations of those who are affected by it.

In furtherance of the principle of presumption of prospective application, a provision cannot be given effect retrospectively unless the statute declares the same in clear and unambiguous words, or when the amended provision is declaratory in nature.[26] Hence, the legislative intent behind the provision to operate retrospectively should be evident from its language and if the court is not satisfied with the same, it must give prospective application to that provision.[27]

Presently, as discussed in further detail later, the language employed by the Parliament for introducing the second proviso neither confers

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[22] Gem Granites v. CIT, (2005) 1 SCC 289; Shyam Kumar v. Ram Kumar, (2001) 8 SCC 24; Keshavan Madhava Menon v. State of Bombay, (1951) AIR 1951 SC 128; ITO v. Kajaria Investment & Properties (P.) Ltd., (2008) 297 ITR 45; Union of India v. Madan Gopal Kabra, (1954) AIR 1954 SC 158; Govinddas v. Income Tax Officer, (1976) 1 SCC 906; CIT Bombay v. Scindia Steam Navigation Co. Ltd., (1962) 1 SCR 788; Hitendra Vishnu Thakur v. State of Maharashtra, (1994) AIR 1994 S.C. 2632.
[23] CIT v. Vatika Township Pvt. Ltd., (2014) 367 ITR 466.
[24] Phillips v. Eyre, (1870) LR 6 QB 1; Government of India v. Indian Tobacco Association, (2005) 7 SCC 396.
[25] L'Office Cherifien des Phosphates v. Yamashita Shinnihon Steamship Co. Ltd., (1994) 1 AC 486.
[26] Saurastra Agencies (P.) Ltd. v. Union of India, (1990) 186 ITR 634.
[27] Associated Industries v. First Income-tax Officer (1982) 134 ITR 565.

retrospective application to it nor does it necessarily implies the same. Therefore, the Courts should have presumed the proviso to be prospective in its application.

A. The Second Proviso is Substantive in Nature

The presumption against the retrospective application is not applicable when the law in question is procedural in nature since it does not affect any existing rights and liabilities of the parties. Therefore, the presumption in favour of the prospective application of the second proviso will only stand as long as it is not procedural in nature. Procedural laws are those which do not affect any vested rights of a person, contrary to substantive laws which relate to an issue of substance and affect the rights, duties, and power of the parties. In its decision in the case titled *Hitendra Vishnu Thakur v. State of Maharashtra,*[28] the Hon'ble Apex Court elucidated that any statute dealing with the procedure should be construed as retrospective in nature.[29] Hence, its provisions shall apply to the proceedings which are pending at the time of its enactment.

Regarding fiscal statutes as well, if the amendment is purely procedural and merely affects the machinery for collecting the tax rather than the tax itself, it may operate retrospectively.[30] A tax provision is considered to be procedural in nature if its terms do not take away or impair any existing right, create any new obligation, or enforce a fresh levy than as regards matters

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[28] Hitendra Vishnu Thakur v. State of Maharashtra, (1994) AIR 1994 S.C. 2632.
[29] Hitendra Vishnu Thakur v. State of Maharashtra, (1994) AIR 1994 S.C. 2632; P. Ram Gopal Varma v. Dy. CIT (Assessment), (2013) 357 ITR 493.
[30] CIT v. Mela Ram Jagdish Raj & Co., (1981) 132 ITR 897; Veerbhandas Purswani v. CWT, (1985) 154 ITR 128; Kanumarlapudi L. Chetty v. First Addl. ITO, (1957) AIR 1957 AP 159.

of procedure.[31] It is an established position that provisions dealing with, *inter alia,* what will be taxed, what should not be taxed, and what amounts can be deducted while computation of taxable income, fall within the paradigm of substantive law, as has been elucidated by the Hon'ble Delhi High Court in the *National Agrl. Co-operative Marketing Federation of India Ltd.* case.[32]

The insertion of the second proviso lowers the tax liability of the assessee provided that the recipient of the income had complied with the provisions of the first proviso to Section 201(1) – thereby, substantially affecting the taxable income of the former. Therefore, the remedy against disallowance under the second proviso cannot be deemed as procedural law.

Furthermore, a two-fold test in the light of Hohfeldian analysis of rights would shed light on the substantial nature of the right bestowed on the assessee under the second proviso to Section 40(a)(ia); Hohfeldian analysis of rights is a system that identifies jural relations by distinguishing the correlative and the opposites of the rights therein.

In the aftermath of the amendment to Section 40(a)(ia), the assessee is granted a benefit of not being treated as an 'assessee in default'; as a result, there exists an accompanying duty on the department not to treat him as an assessee in default.[33] Secondly, the assessee can claim as a matter of right not to be treated as an assessee in default under Section 201, thereby taking away the department's claim to such deduction which was earlier permissible.

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[31] New Shorrock Spinning & Manufacturing Co. Ltd. v. N. V. Raval, (1959) AIR 1959 Bom 477; JUSTICE G.P. SINGH, PRINCIPLES OF STATUTORY INTERPRETATION (13th ed., 2012).
[32] CIT v. National Agrl. Co-operative Marketing Federation of India Ltd., (1999) 236 ITR 766; CIT v. Assam Frontier Tea Ltd., (1997) 224 ITR 398.
[33] HURD, MOORE & MICHAEL, THE HOHFELDIAN ANALYSIS OF RIGHTS, (University of Illinois College of Law Legal Studies, 2018).

Therefore, it is evident that since the proviso is conferring a new right on the assessee, which was previously disallowed, it is substantive in nature and the presumption must stand in favour of its prospective application.

III. THE DOCTRINE OF LITERAL INTERPRETATION

The doctrine of literal interpretation is one of the oldest and simplest rules of interpretation of statutes. It is the most commonly employed tool for interpretation when the language of an Act is unambiguous. This doctrine is the premise of the cardinal principle that while interpreting fiscal statutes, the courts must strictly refer to the language of the statute, without adding or subtracting words from it.[34] This principle is an implication of the general rule that the court can pronounce the judgement, but not write the law.

To elaborate further on this proposition in the light of the Separation of Powers model, the role of the judiciary is to interpret the provisions to bring out the intention of the legislature. However, if the intention of the legislature is already expressly stated through the unambiguous language of the provision, the same does not require any further elaboration, limiting the role of the courts.[35] Hence, unless the amended provision is given retrospective effect by the legislature either expressly or by necessary implication, the court cannot interfere with the same and confer retrospective application to that provision.[36]

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[34] Sangeeta Singh v. Union of India, (2005) 7 SCC 484; CIT v. Calcutta Knitwears, (2014) 362 ITR 673; Grasim Industries Ltd. v. Collector of Customs, (2002) JT (3) SC 555.

[35] State of Kerala v. M.K. Agrotech Pvt. Ltd., (2017) 16 SCC 210.

[36] J.K. Synthetics Ltd. v. CTO, (1994) 119 CTR (SC) 222; CWT v. Varadharaja Theatre Pvt. Ltd., (2001) 250 ITR 523 (Mad.).

Coming back to the retrospective operation of the second proviso, it must be noted that the language employed in the provision, the Memorandum explaining the same,[37] and the Notes on Clauses[38] attached to the 2012 Finance Bill do not imply in any manner that the proviso is to be given retrospective effect. At the cost of reiteration, the proviso was inserted by the Finance Act, 2012, and came into effect from April 1, 2013. The Act explicitly states that the amendment comes into force on April 1, 2013, which strengthens the argument that the legislature had intended the same to be prospective in nature. The specific date prescribed for giving effect to the proviso entails that any other interpretation enabling retrospective effect shall be contrary to the intention of the legislature.

The relevant portion of the Finance Act, 2012 read as under:

> **Amendment of Section 40.**
>
> **11.** In Section 40 of the Income-tax Act, in clause (a), in sub-clause (ia), after the proviso and before the Explanation, the following proviso shall be inserted with effect from the 1st day of April, 2013…[39]

Moreover, even the Memorandum explaining the Finance Act, 2012[40] does not imply that the proviso has retrospective application. It reads as under:

> **II. Disallowance of business expenditure on account of non-deduction of tax on payment to resident payee**

[37] Explanatory Memorandum, Finance Bill 2012 (Cent.) 11.
[38] Finance Bill, 2012, Notes on Clauses.
[39] Explanatory Memorandum, Finance Bill 2012 (Cent.) 11.
[40] Explanatory Memorandum, Finance Bill 2012 (Cent.) 11.

> …These amendments will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

Lastly, the Notes on Clauses attached with the Finance Act, 2012[41] explicitly mention that the above proviso would come into operation on April 1, 2013. It reads as under:

> **Clause 11 of the Bill seeks to amend Section 40 of the Income-tax Act relating to amounts not deductible.**
>
> …This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-2014 and subsequent assessment years.

Since all the material cited above mentions that the second proviso of Section 40(a)(ia) will come into operation from April 1, 2013, and apply from the assessment year 2013-14, the proviso cannot be conferred retrospective application by the Courts against the patent intention of the legislation.

A. Rationalization of the Effect of Section 191

Under the provisions of Chapter XVII-B of the Act, a person was required to deduct tax on certain specified payments at the specified rates if the payment exceeded the specified threshold.[42] In case of non-deduction of such tax under the provisions of this Chapter, he is deemed to be an assessee in default under Section 201(1) in respect of the amount of such non-deduction.

However, Section 191 of the Act provides that a person shall be deemed to be an assessee in default in respect of non-deduction of tax only in

[41] Finance Bill, 2012, Notes on Clauses.
[42] Income Tax Act, 1961, § 190.

cases where the payee has also failed to pay the tax.[43] Consequently, the deductor ought not to be treated as an assessee in default provided the payee has discharged his/her tax liability. *Id est* if tax has already been paid by the recipient on income, it is not justified to recover tax on the said amount in the light of the provisions of Section 191 wherein the legislature has provided for collection of tax directly from the recipient.[44] This rift between the allowance of tax payment in Section 191 and disallowance in Section 40(a)(ia) is clarified by the addition of the second proviso of Section 40(a)(ia); however, this line of thought fails to account for a crucial component, i.e., the explanation to Section 191 and Section 201 is different from one another.

The former explicitly states that the deductor shall be deemed to be an assessee-in-default where the assessee has also failed to pay such tax directly, whereas, in Section 201(1), the above condition is not mentioned. This express omission by the legislature bars interpretation of Section 191 in conjunction with Section 201 – barring the effect of the former. Re-emphasizing on the literal rule of interpretation provides the same conclusion as arrived at by the author, i.e., the second proviso to Section 40(a)(ia) shall only be applied prospectively from the date specified in the Finance Act, 2012.

IV. SECOND PROVISO IS NOT CURATIVE/DECLARATORY IN NATURE

It is an accepted rule of interpretation that all legislations are deemed to be prospective unless the same is expressly, or by necessary implication, conferred retrospective application. Generally, it is the role of the judiciary to

[43] Income Tax Act, 1961, § 191.
[44] ITO v. Manav. Greys Exim Pvt Ltd, (2002) 75 TTJ 115.

gauge the legislative intent regarding the prospective or retrospective application of a provision by referring to its overt language. Nevertheless, at times the overt language of certain provisions fails to clarify the legislative intent. In such a scenario, a subsequent clarificatory or explanatory amendment may be promulgated to clarify the real intention of the legislature regarding the earlier provision – which could be given retrospective operation.[45]

A. Definition

Black's Law Dictionary defines a curative statute as, "[an] act that corrects an error in a statute's original enactment, an error that interferes with interpreting or applying the statute."[46] Curative statutes are also known as remedial statutes; which is defined as, "A law that affords a remedy."[47]

Whereas the Black's Law dictionary defines a declaratory statute as, "[a] law enacted to clarify prior law by reconciling conflicting judicial decisions or by explaining the meaning of a prior statute." A declaratory statute is also known as an 'expository statute'. The Hon'ble Apex Court has defined declaratory provisions as those provisions which seek to remove doubts existing as to the common law or meaning or effect of any statute.[48] In a nutshell, a declaratory act also referred to as an explanatory act, is one that

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[45] Bharathi Shipyard v. DCIT, (2011) 132 ITD 53 (Mumbai).
[46] *Curative Statute Definition*, Black's Law Dictionary (9th ed. 2009).
[47] *Remedial Statute Definition*, Black's Law Dictionary (9th ed. 2009).
[48] CRAIES, STATUTE LAW (7th ed, 1971) 58; Central Bank of India v. Their Workmen, (1960) AIR 1960 SC 12; Jones v. Bennet, (1890) 63 LT 705; Madras Marine & Co. v. State of Madras, (1986) 3 SCC 552; Satnam Overseas (Export) v. State of Haryana, (2003) AIR 2003 SC 66.

is promulgated to supply an overt oversight or to resolve any doubts regarding the meaning of the unamended Act.[49]

B. Curative and Declaratory Amendments

In the present case, the second proviso of Section 40(a)(ia) creates a new exception for cases where disallowance under said Section will not be applicable. It does not seek to further explain the language or operation of the Section to clarify doubts arising from it. Instead, a new right to claim the inapplicability of disallowance under the Section is created by the second proviso.[50]

1. The Legislature did not Intend to Confer Retrospective Operation to the Second Proviso

It is pertinent to note that a provision may be given retrospective application only if the legislature intended to confer the same.[51] The principal rule of construction is that legislative intent must be interpreted from the words used by the legislature itself.[52]

The power of the courts to hold a provision as retrospective is limited to cases, wherein its implementation had led to consequences not intended by the legislature.[53] However, this is not reflected by the second proviso as the Parliament had expressly stated its intention of making the second proviso

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[49] Keshavlal Jethalal Shah v. Mohanlal, (1968) AIR 1968 SC 1336; S.K. Govindan and Sons v. Commr. of Income-tax, Cochin, (2001) AIR 2001 SC 254; Birla Cement Works v. The Central Board of Direct Taxes, (2001) 9 SCC 35; Commissioner of Income-tax Bhopal v. Shelly Products, (2003) 5 SCC 461.
[50] Thomas George Muthoot v. CIT, (2016) 287 CTR (Ker) 101.
[51] CWT v. Varadharaja Theatre Pvt. Ltd., (2001) 250 ITR 523 (Mad.).
[52] Padmasundara Rao v. State of Tamil Nadu, (2002) 255 ITR 147.
[53] Administrator, Municipal Corpn., Bilaspur v. Dattatraya Dahankar, (1992) (1) SCC 361.

prospective with the object of relaxing the underlying intended hardships.[54] It is an accepted notion[55] that while construing fiscal statutes to determine tax liability one must resort to the strict letter of the law.[56] Additionally, a provision of exemption from tax, or a relaxation therein, in a fiscal statute is to be strictly construed.[57]

The language of the second proviso of Section 40(a)(ia) does not indicate that the same has been intended to be curative or remedial in nature. *Per contra,* the amendment has conferred an additional benefit on the assessees by allowing the non-deduction of TDS to not attract Section 40(a)(ia) in consonance with the second proviso; provisions that confer such additional benefits can only be prospective in nature.[58]

As held by the Hon'ble Madras High Court, the object of the Act must be interpreted in consonance to the language employed by the Parliament regarding the scheme of the same.[59] It has been laid down that the removal of hardship by the Parliament does not mechanically indicate a parliamentary intention to remove that hardship from an anterior date; the same may only be interpreted by the courts if the language of the amendment warrants the same.[60]

The underlying intent behind the enactment of Section 40 is to bolster the TDS regime that has been envisioned by the Parliament. The TDS regime

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[54] Housing Corporation and Anr. v. C.I.T, (2010) 326-ITR-642.
[55] Star Industries v. Commissioner of Customs, (2016) 2 SCC 362.
[56] A.V. Farnandez v. State of Kerala, (1957) CriLJ 1014.
[57] Oxford University Press v. CIT, (2001) 20 DTC 13.
[58] Prudential Logistics and Transports v. Income Tax Officer, Kozhikode [2014] (1) KHC 411.
[59] CWT v. Varadharaja Theatre Pvt. Ltd., (2001) 250 ITR 523 (Mad.).
[60] Union of India v. Raghubir Singh, (1989) 178 ITR 548 (SC).

serves the primary function of making the incomes of the public at large known to the authorities[61] and provides a steady flow of revenue to the Government. Moreover, Section 40(a)(ia) had achieved the objective of augmenting the TDS to a substantial extent.[62]

Therefore, the legislative intent behind Section 40(a)(ia) is to augment compliance with TDS provisions, which may be undermined if the amendment adding the second proviso of the Section is treated as retrospective in nature. If the second proviso is given retrospective effect, it may give an impression that TDS provisions are not strict and mandatory in nature- the same comes to being as the Judiciary undermines the tax policy formulated by the Government.[63]

2. The Second Proviso does not cure Unintended Consequences

The procedure laid down by Section 40(a)(ia) does not lead to a situation of double taxation provided that the letter of the law is followed; the Legal Information Institute defines double taxation as, "imposition of taxes on the same income, assets or financial transaction at two different points of time." Further, assuming but not admitting that the matter causes double taxation, the rule of avoidance of double taxation is merely a rule of construction.[64] Consequently, this rule of construction ceases to have application when the legislature expressly passes a statute that results in double taxation.[65] The rule of avoidance of double taxation essentially states

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[61] Tube Investments of India Ltd. v. Asstt. CIT, (TDS) (2010) 325 ITR 610.
[62] *Id.*
[63] J.K. Synthetics Ltd. v. CTO, (1994) 119 CTR (SC) 222.
[64] Canadian Eagle Oil Co. v. R, (1945) 2 All ER 499; Laxmipat v. CIT, (1969) AIR 1969 SC 501; Jain Bros. v. Union of India, (1970) AIR 1970 SC 778.
[65] IRC v. F.S. Securities Ltd, (1964) 2 All ER 691 (HL).

that a legislation cannot be nullified on the sole basis that it results in double taxation.[66] The rule implies that the legislature has an inherent power to impose double taxation when it deems necessary, i.e., the Parliament, in theory, imposes double taxation as long as the same does not infringe on the Rights guaranteed under law.

Under the pre-amended Act if an assessee had deducted the TDS applicable – the contention of double taxation or unintended consequence would not arise. In such a scenario, the TDS paid by the assessee would have lessened the tax burden on the recipient of the same - resulting in no double taxation.

3. The Second Proviso does not seek to rectify any undue hardship

Every fresh levy of tax may be described as harsh from the perspective of taxpayers but beneficial from the point of view of the community. The legislature is empowered to impose a certain levy, even if it is presumed to be harsh, provided it falls within the overall framework of the Constitution of India. Given that the prospective application of an amendment is constitutional, the Court should avoid interpreting the same retrospectively.[67]

The courts are not empowered to give retrospective effect to a provision on the sole touchstone that the unamended provision caused hardship to the assessees.[68] The relevant consideration ought to be to ascertain whether the legislature intended to implement the original provision as is. That is, if the legislature took into account the harsh nature of the tax while

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[66] Municipal Council, Kota v. Delhi Cloth & General Mills Co. Ltd., (2001) JT (3) SC 275.
[67] Bharathi Shipyard v. DCIT, (2011) 132 ITD 53 (Mumbai).
[68] De Vigier v. Inland Revenue Commissioners, (1964) 2 All ER 907 (HL).

promulgating the original provision then the Courts cannot grant retrospective application to future relaxations. Therefore, if the judiciary grants retrospective application to a provision that was expressly made prospective- the same would be in direct contravention to the doctrine of separation of powers.

The presumption against retrospective operation may be rebutted by necessary implication, where the amended Act is declaratory or curative in nature,[69] or where it is sought to cure an acknowledged evil for the benefit of the community as a whole.[70] *Per contra,* a declaratory provision is intended to remove any doubts from the language or interpretation of the existing law[71] or to rectify or clarify a gross mistake or omission in the former statute.[72] Hence, declaratory or explanatory statutes may be given retrospective operation.[73]

However, it is imperative to note that in absence of clear words indicating that the amending Act is declaratory in nature,[74] it cannot be so construed in the language, and the effect of the pre-amended provision were clear and unambiguous.[75]

The language of Section 40(a)(ia) was clear and unambiguous even before it was amended by Finance Act, 2012. It strictly disallowed deductions of those sums which warrant tax deduction at source and there was no

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[69] CIT v. Vatika Township Pvt. Ltd., (2014) 367 ITR 466.; Zile Singh v. State of Haryana, (2004) 8 SCC 1.
[70] Singh, *supra* note 27.
[71] CIT v. Agriculture Market Committee, (2011) 337 ITR 299; CIT v. Vithal Textiles, (1989) 175 ITR 629.
[72] K. Govindan & Sons v. CIT, (2001) 247 ITR 192 (SC); CIT v. Podar Cement (P.) Ltd, 226 ITR 625 (SC); Keshavlal Jethalal Shah v. Mohanlal Bhagwandas, (1968) 3 SCR 623.
[73] CIT v. Vithal Textiles, (1989) 175 ITR 629.
[74] Union of India v. S. Muthyam Reddy, 1999 JT (7) SC 596.
[75] CIT v. Vithal Textiles, (1989) 175 ITR 629.

confusion in the language and operation of the same. Further, the amendment made by the Act does not seek to rectify any gross mistake or omission in the pre-amended statute.[76]

C. Test of Prior Implication

The Hon'ble Madras High Court has laid down the test to determine whether an amending Act is merely declaratory or is substantive in nature, thereby warranting prospective application.[77] It stated that the court must examine whether the pre-amended provision without the aid of the amendment is capable of taking within it what was subsequently included after the amendment.[78] This test has been followed in a plethora of judgments subsequently.[79]

Further, the Hon'ble Supreme Court has elucidated that the rule is that when a subsequent Act amends an earlier one in such a way as to incorporate itself, or a part of itself, into the earlier Act, then the earlier Act must thereafter be read and construed as if the altered words had been written into the earlier Act and the old words expunged - eliminating the need to refer to the amending Act.[80]

Presently, reading of the second proviso of Section 40(a)(ia) does not show that it was intended to be curative or remedial in nature. Instead, by this

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[76] Prudential Logistics and Transports v. Income Tax Officer, Kozhikode [2014] (1) KHC 411.
[77] CWT v. Varadharaja Theatre Pvt. Ltd., (2001) 250 ITR 523 (Mad.).
[78] *Id.*
[79] Dravida Munnetra Kazhagam v. CIT, (2002) 258 ITR 167 Mad; The Director of Income-Tax v. Paramartha Bhushanam, (2003) 182 CTR Mad 380, Commissioner of Wealth-tax v. T.N.K. Govindaraju Chetty & Co. Pvt. Ltd, (2004) 192 CTR (Mad) 382; Commissioner of Wealth-tax v. B.R. Theatres & Industrial Concerns (P.) Ltd, (2005) 272 ITR 177 (Mad).
[80] Shamrao v. District Magistrate Thana, (1957) AIR 1957 SC 23.

proviso, an additional benefit was conferred on the taxpayers. Since any reasonable interpretation of the pre-amended language of the Section cannot incorporate this consequence, the aforementioned test cannot be satisfied.[81]

V. DO BENEFICIAL PROVISIONS NECESSARILY WARRANT RETROSPECTIVE EFFECT?

Unless the language of the provision is ambiguous or confusing, they cannot be interpreted to confer a benefit to the assessee.[82] Hence, every case of removal of hardship by the legislature does not imply a parliamentary intention to remove the hardship from an anterior date, unless the scheme of the Act, the context in which the amendment was made, and the language of the amendment warrant the same.[83]

Recently, in the case of *Shree Choudhary Transport Corporation*[84], the Hon'ble Apex Court interpreted the 30% restriction on disallowance under Section 40(a)(ia) introduced by the 2014 Amendment to be prospective in nature even though the same was beneficial to the assessee. The Court opined that the language of the Act is clear and unambiguous and does not warrant interference by the Court.[85] It further discussed the *Calcutta Export*[86]

[81] Prudential Logistics and Transports v. Income Tax Officer, Kozhikode [2014] (1) KHC 411.
[82] CIT v. Berger Paints (India) Ltd, (2002) 254 ITR 503 (Cal); IPCA Laboratory Ltd v. DCIT, (2004) (SC) 266 ITR 521; Shakti Tubes Ltd. v. State of Bihar, (2009) (3) AWC 2820 (SC); CIT v. N.C. Budharaja & Co, (1993) 204 ITR 412 (SC).
[83] CIT v. Pooshya Exports Pvt. Ltd, (2003) 262 ITR 417; Gem Granites v. CIT, (2005) 1 SCC 289.
[84] Shree Chaudhary Transport Company v. Income Tax Officer, [2020] 118 taxmann.com 47 (SC).
[85] *Id.*
[86] CIT v. Calcutta Export Co, (2018) 16 SCC 686.

judgement and distinguished the case, holding that the amendment in question was not curative or declaratory in nature.[87]

VI. EQUITY CONSIDERATIONS IN FISCAL STATUTES

Assuming but not admitting, that the notion of equity forms the sole touchstone upon which a provision is interpreted – the legislature has already put in place several equitable cut-offs[88] under which, the provision of TDS would not be applied to ensure that the Act does not cause harm to small businesses. The central government has given a blanket exemption of ₹ 30,000 for all assessees regarding fees received in lieu of technical services, professional services, royalties, or any sum that has been mentioned under Section 28 of the Act. In this regard, the legislature, in its infinite wisdom, has provided ample safeguards to small businesses against the rigor of TDS provisions.

Nonetheless, a plethora of decisions by various courts have categorically held[89] that equity considerations do not apply to tax statutes provided that the legislature was competent in promulgating the statute and that the same is not in violation of the rights guaranteed under the Constitution.

VII. CONCLUSION AND RECOMMENDATIONS

It is clear from the above discussion that the second proviso is not procedural, declaratory, or curative in nature and there exists no other reason why it should have been given retrospective operation by the Courts.[90] The

[87] *Supra* note 77.
[88] Income Tax Act, 1961, § 194J.
[89] Income Tax Act, 1961 § 194J (1)(B); Income Tax Act, 1961, § 194C (5).
[90] Commissioner of Income-tax v. S. K. Tekriwal, [2014] 361 ITR 432 (Calcutta); CIT v. Naresh Kumar, [2014] 262 CTR (Del.) 389.

prime consideration in most of the High Court judgements mentioned above was that the provision is beneficial in nature. However, as already discussed, and especially in light of the *Shree Choudhary*[91] judgement, a provision does not necessarily warrant retrospective operation merely because it is beneficial in nature. Therefore, all the reasons why the second proviso could have been given retrospective application by the Courts have been rebutted and the presumption in favour of prospective application stands untouched.

The lack of clarity regarding the second proviso of Section 40(a)(ia) has primarily stemmed from the different interpretations arrived at by the various High Courts – such discord shall be resolved by a Supreme Court decision in the aforementioned pending appeals[92] on the matter. However, the predictability of the statute is a cornerstone of tax law and one must ensure that the provisions of the Act are not susceptible to multiple interpretations. The suggestions of the present authors to remedy such vagueness are:

i. The statute must necessarily be interpreted in a strict manner; the courts ought to refrain from interpreting a statute merely on hardship to the assessees. If legislative competence is sound and the statute does not breach constitutional rights – the statute ought to be enforced in its express terms;

[91] Shree Chaudhary Transport Company v. Income Tax Officer, [2020] 118 taxmann.com 47 (SC).

[92] Commissioner of Income-tax-1 v. Ansal Landmark Township (P.) Ltd., (2016) 73 taxmann.com 63 (SC); Principal Commissioner of Income-tax-6 v. Noida Software Technology Park Ltd., (2020) 113 taxmann.com 145 (SC); Principal Commissioner of Income-tax-8, Delhi v. Shivaai Industries (P.) Ltd., (2020) 113 taxmann.com 166 (SC); Thomas Muthoot v. Commissioner of Income-tax, (2020) 120 taxmann.com 317 (SC).

ii. The intention of the legislature may be garnered from the memorandum accompanying the impugned provision however if the memorandum runs contradictory to the express terms of the statute the latter must be awarded a higher weightage;

iii. The second proviso of Section 40(a)(ia) should be interpreted as having prospective operation since the patent intent of the legislature substantiates such interpretation. Following the observations of the Hon'ble Apex Court in the *Shree Chaudhary* judgment, it is inferred that the second proviso is not curative or declaratory in nature since it does not seek to cure any ambiguity caused by the pre-amended language of the Act;

iv. Courts must not blindly interpret provisions as being beneficial to the assessee. Beneficial interpretation should only be resorted to in cases of patent ambiguity in the language of the statute which renders it impossible to understand the intention of the legislature. Similarly, the High Court decisions conferring retrospective application to the second proviso need to be revisited and reversed.

V. GROUP INSOLVENCY: TIME TO STOP RELYING ON THE JUDICIARY TO FILL A LEGISLATIVE LACUNA?

- Varada Jahagirdar and Sanjhi Agarwal*

ABSTRACT

The Insolvency and the Bankruptcy Code, 2016 ("IBC"), though a comparatively new legislation of the country has developed a massive jurisprudence in merely five years. Considering the intricacies involved in the insolvency process, IBC has been subjected to various amendments and changes, and yet the legislation has failed to accommodate for more complicated transactions like cross-border insolvency and group insolvency matters. Exclusion of such areas have provided for a major lacuna in the scope of IBC and led to academic, judicial and legislative debates and discourses. Groups and conglomerates are becoming exceedingly popular and play an integral role in the national and the global corporate world. However, the lack of provisions addressing group insolvency resolution provision in the IBC, have forced and promoted the need of judicial interpretations and widening of scope of the existing provisions. Judicial interpretations though important in places of legislative lacuna, has led to conflicting interpretations of the statute. The question or the problem that remains with introduction of the provisions regarding group insolvency is whether the corporate veil can be pierced by force of law when there is no public interest or malafide intention on the part of the corporate entity. The paper seeks to understand the application and scope of group insolvency proceedings in various jurisdictions and specifically in India, and attempts to answer the question that whether it is time to introduce the provisions regarding the same in our domestic legislation and dwells on the aspects required to be kept in mind before such addition and inclusion.

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I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 **("IBC")** has a robust jurisprudence with an aim to consolidate and align all the fragmented laws and provisions regarding dissolution and revival of bankrupt or insolvent persons. Before the enactment of the IBC, the framework for dealing with insolvency and restructuring procedures with respect to corporate entities, individuals, and firms was extremely complex, tiresome, and extended from the Companies Act, 2013 to the Sick Industries Companies Act **("SICA")** and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 **("SARFAESI Act")** among others. This led to a severe delay in the valuation of assets and made the whole process redundant.[1] The IBC sought to revolutionize the whole process and simplify it for businesses to either go for dissolution or revival.

One of the major objectives of the legislation was to ease out the complete process of resolution, therefore, the insolvency resolution of group companies as a whole cannot be neglected. A "Group" is an economic entity and consists of a set of companies, either controlled by one common administrative or financial head, wherein the companies are involved in businesses in different markets.[2] Groups as a form of an organizational

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[1] Sachin Gupta, India: The Journey of Insolvency and Bankruptcy Code, MONDAQ https://www.mondaq.com/advicecentre/content/3750/The-Journey-of-InsolvencyBankruptcy-Code.
[2] Asli M. Colpan & Alvaro Cuervo Cazuraa, Business Groups as an Organizational Model, BUSINESS AND MANAGEMENT (2001).

structure are becoming extremely popular. Moreover, companies that are part of a group do not work in one market, and merely because one company declares insolvency, does not correlate, or translate into the group turning insolvent. Therefore, it is better for the creditors of the company to know the position of the assets of the group for a clearer position with respect to their debts.[3] Group Insolvency is essentially a mechanism to consolidate multiple cases against different companies of a single group that could affect the corporate debtor and creditors and thereby lift the corporate veil.[4] It is a complex matter in India, keeping in mind that there are no clear provisions with regards to the same in the IBC.[5]

This paper is divided into five chapters, the first chapter is the introduction, the second chapter deals with the need for group insolvency provisions, where it caters to the questions of what is group insolvency and what effect does it have on the concept of separate legal personality, specifically keeping in mind the report released by the Insolvency and Bankruptcy Board of India (**"IBBI"**). The third chapter discusses the various provisions in other jurisdictions and talks about the rules and regulations regarding group insolvency as provided under United Nations Commission on International Trade Law (**"UNCITRAL"**) Model with regards to the same. The fourth chapter talks about the position of group insolvencies in India and the approach adopted by the Tribunals and Courts while dealing with the same. Finally, the last chapter concludes the article and suggests some

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[3] Raghuram Manchi, *A New Case Law relating to Group Insolvency*, IBC LAWS (May 10, 2020), https://ibclaw.in/a-new-case-law-relating-to-group-insolvency-by-raghuram-manchi-insolvency-professional/.

[4] *Supra* note 3.

[5] MINISTRY OF CORPORATE AFFAIRS, REPORT OF THE INSOLVENCY LAW COMMITTEE (2019) ¶ 17, Annexure II, 83.

recommendations that can be adopted in the Indian legal system to assist and develop group insolvency proceedings.

II. NEED FOR GROUP INSOLVENCY PROVISIONS

A. What is a Group and Group Insolvency?

Groups are essentially a set of entities, either related by an economic dependency or based on the control for the pursuit of common goals and objectives.[6] In the Indian context, groups can also be bound by formal or informal ties in a constellation like structure that may act in a coordinated manner.[7] For example, the Tata Group, though acting in diverse markets and with independent management, continues to be tied because of the majority holding of Tata Sons Ltd. in most companies and the Tata Group.[8] The main objective of a grouped corporate structure is to utilize the energies and internal synergies of each company efficiently. The synergies of a company can include information technology, supply chain, research and development projects among other things. Thus, the collaboration of different companies will not only improve the individual performance of each company but also of the group as a whole.

Further, grouping helps companies with regards to ring-fencing of assets and liabilities, wherein each company of the group has limited liability and there is a separation and reduction of risks for the group. The separation

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[6] INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, REPORT OF THE WORKING GROUP ON GROUP INSOLVENCY 12 (2019).
[7] T. Khanna & J.W. Rivkin, Estimating the Performance Effects of Business Groups in Emerging Markets, 22 STRATEGIC MANAGEMENT JOURNAL, 45-74 (2001).
[8] Steen Thomsen, Trust Ownership of the Tata Group, COPENHAGEN BUSINESS SCHOOL (2011).

of assets also eases the process of sale as the group does not need to be involved with the company directly and the sole decision of the sale of assets of one group company does not affect the other companies. A group system also has regulatory advantages with regards to ease of administration and tax benefits considering that group companies generally are provided with certain exemptions and reliefs and can claim for a group loss.[9] Additionally, it is important to note that creditors prefer giving loans to a company belonging to a group because lending is more secure given the intra-group capital marker and the investment is less likely to face financial distress.[10]

It is estimated that groups account for nearly 56% of the combined assets and about half of the revenue and profits generated in India in 2015-16.[11] The substantial position of corporate groups in the Indian market has led to the difference in treatment of the entities as separate legal personalities. The major point to be noted for this differential treatment is the effect of the same on the decision of the investors.[12] In this regard, group insolvency is a legal framework through which multiple companies of a corporate group are declared insolvent and the Court, merges or consolidates all the cases and creditors to achieve the greatest advantage for all stakeholders.

Group insolvency proceedings inherently require the lifting or piercing of the corporate veil to determine the controlling group of the entities. The

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[9] Darwin Gray, *What are the Benefits of a Group Company Structure?*, BUSINESS NEWS WALES (Aug. 7, 2019), https://businessnewswales.com/what-are-the-benefits-of-a-group-company-structure/.
[10] *Supra* note 6.
[11] Krishna Kant, *The end of conglomerates?* BUSINESS STANDARD (Mar. 17, 2017, 7:36 PM), https://www.business-standard.com/article/companies/the-end-of-conglomerates-117031700943_1.html.
[12] MINISTRY OF FINANCE AND COMPANY AFFAIRS, REPORT OF THE COMMITTEE ON THE COMPANIES BILL 1997, ¶ 5.5 (2002).

entities are majorly mere subsidiaries with a holding organization or an entity. Therefore, such piercing of the veil without the grounds of fraud, tax evasion, or criminal wrong committed, is a clear violation of the concept as according to *Solomon v. Solomon.*[13] The Companies Act, 2013 has specific provisions which require conglomerate companies to prepare a consolidated financial statement of all the subsidiaries and associated companies during the process of insolvency.[14] Furthermore, the Act also recognizes the concept of a shadow director, who is a person holding an office that puts him in a position to affect the actions of the directors.[15] Lastly, the Indian jurisprudence has a plethora of cases where the Courts have lifted the corporate veil in cases of insolvency to hold the parent company responsible for the actions of the subsidiaries.[16] Therefore, the provisions of group insolvency, though an exception to the principle of piercing the corporate veil, are nevertheless a necessity and must be adopted as a part of the legislation. Adoption of such provisions will ease out and clarify the Insolvency Resolution Process (**"IRP"**) to be followed, the circumstances that need to be looked at and the thresholds that need to be achieved for group proceedings to be taken forward which will benefit both the corporate creditors and the debtors.

On the flip side, various jurisdictions like Japan, the United States of America and India among others have continued to shy away from adopting group IRP provisions considering that piercing of the corporate veil would demotivate businesses from initiating resolution processes as well as from

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[13] Solomon v. Solomon [1896] UKHL 1, [1897] AC (HL) 22.
[14] The Companies Act, 2013, No. 18, Acts of Parliament, 2013, § 129(3).
[15] *Id.* § 2(60).
[16] Rishi Shroff & Shwetank Ginodia, A Corporate Governance Perspective on Lifting the Veil in Group Companies in India and the United Kingdom, 25(12) INTERNATIONAL COMPANY AND COMMERCIAL LAW REVIEW 423 (2014).

setting up group structures involved in different industries which would impair the commercial strength of the country. Separation of the IRP thus helps to safeguard the assets of the whole group and the process is always initiated against the one company. This protects other businesses of the parent company from being dragged into the mess of insolvency. Additionally, separation of processes is advantageous to the resolution professional as he would not have to look into other companies that are not insolvent or involved in the process. Despite certain advantages to the separation of the process, which include simplicity, the complications and difficulties faced in the resolution of companies with interlinked businesses are supervening and therefore, the need for provisions for consolidating the process cannot be denied or ignored.

B. Need for Such Provisions in Legal Proceedings

Considering the Pandemic and the increased number of companies becoming insolvent, the ease and strength of the insolvency procedure becomes all the more important. Further, it is also important to note that most conglomerate structures work in different markets and there is a great inter-relationship or interdependency between the different entities.[17] Such entities may be dependent on each other for operational or financial help, which can include providing raw material or inter-group loans and aids, making them creditors and debtors of each other.[18] Hence, such interlinkages make it extremely difficult for shareholders, creditors and insolvency professionals to

[17] UNCITRAL, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW, PART THREE: TREATMENT OF ENTERPRISE GROUPS IN INSOLVENCY ¶ 93 (2012).
[18] *Supra* note 6, at 13.

look at the situation of the companies objectively and without duplication of efforts and data.

Additionally, these inter-linkages are also difficult to disentangle as the main purpose or objectives of groups is to use internal synergies for the best of the group and in this case, the group is looked at as a going on concern to achieve value maximization.[19] In the case of *Amtek Auto*[20] where instead of the resolution of all the three units of the group, only one was resolved, but due to the interdependency of the three units, the general corporate world is of the opinion that resolution of all three would have been more valuable to the stakeholders.[21] The Amtek IRP has been going on for about five years now, with multiple resolution plans proposed by investors which were either rejected by the Committee of Creditors (**"CoC"**) or judicial authorities on various grounds like force majeure and frivolous claims by the investors. A common IRP would not only have expedited the process considering that the businesses are extremely interdependent but also brought all the creditors and investors on a common platform to arrive at an amicable and value-maximizing resolution plan. This shows the dire need for a proper group insolvency procedure to achieve the best value for the creditors and the companies.

Another important factor to be considered is the growing digital and globalized economy. Cross-border transactions have become increasingly

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[19] *Id.*

[20] Corporation Bank v. Amtek Auto Limited, C.P. (IB) No. 42/Chd/Hry/2017- decision dated 24.07.2017.

[21] Deborshi Chaki, *Creditors may offer to sell Amtek Auto along with subsidiaries*, LIVEMINT (Feb. 27 Feb, 2018) https://www.livemint.com/Companies/B0iQvSkRcVZrdj2Xoxoa7I/Creditors-may-offer-to-sell-Amtek-Auto-along-with-subsidiari.html.

common, where either the group or one or more of the subsidiaries are registered either outside the country or vice versa. These multi-jurisdictional companies are majorly looked at as one single entity which motivates the creditors to increase their investment.[22] India lacks a robust mechanism for cross-border insolvencies and treats each of the entities in a group separately. This system gives smaller creditors little to no say in the IRP, as a resolution requires a 66% majority in the CoC,[23] thereby reducing the effective say of a single small creditor and making it extremely difficult for them to get an ideal resolution for their investment.

The third reason is the nature of the transaction between entities of groups because it is the transaction that leads to asymmetry in the information that is provided to the stakeholders. In the case of *Venugopal Dhoot v. SBI,*[24] fifteen companies of the Videocon group underwent an IRP and the parties sought to consolidate all the matters on the ground that the companies were highly interlinked, in regards to functioning and finances, and the lack of consolidation would lead to undue delay and have an adverse effect on the valuation of assets and liabilities. It is pertinent to note that the major business areas of the group are limited to consumer home appliances, telecom and foreign oil and gas business and out of the 15 companies, 13 companies that were brought under a consolidated IRP were dealing in consumer home appliances business and had taken a common borrowing from a group of lenders. Therefore, the National Company Law Tribunal (**"NCLT"**) while accepting the plea of the Petitioners, noted that out of the 15 companies, the 13 companies had common control, common directors, common assets and

[22] *Supra* note 6, at 15.
[23] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 § 30(4).
[24] Venugopal Dhoot v. SBI, CA- 1022(PB)/2018- decision dated 24.10.2018.

liabilities and majorly pooled their resources giving rise to a common group of financial creditors and corporate debtors. Further, the consolidation turned out to be a good prospect as it not only brought the proceedings being conducted in different NCLTs under one authority but also enabled the banks to be able to recover nearly 80% of the debt.

Additionally, according to the IBBI Working Group, group insolvency provisions in the IBC are required owing to the following reasons:

- Promotion of symmetrical information availability – Different companies of a group maintain different books of accounts and there is a high possibility that their methods of accounting may also differ. When multiple companies of a group undergo an individual IRP, comparison and tallying of accounts would not only be a cumbersome process but also be confusing and ambiguous, leading to information asymmetry. The core or the crux of an IRP is to maximize the welfare of the debtor and the creditors and unambiguous books of accounts reduce the stakeholder's risk to be misled and increases the chances of a viable assessment.[25] Therefore, group IRPs will provide symmetrical information to the stakeholders.
- Reduction in the costs of insolvency process – IRPs are expensive as they require the hiring of professionals, legal advisors and court and tribunal fees. Individual IRPs can lead to duplication of work and involvement of multiple professionals which could make the process even more elongated. Through a group IRP framework, companies will not be dealt with in

[25] *Supra* note 6, at 20.

isolation, therefore reducing the monetary and non-monetary costs involved in the process.[26]

- Value maximization - The purpose of the insolvency resolution framework is to increase the value of the assets of the company/companies for the creditors and generally increase the efficiency of the general process to help maximize the synergy of the company. Group insolvency frameworks would allow the complete group to use and allocate their internal synergies in the most efficient manner and thereby resolve the process quicker and in a more cost-efficient manner.

There are various other reasons which can be used as arguments in favour including a reduction in capital costs, increased certainty of returns for stakeholders, cost efficiency, fairer resolution for smaller stakeholders among others which can be highlighted as far as the need for group insolvency laws is considered.

III. GROUP INSOLVENCY IN FOREIGN JURISDICTIONS

The concept of group insolvency is not new to the world of global corporate law as legislations across the world have discussed the issue and formulated procedures for the same.

Chapter V of the European Union Regulations on Insolvency (**"EU Regulations"**) has been dedicated to the insolvency procedure of group companies. Article 56 of the EU Regulations discusses how the insolvency practitioner should look into consolidating and coordinating the insolvency affairs of two or more members of a group company and administer them

[26] *Id*; 'Tackling Group Insolvency' in Vidhi Centre for Legal Policy & EY, Insolvency and Bankruptcy Code: The Journey so Far and the Road Ahead (2018).

together.[27] The insolvency practitioner can also approach and request the court to hold a group coordination proceeding for the group members regarding whom the insolvency process has been initiated.[28] The court might open the group coordination insolvency process when it is satisfied that the process will help in better administration and would not result in a disadvantage to any creditor.[29] The notice shall then be given to the insolvency practitioner and the coordinator about the same. Even the Preamble of the EU Regulations specifies how group insolvencies should be promoted to ease the administration.[30]

Further, the UNCITRAL Guide also recommends that in cases of group insolvencies, there should be proper sharing of information among the members of the group companies and a common insolvency representative for the role of coordination and administration of affairs of the insolvent companies, such as handling the meetings with the CoC, disposition of assets and others.[31] The World Bank Principles on Effective Insolvency and Creditor/Debtor Regimes (2016) establishes a process for consolidated resolutions plans formulated by the insolvent organizations of the group company and issues recommendations regarding the participation of the solvent organizations of that group company in the IRP to contribute through their assets.[32]

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[27] Regulation (EU) 2015/848, of The European Parliament and of the Council of 20 May 2015 on insolvency proceedings, 2015 O.J. (L 141/19) art. 56(2).
[28] *Id.* art. 61.
[29] *Id.* art. 68.
[30] *Id.* ¶ 52 & Preamble.
[31] UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of enterprise groups in insolvency* (2012) ¶¶139, 140.
[32] World Bank, *The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes* (2016), Principle C 16.

In Ireland, the Companies Act, 1990 specifies that if the court finds it justified and equitable to include solvent group companies in the IRP, then the same shall be done to assist the liquidator in the winding-up process.[33] However, such inclusion of the solvent company in the IRP must be with regards to the conduct of the two companies, their interdependency and the role of the solvent company in regards to the debt provided by the creditors.[34] In presence of such instances, the solvent company will be asked to become a party to the insolvency proceedings. It further suggests the appointment of a single insolvency representative, for all companies, to avoid conflict of interests and ensure smooth conduction of the IRP.[35] A joint application by the creditors for the insolvency proceedings is also suggested for similar reasons.[36]

As India lacks legislation regarding group insolvency proceedings, deriving from the EU and recommendations of the UNCITRAL Guide, the Working Group On Group Insolvency suggested in their Report that there should be a joint application made for the initiation of the process, a single adjudicating authority, a single insolvency practitioner and coordination and communication among the stakeholders.[37] Procedural coordination will result in a speedy remedy for the companies as well as the stakeholders, especially the creditors.

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[33] Companies Act 2014 (Act No. 38/2014) (Ir.), http://www.irishstatutebook.ie/eli/2014/act/38/enacted/en/html, § 140(1).
[34] *Id.* at § 140(2).
[35] *Supra* note 32, Recommendation 232-236.
[36] *Supra* note 32, Recommendation 200.
[37] *Supra* note 6, ¶ 1.3.1,

Moreover, the major question that persists is regarding the extension of liability of a subsidiary company to its holding company in cases of insolvency of that subsidiary company. This principle arises out of the fact that there exists a relationship between ownership and control.[38] However, the question that remains is whether the parent company will continue to bear the penalties for breaches of the subsidiary company in case of group insolvencies. In Australia, the holding company is made liable for the debts of the subsidiary company, if the subsidiary company has become insolvent as a result of such debts or was insolvent while taking the debts.[39] However, it is interesting to note that, although the legislation makes the holding company liable for the debts of the subsidiary company, it does not specifically talk about such liability in cases of group insolvency.

The UNCITRAL in this respect has not mentioned much in its Guide for Group Insolvencies[40] but has highlighted that mere control of a company over others should not result in the integration of the proceedings. In the United Kingdom, the Extension of Liability Principle is applied in a rather different way. The Courts in the UK while interpreting the principle have held the directors of the company to be liable for the insolvency of the company, as they are the ones who agreed to take steps that have led to such insolvency.[41] Although, the UNCITRAL Guide on Group Insolvency has discussed that directors can be made liable only when they have been an active part in the

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[38] *Supra* note 32, ¶ 96.
[39] Corporations Act 2001 (Cth) s 588V (Austl.).
[40] *Supra* note 32, ¶ 98.
[41] VANESSA FINCH, CORPORATE INSOLVENCY LAW PERSPECTIVES AND PRINCIPLES, (Cambridge Publications 2nd ed., 2009) 590; Insolvency Act 1986, c. 45, § 214(2) (Eng.).

management of the controlled group company or has a direct relationship between the insolvency and management of the group company.[42]

Thus, India can incorporate such extension of liability of companies to their holding companies as we saw in the *ArcelorMittal Case*[43] (as discussed further) and in the Australian legislation.

IV. INDIAN PERSPECTIVE ON GROUP INSOLVENCY

The IBC has provisions for insolvency of corporate debtors but is silent about group insolvency proceedings. Professionals have believed that considering the nascent stage of the IBC in India, the introduction of group insolvency provisions would be a hasty step and could disrupt the balance between debtors and creditors.[44] However, the lacuna present has been challenged and brought before courts and tribunals multiple times. The question that has been sought to be answered throughout the established Indian jurisprudence is whether the assets and liabilities of a holding company or other companies in a group be held accountable for the IRP of a single subsidiary company. The reason for the reluctance of the legislators to include such a provision is the limited scope of piercing the corporate veil in the Indian Jurisprudence.

The Supreme Court in *ArcelorMittal India v. Satish Kumar Gupta,*[45] categorically stated that the principle of a separate entity is essential to the smooth functioning of businesses. However, where a statute requires or in cases where protection of public interest is of paramount importance or where

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[42] *Supra* note 32, ¶ 99.
[43] ArcelorMittal India v. Satish Kumar Gupta, (2019) 2 SCC 1.
[44] *Supra* note 3.
[45] *Supra note* 44.

an entity has purposefully acted in a manner to evade the obligations of the Law, the Courts have the power to pierce the corporate veil and disregard it.[46] The Court further held that the disregard of the principle can also be done for group companies where it is extremely important to look at the economic position of a group to understand the bigger or entire economic position of the entity and the group.[47]

The case of *State Bank of India v. Videocon Industries Ltd,*[48] was the first case regarding consolidation of insolvency proceedings for group companies wherein the NCLT clubbed or grouped 13 out of the 15 companies in favour of the claim of the consortium, into a single entity as the common debtor. Generally, the practice followed by different jurisdictions regarding group insolvencies can be divided into two broad forms - procedural coordination or substantive consolidation.[49] Substantive consolidation is the process that can be adopted only when the entities are highly interlinked with regards to staff, management, manufacturing process, funding, etc., and therefore, segregation of the process of insolvency would be detrimental to the interests of creditors and affect value maximisation negatively.[50]

On the other hand, procedural coordination is the integration of the processes of insolvency and indebtedness for various group companies while keeping the assets exclusive to each company.[51] This mechanism can take

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[46] *Id.*
[47] *Id.*
[48] State Bank of India v. Videocon Industries Ltd, M.A 2385/2019 in C.P.(IB)-02/MB/2018 (2019).
[49] *Supra* note 6.
[50] State Bank of India v. Videocon Industries Ltd, M.A 1306/ 2018 & Ors. in CP No. 02/2018 & Ors. (2019) ¶ 82.
[51] *Supra* note 6, at ¶ 24.

different forms but majorly involves the appointment of one or the same insolvency representative, a common CoC, cooperation between the courts and judicial proceedings including the hearing of the matter, the communication of the representatives, the negotiation process, submission and verification of claims and documents, among other things.[52] India has adopted the procedural coordination method as evident from its judicial pronouncements.

The major benefit of adopting this mechanism is the ease in the consolidation of the information of the companies, which includes information about the assets and liabilities, the creditors, and the general financial status of the company and the group as a whole. Another advantage of this mechanism is that it provides for an overall perspective with regard to the decisions on the reorganisation or sale of the debtor's businesses and provides clarity in the negotiation process, thereby helping in value maximisation.[53] The process adopted in India, however, requires a greater level of coordination between courts, insolvency professionals, creditors and the entities, to ensure accurate and efficient collection of data and information.[54] However, achieving such coordination is extremely difficult due to the lack of an established procedure in the Indian Legislation.

The lack of specific provisions for group insolvency has forced the NCLT to try and interpret various sections of IBC in a manner so as to accommodate and allow consolidation of the processes as well as ease the initiation process against the group. A close examination of certain sections of

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[52] *Supra* note 32, ¶ 23.

[53] DIRECTORATE GENERAL FOR INTERNAL POLICIES, EU PARLIAMENT, Insolvency proceedings in case of groups of companies: Prospects of harmonization at EU level (2011).

[54] *Supra* note 32, ¶¶22-25.

the IBC elucidates the provisions that can be used in favour of group insolvencies.

For example, Section 60(2) and Section 60(3) of the IBC state that the IRP of a debtor company and any of its guarantors should be taken up by the same Adjudicating Authority (**"AA"**).[55] These provide for an exception and state that in case there is an ongoing IRP before any bench of the NCLT or any other Court, any application for clubbing the two processes can be presented, and then the Tribunal or Court can transfer the same to the AA handling the matter.[56] The provision allows and provides for an opportunity to the Courts or Tribunals to club together the proceedings of the companies where the debtor company and the guarantor belong to the same group of industries.

Further, another approach that can be utilised to bring group entities under the ambit of a single insolvency proceeding is to widen the scope of the term "related party" under Section 5(24) and 5(24A) of the IBC. The definition clearly mentions that when any person of one corporate entity such as a director, partner or key managerial personnel or his relative has substantial control over the working of another entity, either a partnership or any company, then such corporate entities can be said the related parties of the corporate debtor.[57] The exhaustive interlinkage between two entities as provided for in the definition makes it easier for the Court to link companies of the group.

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[55] *Supra* note 24, §§ 60(2)-60(3).
[56] *Id.*
[57] *Id* §§ 5 (24), 5(24).

Section 18(f) and Section 36 of the IBC also facilitate in smooth transition and clubbing of the proceedings as they specify that the shares of the subsidiary company should be transferred to the resolution professional and the liquidator of the holding company. This is done to ensure that the consolidation of the shares of all the relevant group companies will help the insolvency professional to fasten the process and look for the total liabilities accordingly.[58]

The NCLT in the S*tate Bank of India v. Videocon Industries Ltd,*[59] adopted a similar approach as mentioned above and tried to pierce the corporate veil. The main reason that the Tribunal ordered for consolidating the proceedings was that the assets and liabilities of all the companies were closely interlinked and intertwined and the lending was done on the assumption that the corporate debtors would be jointly and severally liable for the lending. The NCLT laid down a two-fold test in order to determine whether consolidation of the IRP can be carried:

a. A *prima facie* existence of elementary governing factors; and

b. Categorisation based on the governing factors.

The NCLT also enlisted the conditions that must be checked before bringing together the proceedings of the companies - common control among companies, multi-layer subsidiaries, basic common assets and liabilities, common directors, pooling of resources, common financial creditors, intertwined accounts, singleness of economics of units, among others. Once these proceedings were consolidated, a single Corporate Insolvency

[58] *Id* §§ 18(f), 36.
[59] *Supra* note 49.

Resolution Process (**"CIRP"**) was conducted showing intertwined workings and functions, and a common CoC for all 13 companies was made, while the resolutions plans were different. The NCLT divided the companies into two classes - the first category was the companies where the asset value was better than others and there was scope for liquidation. The second category was the companies where they would survive even if the resolution process is done separately for them. Thus, only the first category companies were consolidated.

Further, in the case of *Edelweiss Asset Reconstruction Company Ltd v. Sachet Infrastructure Pvt Ltd*,[60] the National Company Law Appellate Tribunal (**"NCLAT"**) faced the question of whether loans taken under the guarantee of a common "Corporate Guarantor" can be clubbed together for a fair process. The NCLAT held that Corporate Debtors and Corporate Guarantors in the given transaction were common or co-borrowers and any resolution plan passed by Resolution Professionals individually would not be fair and just. It was also held that having a common resolution professional will lead to common proceedings and plan against the corporate debtor which would benefit the stakeholders of the company, especially the creditors.[61]

The NCLAT also laid down a test to determine whether a group insolvency process can be initiated or not and stated that the plea of grouping must be supported with evidence of an interlinked and interdependent nature of transactions, which cannot be looked at in isolation. Therefore, in the aforementioned case, out of the 9 companies that were requested to be

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[60] Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. &OR's, CA(AT) (Insolvency) Nos. 377 to 385 (2019).
[61] *Id.*

clubbed, only five were clubbed together. The case of *Bikram Chatterji v. Union of India*[62] also saw the Supreme Court initiating the insolvency proceedings against the whole Amrapali Group and attaching all the properties of the 40 companies and freezing bank accounts of all directors.

The NCLT in its most recent judgement in *Axis Bank Limited v. Lavasa Corporation Limited,*[63] looked at various control factors and observed that there was an element of common control. The subsidiary companies against whom insolvency proceedings were initiated were wholly-owned subsidiaries of the Lavasa Corporation Ltd., with common directorship, assets, and liabilities. Thus, the NCLT observed that for group proceedings, there must be a substantial interdependence in the activities of the groups and an element of inter-lacing of substantial finance where the entities were acting as guarantors for loans of the others. Further, the companies pooled their resources, coexisted, and acted in consonance and had a common brand name "Lavasa" which made it very difficult for creditors to differentiate between the different entities. Considering the commonalities between the four entities and the intertwined transactions, the NCLT held that the insolvency procedure of the parent company affects the insolvency process of the subsidiary company, as both are financially dependent on each other. Thus, the Tribunal in this case had consolidated the insolvencies of the Lavasa group for the overall benefit of the creditors and stakeholders.

Such judicial pronouncements by the NCLT have tried to move the Indian companies towards group insolvency procedures. However, the lack of

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[62] Bikram Chatterji v. Union of India, W.P. (Civil) No(s).940/2017 (2018).
[63] Axis Bank Limited and others v. Lavasa Corporation Limited, MA 3664/2019 in C.P.(IB)-1765, 1757 & 574/MB/2018 (2020).

concrete laws creates chaos. Thus, a Working Group was constituted by the IBBI on January 17, 2019 to recommend a framework for the collective insolvency resolution as well as the liquidation of group companies. There have been insightful recommendations made by the Report of the Working Group. Firstly, it recommended that the definition of "corporate group" should include holding, subsidiary and associate companies, as per the ownership and control aspects.[64] Secondly, the Working Group proposed to include a provision allowing the financial and operational creditors of various organisations or a group to file a joint application to initiate the CIRP against them under Section 7, 8 and 9 of the IBC.[65] This will not only save expenses of filing separate applications but also save the time of the courts/ tribunals to deal with each case separately. In furtherance, the Working Group suggested that a single AA should take up the whole insolvency process of the group company.[66] However, the Report also specifies that multiple AAs or insolvency professionals can also be involved in cases where the issues are regarding the conflict of interest, lack of resources or a negative impact on any stakeholder. This process can be made effective only when there is proper communication and coordination among parties involved in the whole process.

V. CONCLUSION

We have seen how large groups of companies are involved in insolvency proceedings and separate cases are filed against each of the organisations under such a group. This makes the whole resolution process unnecessarily long and delays the proceedings. The stakeholders, especially

[64] *Supra* note 6, at ¶ 26.
[65] *Supra* note 6, at ¶ ¶ 37, 42.
[66] *Supra* note 6, at ¶ 37.

the creditors, suffer a lot due to this delay. Here, consolidation of such proceedings helps in timely remedy.

India has adopted IBC to govern the insolvency process but the legislation lacks provisions for group insolvencies. Although the NCLT and Supreme Court have tried to make judicial interpretations in various cases and introduce the concept of group insolvency in India, the need to have a legal framework in this regard is undeniable. The UNCITRAL Model Law on Group Insolvency can be taken as a reference and can be adopted into the domestic law keeping in mind the Indian market and companies.

Various jurisdictions have established provisions and procedures for carrying out group insolvencies and the same can be taken into consideration while formulating a proper procedure in India. Extension of liabilities, collaboration and unity of insolvency practitioners, judicial authority, joint books of accounts, a joint application for initiation of the process, and provisions regarding clubbing of claims on a later date must be some aspects that should be taken into consideration. Though extension of liability of insolvency matters of a subsidiary company to the holding company is beneficial to the creditors and the stakeholders, the same is a serious breach of the principle of separate legal entity and lifting of the corporate veil, specifically when there is no breach of law or malafide intention of the corporate debtor. However, as discussed earlier, the provisions for group IRPs need to be introduced as an exception to the principle of separate legal entity and lifting of the corporate veil, in order to bring an end to the chaos and confusion created by multiple CIRPs of the same group before different AAs as observed in the Amtek Auto Case.

Further, the structure of companies, especially conglomerates is very different and diversified in India. Certain conglomerates in India due to the diverse business outreaches have little to no decision-making power with respect to other related companies, which also includes having a separate board of directors. However, in jurisdictions like Australia and the United Kingdom, the parent company has substantial control in the subsidiary company, with unified management and assets and generally an intertwined relationship. Therefore, introducing an absolute provision of holding a parent company responsible for the breach of the subsidiary company, without any malafide intention or breach of law, would be a slippery slope and play against the purpose causing more damage than good.

It is also imperative to note that in India the group companies are generally promoter groups[67] and laws should be made accordingly. The Working Group Report has tried to bring in recommendations considering the laws in different jurisdictions but the Indian market has seen conglomerates with a base of promotor groups and thus, those ideas from other countries might not be as feasible for us. Considering the diverse structure of the corporate entities in India, we as a jurisdiction can start with bringing in administrative and procedural changes like filling common applications and establishing common CoCs until a proper legislative framework has not been formulated. The IBBI and the NCLT must encourage companies and the creditors to initiate consolidated proceedings and undertake proactive measures for ensuring the same.

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[67] India Bankruptcies Status Report: NCLT Sanctioned Plans, DEBTWIRE SPECIAL REPORT (Oct. 18, 2018).

Additionally, the legislation must include separate characterisation and tests for the IRPs that can be consolidated and those that cannot. This differentiation is extremely crucial as not all companies of a group may be involved together, either operationally or financially, and the consolidation of the same would impact the creditors negatively. The legislation for group insolvencies must be drafted with due care so as to ease the whole process and not open the floodgates for litigation or make the process more cumbersome than it is.

VI. BID-RIGGING IN INSOLVENCY RESOLUTION APPLICATIONS: HARMONIZING COMPETITION LAW WITH INSOLVENCY LAW

- Ameya Garud*

ABSTRACT

The Corporate Insolvency Resolution Process ("CIRP") determines the fate of the Corporate Debtor wherein third-party entities can acquire the debtor in order to revive it. Some opportunistic notorious entities may indulge in bid-rigging in insolvency resolution applications. Now as the economy is revitalizing again after insolvency initiations being barred for a year, India may witness such bid-rigging. The insolvency jurisprudence of the USA has seen a few such cases of which India can take cognizance. This misconduct can be in form of bid-suppression, collusive joint-bidding, multiple bidding & collective boycotts. To tackle this issue, there is a need to make the CIRP process fairer & more transparent for all the stakeholders. The Committee of Creditors ("CoC") must be made accountable for their powers & decision-making. The acts of bid-withdrawals, bid-revisions & bid-suppressions can spark suspicion of bid-rigging. This paper attempts to explain how bid-rigging can happen in Insolvency Resolution Applications, how it can be suspected & how a harmonious construction between the Insolvency and Bankruptcy Code, 2016 and Competition Law can be made to penalize & regulate this misconduct.

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I. INTRODUCTION

When an entity announces Insolvency or Bankruptcy, the existence of the company depends on the Corporate Insolvency Resolution Process (**"CIRP"**), along with the fate of all the workers, employees, financers and other stakeholders. The insolvent company (Corporate Debtor or **"CD"***)* can be revived by another company which shows interest to acquire the debtor by submitting their plan to resolve the insolvency of the debtor (Resolution Plan).[1] However, this process can be manipulated by some dominant or notorious players in the market by Bid-Rigging, which puts the interests of all other stakeholders of the debtor company in jeopardy. Even though there are very few resolution plan applicants in a CIRP, there are rare chances of bid-rigging in insolvency resolution plans. Although the developing Indian insolvency law regime has not witnessed any case of such bid-rigging, it can take cognizance of the partly-similar[2] American (**"USA"**) insolvency law

[1] The Insolvency & Bankruptcy Code 2016, No. 31, Acts of Parliament, 2016 (India), § 30 [hereinafter *The Insolvency & Bankruptcy Code 2016*].
[2] Prof. Rashid Shamim, *Bankruptcy Laws: A Comparative Study of India and USA,* 6(2) J. O. MG'MENT 247, 252 (2019). See also NISHITH DESAI ASSOCIATES, https://nishithdesai.com/fileadmin/user_upload/pdfs/Bankruptcy_Laws_-_A_Comparative_analysis_-_United_States_and_India.pdf (last visited July 22, 2021).

regime which might be the only developed regime to have witnessed a few cases of this form of bid-rigging.

The US Bankruptcy Model follows a Debtor-in-Possession system wherein the directors and management stay in control of the bankrupt debtor company unless a bankruptcy trustee is appointed under Section 322[3] of Chapter 11 US Bankruptcy Code (**"USBC"**). The debtor has the sole right to formulate a reorganization plan (resolution plan in Indian parlance) pursuant to Section 1121[4] of USBC within a period of 120 days of the announcement of bankruptcy, which can be extended till 18 months. Pursuant to Section 341[5] of USBC, the debtor can negotiate the terms of the plan with senior creditors (secured creditors in Indian parlance), with the trustee (if any) chairing this meeting. Similar to the 'waterfall mechanism' given under Section 53 of the Indian Insolvency and Bankruptcy Code, 2016 (**"IBC"**),[6] the US model also divides creditors into different classes according to the nature and priority of their credit wherein senior creditors are prioritized over other junior creditors pursuant to the 'Absolute Priority' rule explained in Section 1129[7] of USBC. Both regimes provide some protections to debts to waged labourers and employees.

The reorganization plan proposed by the debtor is required to be approved by all the impaired classes of creditors by a minimum voting requirement before courts can pass a 'confirmation order' to implement the

[3] The United States Bankruptcy Code 1978, https://www.govinfo.gov/content/pkg/USCODE-2011-title11/pdf/USCODE-2011-title11.pdf, § 322 [hereinafter *The United States Bankruptcy Code 1978*].
[4] The United States Bankruptcy Code 1978, § 1121.
[5] The United States Bankruptcy Code 1978, § 341.
[6] The Insolvency & Bankruptcy Code 2016, § 53.
[7] The United States Bankruptcy Code 1978, § 1129.

plan under Section 1129 of USBC. Even if some impaired classes of creditors dissent in approval of the plan, either the court can still approve the plan if it finds the plan 'fair and equitable', or it can modify the plan to resolve the grievances of dissenting creditors. The court passes the confirmation order for implementing such plans only when certain requirements mentioned in Section 1129, such as compliance to all laws being in force, compliance to the 'absolute priority' rule, submission of plans in good faith by a debtor, etc. are fulfilled. This is similar to the conditions mandated to be satisfied before the approval of a plan under Sections 30 and 31 of IBC,[8] which the resolution professional is obligated to check before the adjudicating authority approves the resolution plan. In the US, the plan can be amended, modified or withdrawn by the debtor at any time before it gets the court's 'confirmation order',[9] subject to Sections 1122 and 1123 of USBC.[10] This mechanism of amending the plan can be said to be partly similar to the Indian procedure, which allows withdrawal of resolution plans till the CoC approval.

In both jurisdictions, either the debtor can announce bankruptcy voluntarily, or a group of creditors can file a petition to initiate bankruptcy proceedings. These petitions for initiating bankruptcy can be withdrawn by courts approval. After the bankruptcy is admitted by the courts, Section 362 of USBC[11] imposes an 'automatic stay' on all proceedings pending against the debtor, resembling the imposition of a 'moratorium' under Section 14 of

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[8] The Insolvency & Bankruptcy Code 2016, §§30, 31.

[9] In Re. Delta Petroleum Corporation, et al., Case No. 11-14006 (KJC), https://www.sec.gov/Archives/edgar/data/821483/000119312512385136/d408010dex21.htm (Last visited Sept. 4, 2021).

[10] The United States Bankruptcy Code 1978, §§1122, 1123.

[11] The United States Bankruptcy Code 1978, § 362.

IBC.[12] Thus, in addition to the imposition of moratorium and withdrawal of resolution plans, the bargaining power and priority given to secured creditors is what makes the Indian and American regimes partly similar in spite of some differences, which make a case for an intriguing comparison, which the author attempts to make in this paper.

This article shall deal with what bid-rigging is, why it can happen in insolvency resolution applications, how can it happen & what can be the reforms made by the Insolvency & Bankruptcy Board of India (**"IBBI"**) and the Competition Commission of India (**"CCI"**) to tackle this antitrust issue.

II. BID-RIGGING FROM A COMPETITION LAW PERSPECTIVE

Bid-rigging is a type of Anti-Competitive Agreement under Section 3 of the Competition Act, 2002 (**"Act"**), which is presumed to have an Appreciable Adverse Effect on Competition (**"AAEC"**) in the market. The explanation to Section 3(3)(d) of the act defines bid-rigging as an agreement between entities engaged in similar or identical production or trading of goods which has the effect of reducing or eliminating the competition for bids, which adversely affects the process of bidding.[13] These agreements are a result of collusion amongst bidders to keep the bid money at pre-determined levels and collaborate over the response to invitations of tenders, whereby individual bidders surrender the autonomy to file bids.[14] Thus, the entire process of free-

[12] The Insolvency & Bankruptcy Code 2016, § 14.
[13] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), § 3(3)(d).
[14] VERSHA VAHINI, INDIAN COMPETITION LAW 96, (Lexis Nexis 2016).

bidding is manipulated. Bid-rigging can be in many forms such as bid-suppression, collective boycotts, collusive joint-bidding & cover-bidding.[15]

The main object sought by the IBC is to secure the most feasible and viable resolution plan benefiting all the stakeholders in CIRP to financially revive the corporate debtor and keep it a going concern.[16] This is synchronous with the object sought by competition law in competitive bidding i.e., enabling procurement at the most suitable terms and conditions. Collusive bid-rigging by resolution applicants negates and defeats this very goal of securing the most feasible resolution plan for the corporate debtor, making bid-rigging inherently anti-competitive.[17] Further, while such procurement by tenders has a huge impact on the GDP of the country and bid-rigging or corruption in this activity may have adverse ramifications, effective enforcement of competition law is a key solution.[18]

III. POSSIBLE REASONS FOR BID-RIGGING IN INSOLVENCY RESOLUTION APPLICATIONS

There are many possible reasons why entities may indulge in anti-competitive practices like bid-rigging in insolvency resolution applications. An ongoing CIRP only means that the debtor is loss-making & it cannot pay off its debts. Although an entity announces insolvency or bankruptcy, the

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[15] John Handol, *Establishing breach of Section 3 of the Competition Act: The Indian Bid-rigging cases,* 27 NLSI REV. 147, 150-51 (2015), https://nlsir.com/wp-content/uploads/2020/07/John-Handoll.pdf.

[16] Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India, 2019 SCC OnLine SC 73, (27, 73).

[17] PROVISIONS RELATING TO BID-RIGGING, CCI ADVOCACY SERIES- 3, Pg. 5 (2020), https://www.cci.gov.in/sites/default/files/advocacy_booklet_document/Bid%20Rigging.pdf (last visited Jul. 23, 2021).

[18] M/s Jupiter Gaming Solutions Pvt. Ltd. v. Secretary, Finance, Government of Goa & Anr., 2011 SCC OnLine CCI 23, 71.

entity may still have a wide consumer base, valuable assets in form of machinery, factories, land, etc., a strong supply chain, or good production capacity. Due to the aforementioned factors, the debtor may remain a viable entity to invest in. The well-organised and settled system of manufacturing & supply, certain fixed employees & workplace make the debtor attract other entities to acquire the debtor.

Hence, owing to the commercial ambition of other entities, the entities submitting a resolution plan have some vertical or horizontal overlap in their operations and the nature of products. From a competition law perspective, the acquiring entity may fall in the same 'Relevant Product Market'[19] or 'Relevant Geographical Market'[20] of the debtor. Also, in some cases, a commercially strong entity may submit a plan to enter into other product or geographical markets.

For instance, if a beverage manufacturing company 'A' is insolvent, but it has a wide consumer base, organised supply chain, production units, workforce in North India & another beverage manufacturing company and a bottle-making company 'B' has the same in South India, 'B' may submit a resolution plan to acquire 'A' to enter into the market in North India. Here, the operations of A & B may overlap with respect to the products, vertically or horizontally. In other cases, the investing entity may be a group of companies engaged in different businesses, with an ambition to start another field of business. Thus, to invest in 'A', there can be more such entities like 'B' which may submit a resolution plan.

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[19] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), §2(s).
[20] *Id.* § 2(f).

The commercial ambition of entities may urge them to eliminate competition in bids, to move ahead in the line. Some commercially strong entities can engage in side-agreements with other bidders to prevent them from bidding or withdrawing their bid, resulting in bid-suppression. Also, bidders can indulge in collusive bidding to geographically allocate or divide the products of the debtor by inviting tenders within themselves. Such allocative bidding was also seen in the case of *Rajasthan Cylinders & Containers v. Union of India,*[21] where nineteen-cylinder manufacturers had colluded in Hotel Sahara Star, Mumbai to discuss & fix prices of bids & had allocated geographical territories amongst themselves. It was found that bidders bidding for Western India had not quoted bids for Eastern India and so on. The CCI found a cartel-like behaviour in this case of bid-rigging.[22]

Adding to the competition law jurisprudence, Supreme Court held that the necessary ingredients of bid-rigging are: (i) An agreement between competing bidders; (ii) Parties must be engaged in identical or similar production of goods and services; and (c) the agreement effects in elimination or reduction of competition, or adversely affects or manipulates the bidding process.[23] Further, it can be observed that there may not be direct evidence to prove the existence of agreements as they are secretive in nature, the standard of proof required is one of probability.[24] In the absence of a formal agreement, mere practical cooperation or concerted actions risking competition would amount to anti-competitive practices.[25] Further, although "collusive bidding"

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[21] Rajasthan Cylinders & Containers Ltd. v. Union of India, 2018 SCC OnLine SC 1718.
[22] *Id.* at ¶8-9.
[23] *Id.* at ¶ 77.
[24] *Id.* at ¶ 81.
[25] *Id.* at ¶ 84.

is not defined in the Act, "bid-rigging" and "collusive bidding" are overlapping concepts[26] and have been used interchangeably by various competition authorities.[27]

Among other reasons, the possibility of such bid-rigging was even recognized by Educomp Solutions Ltd.,[28] when it invited insolvency resolution plans while undergoing CIRP. The invitation request explicitly ordered the CoC and Resolution Professional to observe "highest ethics" and avoid all "coercive", "corrupt" or "collusive" practices,[29] which included bid-rigging[30] in their respective definitions as given in the public invitation. Still, no further deliberations were made as to how such collusive practice must be diagnosed and tackled. Hence, the threat of bid-rigging remains an unexplored area in insolvency law jurisprudence, which this paper shall deliberate on.

IV. TYPES OF POTENTIAL BID-RIGGING

A. Bid-Suppression & Withdrawals of Resolution Plans

As mentioned earlier, bid-suppression is a form of bid-rigging wherein one or more entities, who would otherwise submit a bid, agree to refrain from bidding or withdraw the previously submitted bid in exchange for a 'pay-off' or making a side deal benefiting the entity as the consideration incentivizing

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[26] *Id.* at ¶ 78.
[27] Excel Crop Care Ltd. v. Competition Commission of India & Anr., (2017) 8 SCC 47, 40-41.2.
[28] Committee of Creditors of Educomp Solutions Ltd. v. Ebix Singapore Pte. Ltd. & Anr., 2020 SCC OnLine NCLAT 592.
[29] EDUCOMP SOLUTIONS LTD., *Invitation for Submission of Resolution Plans for Educomp Solutions Limited*, 36-37, http://www.educomp.com/Data/ESL-RFRP-17012018.pdf (last visited Jul. 23, 2021).
[30] *Id.* at 50.

such abstinence,[31] so that the designated winning competitor's bid will be accepted unchallenged.[32] This can result in a reduction of the number of competitors bidding, thereby adversely affecting the process of bidding, violating Section 3(3)(d) of the Act.

I. Analysing the Sagecrest II Bankruptcy case

Although the CCI may not have seen cases of bid suppression, this type of misconduct was punished by the Bankruptcy Court of Connecticut (United States) in the case of *In Re. Sagecrest II LLC et al.*[33] (**"Sagecrest II case"**). In 2004, two entities named Sagecrest LLC (**"SCII"**) and Jean-Daniel Cohen (**"Cohen"**) submitted separate insolvency resolution plans after a Canada based Corporate Debtor filed for insolvency under Canada's Companies Creditors' Arrangement Act, 1985.[34] After the bids were submitted, a creditor filed a case in the Canadian Court for re-opening of bids due to the possibility of better offers in the interests of creditors, to which the Canadian Court agreed. After this, SCII approached Cohen asking the latter to withdraw the bid & support the former in exchange for the latter receiving a 'pay-off' benefiting Cohen. Cohen then withdrew its bid and the two bidders made a secretive 'Settlement Agreement'. Finally, the Bankruptcy Court of Connecticut on a complaint, held that this collusive side deal was

[31] In re. Sagecrest II LLC and Sagecrest Holding Limited, No. 3:16-cv-00021 (VAB), Pg. 5, 12, https://www.govinfo.gov/content/pkg/USCOURTS-ctd-3_16-cv-00021/pdf/USCOURTS-ctd-3_16-cv-00021-0.pdf (last visited Jul. 23, 2021).
[32] VERSHA VAHINI, INDIAN COMPETITION LAW 96, (Lexis Nexis 2016).
[33] In re. Sagecrest II LLC et al., Case No. 08/50754, (Bankr. D. Conn. Dec. 23, 2015), bankrupt.com/misc/SageCrestII.DS.pdf.
[34] The Canada Company Creditors' Arrangement Act 1985, R.S.G. 1985, c. C-36, laws-lois.justice.gc.ca/eng/acts/c-36/FullText.html.

unenforceable & that this agreement amounted to 'bid-suppression' due to the collusive thwarting of a rival bid.

The argument that bid-rigging is very rare due to very low number of insolvency resolution applicants can be made. But in the *Sagecrest II case*, although there were only 2 resolution applicants, bid-rigging was shown. This proves the mere low number of resolution applicants in CIRP does not eliminate the chances of such anti-competitive practices like bid-rigging.

It was the sudden bid-withdrawal of Cohen that sparked suspicion of collusion, which helped to prove bid-rigging. A solution to counter this issue is to make parties withdrawing their bids submit the reason behind their withdrawal. An abnormal reason submitted by parties can spark suspicion of collusion. The subsequent part of the paper shall highlight lessons from the facts seen in the *Sagecrest II case* of which the Indian insolvency law jurisprudence can take cognizance.

II. Lessons for Indian Insolvency Law regime

Although Indian law prohibits withdrawal of bids after the resolution plan gets the approval of the CoC, an issue here is that the withdrawing resolution applicants are not demanded to give a reason behind withdrawing their bids. Hence, bid-withdrawals in furtherance of collusive agreements can be done by parties without being held accountable to give a reason behind such withdrawal. In a progressive step, NCLAT in *Kundan Care v. Amit Gupta*[35] held that a resolution applicant whose resolution plan is approved by CoC is not at liberty to alter his stand and withdraw the resolution plan as it would sabotage the CIRP, thereby frustrating the object sought by the IBC. The

[35] Kundan Care Products Ltd. v. Mr. Amit Gupta & Ors., 2020 SCC OnLine NCLAT 670, 7.

NCLAT reasoned that there is no provision in IBC allowing successful resolution applicants to withdraw their bids; the approved resolution plan is contractually binding on the resolution applicant; and that the resolution applicant is bound by estoppel. This judgement overruled NCLAT's verdict in *Metalyst Forgings v. Consortium of Deccan Value Investors*[36] holding that 'unwilling' successful resolution applicants cannot be estopped to obey the approved resolution plan. However, here, the issue is the reason behind such withdrawal of resolution plans.

While the absence of a provision in IBC dealing with the withdrawal of resolution plans can give courts the liberty to decide the issue as per the merits of each case, this can also result in resolution applicants using this as a tool to 'wiggle out' of CIRP as seen in *Metalyst Forgings*.[37] To tackle this issue, the stance taken in *Kundan Care*[38] can be cemented by amending the IBC by prohibiting such withdrawal of resolution plans in late stages, which will also prevent resolution applicants from colluding and withdrawing their resolution plan. Further, a provision empowering the CoC to demand a reason behind such withdrawal may also be added to make withdrawing resolution applicants accountable for their decision. Furthermore, many successful resolution applicants claim 'renegotiation' with CoC to alter the resolution plan or to 'wriggle' out of CIRP.[39]

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[36] Committee of Creditors of Metalyst Forging Ltd. v. Deccan Value Investors LP & Ors., 2020 SCC OnLine NCLAT 837, 39.
[37] *Id.*
[38] *Supra* note 27.
[39] Joel Rebello & Satish John, *IBC Process faces new challenges as some winners look to wriggle out,* ET PRIME, (April 28, 2020, 07:29 AM), https://economictimes.indiatimes.com/industry/banking/finance/banking/ibc-process-faces-new-challenges-as-some-winners-look-to-wriggle-out/articleshow/75415737.cms (last visited Jul. 26, 2021).

Another solution can be to enforce time-bound electronic bidding of resolution plans. Presently, resolution applicants are allowed to negotiate with CoC and submit revised bids. This not only delays the final bid for CoC's consideration but also increases associated litigation which delays CIRP.[40] Such instances of revised multiple-bidding seen in *Jay Overseas v. George Samuel,*[41] in *Ruchi Soya Bankruptcy,*[42] and the *Bhushan Steel Insolvency*[43] have been discussed in the subsequent part of the paper. Now, physical or in-person submission and negotiation of bids enables bidders to identify competing bidders and increases communication between competing bidders during the tendering process.[44] Time-bound electronic bidding prevents this communication, thus reducing potential collusion and reducing the 'participation cost' of bidding which is convenient for many genuine bidders.[45] On similar lines, a part of such a process of time-bound electronic bidding was proposed by the government.[46] Thus, Section 30 of the IBC can be amended to allow time-bound electronic bidding.

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[40] Karunjit Singh, *Time Bound e-bidding to speed up IBC resolution*, THE ECONOMIC TIMES, (February 24, 2021, 18:35 PM), https://economictimes.indiatimes.com/news/economy/policy/time-bound-e-bidding-to-speed-up-ibc-resolution/articleshow/71496833.cms#:~:text=Time%2Dbound%20e%2Dbidding%20to%20speed%20up%20IBC%20resolution, SECTIONS&text=The%20government%20amended%20the%20Insolvency,the%20time%20taken%20for%20litigation (last visited Jul. 26, 2021).

[41] Jay Overseas Pvt. Ltd. v. George Samuel Resolution Professional of Jason Décor Pvt. Ltd. & Anr., 2020 SCC OnLine NCLAT 835.

[42] *Infra* note 39.

[43] *Infra* note 41.

[44] Ken Danger & Antonio Capabianco, *Guidelines for Fighting Bid Rigging in Public Procurement,* ORGANISATION OF ECONOMIC CO-OPERATION & DEVELOPMENT (OECD), Pg. 7, https://www.oecd.org/competition/cartels/42851044.pdf (last visited Jul. 26, 2021).

[45] *Id.* at Pg. 4. See also *Designing Tenders to Reduce Bid Rigging,* OECD, Pg. 9, https://www.oecd.org/daf/competition/cartels/42594504.pdf (Last visited Jul. 26, 2021).

[46] *Supra* note 32.

Apart from the sudden withdrawal of a bid, even multiple bids can spark suspicions of a collusion. The subsequent chapter shall explain the same.

B. Suspicions arising from Multiple-Bidding

Multiple bidding means when a bidder places another bid subsequently after withdrawing the previously submitted resolution plan or revises the bid originally submitted. In most cases, the new bid submitted provides for a bigger amount than the amount quoted in the previous bid. The question arises whether such revisions should be allowed. The principle of 'maximization of assets', which is one of the main objectives sought by IBC,[47] can be argued to allow such revisions, but it may give leisure to many bidders to re-bid, further slowing the CIRP. This can be considered another reason why IBC can be amended to introduce time-bound electronic bidding as argued previously.

1. Analysing the Ruchi Soya Insolvency case

In the *Ruchi Soya Industries Bankruptcy case,*[48] the NCLT allowed Patanjali Ayurveda Ltd. and Adani Wilmar Ltd. to submit multiple bids before the former won the tender for the final bid of Rs. 4350 Crore. Again, it is reiterated that the authority must demand a reason behind such re-submission of bids if the revision was not in furtherance of a negotiation between the bidder and the CoC. Also, such revisions can arise when bidders collude after the original submission and designate one entity as the winner and the winner increases the bid by a revision. It is convenient for one bidder to increase the bid than all other colluders reducing their bids. It is to be noted that there have

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[47] Committee of Creditors of Essar Steel India Ltd. thr. Authorised Signatory v. Satish Kumar Gupta & Ors., 2019 SCC OnLine SC 1478, ¶ 45.

[48] Standard Chartered Bank & Anr. v. Ruchi Soya Industries Ltd., 2017 SCC OnLine NCLT 12689.

been instances of bidders colluding after the original bid, as in the *Sagecrest II case* in the US.[49] Considering a low number of bidders, the collusion can be easier.

2. ***The Bhushan Steel Insolvency case***

In the *Bhushan Steel Bankruptcy case,*[50] the NCLAT accepted a late bid by Liberty House. This multiplicity in bids creates an informality, which is sufficient to create suspicion of collusion between competing bidders if such revisions are without reason or explanation. Such revisions should only be accepted when they are in the interests of creditors, which is the objective of the IBC.

Such informalities, however, adversely affect the CIRP, highlighting the need to amend IBC to have more a consolidated & organised system for the submission, withdrawal & revision of bids under IBC. This can be a cause for instigating investigations on the bidders if more evidence is obtained. From an antitrust perspective, the CCI uses the test of 'preponderance of probabilities' or 'beyond reasonable doubt'[51] to start investigations. Factors like price parallelism,[52] similarity in time of bid submission & other circumstantial evidence may be used to impose penalties for proven misconduct.[53] If such bid-rigging agreements are proven, the damage on the

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[49] *Supra* note 23; (In re. Sagecrest II LLC).
[50] Tata Steel Ltd. v. Liberty House Group Pvt. Ltd., 2019 SCC OnLine NCLAT 13.
[51] Director General (Supplies & Disposals) v. Puja Enterprises, 2013 SCC OnLine CCI 55, 25.
[52] In Re. Builders Association of India v. Cement Manufacturers' Association & Ors., 2016 SCC OnLine CCI 46.
[53] In Re. Aluminium Phosphide Tablets Manufacturers, 2012 SCC OnLine CCI 25.

market need not be proven as such agreements are presumed to have an AAEC.[54]

Collusion in bidding has been at the centre of this discussion. Now, joint bids can also spark suspicion because competing bidders submitting joint bids have an opportunity to collude between themselves. This can also be a cause for investigation for bid-rigging. The subsequent chapter shall deal with the same.

C. Collusive Joint-Bidding

Joint-bidding is another form of potential collusive bid-rigging in the CIRP. In the US case of *Grand Union Company Bankruptcy,*[55] Grand Union filed for a Chapter 11 Bankruptcy in the New Jersey Bankruptcy Court. C&S Wholesale Grocers Inc. submitted a joint bid along with several other small players, and the bid outnumbered all other bids. Hence, another bidder Great Atlantic & Pacific Tea Co. (**"A&P"**) objected stating that such collusive bidding *per se* violated the Sherman Act (US Competition Law). Also, Section 363(n) of the USBC[56] states that the sale of a company can be avoided if it results from an agreement between bidders in bad faith. This makes collusive bid-rigging in insolvency resolution bids null & void.[57]

The Court found collusion in the bid by C&S but allowed the sale of assets of the debtor because all the necessary disclosures of collusion were made to the CoC. The court held that such collusive bidding did not violate antitrust laws because disclosures were made to all the stakeholders & that the

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[54] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), § 3(3)(d).
[55] In Re. The Grand Union Company, et al. Debtors, 266 B.R. 621 (2001).
[56] The United States Bankruptcy Code 1978, § 363(n).
[57] In Re. Abbots Dairies of Pennsylvania, Inc., 788 F.2d 143, 149-50 (3d Cir. 1986).

conduct did not depress the process of bid-rigging. Relying on the *New York Trap Rock Corp. v. Compania Naviera Perez,*[58] the court held that joint-bids are not collusive when they are done in good faith in public interest. Thus, not all forms of bid-rigging can affect the insolvency resolution process.

The abovementioned were potential forms of bid-rigging by insolvency resolution applicants, in which only the applicants/bidders are a part of the agreement. However, bid-rigging means manipulating or controlling the outcome of bids, and it is not necessary that only the applicants can manipulate or control bids. In some cases, the outcome of bids can also be controlled by the committee which approves or rejects bids. The subsequent chapter shall emphasize on the unchecked discretion of the CoC & how these powers can be abused to manipulate bids. Again, India has not seen such cases but can take cognizance of the facts seen in the afore-cited *Grand Union Company Bankruptcy* to tackle such circumstances if they arise in India.

D. Abuse of Power by Creditors

The IBC regime has received many criticisms with respect to the formation of the CoC, the rights & powers of CoC in the resolution plan approval process. Thus, the creditors, by virtue of their dominance can abuse this power to affect the resolution plan bidding process. In the *Neiman Markus Group Insolvency case* in the USA,[59] the co-chair of the committee of unsecured creditors was held guilty of manipulating the bids by abusing his position as co-chair for the individual profit of the creditor company. Due to

[58] In re. New York Trap Rock Corp. v. Compania Naviera Perez Companc, S.A. 42 F.3d 747 (2d Cir. 1994).
[59] In re. Neiman Marcus Group Ltd LLC, No. 20-32519 (Bankr. S.D. Tex. 2020), https://cases.stretto.com/public/X064/10214/PLEADINGS/1021405072080000000221.pdf.

incurring huge losses during COVID-19, Neiman Markus Group (**"NMG"**) filed for a Chapter 11 Bankruptcy Proceedings in Texas on May 7, 2020. Damien Kamensky (**"DK"**), the Managing Partner of Markie Ridge, an unsecured creditor, was appointed as the co-chair of the Committee of Unsecured Creditors. The Texas Bankruptcy Court later found that DK abused his position as the co-chair to pressurize rival bidders not to bid for resolution plans because Markie Ridge wanted to buy the assets of NMG. DK had also faced a criminal prosecution by the U.S. Securities and Exchange Commission[60] in which the District Court of Southern New York sentenced him to imprisonment for six months.[61]

I. The Decision in the Neiman-Marcus Group Insolvency case

The court further held that each member of the CoC has a fiduciary obligation to other members & this duty supersedes the personal economic interests of individual members.[62] Also, it became a well-established rule in US Insolvency Law that creditors can make economically opportunistic bids/moves in regard to the insolvency resolution, but this must not be a result of them taking unfair advantage of their committee membership.[63] It is also notable that even though creditors have qualified immunity in insolvency proceedings, this immunity does not apply to wild misconduct ultra-vires their

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[60] U.S. Securities and Exchange Commission, *SEC Charges Fund Manager for Fraud in Securities Offering in Neiman Markus Bankruptcy,* Press Release No. 2020-203, https://www.sec.gov/news/press-release/2020-203 (last visited Jul. 26, 2021).
[61] Jonathan Stempel, *New York hedge fund founder Kamensky sentenced to prison in Neiman Marcus fraud,* REUTERS (May 7, 2021, 10:18 PM), https://www.reuters.com/world/us/new-york-hedge-fund-founder-kamensky-sentenced-prison-neiman-marcus-fraud-2021-05-07/ (Last visited Jul. 27, 2021).
[62] In re. Rickel & Assocs., Inc., 272 B.R. 74, 100 (Bankr. S.D.N.Y. 2002).
[63] In re. El Paso Refinery, L.P., 196 B.R. 58, 75 (Bankr. W.D. Tex. 1996).

rights.[64] Thus, the Insolvency resolution process needs to be made more transparent.

II. Making CIRP more Inclusive & Transparent

The importance of the duties of the CoC & IRP in CIRP is not disputed. The IBBI advisory charter on the rights of the CoC[65] states that the CoC has the fate of not only the debtor but also other stakeholders. Hence, they automatically have a fiduciary duty as mentioned in the *Neiman-Marcus Group Insolvency case.* But the charter, referring to the *K. Sashikar v. Indian Overseas Bank case,* also says that the NCLT does not have the jurisdiction to question or evaluate the commercial decision of the CoC due to their 'commercial wisdom'.[66] This was recently reiterated by the Supreme Court of India in *Kalparaj Dharamshi v. Kotak Investment Advisors.*[67]

III. Decisional Accountability of the CoC to Ensure Transparency

The power of the CoC to not be answerable for their commercial decisions made after deliberations in the CoC meetings will thwart accountability & transparency in the CIRP. Although the 'Commercial Wisdom' of the CoC is undisputed, this does not excuse them from being accountable for reasons behind their decisions pertaining to resolution plans.

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[64] In re. PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000).

[65] *In aid of Insolvency Professionals and Committee of Creditors involved in the Corporate Insolvency Resolution Process*, INSOLVENCY & BANKRUPTCY BOARD OF INDIA, Press Release dated 1st March, 2019, (February 25, 2021, 18:45 PM), 3, https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2019/Mar/Charter%20IP-CoC_2019-03-01%2021:55:28.pdf.

[66] K. Sashikar v. Indian Overseas Bank Ltd. & Ors., (2019) 12 SCC 150, 33 & 52.

[67] Kalapraj Dharamshi & Anr. v. Kotak Investment Advisors Ltd. & Ors., C.A. No. 002943-002944/2020, ¶ 155, https://main.sci.gov.in/supremecourt/2020/16649/16649_2020_33_1501_26784_Judgement_10-Mar-2021.pdf.

This is because the IBC intended the CIRP to ensure the revival of the Corporate Debtor & keep it afloat.[68] Hence, if not the court, at least the stakeholders in the CIRP have a right to know whether the plan is genuinely aimed at reviving the debtor and if the revival conforms to larger public interest and commercial morality[69] to fulfil the conditions in Section 30(2) of the Code.[70] While the concept of 'commercial morality' has not been deliberated upon at length, but the SC states that to strike a balance between abuse of discretionary powers & public interest, it becomes essential to raise commercial morality.[71] Further, a proper reason by the CoC will persuade the stakeholders in the CIRP about the legitimacy of the decision more effectively, rendering such decisions of the CoC to be more acceptable.[72]

The CoC must have decisional accountability, at least to justify their decision to other stakeholders in CIRP, which will ensure transparency and keep a check on arbitrariness.[73] Further, in an event organized by IBBI, while the IBBI stated that the IBC assigns the role of a 'saviour' on the CoC and that the CoC's commercial wisdom is supreme, it also recognized that firstly, with this tremendous responsibility and power comes accountability; and secondly, because the commercial decisions made by CoC affects the life of the corporate debtor and other stakeholders in CIRP, the CoC must be 'fair and

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[68] Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India, 2019 SCC OnLine SC 73, 28.
[69] Meghal Homes Pvt. Ltd. v. Shree Niwas Girni K.K. Samiti & Ors., (2007) 7 SCC 753, 51. Also see Shebani Bhargava, *Schemes of Compromise or Arrangement during Liquidation*, (2020) PL June 76, 80.
[70] The Insolvency and Bankruptcy Code 2016, § 30(2).
[71] Jasbhai Motabhai Desai v. Roshan Kumar & Ors., (1976) 1 SCC 671, 50.
[72] Makoto Hong Cheng, *Shaping a Common Law Duty to Give Reasons in Singapore*, 28 SINGAPORE ACAD. OF L. J. 24, 26 (2016).
[73] Avinash Bhagi, Judicial Accountability in India: An Illusion or Reality?, 8 GNLU J. OF LAW, DEV. & POL. 145, 149 (2018).

transparent' in its decisions.[74] Furthermore, on similar lines, the England & Wales Court, in the case of *Flannery v. Halifax Estate Agencies Ltd.,*[75] held that in cases of disputes involving an intellectual exchange, it is a general duty of the Judge to state reasons for his views or decision on the particular issue, along with the analysis of the reason, because this ensures 'fairness' in the trial.

Also, some creditors in the CoC may have larger voting rights in comparison to other creditors owing to a larger debt share. Therefore, the creditor having a higher debt share can easily control a substantial portion of the required 66% approval from the CoC, and accountability becomes important here. Hence, to control unilateral & arbitrary misconduct by the CoC, the CoC must be made accountable for stating the rationale behind the approval or rejection of a resolution plan.

Now, the subsequent chapter shall deal with steps the regulators can take to tackle & penalize such offences.

V. PENALTIES FOR PROVEN BID-RIGGING CASES IN RESOLUTION APPLICATIONS.

Similar to the Indian model which mandates resolution applicants to get prior clearance from the CCI under Section 31(4) of IBC[76] read with Section 5 of Competition Act, 2002,[77] the US Federal Trade Commission

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[74] Committee of Creditors: An Institution of Public Trust?, IBBI, Pg. 2, https://www.ibbi.gov.in/uploads/whatsnew/cf377e43c2fbd827d74419f2ca1afe8b.pdf (last visited Jul. 26, 2021).
[75] Flannery & Anr. v. Halifax Estate Agencies Ltd., [2000] 1 All ER 373.
[76] The Insolvency & Bankruptcy Code 2016, No. 31, Acts of Parliament, 2016 (India), § 31(4).
[77] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), § 5.

(**"FTC"**) also mandates a 'pre-merger' notification and merger review process[78] for bankruptcy-driven mergers/acquisitions under Section 363(b)(2) of the USBC[79] and the Hart-Scott-Rodino Antitrust Improvements Act, 1976[80] (**"HSR Act"**). Now, the IBC does not specifically deal with bid-rigging in Insolvency Resolution Applications, and hence, the US model can be referred to. Following the US model, bid-rigging in Insolvency resolution plans can be invalidated due to its violation of the US Antitrust law under Section 363(n) of the USBC, provided that collusion was done in a bad faith. Thus, although the pre-merger clearance may have been obtained by the resolution applicant, the successful resolution plan can be invalidated if bid-rigging is proved later.

Now, in such cases to defend bid-rigging, a larger public interest can be a valid defence. The Indian Competition Act makes bid-rigging illegal *per se* under Section 3(4) of the Act. The CCI has imposed heavy penalties on parties charged for bid-rigging,[81] along with making the bids invalid in some cases. However, the erstwhile Monopolistic & Restrictive Trade Practices (**"MRTP"**) Commission had excused the parties for bid-rigging due to a larger public interest in the *Swastic Laminating Industries case.*[82] The MRTP Commission had held that the bid-rigging was not prejudicial to public interest, as pursuant to the erstwhile MRTP Act, 1969, before issuing any

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[78] FEDERAL TRADE COMMISSION, *Premerger Notification and the Merger Review Process,* https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/premerger-notification-merger-review, (Last visited Jul. 27, 2021).
[79] The United States Bankruptcy Code 1978, § 363(b)(2).
[80] The Hart-Scott-Rodino Antitrust Improvements Act, 1976, 15 U.S.C. § 18a.
[81] The Competition Act 2002, § 27(b).
[82] In Re. Swastic Laminating Industries & Ors., R.T.P. Inquiry No. 81/1984. *See also* CUTS International & National Law University, Jodhpur, *Study of Cartel Case Laws in Select Jurisdictions- Learnings for the Competition Commission of India,* CCI ADVOCACY- MARKET RESEARCH (2008), 97, https://www.cci.gov.in/sites/default/files/cartel_report1_20080812115152.pdf.

order, it had to determine whether any restrictive trade practice was prejudicial to public interest. Hence, parties would claim public interest defending bid-rigging, as seen in *Peico Electronics v. Union of India,*[83] where this defence was rejected both by the MRTP Commission and the SC subsequently. However, the CCI has never discussed public interest vis-à-vis bid-rigging citing the *Swastic Laminating* case. It will be interesting to see subsequent developments in this regard.

However, if resolution bids are to be cancelled & re-invited, due to the need for a speedy CIRP process, orders for re-inviting bids can cause delays in resolution, affecting many stakeholders like workers, employees and other operational creditors as seen in the *Jaypee Infratech Insolvency case.*[84] Hence, even if bid-rigging violates the Act, this can be let go with certain civil and criminal penalties on the parties indulging in bid-rigging. The appropriate civil and criminal penalties can be determined by the competent authorities after scrutinizing several factors, for e.g., the gains and profits obtained by parties involved in bid-rigging; injustice caused or losses incurred to other stakeholders in CIRP; penalties given under Chapter VII of IBC, and Chapter VI of Competition Act, 2002 respectively, etc. This will be necessary to deter parties from indulging in bid-rigging and incentivizing them to follow the due process established by law rather than indulging in bid-rigging and paying the imposed fines. Placing reliance on using economic reasoning to determine optimal penalties for effective deterrence, it needs to be ensured that the expected penalty of the offender in event of being convicted for the offence

[83] Peico Electronics & Electricals & Anr. v. Union of India & Anr., (2004) 8 SCC 658, 18.
[84] Anuj Jain, Interim Resolution Professional of Jaypee Infratech Ltd. v. Axis Bank Ltd., 2020 SCC OnLine SC 237.

committed is more than the total expected gain of the offender from committing the offence.[85]

A. Harmonizing Interplay Between IBC & the Competition Act

Under the lens of Competition law, Section 3(3)(d) presumes bid-rigging to cause an AAEC. Thus, the bids of resolution applicants could be made void. But this will result in the debtor going into liquidation, which may hurt the interests of the creditors and debtors. However, under the lens of Insolvency Law, bid-rigging may be excused if it serves the purpose of maximization of assets. Here, we see a conflict between the interests of Competition Law and Insolvency Law. Thus, there can be a jurisdictional overlap between the CCI and the NCLT/IBBI. To address this, the verdict of the SC in *CCI v. Bharti Airtel*[86] can be referred to. The SC held that the Telecom Regulatory Authority of India (**"TRAI"**) being the subject matter regulator on Telecommunication, is better equipped to examine issues of Telecommunications and that the CCI is ill-equipped to exercise jurisdiction until TRAI concludes on the telecom issues. Thus, the CCI needs to wait for its turn. It can be argued that the NCLT shall have the primary jurisdiction to examine the viability of the resolution plan with respect to the interests of the creditors, the debtor & other stakeholders in CIRP.

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[85] GARY S. BECKER, ESSAYS IN THE ECONOMICS OF CRIME AND PUNISHMENT 43-45, (National Bureau of Economic Research, 1974), https://www.nber.org/system/files/chapters/c3625/c3625.pdf (Last visited Jul. 27, 2021).

[86] Competition Commission of India v. Bharti Airtel Ltd. & Ors., 2018 SCC OnLine SC 2678, ¶¶104, 105, 109, 112 & 113. *See also* Star India Pvt. Ltd. & Anr. v. Competition Commission of India & Ors., 2019 SCC OnLine Bom 3038.

Both the Competition Act, 2002 and the IBC, 2016 are special laws, containing non-obstante clauses. Section 60[87] of the Competition Act gives it an overriding effect over other laws, and so does Section 238[88] of the latter to the IBC. Now in the *Pioneer Urban Lands case,*[89] the SC held that IBC would prevail over the Real Estate (Regulation and Development) Act, 2016 (**"RERA"**) because the former was enacted after the latter and that the parliament in enforcing the obstante clause in IBC (Section 238) clearly shows the intent to overrule all other laws being in force including Section 88 of RERA. In this case, the same argument can be made that the IBC was enacted after the Competition Act, 2002 and that the Parliament while enacting Section 238 clearly intended to give IBC an overriding effect over all laws, even Section 60 of the Competition Act. Also, Section 62[90] of the Competition Act states that the application of other laws is not barred. Thus, reading Sections 60 and 62 with Section 238 of the IBC in the light of the *Pioneer Urban Lands Case,* it is clear that IBC will prevail over the Competition Act, 2002. Thus, with these steps, a harmonious construction between the principles of Competition Law & Insolvency Law can be done.

Furthermore, in circumstances in which approving the second-best resolution plan, if any, also caters to the interests of all stakeholders in CIRP, the rigged bid can be set aside, and the subsequent best resolution plan can be

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[87] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), § 60.
[88] The Insolvency & Bankruptcy Code 2016, No. 31, Acts of Parliament, 2016 (India), § 238.
[89] Pioneer Urban Land & Infrastructure Pvt. Ltd. & Anr. v. Union of India, 2019 SCC OnLine SC 1005, ¶¶25, 27 & 29. *See also* KSL Industries Ltd. v. Arihant Threads Ltd. & Ors., 2014 SCC OnLine SC 846.
[90] The Competition Act 2002, No. 12, Acts of Parliament, 2003 (India), § 62.

approved by the adjudicator. This may be another solution to harmonize the objectives of the two laws.

VI. CONCLUSION

Thus, although Indian Jurisprudence has not seen cases of bid-rigging in Insolvency Resolution Application bids, the USA has seen a few such instances from which India can take lessons. Owing to the recession due to the pandemic, the initiation of CIRP was prohibited for a year from March 25, 2020.[91] Hence, such bid-rigging was out of the question then. But now as the economy has started recovering, we may see such issues in the future. To tackle the same, the author suggests the need to make CIRP more transparent & enforce more accountability on the CoC and the resolution applicants for their actions, to prevent, or diagnose this issue of bid-rigging. Further, sudden withdrawal of bids, multiple bidding, and joint bids create a suspicion of collusion, which may lead to bid-rigging.

The author also suggests that the applicants state reasons behind their actions, so as to curb this issue. Bid-rigging can also happen by abuse of discretionary powers by the members of the CoC, as seen in US cases. The paper asserts how a more transparent CIRP can curb this problem. Although the CIRP is a confidential process & not every information is privy to the public, the same does not exempt the stakeholders in the CIRP to ascertain whether the CIRP is fair and reasonable. In instances when bid-rigging is proved, the Competition Law & Insolvency Law regimes present conflicting approaches to punish offences. So as to strike a middle ground between these

[91] The Insolvency & Bankruptcy Code (Second Amendment) Bill 2020, Bill No. 31, Bills of Parliament, 2020, https://www.ibbi.gov.in/uploads/whatsnew/aa1ac00c9a594c699c71c2d34fb990f9.pdf.

conflicting regimes, this paper further opines a way of harmonizing these contrasting interests of both the laws.

VII. TRADE DISTORTIONS DUE TO CROSS-SUBSIDIZATION DURING THE PANDEMIC: A CRITICAL ANALYSIS

- Vijay Rohan Krishna and Sambhawi Sanghmitra*

ABSTRACT

The modalities of the WTO Agreement on Agriculture ("AoA") oversee the liberalization of global agricultural trade through the regulation and reduction of agricultural subsidies, which are categorized under two heads, domestic support and export subsidies. While export subsidies have been successfully phased out, the AoA reduction commitments provide ample policy space for nations to implement trade distorting domestic support programs without contravening said commitments. The concept of cross-subsidization contemplates the use of domestic support measures to subsidize the export of agricultural products. The use of domestic support measures has increased exponentially during the COVID-19 pandemic as WTO members continue to deal with the exigencies of the pandemic, and support their domestic agricultural sectors to maintain stability and prevent critical shortages, and such heavy domestic subsidization has an adverse impact on the global market prices of agricultural products, especially during the pandemic. In the present paper, the authors seeks to critically analyse the provisions of the AoA, and highlight the inability of the statute to effectively curb cross-subsidization. To that end, Part I of the paper provides a brief overview of the regulation of agricultural subsidies. Part II deals with the concept of cross-subsidization, and the ways in which developed nations use their substantial financial resources to engage in trade distorting activities that adversely affect the markets of developing and least developed nations that cannot afford to subsidize their agricultural sector. Furthermore, Part II underscores the exacerbated effect of trade distortions due to the pandemic, and the inadequacy of the current AoA regime to reduce the impact of such distortions. In light of the fact that the AoA does not envisage an explicit scheme for the regulation of cross-subsidization, Part III proposes enlargement of the scope of Articles 9 and 10 of the

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AoA, and the Agreement on Subsidies and Countervailing Measures to directly prohibit cross-subsidization. An explicit regime is necessary due to the nebulous nature of cross-subsidies as they blur the lines between export subsidies and domestic support. Lastly, Part IV concludes while noting that although the effect of cross-subsidization has been aggravated due to the pandemic, the vast policy space available to developed nations to provide trade distorting domestic support has misused before the pandemic, and will be misused after the pandemic. Therefore, there is a stark need for reform in the AoA regime.

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I. INTRODUCTION

The COVID-19 pandemic has presented an unprecedented challenge for international trade and global food security as large portions of the world economy have been forced to cease operations. While the agriculture sector was exempted from the lockdowns, and has been resilient to the externalities of the pandemic, it was still impacted by the overall stagnancy of trade.[1]

The pandemic has also emphasized the fragility of global food supply chains as countries strive to ensure that their populations do not suffer from critical food shortages. In doing so, countries are disrupting supply chains to meet domestic demands for food products and medical supplies, and contravening their obligations under the World Trade Organisation (**"WTO"**),

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[1] *COVID-19 and agriculture: a story of resilience*, WTO (August 2020), https://www.wto.org/english/news_e/news20_e/agri_27aug20_e.htm.

specifically the Agreement on Agriculture (**"AoA"**). Trade negotiations to prevent trade distortions due to such measures are primarily focusing on the disruption of international trade due to the export prohibitions and restrictions.

However, the impact of agricultural subsidies and their trade distorting effects on global food security, and the exacerbation of such effects due to the exigencies created by the pandemic have been discussed in a very limited manner in the meetings on the Committee on Agriculture.[2] As countries scurry to recover from the economic slowdown, they have been providing significant amounts of agricultural subsidies, specifically domestic subsidies, to their agricultural sector to bolster production and food security.[3]

Export subsidies are subject to strict reduction commitments under Articles 9 and 10 of the AoA.[4] However, such subsidies may have long-lasting trade distorting impacts as member states are utilising the ample policy space available under the Agreement to domestically subsidize their agricultural production.[5]

The present paper highlights the issue of cross-subsidization of agricultural products during the pandemic. While cross-subsidization is not a novel concept, its trade distorting effects are exacerbated by the exigencies of the pandemic. As heavily subsidized agricultural products flood the markets and the world price of the product is depressed, it is the developing and least

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[2] J. Hepburn, *Coronavirus, resilience, and food security: how can trade policy help?*, THOMSON REUTERS FOUNDATION (Apr. 30, 2020), https://news.trust.org/item/20200430103801-dijoh/.

[3] Sparsha Janardhan, *'Treatment' of Subsidies in Times of Crisis: Reviving the Economy through Trade Agreements*, C110 UNESCAP 1, 3 (2020).

[4] WTO Agreement on Agriculture, art. 8.

[5] Koo and Kennedy, *Impact of Agricultural Subsidies on Global Welfare,* 88 AMERICAN JOURNAL OF AGRICULTURAL ECONOMICS, 1219, 1223 (2006).

developed countries (**"LDCs"**), which do not possess the financial resources and Aggregate Measure of Support (**"AMS"**) entitlements available to developed nations to provide domestic support to their agricultural sectors, who bear the brunt of the trade distorting effects of such practices.[6]

A. Agricultural Subsidies and the Agreement on Agriculture

The AoA was a significant step in the liberalization of international agricultural trade by eliminating trade barriers and reforming the trade-distorting policies of states through commitments under the Agreement. In this regard, member states agreed to reform their policies in three areas, namely: market access, domestic support, and export subsidies; and they have endeavoured to institute reductions in these areas.

Domestic support programs, in the form of direct subsidies or payments-in-kind, are considered to be a viable method for minimizing the costs of production of agricultural products, and stimulating growth in the agriculture industry. Initially, such subsidies were envisioned as supplementary income for farmers and agribusinesses to boost the production of agricultural products, and consequently, stabilise global food security.[7] On the other hand, export subsidies are granted to exporters of agricultural products to incentivise the sale of surplus on the international market through payments contingent upon export, exemptions from domestic sale, and excise

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[6] *Id.*

[7] Satya Ranjan Swain, *Trade Externalities of Agricultural Subsidies and World Trade Organization*, 1 AMERICAN JOURNAL OF ECONOMICS AND BUSINESS ADMINISTRATION 225, 229 (2009).

taxes or credit facilities to lower the cost of export.[8] The grant of such subsidies is legally or factually contingent upon their exportation.[9]

The AoA was enacted to create a more egalitarian international market for agricultural trade, and to recognize the severe effects of agricultural subsidies. Consequently, it imposes reduction commitments on the WTO members to reduce, and eventually abolish subsidies. In that regard, the 10th WTO Ministerial Conference in Nairobi was a significant achievement of the WTO as members recognized the highly distorting and detrimental effects of export subsidies on international trade. To that end, where developed country members resolved to "immediately eliminate their remaining schedules of export subsidy entitlements," developing countries would do the same by 2018.[10] Presently, export subsidies no longer pose a significant threat to international trade, and their regulation is largely limited to ensuring that member states do not circumvent their commitments through the modalities of the Committee on Agriculture and the Agreement on Subsidies and Countervailing Measures (**"SCM Agreement"**).[11]

B. Domestic Support Policy Space

Per Contra, member States have ample policy space under the AoA to implement domestic subsidies that have trade-distorting impacts. Since they constitute a variety of governmental measures, they are very challenging from

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[8] WTO Agreement on Agriculture, art. 1(e).

[9] WTO Agreement on Subsidies and Countervailing Measures, art. 3.1 (a).

[10] Heinz Strubenhoff, *The WTO's decision to end agricultural export subsidies is good news for farmers and consumers*, BROOKINGS (Feb. 8, 2016), https://www.brookings.edu/blog/future-development/2016/02/08/the-wtos-decision-to-end-agricultural-export-subsidies-is-good-news-for-farmers-and-consumers/.

[11] S. EVENETT & R BALDWIN, COVID-19 AND TRADE POLICY: WHY TURNING INWARD WON'T WORK 36 (CEPR Press 2020).

a regulatory perspective. Furthermore, domestic subsidization is often done in furtherance of legitimate sovereign actions, such as securing food security for the people. Consequently, a complete ban like that in the case of export subsidies is not feasible.

Domestic support programs under the AoA may be implemented under four categories or boxes, namely, Green, Blue, Development and Amber. Under the Green[12] and Blue[13] Boxes, member states are entitled to provide unlimited support to their agricultural sectors. The Development box was implemented as a Special and Differential Treatment mechanism (**"S&DT"**), wherein developing members may provide unlimited investment and input subsidies to their agricultural sectors and struggling farmers.[14]

Domestic measures outside the three boxes are measured in terms of the AMS, and are covered under the Amber Box. Such measures are subject to stringent financial limitations. Under the Amber Box, member states may provide for price support which can be product-specific support (**"PSS"**) or non-product specific support (**"NPS"**). PSS and NPS is permissible up to the de minimis limit,[15] which is 5% of the value of production for developed nations, and 10% for developing nations.

Under the AoA, there is a stark disparity between the AMS entitlements available to developed members as opposed to developing members. For developing and least developed nations, the de minimis limit is the maximum limit for providing AMS. However, developed nations are

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[12] WTO Agreement on Agriculture, Annex 2.
[13] *Id.*, art. 6.5.
[14] *Id.*, art. 6.2.
[15] *Id.*, art. 6.4.

entitled to provide Amber box support beyond the de minimis levels, subject to a maximum AMS entitlement.[16] This is due to the fact that developed members had the financial resources to provide for AMS support beyond the de minimis levels during the base period, i.e. 1986 to 1990. The AMS support provided during the base period was used as a benchmark for AMS support reduction for member states after the implementation of the WTO guidelines. 17 developed members may provide for unlimited PSS or NPS beyond the de minimis limit, provided that it does not exceed their maximum AMS entitlements. Developing members, on the other hand, did not provide for Amber box support beyond the de minimis levels during the base period and therefore, their AMS entitlements beyond de minimis are zero.[18]

The wide policy space due to high AMS entitlements available to developed members allows them to implement highly distorting support measures without actually breaching their commitments. For example, the European Union (**"EU"**) provided for PSS to sugar and cotton up to 177% and 139% of their value of production respectively, and did not breach its commitments.[19] The wide policy space available to developed members puts

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[16] WTO Agreement on Agriculture, art. 6.3.

[17] *Understanding the WTO: The Agreements*, WTO, https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm#:~:text=It%20was%20a%20significant%20first,)%2C%20that%20began%20in%201995.

[18] Sachin Kumar Sharma, *A Quantitative Analysis of Proposals on Domestic Support in WTO Agriculture Negotiations: Need for Reaffirming the Development Agenda* 1-7, CENTRE FOR WTO STUDIES, INDIAN INSTITUTE OF FOREIGN TRADE, Working Paper No. CWS/WP/200/63, 2021.

[19] *Elimination of AMS to Reduce Distortions in Global Agricultural Trade, Submission by India and China*, WTO (July 17, 2017), https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=237728&CurrentCatalogueIdIndex=0&FullTextHash=371857150&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True.

them in a very advantageous position from an international agricultural trade perspective, and forces the agricultural sectors in developing states to compete from an extremely weaker position in comparison.[20]

II. CROSS-SUBSIDIZATION OF AGRICULTURAL PRODUCTS

Domestic subsidies and export subsidies are fundamentally different in nature, and are regulated in distinct spheres. However, the trade distorting effects of the two pillars of the AoA are intricately linked. Domestic subsidies incentivise production, and consequently, the market is flooded with the subsidized product. Subsequently, as the supply increases, the price of the product on the global market is depressed.[21] This allows the subsidizing state, which is generally a developed nation and possesses the financial resources to domestically support its producers and can utilise the vast policy space available to it under the AoA, to export and sell its product on the global market at a lower price.[22]

However, developing and LDCs, which are largely agrarian economies that rely on their agricultural surplus for revenue through export, cannot afford to subsidize their agricultural products and have to compete with the subsidized prices. Furthermore, they have to adhere to the de minimis levels of AMS support to ensure that they are not breaching their commitments under the AoA.[23]

When these subsidized products are exported, they are available at cheaper prices in the importing countries. For example, American wheat

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[20] *Id.*, at 17.
[21] *Supra* note 7, at 4, p. 227.
[22] *Id.*
[23] S*upra* note 18, at 6.

available in Chennai is much cheaper than the domestically grown grain. Consequently, food processors in South India find it more economical to use the imported wheat than to transport it from North India. As a result, while there is a surplus of wheat in North India, processors in the South continue to import cheaper wheat from the United States of America (**"US"**).[24] Similarly, farmers in Brazil have had to sell their cotton produce for artificially lower prices due to the high extent of subsidization of cotton done by the US.[25] This concept of 'cross-subsidization' has been discussed in a number of instances, most notably in the *EC – Export Subsidies on Sugar*[26] and the *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (**"Canada – Dairy"**)[27] cases.

A. Cross-Subsidization of Agricultural Products:

Article 9 of the AoA contemplates an elaborate list of export subsidies that are subject to reduction commitments. For the purposes of the present discussion, Article 9.1(c) assumes significance and has been reproduced below:

> payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an

[24] S*upra* note 7 at 4, p. 229.
[25] Appellate Body Report, *US – Upland Cotton*, WTO Doc. WT/DS267/AB/R (adopted 2014).
[26] Appellate Body Report, *EC – Export Subsidies on Sugar*, WTO Doc. WT/DS265/AB/R (adopted 2005).
[27] Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WTO Doc. WT/DS103/AB/R (adopted 2003).

> agricultural product from which the exported product is derived.[28]

Therefore, to fall within the jurisdiction of Article 9.1(c), an agricultural subsidy would have to be a payment that subsidizes the export of an agricultural product that was financed by virtue of governmental intervention. The concept of cross-subsidization involves the subsidization of exports through domestic support programs.

The concept of cross-subsidization is best explained through the factual matrix of the EC–Export Subsidies on Sugar case, wherein domestic prices of two categories of sugar, termed as 'A sugar' and 'B sugar' were supplemented by combinations of minimum support prices, import restrictions, and other forms of governmental intervention. Sugar produced in excess of the quantities covered under A and B sugar was termed as 'C sugar', and was eligible to be exported, unlike A and B categories. The contention brought by Australia, Brazil and Thailand was that the EC was providing for export subsidies for sugar in excess of its reduction commitments under the AoA.[29]

The Panel and the Appellate Body noted that there was no differentiation between the production or the manufacturing process of the three categories of sugar, and held that the domestic subsidies and protectionist trade restrictions that were provided for the domestic sale of A and B sugar, were also benefiting the production of C sugar. Consequently, the export price of C sugar was much lower than the average cost of production due to the fact

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[28] WTO Agreement on Agriculture, art. 9.1 (c).
[29] S*upra* note 26, at 7.

that the subsidization of A and B sugar was also subsidizing the export of the C sugar through the process of cross-subsidization.[30]

In the Canada–Dairy case, the Appellate Body stressed the importance of a benchmark for assessing whether a measure constituted a 'payment' within the meaning of Article 9.1(c). The AoA does not identify a specific benchmark, and that the term 'payments' must not be restricted to a rigid definition. The meaning of the term would depend on the facts and circumstances of each case, and the regulatory framework that surrounded the domestic support measure.[31] The Appellate Body determined that the comparison between the average cost of production and the price at which the product was being exported would be a suitable industry-wide benchmark in that case.[32]

The Appellate Body in EC–Export Subsidies on Sugar relied on the report in Canada–Dairy to hold that the term 'payments on export' directly or indirectly[33] 'financed by virtue of governmental action' under Article 9.1(c) did not mean that the subsidies were contingent upon export, but rather that they had the effect of subsidizing exports, or were connected to export performance. The Appellate Body held that the term should be interpreted widely to further the object of Article 9, so that all agricultural subsidies that distort export performance can be regulated under the AoA.

Therefore, through the process of cross-subsidization, the export price of domestically produced agricultural products is subsidized through domestic

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[30] *Supra* note 26, at 7.
[31] *Supra* note 27, at 7, ¶ 74-76.
[32] *Supra* note 27, at 7, ¶ 110, 116.
[33] *Supra* note 26, at 7, ¶ 237.

support and market access measures. A domestic support measure that subsidizes the export of a particular agricultural product in this manner would come within the ambit of Article 9. However, due to the fact that the AoA does not specifically deal with cross-subsidization, it is easy for nations to utilise their domestic support policy space to circumvent their export subsidy reduction commitments under the AoA and the SCM Agreement.

B. Excessive Domestic Support during the Pandemic

Unlike the food crisis in 2008, where market disruptions were exacerbated by export prohibitions and stockpiling of agricultural products to combat the critical food shortages faced by many countries, the Global Trade Alert[34] paints a starkly different picture during the COVID-19 pandemic. While export prohibitions and restrictions in the healthcare sector saw the usage of highly distorting state policies, the agricultural sector was untouched by such measures. Measures restricting the export of food and other ancillary products were less in number than half the measures on surgical gloves alone.[35]

However, domestic support programs for the agricultural sector were used by member states to relieve the pressure of the economic slowdown. For example, the US financial relief to agricultural producers in the form of direct transfers and domestic subsidies amounted to $19 billion.[36] Similarly, the EU has been providing for domestic support measures to mitigate the effects of

[34] *COVID-19 and world trade*, WTO (November 2020), https://www.wto.org/english/tratop_e/covid19_e/covid19_e.htm.
[35] *Id.*
[36] *USDA Announces Coronavirus Food Assistance Program*, USDA Release No. 0222.20 (Apr. 17, 2020), https://www.usda.gov/media/press-releases/2020/04/17/usda-announces-coronavirus-food-assistance-program.

the pandemic by offering loans and crisis support for farmers.[37] Even developing countries like India are offering domestic support to their farmers in the form of working capital to the tune of INR 30,000 crores, and direct transfers under the PM KISAN fund amounting to INR 18,700 crores, among other measures.[38]

While domestic measures are inevitable in times of crisis, their distorting effects on international agricultural trade may have drastic impacts. Even though such measures may not be in contravention of the AoA, and cannot be classified under the Amber Box, it is the duty of WTO members to ensure that such measures are proportionate, targeted, temporary, and transparent, so that they do not adversely affect trade during this sensitive period.[39]

C. Impact of Cross-Subsidization in the wake of the Pandemic

As the world economy was shut down due to the pandemic, the reactionary response of nations was an inevitability due to the unprecedented nature of the crisis. Broadly, this response can be characterized under two heads: firstly, implementing prohibitions and restrictions on the export of essential commodities, healthcare supplies and food products to prevent

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[37] *Supporting the Agriculture and Food Sectors amid Coronavirus*, EUROPEAN COMMISSION (2020), https://ec.europa.eu/info/foodfarming-fisheries/farming/coronavirus-response_en#measures.

[38] *COVID-19 in India – GOI's Economic Package for Self-Reliant India – Food and Agriculture Items*, USDA (May 29, 2020), https://www.fas.usda.gov/data/india-covid-19-india-gois-economic-package-self-reliant-india-food-and-agriculture-items.

[39] *DG Azevedo welcomes G20 ministers' commitment to notify WTO of COVID-19 related trade measures*, WTO (Mar. 30, 2020), wto.org/english/news_e/news20_e/dgra_30mar20_e.htm.

critical shortages,[40] and secondly, providing domestic support to the producers of such products.[41]

However, as the pandemic progressed and countries acclimated to the new reality, the concerns of the WTO members shifted from self-preservation to honouring their commitments under the WTO rules and ensuring that global supply chains are not terminally affected. The preservation of global food security is an important aspect of the Sustainable Development Goals of the WTO.[42] However, it is important to note that the WTO rules do not prescribe best practices to ensure that trade distorting measures are avoided. Instead, they provide space for members to legislate their own policies and prescribe the boundaries within which such policies must necessarily lie. The utilisation of that policy space is left entirely up to the members.[43]

Therefore, it is no surprise that members continue to heavily subsidize domestic production to relieve the pressure felt by the agricultural industries in the respective nations. Under Section 1 Part IV of the Member's Schedules under the AoA, domestic support commitments provide ample policy space for providing potentially trade distorting subsidies. While the support provided by developing countries is limited due to the de minimis limitations and the lack of financial resources, developed countries can utilise the policy space to destabilise the global market.[44]

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[40] *COVID-19: Why export restrictions are the wrong response*, AMIS (May 14, 2020), http://www.amis-outlook.org/news/detail/en/c/1152643/.
[41] *Supra* note 11, at 5, p. 45.
[42] Peter Ungphakorn, *Lessons from the pandemic for WTO work on agriculture trade and support*, WTO SECRETARIAT 257, 260 (2020).
[43] *Id.*, p. 263.
[44] *Id.,* p. 267.

The level of domestic support leeway available to developed nations is a threat to the preservation of global food prices. The threat is further exacerbated by the pandemic as members strive to apply the maximum level of domestic support that is within their commitment limits. An example of the unease caused due to such subsidies can be seen in the meetings of the Committee on Agriculture, as members raise questions against the support packages of major economies like the US' Coronavirus Food Assistance Program and Canada's Food Purchase Program.[45] While these policies may not contravene the commitments under the AoA, their trade-distorting impacts will adversely affect the food security and livelihood of developing countries and LDCs.

In light of the above, the cross-subsidization of agricultural products has been elevated to as a major threat against global food security and the ability of developing countries to deal with the realities of the pandemic. While the beginning of the pandemic saw hastily implemented export prohibitions,[46] restrictive trade measures were lifted as the economy stabilized and as WTO members were urged not to disrupt food supply chains. At the end of 2019, trade restrictions were at historically high levels in anticipation of the pandemic.[47] However, the Trade Monitoring Report of the WTO dated 11 December, 2020 shows a marked decline in such restrictions.[48] *Prima facie*,

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[45] Committee on Agriculture, *Compilation of Questions for the Special Meeting of 18 June 2020*, WTO Doc. No. G/AG/W/206 (Jun. 8, 2020).

[46] *Export Prohibitions and Restrictions*, WTO (Apr. 23, 2020), https://www.wto.org/english/tratop_e/covid19_e/export_prohibitions_report_e.pdf.

[47] *Report shows trade restrictions by WTO members at historically high levels*, WTO (Dec. 12, 2019), https://www.wto.org/english/news_e/news19_e/dgra_12dec19_e.htm.

[48] *Report shows marked decline in trade restrictions by WTO members amidst COVID-19 pandemic*, WTO (Dec. 11, 2020), https://www.wto.org/english/news_e/news20_e/trdev_11dec20_e.htm.

these developments may seem positive as healthy trade in agricultural products will result in an increasingly stable market. However, it may have long lasting distorting impacts due to the cross-subsidization of such productions.

Similar to the highly distorting nature of C sugar[49], agricultural products exported by developed economies have been significantly cross-subsidized.[50] As domestic support measures are followed by an up-tick in production, such nations will have surplus goods that can be exported to foreign markets. Therefore, due to the domestic support, the price of such products would be lower than the average cost of production, and this will also be reflected in the price of the product in markets where the product is exported. As a result, the global market for the cross-subsidized product would be destabilized because the market would be flooded with the product due to increased production, and the global price of the product would be depressed.

As a consequence, despite the AoA and the developments made through WTO negotiations with regard to the subsidization of exports, such subsidies have been repackaged and legitimized through the domestic support policy space. Developing countries and LDCs that have especially fragile economies due to the pandemic and need to benefit from the protectionist measures of the WTO regime in these trying times would suffer the most due to cross-subsidization. The ability of such nations to support their agricultural sectors due to suffocating and inequitable reduction commitments causes their

[49] *Supra* note 26, at 7.
[50] *Supra* note 5, at 3.

domestic producers to feel the negative effects in both the domestic and the international market.

III. FRAMEWORK FOR REGULATING CROSS-SUBSIDISATION

The regulation of agricultural subsidies and ensuring adherence to the commitments under the AoA in order to achieve holistic liberalization in international agricultural trade involves striking a balance between the ability of members to implement programs and support in the pursuance of legitimate policy goals, and ensuring that these programs do not distort trade. However, during times of crisis such as the pandemic, ensuring open and transparent trade practices that do not have long term effects on the market is a tall order.

This is especially true in the case of cross-subsidization due to the fact that the lines between export subsidies and domestic support are blurred, and the regulatory framework does not specifically address the issue. However, if domestic support measures are used to provide support for exports without any limits by developed countries, specifically Green Box and Blue Box support, then the benefits and protections that accrue to developing nations and LDCs under the AoA export subsidy commitments would be undermined.[51]

Developing countries have been advocating that the flexibilities and vast policy space that is available to developed nations for providing domestic support should be curtailed through the implementation of an overall trade-distorting support limit (**"OTDS"**). For example, India and China put forth a Joint Proposal at the 11th WTO Ministerial Conference, 2017 calling for

[51] *Supra* note 27, at 7.

reduction in the domestic support policy space. It was contended that developed nations utilise 90% of the global AMS entitlements to subsidize their agricultural products from 50% to 100% of the cost of production.[52]

However, it has been very difficult for developed and developing states to resolve conflicting views on the subject, and formulate a solidified mechanism for reducing the AMS entitlements and policy space. Developing states argue that the policy space that is available to them according to the de minimis Amber Box support maximums is constantly shrinking and it is paralysing them from providing domestic support without breaching their commitments, whereas developed nations are utilising their AMS entitlements to implement trade-distorting support programs.[53]

In contrast, developed states argue that the 10% de minimis limit under the Amber Box along with the relaxations provided to developing members under the Development Box, the domestic support policy space for developing states is expanding much faster in monetary terms as the value of production of agricultural products increases with time.[54]

Debates between WTO members with regard to the domestic support policy space under the AoA have been an ever-present element in WTO negotiations since the Doha Round in 2001. However, the trade distorting practices of developed member states have an adverse impact on the interests

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[52] *Supra* note 19, at 6.
[53] A. M. Thow et al., *An Analysis of Indonesia's Shrinking Food Security Policy Space under the WTO*, 11(6) INTERNATIONAL SOCIETY FOR PLANT PATHOLOGY 1275, 1281-1283 (2016).
[54] *Higher and Higher – Growth in the Domestic Support Entitlements since 2001, Submission by Australia and New Zealand*, WTO (Nov. 22, 2019), https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/Jobs/AG/171.pdf&Open=True.

of developing members. While domestic support under the AoA is a multi-faceted issue, the authors posit that the issue of cross-subsidization can be addressed independent of the domestic support regulations by widening the scope of the AoA, specifically Article 9 and 10, and the enforcement mechanism under the SCM Agreement, and explicitly incorporating cross-subsidization within their scheme.

A. Widening the Scope of Article 9 and 10 of the AoA

The language of Article 9.1(c) has played a crucial role in bringing cross-subsidies into the ambit of the AoA. By widening the ambit of the terms 'payment' and 'export' under the provision, the Panel and the Appellate Body have brought the economic impacts of excessive domestic support within the ambit of the export subsidy regulations.[55] However, suitable modifications can be made to the provisions regulating export subsidies, and the substantive modalities of the SCM Agreement can ensure that the distorting effects of such subsidies are efficiently regulated.[56]

While the concept of cross-subsidization can be absorbed into the language of Article 9.1(c), amendments are needed in the AoA to ensure that all circumstances where countries are utilising their domestic support policy space to subsidize exports are covered.[57] In Canada–Dairy and EC–Export Subsidies on Sugar, the level of governmental intervention with respect to

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[55] *Supra* note 27, at 7.
[56] Puyana et. al., *The Cumulative Application of the Agreement on Agriculture and the Subsidies and Countervailing Measures Agreement: An Approach to Agricultural Subsidies Based on its Effects*, REV. COLOMB. DERECHO INT. BOGOTA 209, 212 (2007).
[57] *Id*.

domestic support and market access tariffs was very high, and consequently, proving the nexus between financing and governmental action was easy.[58]

However, member states may utilise their policy space to implement domestic support programs that have more subtle effects on the export performance of the agricultural products, and are effectuated through indirect governmental action. For example, programs that indirectly incentivise productions through mechanisms that do not necessarily involve direct payments or rebates and do not have an effect on the price of the product should also come within the ambit of Article 9.[59]

To that end, Article 10 of the AoA is of paramount importance for widening the scope of the AoA to incorporate the concept of cross-subsidization. Export subsidies that do not fall within the ambit of Article 9.1 but are applied in a manner that threatens to, or results in the circumvention of reduction commitments under Article 9 are also prohibited under Article 10.[60]

In the US-FSC case, the Appellate Body held that the term "export subsidy commitments" under Article 10 has a wider reach than the term "reduction commitments" used in Article 9.[61] The provision must be widely interpreted to hold that circumvention of export subsidy commitments could be effectuated in a myriad of ways, and that "it is not necessary to demonstrate actual 'circumvention' of 'export subsidy commitments'. It suffices that

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[58] *Supra* note 3, at 3, p. 11.
[59] D. A. Sumner, *Farm Programs and Related Policy in the United States*, SEMANTIC SCHOLAR (1995), https://pdfs.semanticscholar.org/603a/4033fb0f924a8485e9f7e1e8648b2f3a563d.pdf.
[60] WTO Agreement on Agriculture, art. 10.
[61] Appellate Body Report, *US – Tax Treatment for "Foreign Sales Corporations"*, WTO Doc. WT/DS108/AB/R, ¶ 144, 147 (2006).

'export subsidies' as 'applied in a manner which threatens to lead to circumvention' of export subsidy commitments."[62] Therefore, the provisions of Article 10 would also apply to situations wherein an export subsidy measure did not create an explicit 'legal entitlement' in favour of the exporter of agricultural products. The term 'threat' must be interpreted holistically to include export subsidy programs that implicitly or indirectly circumvent export subsidy reduction commitments.[63]

Additionally, Article 10 makes it obligatory for the subsidizing state to prevent circumvention through precautionary measures.[64] If domestic support measures that result in cross-subsidization are included explicitly under Article 10, then the policy space available to developed members would shrink automatically as the onus would be on the subsidizing state to ensure that domestic support measures are not cross-subsidizing exported products.

Furthermore, the burden of proof requirements under Article 10.3 which are different from the onus under Article 3.3 would also prove to be a useful tool for the determination of cross subsidization.[65] Article 3.3 merely imposes a restriction on member states for the provision of export subsidies in terms of Article 9 and the specific requirements in the member's Schedule.[66] However, under Article 10.3, it is for the complaining member state to prove that the exporting member has exported agricultural products in excess of the quantities of their commitments. After that is proven, the burden of proof lies

[62] *Id.*, ¶ 148.
[63] *Id.*, at 57.
[64] *Supra* note 25, at 7.
[65] *Supra* note 27, at 7, ¶ 68- 69.
[66] WTO Agreement on Agriculture, art. 3.

on the exporting nations to prove that the excess quantity was not subsidized.[67] Member states that are domestically subsidizing their agricultural product and are exporting that product at subsidized prices must be held accountable for their trade distorting practices, and must show that the export product has not been indirectly subsidized through domestic support programs.

Developed nations use cross-subsidization to implicitly circumvent their export subsidy reduction commitments under the AoA. Therefore, it is contended that if the ambit of Article 10.1 is expanded to include the circumvention or threat against circumvention of export subsidy reduction commitments through the domestic subsidization of agricultural products, the concept of cross-subsidization would be easily and effortlessly incorporated into the AoA scheme.

B. SCM Agreement

Similar changes to the SCM Agreement would ensure that members can enforce subsidy reduction commitments through the invocation of the WTO dispute settlement mechanism, and the levy of countervailing duties. The term 'subsidy' is defined under Article 1, as a "financial contribution" made by a "government or a public body within the territory of a Member" including the agencies of that government,[68] or at the direction of such authority which confers a "benefit".[69] In order to qualify as a subsidy, the actions of the Member must meet all three of the above-mentioned criteria.

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[67] *Supra* note 27, at 7, ¶ 70-73.
[68] *Supra* note 27, at 7, ¶ 75.
[69] WTO Agreement on Subsidies and Countervailing Measures, art. 1.

However, as seen earlier, governmental intervention in cases of cross-subsidization may not necessarily be in the form of 'financial contributions.' Member states engage in a plethora of practices are not financial contributions but result in cross-subsidization. Therefore, the term 'payment' as interpreted in the EC-Export Subsidies on Sugar and the Canada-Dairy cases is broader, and includes domestic support beyond mere financial contributions. Similarly, the term 'benefit' was held to not be a prerequisite of 'payment' by the Panel and the Appellate Body in the above-mentioned cases.

Furthermore, Article 5 of the SCM Agreement contemplates an intensive investigation mechanism for the determination of 'adverse effects' of the subsidization on the aggrieved member state, which involves collection of data, and an elaborate study. Under Article 9.1(c) of the AoA, the determination of cross-subsidization is limited to a comparison of the average cost of production and the actual price of the exported product.[70] While the latter is more convenient, the mechanism under Article 5 may prove to be useful for the determination of cross-subsidization in cases where governmental intervention is subtle.

Domestic support regulations allow for member states to implement creative mechanisms to circumvent their reduction commitments. Changes in the export subsidy regulatory framework are necessary to ensure that the effects of such domestic support does not spill over into the domain of export. Therefore, the effects of all types of domestic support on the export market

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[70] *Supra* note 27, at 7.

should be taken into consideration when determining whether a member has satisfied their reduction commitments.[71]

Such measures would be a significant step towards achieving the goal of agricultural trade liberalization. Firstly, this will further reduce the detrimental effects of export subsidies on global agricultural trade. Secondly, the implementation of these measures would result in the narrowing of the policy space available to member states vis-a-vis domestic support. While implementing domestic support programs, members would also have to consider the effects of such programs on export, and this will prevent over-zealous trade-distorting subsidies.[72]

IV. CONCLUSION

The COVID-19 pandemic has been an unprecedented challenge for the global community, and has revealed the fragility of international trade mechanisms, and the importance of global supply chains. While the circumstances necessitate that nations use their policy space under the AoA to provide the maximum amount of domestic support possible to prop up their agricultural industry, the pandemic has also highlighted the inadequacy of the current AoA regime to deal with misuse of the said policy space, the inequality between developed and developing states with regard to AMS entitlements, and the inability of the regime to prevent the resultant deleterious effects on agricultural trade.

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[71] R. H. Steinber & T. E. Josling, *When the Peace ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenges*, 6 J. INT'L ECO L. 374, 375 (2003).
[72] *Supra* note 3 at 3, p. 10.

The AoA contemplates mechanisms for the regulation of trade distortions in agriculture due to the combined effects of a plethora of governmental policies and subsidies. However, there is a need for reforming the AoA and the SCM Agreement to address the concerns of cross-subsidization, and the vast policy space for domestic support, and to widen the ambit of the export subsidy commitments to encompass cross-subsidization and the scenarios in which such spill occurs.

This is doubly true in the wake of the pandemic, and the consequent economic downturn, as the fragile economies of developing and least developed nations try to reverse the damage caused by the chaotic and uncertain circumstances. The trade distorting effects of export subsidization by developed nations will destabilise the markets of such nations, in both the short and the long term. The recognition of cross-subsidization as a substantial contributor to the instability in international agricultural trade would ensure better food security, and protect the interests of agricultural producers and farms in poorer agrarian economies that depend heavily on domestic sales as well as the exportation of agricultural products.

Recognition is a precursor to regulation. Therefore, it is paramount that the principle of cross-subsidization is incorporated into Articles 9 and 10 of the AoA and the regulatory procedure under the SCM Agreement in a more comprehensive manner to include all the circumstances in which domestic support programs have an impact on the export of a product, including the support packages that do not directly affect export, but do so subtly and indirectly.

VIII. CARVING A COMPETITIVE LANDSCAPE IN THE TRADING SPACE: ASSESSING THE PROPOSED OWNERSHIP STRUCTURE FOR STOCK EXCHANGES IN INDIA

- Rashmi Birmole*

ABSTRACT

Given the dynamic nature of financial markets, the need to introduce inter-exchange competition assumes paramount importance for an investor to exercise choice, and for the market to adapt to evolving challenges at large. At present, the competitive landscape in the Indian trading space pales in comparison to global developments. Market infrastructure in India has been in a state of duopoly for the last two decades, raising concerns about excessive concentration of market share and its unintended stagnating consequences on innovation. To address these concerns, the Securities and Exchange Board of India recently released a Discussion Paper on Review of Ownership and Governance Norms for facilitating new entrants to set up Stock Exchange/Depository for public consultation. The framework proposed in the paper aims to introduce competition in the trading space and facilitate the setting up of new stock exchanges by lowering a crucial entry barrier, i.e., the default precondition of dispersed shareholding, as is imposed by the extant ownership framework. Through this paper, the author attempts to analyse the possible repercussions of the proposed framework on inter-exchange competition and puts forward recommendations and issues that ought to be considered prior to implementation. In the course of doing so, the author also discusses factors that have contributed to the emergence of duopoly in stock exchanges, while briefly commenting on the shortcomings of the dominance and the dispersed ownership model.

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I. INTRODUCTION

The end of what could perhaps be termed as the most unprecedented year in human history, witnessed the launch of three new stock exchanges in the United States of America ("**US**"), bringing the count to a total of 16 stock exchanges presently operating in the country.[1] The launch was expected to increase competition against heavyweights like the New York Stock Exchange (**"NYSE"**) and NASDAQ, and potentially lower the trading costs in the financial markets. The author's intention of beginning with a contemporary illustration is to emphasize the dramatic changes that stock markets are presently undergoing on a global front. With globalization taking a hold over capital markets around the world, investors are becoming increasingly wary

[1] John McCrank, *Competition to heat up among U.S Stock Exchanges with new entrants*, REUTERS (Mar 21, 2021), https://www.reuters.com/article/us-usa-exchanges-idUSKBN25H23K.

of better trading facilities and market efficiency.[2] The rapid strides made by the global FinTech industry has made innovation become an absolute imperative to drive future growth and address industry challenges in the financial markets.

Taking a leaf out of the book of other jurisdictions, the Securities and Exchange Board of India ("**SEBI**") released a Discussion Paper on Review of Ownership and Governance Norms for facilitating new entrants to set up Stock Exchange/Depository ("**Paper**") on January 06, 2021, proposing changes to the extant framework under the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 ("**SECC Regulations**"). The proposed changes address the sine qua non of introducing competition in the Market Infrastructure Institutions ("**MII**") space, i.e., low entry barriers, the absence of which has inhibited new players from setting up or acquiring existing stock exchanges on account of the default pre-condition of dispersed shareholding at the initial stage itself. At the outset, the recommendations outlined in the Paper seem radical and pathbreaking, coming second only to the corporatisation and demutualization of stock exchanges which was undertaken in 2005 to separate exchange ownership and management in India.

II. EMERGENCE OF DOMINANCE IN THE TRADING SPACE

The National Stock Exchange of India Ltd. ("**NSE**") first commenced operations in 1994 with the launch of the wholesale debt market.[3] At the time,

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[2] All Answers Ltd., *Competition and Integration of Stock Exchanges*, UKDISS.COM (Mar 25, 2021), https://ukdiss.com/examples/competition-stock-exchange.php?vref=1.

[3] *History and Milestones*, NATIONAL STOCK EXCHANGE OF INDIA LTD., (Mar 21, 2021), https://www.nseindia.com/national-stock-exchange/history-milestones.

the Bombay Stock Exchange ("**BSE**") occupied the position of the dominant stock exchange in a market with nineteen others operating across India but remained plagued with outdated trading and settlement procedures. BSE's Sensex, a value weighted equity index, is regarded as a barometer to this day and is presumed to reflect the economic development and health of the country. Soon after its launch, NSE dramatically improved the quality of trading services offered, and soon surpassed BSE and the other stock exchanges to become the exchange of choice,[4] with the use of superior technology, professional management and foreign investor preference driving its growth.[5]

Presently, NSE and BSE command dominance in the Indian trading space out of the nine exchanges operating in India (inclusive of the affiliates of NSE and BSE), both in terms of trading volumes and market shares. In the year 2019-20 itself, NSE amassed profits to the tune of INR 1560 crores,[6] and a majority share in the equity derivatives and cash segments of the capital markets.[7] In addition to their extensive reach and technological efficiency, the journey of the two stock exchanges into dominant market players was also catalysed by the decline of regional stock exchanges in the Indian financial

[4] Chandrasekhar Krishnamurthy, John. M. Sequeira, Fangjian FU, *Stock Exchange Governance and Market Quality*, 27 JOURNAL OF BANKING AND FINANCE 1859, 1861-1862 (2003).

[5] *NSE may overtake BSE in market cap for the first time*, LIVE MINT, Aug 09, 2009, https://www.livemint.com/Money/umDdFDlhn3bfHf1BkDvrZP/NSE-may-overtake-BSE-in-marketcap-for-the-first-time.html.

[6] *NSE Annual Report 2019-20*, NATIONAL STOCK EXCHANGE OF INDIA LTD., (Mar 25, 2021), https://www1.nseindia.com/global/content/about_us/NSE_Annual_Report_2020.pdf.

[7] Chiranjivi Chakraborty, *SEBI prepares ground to end NSE's dominance with liberal ownership norms for MIIs*, THE ECONOMIC TIMES, Jan 06, 2021, https://economictimes.indiatimes.com/markets/stocks/news/sebi-prepares-ground-to-end-nses-dominance-with-liberal-ownership-norms-for-miis/articleshow/80137053.cms?from=mdr.

markets. Moreover, the high entry barriers in terms of minimum net worth and dispersed shareholding requirements in the existing regulatory framework played a crucial role in strengthening the dominant position of NSE and BSE in the Indian trading space.

A. Decline of Regional Stock Exchanges

The advent of electronic trading in the year 2000 and the extension of the nationwide reach of the trading terminals, brought with it a simultaneous decline in the trading volumes of all regional stock exchanges ("**RSEs**") in India.[8] RSEs, which were primarily established to cater to the needs of regional allocation of capital and investors, lost their relevance. The prior requirement of compulsory listing by companies on RSEs located in the areas where the main works or fixed assets were situated, proved to be a compliance burden. Consequently, SEBI took steps towards the withdrawal of the requirement and issued the SEBI (Delisting of Securities) Guidelines, 2003, permitting listed entities to voluntarily delist from RSEs provided that they remain listed on an exchange with nationwide terminals.[9] This step, in turn led to a further decline in the operations of the RSEs, which soon after turned defunct. In 2008, SEBI issued an exit policy for RSEs whose recognition had been withdrawn, renewal had been refused or those that wished to voluntarily surrender their recognition.[10] The policy was subsequently reviewed and

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[8] Sujit Kumar Acharya et al., *Relevance of Regional Stock Exchanges in India*, 1 SEARCH – A JOURNAL OF ARTS, HUMANITIES AND MANAGEMENT 43, 46 (2012).

[9] Securities and Exchange Board of India, SEBI (Delisting of Securities) Guidelines, 2003, SMD/Policy/Cir-7,2003 (Issued on Feb 17, 2003), SEBI, https://www.sebi.gov.in/legal/circulars/feb-2003/circular-no-7-dated-february-17-2003_15827.html.

[10] Securities and Exchange Board of India, Guidelines in respect of exit option to Regional Stock Exchanges, MRD/DoP/SE/Cir- 36 /2008 (Issued on Dec 29, 2008) SEBI,

reissued in 2012,[11] requiring non-operational RSEs to compulsorily delist on failure to meet the stated turnover and net worth requirements within the specified time. These developments were the primary factors driving the decline of RSEs in India, all the while stimulating the growth of NSE and BSE as the leading exchanges in the trading space.

B. Shortcomings – Technical and Competition Concerns

Concerns surrounding the excessive concentration of market share in the hands of NSE and BSE and the possibility of anti-competitive conduct and institutional tardiness in responding to the changing dynamics of the financial market are outlined as few of the reasons necessitating a review of the present framework. Disruption in trading activities caused on account of technical glitches faced by investors and market participants is not an uncommon phenomenon.[12] In a recent occurrence, trading on the terminals of NSE went through a four-hour long suspension following technical snags faced in the risk management system.[13] Traders in the derivative segment complained of

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https://www.sebi.gov.in/legal/circulars/dec-2008/guidelines-in-respect-of-exit-option-to-regional-stock-exchanges_6994.html.

[11] Securities and Exchange Board of India, Exit Policy for De-recognized/Non-operational Stock Exchanges, CIR/MRD/DSA/14/2012 (Issued on May 30, 2012), SEBI, https://www.sebi.gov.in/legal/circulars/may-2012/exit-policy-for-de-recognized-non-operational-stock-exchanges_22825.html.

[12]See *Technical glitch hits trading in Bank Nifty*, THE HINDU (Jun 04, 2020), https://www.thehindu.com/business/technical-glitch-hits-trading-in-bank-nifty/article31751271.ece;
Palak Shah, *Brokers shoot off letter to NSE over technical glitch*, THE HINDU BUSINESS LINE (Nov 19, 2019), https://www.thehindubusinessline.com/markets/stock-markets/nse-trading-disruption-brokers-shoot-off-> complaint-letter/article30018153.ece;
National Stock exchange impacted by technical glitch intra day trading affected, THE FIRST POST (Jun 04, 2020), https://www.firstpost.com/tech/news-analysis/national-stock-exchange-impacted-by-technical-glitch-intra-day-trading-affected-3835947.html.

[13] Palak Shah, *Tech-glitch brings trading to a halt at NSE for four hours*, THE HINDU BUSINESS LINE (Feb 24, 2021), https://www.thehindubusinessline.com/markets/stock-markets/tech-glitch-brings-trading-to-a-halt-at-nse-for-four-hours/article33926628.ece.

losses and NSE's failure to migrate to the disaster recovery site came under heavy criticism. Claims surrounding technical malfunction in the BSE tendering page were also made in respect of the recent delisting offer made by Vedanta Limited,[14] which fell through for lack of the minimum participation required for the process to be deemed a success under the erstwhile SEBI (Delisting of Equity Shares) Regulations, 2009.[15]

The frequent technical snags faced by investors on trading terminals become more problematic when viewed from the perspective of institutional difficulty and lack of judicial precedent in imposing financial liability on exchanges for losses suffered by investors on account of such technical malfunctions or suspensions.[16] As per SEBI's mandate, stock-brokers are required to follow prescribed uniform documentation to simplify the trading account opening process with their clients.[17] An integral part of the standard documentation that is executed with clients is the document outlining the 'Rights and Obligations of stock-broker, sub-broker, and client for trading on exchanges',[18] which contains clauses that categorically amount to a relinquishment of any claim against the exchange on account of any

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[14] Hormaz Fatakia, *Vedanta Delisting Offer Fails*, BLOOMBERG QUINT (Oct 10, 2020), https://www.bloombergquint.com/markets/vedanta-delisting-offer-fails.

[15] Regulation 17, Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, PART III SEC. (IV), THE GAZETTE OF INDIA, https://www.sebi.gov.in/sebi_data/commondocs/delisting2009_p.pdf.

[16] Sachin Mampatta, *Seeking compensation for tech glitches could be a tough task for investors*, THE BUSINESS STANDARD (Mar 04, 2021), https://www.business-standard.com/article/markets/seeking-compensation-for-tech-glitches-could-be-a-tough-task-for-investors-121030300139_1.html.

[17] Securities and Exchange Board of India, Simplification and Rationalization of Trading Account Opening Process, CIR/MIRSD/16/2011 (Issued Aug 22, 2011), https://www.sebi.gov.in/sebi_data/attachdocs/1314013806825.pdf#page=1&zoom=page-width,-16,300.

[18] *Id.* at Annexure 4.

"suspension, interruption, non-availability, or non-functioning of the exchange's service or systems". These documents also indicate the client's acknowledgement of the uncertainty of trading over the internet and the absence of any representations and warranties made by the exchange with reference to the same. By and large, the aforementioned processes, coupled with the unavailability of alternative exchanges and terminals, limit an investor's ability to recover losses faced on account of such technical snags and disruption in trading, and place investors in an inherently disadvantageous position. The proposals outlined in the Paper, in addition to the recent introduction of 'Financial Disincentives' that stock exchanges are mandated to pay in the event of technical glitches and disruption,[19] can be viewed as a part of SEBI's ongoing efforts to tackle these issues. Firstly, doing away with dispersed ownership requirements and effectively introducing competition in the MII space may lead to a potential reduction in instances of technical snags and business disruption as stock exchanges will be compelled to adopt efficient practises in order to stay relevant and profitable. Secondly, the setting up of new stock exchanges will permit investors to exercise choice, an element that the present state of market infrastructure fails to offer.

NSE's dominant position and its possible abuse was recently assessed by the Competition Commission of India ("**CCI**") in *Manoj K Sheth v. National Stock Exchange of India Ltd.*,[20] in the context of its co-location

[19] Securities and Exchange Board of India, Standard Operating Procedure for handling of technical glitches by Market Infrastructure Institutions (MIIs) and payment of 'Financial Disincentives' thereof, SEBI/HO/MRD1/DTCS/CIR/P/202 (Issued Jul 05, 2021), https://www.sebi.gov.in/legal/circulars/jul-2021/standard-operating-procedure-for-handling-of-technical-glitches-by-market-infrastructure-institutions-miis-and-payment-of-financial-disincentives-thereof_50903.html.

[20] Manoj K Sheth v. National Stock Exchange of India Ltd., 2021 SCC OnLine CCI 38.

facility, and largely pertained to the preferential access granted to high frequency traders and market participants by way of the co-location servers located within the premises. In the matter, the informant alleged that NSE had created artificial information asymmetry and manipulated the market by granting access to its servers in a preferential manner. While CCI delineated the relevant market as the "market for providing co-location services for algo-trading in securities to the trading members in the territory of India", it noted that NSE would still remain dominant if the scope of the relevant market was extended to traditional non-algorithmic trading. However, there was no *prima facie* case of anti-competitive conduct made out against NSE. The actions and policies of NSE in relation to its co-location facility have also previously come under CCI's scrutiny in *Advocate Jitesh Maheshwari v. National Stock Exchange of India Ltd*.[21] At the time, CCI decided against delving into the allegations for want of sufficient information and data to form a *prima facie* view about NSE's role in providing discriminatory co-location services. While accepting that the grant of preferential access led to the denial of market access to others, CCI's decision to drop the matter was primarily motivated by SEBI's ongoing investigation into the same.

In the past, a finding of abuse of dominance by NSE was arrived at in *MCX Stock Exchange Ltd. v. National Stock Exchange of India Ltd.*,[22] where CCI imposed a penalty to the tune of INR 55.5 crores on NSE for abuse of dominant position under the Competition Act, 2002,[23] for, *inter alia*, having

[21] Advocate Jitesh Maheshwari v. National Stock Exchange of India Ltd., 2019 SCC OnLine CCI 13.
[22] MCX Stock Exchange Ltd. v. National Stock Exchange of India Ltd., 2011 SCC OnLine CCI 52.
[23] Competition Act, 2002, Act No. 12, Acts of Parliament, 2003, § 4(2).

waived transaction fees in respect of currency futures trades executed on its platform and adopting a predatory pricing policy. On an appeal preferred by NSE to the Competition Appellate Tribunal, the order of the CCI was upheld.[24] The Supreme Court, on appeal, stayed the order imposing penalty on NSE and the matter is presently sub-judice. From the foregoing discussion, it can be observed that CCI has consistently found NSE to occupy a dominant position in the trading space. While occupying a dominant position is not a violation in itself, it has significant repercussions on the smooth functioning of a market as dynamic as the financial market, where the slightest possibility of abuse carries with it the risk of considerable monetary losses for investors and general loss of confidence in the market. Thus, the proposals outlined in the Paper can be viewed as an attempt to counter this risk and eliminate this long-held dominance by introducing efficiency and competition in the financial market.

III. OWNERSHIP NORMS IN STOCK EXCHANGES – REGULATORY OVERVIEW

A. Existing Limits on Shareholding

Limits on shareholding and ownership in stock exchanges were introduced post-de-mutualization through the Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges) Regulations, 2006,[25] which also mandated stock exchanges to maintain a minimum public shareholding of 51%. In 2012, the said regulations

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[24] National Stock Exchange of India Ltd. v. Competition Commission of India, 2014 SCC OnLine Comp AT 37.

[25] Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges) Regulations, 2006, PART II SEC. (III) (2), THE GAZETTE OF INDIA, https://www.sebi.gov.in/acts/screguupdate.pdf.

were repealed with the issuance of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012,[26] which imposed similar limits on shareholding and voting rights under Chapter IV of the regulations. These regulations were subsequently replaced with the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 ("**Regulations**"),[27] which govern ownership in stock exchanges at present. Under the Regulations, the maximum shareholding in a stock exchange is capped at 5% for persons, acting individually or with persons acting in concert, and at 15% for specific classes of institutions, including banks, insurance companies and depositories, respectively.[28] With respect to foreign ownership, persons acting individually or with persons acting in concert, are permitted to hold up to 5% shareholding, and institutions up to 15% of the total shareholding,[29] with an additional cap of 49% on the combined holding of all persons' resident outside India.[30] The requirement on maintaining 51% public shareholding has also been retained in the extant Regulations.[31]

B. Prior Attempts at Review

The scope of setting up new stock exchanges in India and introducing fair competition was first explored by the Committee on the Review of

[26] Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012, PART III SEC. (IV), THE GAZETTE OF INDIA, https://www.sebi.gov.in/sebi_data/attachdocs/1340272091708.pdf.
[27] Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, PART III SEC. (IV), THE GAZETTE OF INDIA, https://www.sebi.gov.in/legal/regulations/oct-2018/securities-contracts-regulation-stock-exchanges-and-clearing-corporations-regulations-2018_40630.html.
[28] *Id.* at Regulation 17(2).
[29] *Id.* at Regulation 17(3).
[30] *Id.* at Regulation 17(4).
[31] *Id.* at Regulation 17(1).

Ownership and Governance of Market Infrastructure Institutions, also known as the Bimal Jalan Committee, in 2010. The Committee, in its report,[32] recognized the negative consequences of dispersed shareholding on an investor willing to further the operational interests of the firm. However, it went on to justify the existing framework as a way to exercise sufficient control on a stock exchange which is also entrusted with regulatory functions. Taking note of the committee's suggestion to review the norms after a period of five years, a committee was constituted under the Chairmanship of Shri R. Gandhi to review the existing framework governing MIIs in 2017,[33] which proposed stricter governance requirements and proposed classifying intermediaries like registrar and transfer agents as MIIs.

IV. PROPOSED CHANGES TO THE EXTANT FRAMEWORK

A. Ownership Norms

I. Setting up an MII – domestic promoters

The Paper proposes to liberalize the existing ownership framework and permit promoters to hold up to 100% of the shareholding in an MII, subject to gradual dilution to 51% or 26 % over 10 years.

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[32] Securities and Exchange Board of India, *Report of the Committee on 'Review of Ownership and Governance of Market Infrastructure Institutions'* (2010), GOVERNMENT OF INDIA, https://www.sebi.gov.in/sebi_data/commondocs/marketinfraAnnexA_p.pdf.

[33] *See* Press Release, Securities and Exchange Board of India, SEBI seeks public comments on Report submitted by Committee on Review of Regulations and Relevant Circulars pertaining to Market Infrastructure Institutions (MIIs) (May 04, 2018), https://www.sebi.gov.in/media/press-releases/may-2018/sebi-seeks-public-comments-on-reports-submitted-by-committee-on-review-of-regulations-and-relevant-circulars-pertaining-to-market-infrastructure-institutions-miis-_38855.html.

II. Setting up an MII - foreign promoters

Further, foreign promoter individuals or entities belonging to Financial Action Task Force ("**FATF**") compliant countries are allowed to hold up to 49% of the shareholding in an MII, subject to similar gradual dilution requirements. The period of 10 years is reduced to 5 years for foreign promoter individuals and entities belonging to jurisdictions that are no longer members of the FATF. The Paper seeks to retain the existing restriction on the combined holding of persons resident outside India of 49 % of the shareholding in an MII.

III. Domestic acquisition in an existing MII

The Paper permits domestic individuals and entities to acquire and hold up to 100% of the shareholding of an MII, provided that acquisitions beyond 25% shall be subject to SEBI's approval. Acquisitions of a stake beyond 25% shall also be gradually diluted to 51% or 26% over 10 years from the date of closure of the open offer.

IV. Foreign acquisition in an existing MII

The paper proposes a set of conditions similar to the ones applicable to foreign promoters seeking to set up an MII in India for foreign individual or entities looking to acquire a shareholding in an existing MII. Foreign individuals and entities belonging to FATF member jurisdictions are permitted to acquire and hold up to 49% of the shareholding of an MII, provided that acquisitions beyond 25% shall be subject to SEBI's approval. Acquisitions of a stake beyond 25% shall also be gradually diluted to 51% or 26% over 10 years from the date of closure of the open offer.

V. DISPERSED SHAREHOLDING MODEL – A PRIMER

The proposals outlined in the Paper have been premised on the understanding that a dispersed shareholding model inhibits competition between stock exchanges by depriving a promoter of exercising sufficient control, thereby limiting upside gains arising out of entrepreneurial capital. Understanding the repercussions of the proposals on inter-exchange competition necessitates a closer look at the dispersed shareholding model and its various drawbacks.

Entities with widely dispersed shareholding fall within the 'outsider' system of corporate governance, which places a higher emphasis on the protection of minority shareholder rights and informational transparency.[34] However, the inherent fragmentation of ownership makes it difficult for shareholders to take collective decisions and acts as a barrier in exercising control. It can be reasonably understood that shareholders in such entities have little economic incentive to actively engage in corporate governance and monitor the management,[35] rendering the management largely unaccountable for their actions. This creates a clear demarcation between the domains of ownership and management, introducing agency problems that are typically associated with such shareholding models. The separation of ownership and professional management in entities with dispersed shareholding models are known to result in the divergence of shareholders' and managers' interests, which may have some significant implications on performance and

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[34] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [OECD], CORPORATE GOVERNANCE: EFFECTS ON FIRM PERFORMANCE AND ECONOMIC GROWTH, at 47, (1999), https://www.oecd.org/sti/ind/2090569.pdf.

[35] Jonathan Mukwiri, Mathias Siems, *The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?*, 41 JOURNAL OF LAW AND SOCIETY 51, 61 (2014).

innovation. For instance, since a manager's position, personal wealth and prestige is tied to an entity's performance, he may prefer low-risk projects which yield short-term returns over projects which are aimed at the long- term profitability and performance.[36] This is because managers usually do not have a financial interest in ensuring the optimal performance of an entity,[37] but are exposed to employment risk, which unlike financial risk, cannot be managed by diversification. However, a dispersed shareholding model can have a favourable effect when innovative activity and entrepreneurial gain rely on external funding from market participants, which is attracted by the presence of minority shareholder protection and transparency, which such models are known to guarantee. Conversely, shareholders of entities with concentrated ownership patterns have a strong incentive to monitor and exercise better control over the actions of the management, which comes at the cost of a host of difficulties in terms of innovation and performance. The presence of shareholders with consolidated shareholdings may influence the independence of the management in a self-serving way and impede their ability to take independent and rational decisions. While the concentrated shareholding model may not be the ultimate answer to all agency problems, the Paper's reliance on the model to encourage the setting up of new stock exchanges is reasonably well placed.

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[36] Barry D. Baysinger et al., *Effects of Board and Ownership Structure on Corporate R&D Strategy*, 34 THE ACADEMY OF MANAGEMENT JOURNAL 205, 205 (1991).

[37] Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VIRGINIA LAW REVIEW 789, 790 (2007).

VI. INTER-EXCHANGE COMPETITION IN THE US AND EUROPEAN UNION

A. The United States

The equity markets of the US are inarguably one of the most developed and sophisticated financial markets in the world. The Securities Exchange Commission's ("**SEC**") vision with respect to inter-exchange competition is focused on encouraging a structure in which exchanges compete for trading volume in individual stock instead of listing.[38] Resultantly, competition among exchanges is based on incentives for attracting order flow. The Securities Exchange Act, 1934, the principal enactment governing securities exchanges in the US, initially barred brokers from transacting in any security unless it was registered and listed on that specific exchange.[39] This effectively gave the exchange on which the stock was listed monopoly over trading in that stock. Consequently, the requirement was amended in 1994 through the Unlisted Trading Privileges Act to permit stocks to trade on all exchanges, independent of where the stock was technically listed.[40] In a bid to further encourage competition among stock exchanges, the SEC urged the creation of a central market linking the various venues where stock is traded. SEC's report led to the creation of a National Market System (**"NMS"**) through the Securities Acts Amendments of 1975, aimed at promoting competition

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[38] Paul G. Mahoney et al., *The Regulation of Trading Markets: A Survey and Evaluation*, *in* SECURITIES MARKET ISSUES FOR THE 21ST CENTURY 222, 223 (Merritt Fox, Lawrence Glosten, Edward Green, Menesh Patel ed., 2018).
[39] The Securities Exchange Act, 15 U.S.C § 12(a) (1934).
[40] Eric Budish Robin S. Lee John J. Shim, *A Theory of Stock Exchange Competition and Innovation: Will the Market Fix the Market?* (National Bureau of Economic Research, Working Paper No. 25855, 2019), https://www.nber.org/system/files/working_papers/w25855/w25855.pdf.

between trading venues.[41] Among other changes, the amendment inserted Section 11A in the Securities Exchange Act, 1934, the rules created under which were subsequently recast and introduced through a massive set of rules known as Regulation NMS which took effect in 2007.[42] Regulation NMS ushered in a new era of competition and allowed brokers to view quotations in every market that the stock is trading in, and route the customer's order to the exchange offering the best price. Rule 611 of the regulation, also known as the 'Order Protection Rule' prohibits an exchange from executing a trade at a price that is inferior to that of a 'protected quote' on another exchange. The rule is primarily aimed at preventing what are known as 'trade-throughs' or execution of trades at a price inferior to that available in another exchange. Overall, these developments have led to market wide connectivity, acceleration in trading volumes and reduction in cost.[43] These measures have also enabled retail investors in the US to trade with greater convenience and lower commissions.

C. European Union

Prior to 2007, stock exchanges in the European Union ("**EU**") were regulated by the Investment Services Directive ("**ISD**"),[44] which primarily sought to facilitate a single European market for all financial services and products. The "single passport" regime created under the directive permitted

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[41] Pierre-Cyrille Hautcoeur, Amir Rezaee, Angelo Riva, *Competition among Securities Markets: Stock Exchange Industry Regulation in the Paris Financial Center at the Turn of the Twentieth Century* (INCAS Project Discussion Paper No. 8 (2018), https://halshs.archives-ouvertes.fr/halshs-01863942/document.

[42] Regulation NMS, 17 C.F.R. § 200, 201, 230, 240, 242, 249, 270 (2005).

[43] Phil Mackintosh, *Regulation NMS for Dummies*, (Mar 25, 2021), https://www.nasdaq.com/articles/reg-nms-dummies-2019-05-09?.

[44] Council Directive 93/22/EEC of the European Parliament and Council of 11th June 1993 on Investment Services in the securities field, O.J. (L 141) [Hereinafter *Investment Services Directive*].

investment firms to offer services in all member states, based on host state authorization and supervision, without being subjected to additional licensing procedures. Full and fair access to stock exchanges classified as 'regulated markets' by host states to investment firms was another ISD mandate. ISD's reliance on mutual recognition proved insufficient in ensuring the operability of investment firms across the EU,[45] and was replaced by the European Commission in an ongoing effort to increase competition among exchanges. The Directive on Markets in Financial Instruments ("**MiFID**") subsequently came into force in 2007 through the 'Lamfalussy' process in stages,[46] with an overarching objective of creating an integrated financial market. Widely regarded as the cornerstone of the EU's regulation of financial markets,[47] the MiFID abolished the "concentration" rule which was found to have a stifling effect on competition and strengthened the segregation of financial markets along national boundaries.[48] As it earlier stood, the rule vested in member states the right to require investment firms to carry out transactions solely on regulated markets where the security in question was listed and the right to exempt resident investors from the rule, contingent on obtaining express member state authorization.[49] This invariably exposed existing exchanges to

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[45]*Commission Proposes New Directive on Investment Services*, INTERNATIONAL LAW OFFICES, (Mar 27, 2021), https://www.internationallawoffice.com/Newsletters/Banking-Financial-Services/European-Union/Oppenheimer-Wolff-Donnelly/Commission-Proposes-New-Directive-on-Investment-Services.

[46] Council Directive 2004/39/EC of the European Parliament and Council of 21st April 2004 on Markets in Financial Instruments, O.J. (L 145).

[47] *Investment services and regulated markets – Markets in Financial Instruments Directive (MiFID)*, The EUROPEAN COMMISSION, (Mar 28, 2021), https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/securities-markets/investment-services-and-regulated-markets-markets-financial-instruments-directive-mifid_en.

[48] Stavros Gkantinis, *Regulation and Innovation: Comparing U.S and European Equity Trading Markets* (Harvard Law School Student Scholarship Series Paper No. 13 (2006), https://core.ac.uk/download/pdf/5080561.pdf.

[49] Investment Services Directive, art.14.

competition from multilateral trading facilities which were subjected to pre and post trade transparency requirements to ensure a level playing field between exchanges and new competitors.[50] In addition to eliminating barriers to cost border trading, the MiFID also introduced improved requirements inter-alia transaction reporting, transparency, risk management and best execution practises,[51] which enabled investors to source quality services at competitive prices, which in turn was instrumental in building investor confidence. On identification of certain shortcomings faced during the global financial crisis, an updated version of the MiFID supported with a corresponding regulation,[52] was adopted in 2014 and took effect in 2018,[53] and seeks to enhance trading on both regulated and multilateral trading platforms and remains applicable to this date.

VII. COMPETITIVE POSITIONING IN THE TRADING SPACE – PROSPECTS

At its core, the Paper recognizes the intersection between technology and financial markets and the need to lead with innovation. Given SEBI's highly prescriptive approach, the proposed changes directed towards easing ownership norms in the stock exchange seem entirely antithetical to the recommendations of the Bimal Jalan Committee but aligned in the right direction. With exchanges around the world competing amongst each other,

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[50] Press Corner, *Markets in Financial Instruments Directive (MiFID): Frequently Asked Questions*, THE EUROPEAN COMMISSION, (Mar 25, 2021), https://ec.europa.eu/commission/presscorner/detail/en/MEMO_07_439.

[51] *Id.* at FAQ no. 6.

[52] Commission Regulation No. 600/2014 of the European Parliament and Council of 15th May 2014 on Markets in Financial Instruments, O.J. (L 173).

[53] Council Directive 2014/65/EU of the European Parliament and Council of 15th May 2014 on Markets in Financial Instruments, O.J. (L 173).

other quasi-exchanges and automated trading systems,[54] it is high time that SEBI jumps on the bandwagon. To that extent, it can be reasonably concluded that the recommendations in the Paper have come at an opportune time.

The underlying idea is to compel existing exchanges to adapt to financial technology and other investor initiatives to remain efficient in an ever-evolving competitive market while facilitating the entry of new exchanges in the market. Easing the existing stringent ownership limits in stock exchanges in the initial stages is likely to spur investment by deep pocketed promoters, both domestic and foreign, truly invested in advancing the capabilities of the stock exchange. A regulatory framework that allows promoters and acquirers to have 'skin in the game' by way of concentrated shareholding in a stock exchange seems like a step forward in the direction of operational and competitive efficiency.

Another crucial factor that warrants consideration is a stock exchange's regulatory and surveillance functions and its role as a public fiduciary. As a matter of fact, a dispersed ownership structure was primarily justified on the basis of a stock exchange's systemic importance in the financial market, and its status as a public utility.[55] In addition to acting as a trading facility for a wide range of asset classes, stock exchanges are also entrusted with functions including inter-alia risk containment through margin requirements, capital adequacy of members, etc., market surveillance, governance of trading members, and investigation and resolution of investor complaints filed against

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[54] Mahmood Bagheri, Chizu Nakajima, *Competition and Integration among Stock Exchanges: The Dilemma of Conflicting Regulatory Objectives and Strategies*, 24 OXFORD JOURNAL OF LEGAL STUDIES 69, 72-75 (2004).

[55] Securities and Exchange Board of India, Board Meeting Memorandum dated Jun 21, 2018, https://www.sebi.gov.in/sebi_data/meetingfiles/jul-2018/1531116664373_1.pdf.

trading members and listed companies. In light of the same, ensuring that an exchange's identity as a 'first-level regulator' remains uncompromised in the face of its commercial endeavours should be prioritized before any decision on the proposed ownership structure is made. It is advisable to divest stock exchanges of their regulatory functions and bring the latter under SEBI's purview, in a centralized manner.[56] On that note, determinations surrounding the eligibility of promoters or acquirers of a stock exchange will need to involve an objective assessment of any possible conflict of interest that exists or may arise.

The proposals, if implemented, may also give rise to several strategic partnerships which will contribute specialised knowledge and ensure long-term development.[57] The acquisition of Refinitiv US Holdings Inc. ("**Refinitiv**"), a financial market data and infrastructure provider, by the London Stock Exchange Group ("**LSEG**") is an accurate representation of competitive positioning in the financial market in recent times. Structured as an all-share transaction, the transaction was aimed at combining two complementary capabilities to create a leading financial market infrastructure provider and broaden the latter's global footprint in terms of coverage in emerging markets. As a result of the transaction, ordinary shares representing 37% economic interest and 29% voting rights were acquired by the sellers of Refinitiv in the LSEG, the parent company or the 'exchange operator' which owns the London Stock Exchange. Acquisitions of such nature, i.e.,

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[56] *Stock Exchanges – the more, the merrier?,* INSTITUTIONAL INVESTOR ADVISORY SERVICES, (Apr 5, 2021), https://www.iiasadvisory.com/institutional-eye/stock-exchanges-the-more-the-merrier.

[57] L.C. Gupta, *Demutualization of Exchanges*, THE ECONOMIC TIMES, November 20, 2006, https://economictimes.indiatimes.com/demutualisation-of-exchanges/articleshow/482140.cms.

acquisitions that rely on the holding company model, are not feasible under the existing ownership framework. That is set to change with the proposed permissibility of 100% promoter and acquirer shareholding, however, the gradual dilution process will largely determine the practicalities of an 'exchange operator' model in the Indian financial market. In the face of growing competition, exchange operators also view ancillary services as crucial strategic partners that can add a new dimension to their existing operations. Stock markets around the world have witnessed this trend in the form of strategic alliances,[58] such as the acquisition of Mergent, an indexing business, by the Nasdaq OMX Group to offer a fuller range of services beyond listings and trading.[59]

The glaring difference between NSE's trading volumes and the number of listed companies, in comparison to its counterpart,[60] paints a rather 'lopsided' picture of the duopoly that exists in the MII space. As a natural consequence, new stock exchanges may face an inherent disadvantage in competing with bourses like NSE, which are known to have established terminals and trading volumes. To that end, certain transitory incentives and relaxations may need to be deliberated upon. Devising a framework that allows stocks to trade on exchanges other than the home exchange on which they are listed is also a preliminary suggestion to tackle the initial hurdles of attracting sufficient order flow. This will also ensure that a suspension in trading as a result of technical malfunction on the home exchange does not

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[58] *Stock Exchange Alliances and a Mechanism for Cooperation among the OIC Member States in the Area of Financial Markets,* 26 JOURNAL OF ECONOMIC COOPERATION 35, 36 (2005).
[59] Chris Flood, *Strategic alliances change face of industry,* FINANCIAL TIMES, Nov 12, 2012, https://www.ft.com/content/ae8891d6-2cf0-11e2-9211-00144feabdc0.
[60] Rakesh Sharma, *BSE vs NSE*, THE BUSINESS STANDARD, Jan 27, 2013, https://www.business-standard.com/article/specials/bse-vs-nse-198012601047_1.html.

necessarily suspend trading across the entire market.[61] However, parallel trading of the same security on different exchanges may contribute to fragmentation of the financial market, a plausible risk that the regulations must be prepared to counter. Drawing from the experience of the NYSE,[62] introducing competition in the MII ecosystem is likely to reduce transaction costs and high commissions charged on trades. In the past, NSE has lowered transaction fees in certain segments following changes announced by the BSE in its fee structure.[63] This supports the proposition that the consequences of growing competition will be strongly felt in terms of revised transaction fees charges by exchanges.

VIII. RECOMMENDATIONS AND SUGGESTIONS

A. Minimum Public Shareholding ("MPS") Norms

Presently, Regulation 17(1) of the SECC Regulations require recognized stock exchanges to maintain a minimum of 51% public shareholding. Under Regulation 19A, the stock exchange is required to institute a monitoring mechanism to ensure compliance with the shareholding limits specified under the regulations. The said limit is also subject to monitoring by the depositories on a daily basis with regard to listed stock

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[61] Ameya Karve, Santanu Chakraborty, *Dual-listed stocks insurance for Indian markets' glitches*, LIVE MINT, Jul 17, 2017, https://www.livemint.com/Money/CS43HvKEIxi0GNBZaK8JbL/Duallisted-stocks-an-accidental-insurance-for-Indian-market.html.

[62] Chris Bummer, *Disruptive Technology and Securities Regulation,* 84 FORDHAM LAW REVIEW 977, 1029 (2015).

[63] *NSE cuts fees on options, currency derivatives to deepen market*, THE HINDU BUSINESS LINE, Jan 15, 2018, https://www.thehindubusinessline.com/markets/stock-markets/nse-cuts-fee-on-options-currency-derivatives-to-deepen-market/article9625316.ece.

exchanges.[64] While the Paper purports to review key ownership norms, it fails to address whether the provisions relating to MPS norms will remain applicable. There is a need to provide sufficient clarity with respect to:

a. Whether the MPS limit is eliminated in the proposed framework.
b. If yes, the threshold on MPS applicable to stock exchanges that are listed or proposed to be listed.
c. If no, the stage at which the retained MPS limit shall become applicable, provided a decision with respect to the gradual dilution process is arrived at.

MPS norms were primarily implemented with the objective of ensuring higher participation from non-promoter shareholders in public listed entities. This rationale was further stressed in a Press Release published on July 4, 2010 by the Ministry of Finance, which stated that "A dispersed ownership structure is essential for the sustenance of a continuous market for listed securities to provide liquidity to the investors and to discover fair prices. Further, the larger the number of shareholders, the less is the scope for price manipulation."

Hence, a proposal seeking to effect a change of this magnitude in the existing ownership structures governing stock exchanges needs to address the applicability of MPS norms, more so in the case of listed exchanges.

[64] Securities and Exchange Board of India, Procedures for ensuring compliance with Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 (SECC Regulations) by Listed Stock Exchanges, CIR/MRD/DSA/01/2016 (Issued on Jan 01, 2016), https://www.sebi.gov.in/sebi_data/attachdocs/1451651951883.pdf.

D. Harmonizing Thresholds Triggering SEBI Approval

Presently, Regulation 19 and 20 of the SECC Regulations requires stock exchanges to ensure that all its shareholders, directors and key management personnel are fit and proper persons. Additionally, persons intending on acquiring shares of both unlisted and listed stock exchanges are required to:[65]

a. Seek post acquisition approval from SEBI for acquiring shares amounting to 2% to 5% of the total shareholding.
b. Seek pre-acquisition approval from SEBI if the acquisition amounts to more than 5% of the total shareholding.

In the Paper, approval from SEBI is to be sought by both foreign and domestic acquirers from acquisitions exceeding 10% and 25%. Moreover, Clause 4.1.2. contains a blanket statement proposing prior approval for all mergers and acquisitions in a stock exchange. It is relevant to highlight that while the role of a stock exchange as a 'first level regulator' is bound to invite heightened scrutiny from SEBI, having to seek approval at practically every stage of acquisition might prove to be cumbersome for potential acquirers.

In this regard, the thresholds of percentage shareholding necessitating SEBI approval should be harmonized to avoid confusion among potential acquirers and investors and the approval procedure remains expedient. The author is also of the opinion that SEBI should refrain from adopting a tight-fisted approach in approving acquisitions to truly encourage innovation and competition, in letter and spirit.

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[65] *Id.* at 2(III).

E. Minimum Benchmark for Transaction Costs

Besides charging a regulatory fee on the value of transactions executed on the terminals and the levy of securities transaction tax, SEBI does not presently regulate the rates at which fees are charged by stock exchanges for the execution of trades. In the past, SEBI had merely issued guidelines to be followed while charging said transaction fees after NSE's pricing policy which was deemed "predatory" by the CCI came to light.[66] It is advisable to put in place a minimum cost benchmark for transaction fees, in consultation with CCI, that can be charged by exchanges in various segments in the near future. In a dissent order released by certain members of CCI in *MCX Stock Exchange Ltd. v. National Stock Exchange of India Ltd.*,[67] the possibility of passing a direction to NSE to indicate a floor price was considered. During the proceedings against NSE, its method of calculating cost on the basis of "average variable cost" to defend allegations of predatory pricing was categorically rejected by the CCI. In light of the above, it is worthwhile to mention that determining variable costs is dependent on industry characteristics and is highly challenging in cases of multi product firms like NSE, as any other stock exchange.[68] This further underscores the need to safeguard against the possibility of pricing policies being found predatory or exclusionary in the face of increased competition and reduce enforcement

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[66] Securities and Exchange Board of India, Revision of transaction charges by stock exchanges, MRD/DoP/SE/Cir-14/2009 (Issued on Oct 14, 2009), https://www.sebi.gov.in/legal/circulars/oct-2009/revision-of-transaction-charges-by-the-stock-exchanges_3479.html.

[67] MCX Stock Exchange Ltd. v. National Stock Exchange of India Ltd., 2011 SCC OnLine CCI 41.

[68] Sunil Barthwal, *NSE vs MCX-SX : Predatory Pricing?,* THE ECONOMIC TIMES (Apr 15, 2010), https://economictimes.indiatimes.com/nse-vs-mcx-sx-predatory-pricing/articleshow/5807329.cms?from=mdr.

actions. However, it must be ensured that the setting of a minimum benchmark does not impede the liberty of the management to determine a viable pricing structure to compete efficiently in the market.

F. Applicability of SEBI (Substantial Acquisition and Takeovers) Regulations, 2011 ("SAST Regulations")

The proposed ownership framework in the Paper mandates compliance with the provisions of the SAST Regulations, in the event of domestic or foreign acquisitions exceeding 25% shareholding in both listed and unlisted stock exchanges. There is no clarity over the specific provisions that will have to comply with or any rationale offered for the said proposal. The mandatory requirement of making an open offer to the existing shareholders of a stock exchange on an acquisition exceeding 25% of the total shareholding may deter financial or private equity investors looking to acquire a strategic stake in a stock exchange, with no intention of gaining control over the day-to-day management of the exchange or being classified as a 'promoter'. In all likelihood, having to comply with mandatory open offer requirements may dilute the essence of the liberalized ownership framework the Paper envisions. Hence, it is recommended that compliance with the provisions of the SAST Regulations be limited to listed stock exchanges and omitted with respect to unlisted stock exchanges.

IX. CONCLUDING REMARKS

The nature of the stock markets is one that calls for constant re-evaluation and re-conceptualization. Stock exchanges, in particular, form the core infrastructure of stock markets and must keep up with the pace at which these markets evolve. Growth and innovation in stock market infrastructure

cannot sustain without a regulatory framework which aims at encouraging inter-exchange competition as a means of achieving efficiency. To that end, the proposals asserted in the Paper seem well-intentioned as a preliminary step. However, for the intended consequences to materialize, a closer and more comprehensive look is warranted in light of the foregoing considerations.

IX. ANTITRUST AND PRIVACY CONCERNS: A DILEMMA ACROSS JURISDICTIONS

– Urshila Pandit and Sanah Javed*

ABSTRACT

"Strikingly, the current approach fails even if one believes that consumer interests should remain paramount. Focusing primarily on price and output undermines effective antitrust enforcement by delaying intervention until market power is being actively exercised". – Lina Khan

This is a glaring issue that confronts antitrust regulators across jurisdictions especially in the context of digital platforms. Consumer harm in digital platform markets manifests in the form of reduced privacy and data protection concerns as opposed to harm in the form of pricing. This Article examines how the price theory fails in digital platform markets. It traces the evolving approach of antitrust authorities in digital markets by examining case laws that have been decided by antitrust regulators in the European Union, the United States and India. The article focuses on two case studies - the Facebook-Reliance Jio deal in India and the case of Amazon's misuse of third-party seller data before the European Commission to highlight the importance of using privacy and data protection principles as a parameter in competition analysis. Lastly, it seeks to provide a theoretical framework as to how such an approach can be applied by competition law regulators across different jurisdictions.

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I. INTRODUCTION

Recent antitrust investigations across jurisdictions pertaining to big-tech companies have compelled the antitrust authorities to address whether privacy concerns raised by these companies fall within the purview of their investigation. Such concerns arose in the Google-DoubleClick merger, Facebook-WhatsApp merger and more recently when India's Competition regulator in a preliminary examination observed that WhatsApp's new privacy policy was anti-competitive.[1] The United States Department of Justice also probed into whether Google's change in its cookie policy amounted to an abuse of dominance.[2]

Some scholars argue that anti-trust laws must be used for the traditional purpose of addressing anti-competitive behaviour and its scope must not be

[1] *WhatsApp's New Privacy Policy 'Exploitative And Exclusionary': CCI Orders Detailed Probe*, LIVEMINT (March 24, 2021), https://www.livemint.com/news/india/cci-terms-whatsapp-s-privacy-policy-as-exploitative-and-exclusionary-directs-detailed-probe-11616593279631.html.

[2] Paresh Dave and Diane Bartz, *Google's Privacy Push Draws U.S. Antitrust Scrutiny*, REUTERS (March 18, 2021), https://www.reuters.com/article/us-tech-antitrust-google-exclusive-idUSKBN2BA10I.

expanded to address non-competitive concerns.[3] However, others claim that the two fields inevitably overlap especially in cases where the investigation concerns practices by digital platforms.[4] The two schools of thought - Harvard and Chicago, vary in their approach to antitrust investigations. The Harvard school propounded that firms with enhanced market power would act in an anti-competitive manner.[5] Whereas the Chicago school of thought was inclined towards a consumer welfare-centric approach wherein the conclusion of the merger being anti-competitive was arrived at once factual evidence regarding the adverse impact on consumers in the market was obtained.[6] The Chicago school measures consumer welfare in terms of the price theory.[7]

Supporters of the latter school of thought often argue that antitrust laws can solve ancillary problems such as fake news issues, environmental

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[3] Maureen K. Ohlhausen and Alexander P. Okuliar, *Consumer Protection, and the Right [Approach] to Privacy*, 80 ANTITRUST L.J. 121 (2015); Noah Joshua Phillips, *Should We Block This Merger? Some thoughts on Converging Antitrust and Privacy*, FEDERAL TRADE COMMISSION (UNITED STATES OF AMERICA), (January 30, 2020), https://www.ftc.gov/system/files/documents/public_statements/1565039/phillips_-_stanford_speech_10-30-20.pdf.

[4] Harri Kalimo and Klaudia Majcher, *The Concept of Fairness: Linking EU Competition and Data Protection Law in the Digital Marketplace*, 42 E.L. REV. 210 (2017); EDPS, "*Preliminary Opinion of the European Data Protection Supervisor, Privacy and competitiveness in the age of big data*" (March 2014); Jacques Crémer et al., *Competition Policy for the Digital Era,* EUROPEAN COMMISSION (2019), https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf; Aymeric de Moncuit, *In which ways should privacy concerns serve as an element of competition assessment*, EUROPEAN COMMISSION (2018), https://ec.europa.eu/competition/information/digitisation_2018/contributions/aymeric_de_moncuit.pdf; *Competition Law & Data*, AUTORITÉ DE LA CONCURRENCE & BUNDESKARTELLAMT, (May 29, 2016), https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Berichte/Big%20Data%20Papier.html?nn=3591568.

[5] Thomas A Piraino, *Reconciling the Harvard and Chicago Schools: A New Antitrust Approach for the 21st Century*, 84 INDIANA L. J. 2, (2007).

[6] *Id.*

[7] Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 932 (1979).

concerns[8] and privacy problems among others. Balkin, for instance, argues that pro-competitive policies ensure a more democratic environment.[9]

In the present paper, the authors side with the latter perspective. However, they attempt to argue that even though antitrust authorities can identify when privacy problems arise from anticompetitive practices, privacy laws must step in to correct this and in turn remedy the wrongful gain acquired in the market.

Part II of the paper deals with zero price markets, a common feature of digital platform markets that poses a major challenge to the traditional antitrust approach. Part III of the paper outlines the existing privacy and data protection framework in place in three jurisdictions - India, the European Union (**"EU"**) and the United States of America (**"US"**), on the grounds that recurring cases of competition concerns and privacy concerns have been addressed in these jurisdictions. Part IV traces the chronological evolution of antitrust law in digital markets by various competition authorities. In Part V, the authors focus on two case studies - the Facebook-Reliance Jio deal in India and the case of Amazon's misuse of third-party seller data before the European Commission (**"EC"**) to highlight the importance of using privacy and data protection principles as a parameter in competition analysis. Part VI seeks to provide a theoretical framework as to how such an approach can be applied by competition law regulators across different jurisdictions.

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[8] Grant Murray, *Antitrust and sustainability: globally warming up to be a hot topic?*, KLUWER COMPETITION LAW BLOG, (October 18, 2019) http://competitionlawblog.kluwercompetitionlaw.com/2019/10/18/antitrust-and-sustainability-globally-warming-up-to-be-a-hot-topic/; Simon Holmes, *Climate change, sustainability, and competition law*, 8 J. ANTITRUST ENFORCEMENT 2, 354 (July 2020).
[9] Jack M Balkin, *Free Speech is a Triangle*, 18 COLUMBIA L. REV. 7 (2018).

II. ZERO-PRICE MARKETS AND THE FAILURE OF TRADITIONAL ANTITRUST APPROACH

Digital platform economies refer to those wherein the consumers can discover and share information via digital platforms/means. This information is subsequently harvested and analysed by service providers.[10] Digital platform markets provide consumers with 'free' products (which merely refers to goods that are not monetarily priced, however the consumer does incur non price costs for the same). For instance, Facebook offers consumers an opportunity to interact with their peers over a platform at a zero-sum cost. Similar models have been adopted by Amazon, Spotify and others.[11] These entities receive varied and often detailed information on consumer preferences and other ancillary information.[12] For instance, in Facebook, an individual is merely required to create a user account. In this case, Facebook uses the personal information given during registration and information acquired with subsequent use of the platform, to develop targeted advertisements. Similarly, all digital platforms acquire information that can be translated into monetary benefits. The consumer also incurs non-monetary costs, such as 'information and attention costs.'[13]

Antitrust law has significantly relied on price factors to investigate instances of abuse in the market. The price theory falls short when examining

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[10] Keith Hylton, *Digital Platforms and Antitrust Law*, No.19-8, BOSTON UNIVERSITY SCHOOL OF LAW, LAW AND ECONOMICS RESEARCH PAPER (2019), https://scholarship.law.bu.edu/cgi/viewcontent.cgi?article=1606&context=faculty_scholarship.

[11] Daniel L Rubinfeld and Michal Gal, *The Hidden Costs of Free Goods: Implications for Antitrust Enforcement*, 80 ANTITRUST L. J. 521 (2016).

[12] *Id.*

[13] John M Newman, *Antitrust in Zero-Price Markets: Foundations*, 164 U. PENN. L. REV. 149 (2016).

anticompetitive practices in a zero-price market as they fail to take into consideration other factors that affect consumer welfare,[14] for instance, reduced privacy. Further, Merger Guidelines fail to take into consideration data acquired as a result of the merger or acquisition. It requires entities to notify mergers or acquisitions only if it exceeds a specified threshold which is based on the turnover.[15] For instance, Section 20(4) of the Competition Act, 2002, of India specifies the factors that the Commission must observe whilst examining a combination to determine whether it leads to or is likely to lead to an appreciable adverse effect on competition in the market.[16] This section however leaves out of its scope privacy issues and volumes of data accumulated by the entity post the combination.[17] Thus, data-intensive mergers by digital platforms often escape scrutiny by competition authorities. Another challenge that competition authorities face whilst examining anti-competitive practices in digital economies is tackling privacy and data-related issues.[18]

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[14] Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L. J. 720 (2017); Konstantina Bania, *The Role of Consumer Data in the Enforcement of EU Competition Law*, EUROPEAN COMPETITION JOURNAL 14:1, 38-80; David S. Evans, *The Antitrust Economics of Free*, 7 COMPETITION POL'Y INT'L 71, 72 (2011); *Competition issues in the digital economy* TD/B/C.I/CLP/54, ¶ 11, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (May 1, 2019), https://unctad.org/system/files/official-document/ciclpd54_en.pdf.

[15] *Stigler Committee on Digital Platforms Final Report*, STIGLER CENTER FOR THE STUDY OF THE ECONOMY AND THE STATE (Sept. 16, 2019), https://research.chicagobooth.edu/-/media/research/stigler/pdfs/digital-platforms---committee-report---stigler-center.pdf?la=en&hash=2D23583FF8BCC560B7FEF7A81E1F95C1DDC5225E; Filippo Lancieri and Patricia Sakowski, *Competition in Digital Markets: A Review of Expert Reports*, Stigler Centre Working Paper Series No. 303 (Oct. 26, 2020), Forthcoming, 63 STANFORD JOURNAL OF LAW, BUSINESS AND FINANCE, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3681322.

[16] Competition Act, 2002, § 20(4), No. 12, Acts of Parliament, 2002 (India).

[17] *Id.*

[18] Annabelle Gawer, *Big Data: Bringing Competition Policy to the Digital Era*, DAF/COMP/WD (2016) 74, ¶54.

III. PRIVACY REGULATION FRAMEWORKS IN DIFFERENT JURISDICTIONS

Back in 2007, Google had urged international bodies such as the United Nations to call for the setting of international standards of privacy. The company had argued that the lack of regulatory standards across countries for privacy facilitates privacy breaches and loss.[19] This problem is still pervasive today. The regulatory frameworks governing privacy and data protection concerns in different jurisdictions are as follows:

A. India

The Information Technology (Intermediary liability) Rules, 2011 impose an obligation upon intermediaries to publish the rules and regulations, privacy policy and user agreement for access or usage of the intermediary's computer resource as per Rule 3.[20] Further, the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 lays down the rules governing collection, disclosure and transfer of sensitive personal data between body corporates.[21] These Rules however do not establish a cohesive framework to protect the privacy rights of individuals and are limited in their application.

The right to privacy was recognised as a fundamental right by the Supreme Court in the *Puttaswamy Judgement*.[22] Subsequently, the Justice

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[19] Bobbie Johnson, *Google urges UN to set global internet privacy rules*, THE GUARDIAN, (2007), https://www.theguardian.com/technology/2007/sep/14/news.google.
[20] Rule 3, Information Technology (Intermediary Liability) Rules, 2011.
[21] Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011.
[22] (2017) 10 SCC 1.

Srikrishna Committee was constituted to formulate recommendations for the privacy regulatory framework in 2017. The Committee submitted its findings in the 'White paper of the Committee of Experts on Data Protection Framework for India' in 2018 and published the Draft Personal Data Protection Bill, 2018. In 2019, the Government released the Personal Data Protection Bill, 2019 which varied in essential features from the Srikrishna Committee report.[23] The Joint Parliamentary Committee recently stated that it is suggesting around 89 amendments to the Bill and an insertion of a new clause.[24] The Bill is yet to be formulated into law, after which it will come into force in a phased manner. The delay in bringing about a sound privacy regulatory framework gives rise to various challenges. Some of the largest big-tech mergers in India have taken place in the absence of a privacy regime, wherein the Competition Authorities have refused to address privacy concerns, often justifying this hesitation on the grounds that the issues ought to be addressed by privacy regulators. The Walmart-Flipkart deal,[25] the

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[23]Anurag Vaishnav, *The Personal Data Protection Bill, 2019: How it differs from the draft Bill,* PRS BLOG (Dec. 27, 2019), https://www.prsindia.org/theprsblog/personal-data-protection-bill-2019-how-it-differs-draft-bill.

[24] Surabhi Agarwal, *89 amendments, 1 new clause in the final draft of India Data Protection Bill*, ECONOMIC TIMES, (Jan. 7, 2021), https://economictimes.indiatimes.com/tech/technology/89-amendments-1-new-clause-in-final-draft-of-india-data-protection-bill/articleshow/80144191.cms.

[25] Beena Saraswathy, *The Flipkart-Walmart Deal in India: A Look into Competition and Other Related Issues* 64 The Antitrust Bulletin 136, 145 (2019).

Facebook-Jio deal,[26] and Google's acquisition of a minority stake in Jio Platforms[27] are a few examples of this.

Concerning the non-personal data regulation framework, the Ministry of Electronics and Information Technology (**"MeiTY"**) formulated an expert committee chaired by Kris Gopalakrishnan in 2020.[28] The Report defines non-personal data negatively i.e. any data that is not categorised as personal data will be considered to be non-personal data. The Committee submitted its report entailing the following observations:[29]

1. A Non-Personal Data Regulatory Authority consisting of experts in the field will be set up which will oversee the governance of data.

2. Sharing of Non-Personal Data may be carried out for specific purposes such as for, *inter alia,* sovereign purposes, public interest purposes, and economic purposes.

The non-personal data regulatory framework will govern meta-data[30] which is used by commercial entities to observe consumer preferences and

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[26] *Notice under Section 6 (2) of the Competition Act, 2002 by Jaadhu Holdings LLC*, COMPETITION COMMISSION OF INDIA (June 24, 2020), https://www.cci.gov.in/sites/default/files/Notice_order_document/order-747.pdf?download=1.

[27] *Notice under Section 6(2) of the Competition Act, 2002 filed by Google International LLC*, ¶ 30, COMPETITION COMMISSION OF INDIA (Nov. 11, 2020) https://www.cci.gov.in/sites/default/files/Notice_order_document/Order775.pdf.

[28] Official Memorandum No. 24(4) /2019-CLES dated 13.09.2019, MINISTRY OF ELECTRONICS AND INFORMATION TECHNOLOGY, GOVERNMENT OF INDIA.

[29] *Report by the Committee of Experts on Non-Personal Data Governance Framework*, MINISTRY OF ELECTRONICS AND INFORMATION TECHNOLOGY, GOVERNMENT OF INDIA, https://static.mygov.in/rest/s3fs-public/mygov_159453381955063671.pdf.

[30] *Report by the Committee of Experts on Non Personal Data Governance Framework*, MINISTRY OF ELECTRONICS AND INFORMATION TECHNOLOGY, GOVERNMENT OF INDIA, https://static.mygov.in/rest/s3fs-public/mygov_160922880751553221.pdf.

behaviour in the market.[31] Notably, the envisaged regulatory framework has not come into force, leaving a regulatory gap with regard to the manner in which personal and non-personal data is presently shared between various entities, whether government or private.

B. Europe

In 1995, the EU Data Protection Directive was brought about to regulate the processing of personal data whilst keeping intact the right to privacy.[32] The said directive then paved the way for the General Data Protection Regulation (**"GDPR"**) that was brought into force in 2018 across the EU to tackle various privacy concerns.[33] The GDPR is enforced by the European Data Protection Board at the EU level along with Data Protection Authorities in Member States of the EU.[34] The Data Protection Authorities either initiate action suo motu or on the basis of a complaint.[35] In cases where the action is initiated suo motu, there is a requirement of grounds of suspicion that a company is not complying with the privacy regulatory framework and hence breaching permitted data processing practices.[36]

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[31] Micah Altman et al., *Practical Approaches to Big Data privacy over time*, 8 INT' L DATA PRIVACY L 1 (Feb. 2018).

[32] Directive 95/46/EC, EUROPEAN PARLIAMENT, https://ec.europa.eu/eip/ageing/standards/ict-and-communication/data/directive-9546ec_en.

[33] ORLA LYNSKEY, THE FOUNDATIONS OF EU DATA PROTECTION LAW, (Oxford University Press 2015).

[34] *EU Data Protection Reform: ensuring its enforcement Fact sheet*, EUROPEAN PARLIAMENT (Jan. 2018), https://ec.europa.eu/info/sites/info/files/data-protection-factsheet-role-edpb_en.pdf .

[35] *Id.*

[36] *EU Data Protection Reform: ensuring its enforcement Fact sheet*, EUROPEAN PARLIAMENT (Jan. 2018) , https://ec.europa.eu/info/sites/info/files/data-protection-factsheet-role-edpb_en.pdf.

C. United States

The US does not have central legislation that tackles privacy entirely, however, various industry-specific legislations have been passed to combat privacy and data breaches. For instance, the Health Insurance Portability and Accountability Act, 1996 (**"HIPPA"**) was formulated on the notion that individuals should have the ability to control the possession and portability of their personal health information.[37] The Children's Online Privacy Protection Act, 2000 (**"COPPA"**) ensures that online platforms take parental consent before collecting personal information from minors.[38] COPPA was brought into force to prevent websites and online services from issuing targeted advertisements to children under the age of 13 that are particularly vulnerable and may not have an absolute understanding of their data and privacy rights.[39]

The regulatory gaps that arise apart from the industry-specific privacy legislation are covered by the Federal Trade Commission (**"FTC"**). The FTC as per the FTC Act of 1914 has the power to prohibit companies from engaging in unfair or deceptive practices.[40] In this context, it is clear that the EU privacy regime is in stark contrast to the legal regime in India and the US which do not have one privacy-specific law. While the US has sector-specific laws that address privacy issues to some extent, India lacks a robust data protection law.

In the antitrust analysis of mergers, competition authorities often state that the potential privacy issues can be tackled post-breach by regulatory

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[37] Health Insurance Portability and Accountability Insurance Act, 1996, (USA).

[38] *Protecting Children's Privacy under COPPA*, FTC, https://www.ftc.gov/sites/default/files/documents/reports/protecting-childrens-privacy-under-coppa-survey-compliance/coppasurvey.pdf.

[39] *Id.*

[40] Federal Trade Commission Act, 1914, (USA).

bodies established for data protection matters. However, this approach is problematic as privacy regulations across jurisdictions are triggered into motion, post the privacy breach taking place. They are reactionary and not anticipatory. In addition to this, privacy regulations are ill-equipped to deal with situations wherein competition issues are entangled with privacy concerns.

IV. CASES WHEREIN THE PRIVACY CONSIDERATION CAME UP FOR HEARING IN ANTITRUST SUITS

A. Google-DoubleClick Merger: A Missed Opportunity [2008 - United States of America]

Previously, competition regulators have failed to adopt a harmonised view of competition and privacy concerns. The Google-DoubleClick merger case is an example of this. In the Google-DoubleClick merger case, one of the fundamental arguments against the merger was the consumer privacy issue. It was argued that the combined data sets of the two entities would lead to dominance in the hands of a single entity with regard to information. The FTC however, distanced itself from the privacy aspect of the merger focusing solely on whether the merger would adversely affect competition in the market.[41]

The majority's reasoning was based on various grounds. The Commission was concerned with antitrust issues solely and observed that it did not have the legal authority to enquire into privacy issues. Further, Google

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[41] *Statement of Federal Trade Commision concerning Google-DoubleClick*, FTC FILE NO. 071-0170,
https://www.ftc.gov/system/files/documents/public_statements/418081/071220googledc-commstmt.pdf.

and DoubleClick operated in different fields hence not impacting each other's price and non-price attributes, and information that was available with Google could also be accessed by its competitors thus making it non-rivalrous. Lastly, the said information was not an essential input hence the essential facilities doctrine could not be evoked.[42]

The Commission in the Google-DoubleClick merger case stuck to the traditional antitrust approach.[43] This approach fails to look beyond price analysis in determining whether antitrust laws have been breached.[44] Marc Rotenberg had stated during the merger that "Unless the commission establishes substantial privacy safeguards by means of a consent decree, Google's proposed acquisition of DoubleClick should be blocked."[45] Individuals arguing against the merger on the grounds of privacy concerns justified the said concerns by emphasizing that the merger would lead to: (i) human rights violation;[46] (ii) undue concentration of economic power;[47] (iii)

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[42] *Id.*
[43] ASNEF-EQUIFAX and Administración del Estado, C-238/05, EU:C:2006:734,¶ 63.
[44] ROBERT H BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF, (1978)
[45] Marc Rotenberg's statement, *An Examination of the Google-Doubleclick Merger and the Online Advertising Industry: What are the risks for Competition and Privacy, Hearing before the Sub-committee on Antitrust*, *Competition policy and Consumer Rights*, 110TH CONGRESS, 29 (Sept 27, 2007), https://www.govinfo.gov/content/pkg/CHRG-110shrg39015/pdf/CHRG-110shrg39015.pdf.
[46] *Id.*
[47] Herb Kohl's statement, *An Examination of the Google-Doubleclick Merger and the Online Advertising Industry: What are the risks for Competition and Privacy, Hearing before the Sub-committee on Antitrust, Competition policy and Consumer Rights*, 110TH CONGRESS, (Sept. 27, 2007), https://www.govinfo.gov/content/pkg/CHRG-110shrg39015/pdf/CHRG-110shrg39015.pdf.

exploitation of consumer data and subsequent price discrimination by harvesting the data;[48] and (iv) there would be foreclosure of access to data.[49]

Commissioner Pamela Jones Harbour dissented in the present case. She stated that approving the Google-DoubleClick merger without imposing any conditions enhances the risk of harm to competition. The dissent stressed that the intention of these two firms behind the merger is to combine their datasets and become a 'super-intermediator'. The Commissioner warned that this will not only affect competition in the market but also raise consumer privacy concerns.[50] The Commissioner further suggested that to tackle these issues the representations regarding the handling of data should be made binding through a consent agreement and the enforcement of a firewall between the entities to prevent the exchange of data.[51]

Google's advertising business is once again a subject of antitrust investigation today.[52] William Kovacic, one of the majority votes in the FDA's

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[48] Nathan Newman, *The Cost of Lost Privacy: Consumer Harm and Rising Economic Inequality in the Age of Google*, 40 WILLIAM MITCHELL L. REV. 870, (2014).
[49] *Dissenting Statement of Commissioner Pamela Jones Harbour, In the Matter of Google-DoubleClick*, FTC FILE NO. 071-0170, https://www.ftc.gov/sites/default/files/documents/public_statements/statement-matter-google/doubleclick/071220harbour_0.pdf ; Pamela Jones Harbour and Tara Isa Koslov, *Section 2 in a Web 2.0 World: An Expanded Version of the Relevant Product Market*, 76 ANTITRUST L. J. 775 (2010).
[50] *Dissenting Statement of Commissioner Pamela Jones Harbour, In the Matter of Google-DoubleClick*, FTC File No. 071-0170, https://www.ftc.gov/sites/default/files/documents/public_statements/statement-matter-google/doubleclick/071220harbour_0.pdf.
[51] *Id.*
[52] *United States v. Google Inc., complaint filed by the department of justice against Google for violating antitrust law in the search and search advertising market*, https://www.justice.gov/opa/press-release/file/1328941/download ; *Justice Department sues Monopolist Google for violating Antitrust Law, Justice Department*, https://www.justice.gov/opa/pr/justice-department-sues-monopolist-google-violating-antitrust-laws .

approval of the Google-DoubleClick merger said "If I knew in 2007 what I know now, I would have voted to challenge the Google-DoubleClick merger."[53] Observers have noted that the merger played a fundamental role in turning Google into an advertisement powerhouse. This case brought into light the need to address privacy concerns during antitrust investigations as failing to do so brings about repercussions in the long run.

B. Microsoft/LinkedIn merger [2016 - European Union]

In 2016, the EC examined the effects of Microsoft's acquisition of LinkedIn. In the market for online advertising services, it observed that data is an important factor in competition analysis and when there is an acquisition of large amounts of data in a merger, competition concerns may arise.[54] The EC approved the merger as it found that even if Microsoft was to combine the data obtained from LinkedIn, it would not raise barriers to entry or foreclose competition as the data could be accessed by competitors as well.[55] In the market for professional social networking services (**"PSN"**), it did note that privacy would be relevant only if consumers view it as an essential factor on the basis of which different service providers compete.[56] However, the

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[53] Steve Lohr, *This Deal Helped Turn Google into an Ad Powerhouse. Is That a Problem?*, NEW YORK TIMES, (Sept. 21, 2020), https://www.nytimes.com/2020/09/21/technology/google-doubleclick-antitrust-ads.html .
[54] Dr. Michele Giannino, *Microsoft/LinkedIn: What the European Commission Said on the Competition Review of Digital Market Mergers* (July 19, 2017).
[55] Greg Sivinski, Alex Okuliar& Lars Kjolbye, *Is big data a big deal? A competition law approach to big data*, 13 EUROPEAN COMPETITION JOURNAL, 199 (2017) 216.
[56] Maria Wasastjerna, *Competitive Law, Big Data and Privacy*, 10 INT'L IN-HOUSE COUNSEL J. 1 (2017) 6.

Commission explicitly stated that subsequent loss of privacy by consumers is out of the ambit of competition law and will not be examined.[57]

C. Vinod Kumar Gupta v. WhatsApp Inc. [2016 - India]

The informant in the present case raised concerns over WhatsApp's change in its privacy policy compelling users to consent to share user data with 'Facebook' to continue availing Whatsapp's services.[58] The informant claimed that this violated Section 4 of the Competition Act, 2002, that is, Whatsapp was abusing its dominant position in the relevant market by introducing an unfair privacy policy. The Competition Commission of India (**"CCI"**) in its observation of this contention held privacy concerns to be outside its purview of examination. Here, the CCI briefly mentioned that there exist cases pending before the Delhi High Court challenging WhatsApp's privacy policy under the relevant Information Technology Act, 2000[59] and accordingly refrained from commenting on this contention.

Whatsapp recently released an in-app notification to its users informing them of its updated privacy policy.[60] According to the new terms of the policy, Whatsapp will be able to engage in sharing of the user's account registration information (including phone number), transaction and service-related data (including data relating to businesses operating using Whatsapp),

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[57] Anca D Chirita, *Theories of Harm in 'Data-Driven' Mergers*, DURHAM UNIVERSITY, https://ec.europa.eu/competition/information/digitisation_2018/contributions/anca_chirita.pdf .

[58] Vinod Kumar Gupta v. Whatsapp Inc., Case No.99 of 2016, https://www.cci.gov.in/sites/default/files/26%282%29%20Order%20in%20Case%20No.%2099%20of%202016.pdf.

[59] Karmanya Singh Sareen and Ors v. Union of India, W.P (Civil) 7663/2016 & CM No. 31553/2016.

[60] *Whatsapp updated its notification on 4th January, 2021*, WHATSAPP, https://www.whatsapp.com/legal/updates/privacy-policy/?lang=en .

IP address, mobile device information and more with Facebook.[61] The above-mentioned data-sharing terms do not have an opt-out option. Hence, consumers are entitled to use WhatsApp's services on the precondition that they agree to give up their data to WhatsApp's parent entity Facebook.

The updated privacy policy went against the initial declarations that were made by Whatsapp when the merger took place which inspired confidence that the entities would not share data between themselves without the user's consent. Facing widespread public backlash, WhatsApp has delayed the enforcement of the new privacy policy.[62]

Recently, the CCI in its preliminary examination ordered the DG to investigate WhatsApp's privacy policy on the grounds that it amounts to an abuse of dominant position under Section 4 of the Competition Act.[63] WhatsApp and Facebook challenged the order of the CCI on the grounds that the CCI cannot investigate privacy issues as the same was being heard by the Supreme Court. However, the Delhi HC has dismissed the petition[64] marking a turning point in the anti-trust approach towards consumer privacy issues.

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[61] *Privacy Policy*, WHATSAPP, https://www.whatsapp.com/legal/updates/privacy-policy/?lang=en.

[62] *Whatsapp pushes back policy roll out to May 15*, THE HINDU, (Jan. 16, 2021), https://www.thehindu.com/news/international/whatsapp-delays-new-privacy-policy-by-three-months-amid-severe-criticism/article33585465.ece .

[63] *In Re: Updated Terms of Service and Privacy Policy for WhatsApp Users*, COMPETITION COMMISSION OF INDIA, https://www.cci.gov.in/sites/default/files/SM01of2021_0.pdf.

[64] Sushil Batra, *Setback for WhatsApp, Delhi HC refuses to stay CCI probe against privacy policy,* LIVEMINT, (June 23, 2021), https://www.livemint.com/companies/news/setback-for-whatsapp-delhi-hc-refuses-to-stay-cci-probe-against-privacy-policy-11624428281411.html.

D. Apple-Shazam Case [2018 - European Union]

The EC in its investigation of Apple's acquisition of Shazam briefly touched upon issues of consumer privacy and data protection. The services offered by Apple and Shazam were complementary. Shazam offered music recognition services whereas Apple offered Apple Music, a platform to stream music. The merger would primarily result in data transfer between the two entities. Margrethe Vestager, the commissioner in charge of competition policy observed that 'data is key to a digital economy', stressing the importance of reviewing the impact of data transfer between these entities on competition in the music streaming industry.[65] However, the EC could not find significant adverse implications on competition arising out of the merger. Concerning the privacy and consumer data-sharing concerns, the EC noted that the companies would still be bound by all data protection laws,[66] indicating that any privacy concern arising out of the merger would have to be tackled by privacy norms and laws. The above-mentioned observation demonstrates that the EC was not oblivious to the privacy challenges faced in digital markets, however, chooses not to bring it within the ambit of competition analysis.

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[65] Mergers: Commission clears Apple's acquisition of Shazam, Press Release, EUROPEAN COMMISSION, (September 6, 2018), https://ec.europa.eu/commission/presscorner/detail/en/IP_18_5662 .

[66] *Id.*

V. ANALYSIS OF THE APPROACH BY COMPETITION AUTHORITIES ACROSS JURISDICTIONS

A. Facebook-Reliance Jio Deal [2020 - India]

In April 2020, Jio announced that social media giant Facebook had gained a minority stake (9.99%) in the company through its wholly-owned subsidiary Jaadhu Pvt. Ltd. and invested Rs. 43,574 crores in the Indian telecommunications company. Facebook also rolled out WhatsApp Pay a payments gateway on its subsidiary platform WhatsApp Messenger.[67] After the launch of JioMart, it will play a crucial role in stimulating digital transactions with approximately three crores *Kirana* (a local store that provides daily grocery items) shops in India. The merger was promoted as being in lieu of the government's flagship 'Digital Indian Mission'.[68] However, it did garner the attention of the CCI.

The two companies have traditionally disagreed on key policy issues relating to data privacy and data sovereignty.[69] Hence, the present deal raises important questions over the level of cooperation that the entities will be willing to engage in especially when they have explicitly stated that no data sharing agreement has been entered into.[70]

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[67] Danny Cyril D Cruze, *How to order from Reliance Jio-Mart on Whatsapp*, LIVEMINT, (Apr. 26, 2020), https://www.livemint.com/companies/news/how-to-order-from-reliance-jiomart-on-whatsapp-11587886799536.html.
[68] David Fisher, *Facebook invests $5.7 Billion in India's Jio Platforms*, FACEBOOK, (Apr. 21, 2020), https://about.fb.com/news/2020/04/facebook-invests-in-jio/ .
[69] Arindrajit Basu and Amber Sinha, *The Realpolitik of the Reliance Jio-Facebook deal*, THE DIPLOMAT (Apr. 29, 2020), https://thediplomat.com/2020/04/the-realpolitik-of-the-reliance-jio-facebook-deal/ .
[70] Romit Guha, *Reliance Jio says no preferential access to Facebook, Whatsapp*, ECONOMIC TIMES (Apr. 22, 2020), https://economictimes.indiatimes.com/opinion/interviews/reliance-

The CCI scrutinized the deal to understand whether the merger will adversely impact competition in the market. As per Section 6 of the Competition Act, 2002, it is a mandatory requirement that enterprises entering into a merger meeting the minimum threshold must obtain prior approval from the Commission.[71] This provision aims to achieve ex-ante regulation, to prevent the possibility of anticompetitive harms from taking place. The CCI's review however was restricted in its approach. It observed that both parties involved in the merger operated in completely different markets that had low entry barriers, ease of entry and exit and high competition.[72] The CCI failed to give due consideration to the fact that such a merger will essentially lead to both parties gaining control over large amounts of user data. This is in line with the competition authority's traditional position of taking into consideration only price factors. The Commission observed that the merger will lead to procompetitive effects on the market and facilitate the Digital India project.[73] However, antitrust inquiries are required to look at not just the immediate impact of a merger on the consumer but also the impact such an agreement can have in the future.

I. Relevant Market

In its submission under Section 6(2) of the Competition Act, 2002, Jaadhu Holdings submitted that it was not necessary to define the relevant market because the acquisition was only of minority shares and the entities

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jio-says-no-preferential-access-to-facebook-whatsapp/articleshow/75305116.cms?from=mdr.

[71] Competition Act, 2002, § 6, No. 12, Acts of Parliament, 2002 (India).

[72] *Summary of the Combination between Jaadhu Holdings and Jio Platform*, COMPETITION COMMISSION OF INDIA, https://www.cci.gov.in/sites/default/files/notice_order_summary_doc/C-2020-06-747.pdf.

[73] *Id.*

would continue operating independently, not affecting competition dynamics in any relevant market.[74] However, if the CCI was to define a market, it should be defined as the 'market for user attention'. This classification is broad and vague. The market for user attention would essentially encompass all digital products and services that cater to users. Jaadhu Holdings went on to state that even if the Commission considered a narrower market such as consumer communication services, the minority acquisition would still not trigger anti-competitive concerns.[75] The Commission adopted the narrow market definition of consumer communication applications as it did in *Vinod Gupta v. Whatsapp Inc.*[76] In the relevant market, the combined share of Whatsapp and Facebook Messenger was estimated to be 45% to 50%. Whereas Jio had upto 5% share of the relevant market. However, despite the narrow market definition, the Commission's findings could not demonstrate that the merger resulted in anticompetitive effects on the market and the acquisition was approved.[77]

In its market analysis, the Commission did touch upon network effects and data sharing between the parties. It was also cognisant of a potential threat of data sharing, however, the Commission refused to go beyond this to analyse the privacy drawbacks of such sharing. The Commission noted that if

[74] *Notice under Section 6(2) of the Competition Act, 2002 by Jaadhu Holdings LLC*, COMPETITION COMMISSION OF INDIA (June 24, 2020), https://www.cci.gov.in/sites/default/files/Notice_order_document/order-747.pdf?download=1.
[75] *Id.*
[76] Shri Vinod Kumar Gupta, Chartered Accountant Vs. WhatsApp Inc., Case No. 99/2016 (CCI).
[77] *Notice under Section 6(2) of the Competition Act, 2002, filed by Jaadhu Holdings LLC*, COMPETITION COMMISSION OF INDIA (June 24, 2020), https://www.cci.gov.in/sites/default/files/Notice_order_document/order-747.pdf.

anticompetitive effects arose out of data sharing between these entities, it would be covered under Sections 3 and 4 of the Competition Act, 2002.

II. Analysis of Facebook-Reliance Jio Deal

The Facebook-Jio transaction is similar to the Google-DoubleClick merger in many ways. Both took place between entities functioning in different markets and did not *per se* reduce the competition in their respective markets. In fact, the regulatory authorities in both mergers recognised the potential for pro-competitive effects of the merger.[78]

The CCI refused to examine data as a crucial factor whilst examining the effects on the market mainly because the parties stated that data sharing was not the purpose of the agreement. The potential effects of the merger in terms of reduced privacy and increased market power as a result of the data acquired were considered insufficient to prevent the merger.[79] In the case of *FTC v. Procter and Gamble*, the Court of Appeals had reversed the lower court's findings of illegality in the merger by stating that it was based upon 'treacherous conjecture'. The Court emphasised that the illegality of a merger cannot be based upon mere suspicion or possibility.[80] In the Facebook-Jio merger too, the CCI refused to declare the merger as illegal due to no immediate evidence that the following will adversely impact the market.

The CCI should be wary of accepting such representations made by the parties as it is non-binding. This concern was also expressed by

[78] *Summary of the Combination between Jaadhu Holdings, LLC and Jio Platforms Limited*, COMPETITION COMMISSION OF INDIA, https://www.cci.gov.in/sites/default/files/notice_order_summary_doc/C-2020-06-747.pdf.
[79] *Id.*
[80] FTC v. Proctor and Gamble Co., 386 US 568 (1967).

Commissioner Pamela Jones Harbour in Google-DoubleClick.[81] These representations do not prevent parties from subsequently engaging in anti-competitive activities due to the increased power acquired from consumer data sharing.

III. Increased Network Effects

A multi-sided market/platform economy usually has two defining features: (i) distinct groups of consumers that are related either directly or indirectly and (ii) network effects are either positive or negative between these different groups.[82] The most commonly cited example of a multi-sided platform economy is the credit card market/video games market.[83] Multi-sided platforms connect various players across different markets by addressing problems of interconnected demand. For instance, Amazon connects merchants, consumers, and advertisers on a single platform. Here, the merchants wish to sell their products as well as advertise their products on a platform that helps consumers compare varied sellers. There exist reduced negative externalities through the establishment of a digital platform.

In the present case, JioMart will act as a multi-sided platform connecting (i) Consumers of various *Kirana* shops; (ii) Various shop vendors; and (iii) Advertisers including *Kirana* shop vendors. Multi-sided platforms

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[81] Dissenting Statement of Commissioner Pamela Jones Harbour, In the Matter of Google-DoubleClick, FTC File No. 071-0170, https://www.ftc.gov/sites/default/files/documents/public_statements/statement-matter-google/doubleclick/071220harbour_0.pdf .

[82] OECD, Policy Roundtable on Two-sided markets, (Dec. 17, 2009), DAF/COMP (2009)2 0, https://www.oecd.org/daf/competition/44445730.pdf.

[83] Patrick R Ward, *Testing for Multi-sided Platform Effects in Antitrust market definition*, THE UNIVERSITY OF CHICAGO LAW REVIEW.

aim to internalise the externalities that usually exist in a market,[84] for example, the consumer's demand for 'digital payment at the local store/*Kirana* shop' and the vendor's demand for network services are linked.[85] The platform provider internalises the costs that arise out of network externality and maintains consumers on both sides of the market.

These multi-sided platforms rely on the increase in the number of users on one side of the market to enhance profitability for users on the other side. For instance, if a large number of an individual's acquaintances are on Facebook, one is inclined to join the platform which in turn induces other users to join the platform, making it an appealing platform for advertisers.[86] Multi-sided platforms rely on their ability to compound data from different consumer sets to improve their services to customers on both sides of the platform.[87] The data collected and analysed by digital platforms is often the personal data of consumers.[88] This raises privacy costs for customers. Consumers disclose varied information either directly (by creating an account and filling in personal information) or indirectly (by the entity tracking consumer behaviour, likes, preferences and more) at zero costs to the platform. The platform then utilises this data to obtain revenue through targeted

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[84] *Id.*
[85] *Id.*
[86] RICHARD WHIST & BAILEY, COMPETITION LAW, (9th ed. 2018).
[87] Ingae Graef, *Market definition and market power in Data: The case of Online platforms*, WORLD COMPETITION LAW AND ECONOMIC REVIEW 476, 477.
[88] Bruno Lasserre and Andreas Mundt, *Competition Law and Big Data: The Enforcers' View*, RIVISTAITALIANA DI ANTITRUST ITALIAN ANTITRUST REVIEW, 2017, https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Fachartikel/Competition_Law_and_Big_Data_The_enforcers_view.pdf?__blob=publicationFile&v=2 .

advertisements, discriminatory pricing and other practices, negatively affecting consumers.[89]

IV. Data as a Source of Market Power

There are two key factors that competition authorities must take into consideration while determining whether the data acquired as a result of a combination adds to or preserves the market power of the undertaking. Firstly, the volume and nature of the data and secondly, the competitors' access to this data.[90] Through the present deal with Facebook, Jio will gain access to extensive nuanced data on consumer habits[91] that its competitors in the retail market do not possess,[92] thus, posing serious competition concerns by raising barriers to entry in the market for retail goods in India. How Jio will have access to such data will be further examined in the paper. Access to Facebook's data on consumer behaviour will give Jio an upper hand in the retail market and reinforce its position in this market[93] as the data obtained will be used to

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[89] Nathan Newman, *The Cost of Lost Privacy: Consumer Harm and the rising Economic Inequality in the Age of Google*, 20 WM. MITCHELL L. REV. (2014).

[90] Autorité de la concurrence &Bundeskartellamt, *supra* note 4, at 13; Aymeric de Moncuit, *supra* note 4.

[91] Asuncion Esteve, *The Business of Personal Data: Google, Facebook, and Privacy Issues in the EU and the USA*, 7 INTERNATIONAL DATA PRIVACY LAW 36 (2017); Cristian Santesteban, Shayne Longpre, *How Big Data Confers Market Power to Big Tech: Leveraging the Perspective of Data Science,* 65 THE ANTITRUST BULLETIN 459 (2020); Ira S. Rubinstein & Nathaniel Good, *Privacy by Design: A Counterfactual Analysis of Google and Facebook Privacy Incidents,* 28 BERKELEY TECHNOL. LAW J. 1333 (2013); Natasha Singer, *What You Don't Know About How Facebook Uses Your Data*, N.Y. TIMES (Apr. 11, 2018), https://www.nytimes.com/2018/04/11/technology/facebook-privacy-hearings.html.

[92] Inge Graef, *Market Definition and Market Power in Data: The Case of Online Platforms*, 38 WORLD COMPETITION LAW AND ECONOMICS REVIEW 473, 479 (2015).

[93] A.P. Grunes & M.E. Stucke, *No Mistake About It: The Important Role of Antitrust in the Era of Big Data*, 14 ANTITRUST SOURCE 1-14 (2015); Lima Khan, *Amazon's Antitrust Paradox,* 126 YALE L.J. 710, 785 (2017); Trefis Team, *Google's Strategy Behind The $3.2 Billion Acquisition Of Nest Labs*, FORBES (Jan. 17, 2014), https://www.forbes.com/sites/greatspeculations/2014/01/17/googles-strategy-behind-the-3-2-billion-acquisition-of-nest-labs/?sh=5c37b3fa1d45; Andrés Arrieta and Mitch Stoltz,

improve its products that are offered to consumers under its private label.[94] Reliance will then be able to dominate the retail market with its private label products.[95] This is termed as cross usage of data and can have a foreclosing effect. Jio could also utilize Facebook's advertisement services to nudge consumers[96] to purchase its private label products through targeted advertisements.

V. *Data Sharing and Privacy Concerns*

The shortcomings of antitrust law can be overcome by using data protection laws. Presently, there exists no-data sharing agreement between the two parties, however, if such an agreement is entered into by the players, it needs to comply with the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011 (**"SPDI Rules, 2011"**). The SPDI Rules, 2011 merely provide that the privacy policy and data sharing terms concerning sensitive personal data must be known to the provider of information and such data shall be shared after the latter's consent is obtained.[97] The present regulatory framework lacks an outline of the data principal's rights and data fiduciary obligations concerning

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Google-Fitbit Merger Would Cement Google's Data Empire, ELECTRONIC FRONTIER FOUNDATION (Apr. 7, 2020), https://www.eff.org/deeplinks/2020/04/Google-fitbit-merger-would-cement-googles-data-empire.

[94] Kalpana Pathak, *For Reliance Retail's JioMart, private labels are the way to go*, LIVEMINT (May 25, 2020), https://www.livemint.com/companies/news/for-reliance-retail-jiomart-pvt-labels-are-the-way-to-go-11590344650286.html .

[95] Abhirup Roy and Aditya Kalra, *How Ambani's Snac Tac is Giving Maggi A Run For Its Money In India's Retail Market,* LIVEMINT, (March 22, 2021), https://www.livemint.com/companies/news/mukesh-ambani-s-not-so-secret-weapon-to-grab-a-bigger-slice-of-india-s-retail-market-11616384823101.html.

[96] J.E Richard & Sarita Guppy, *Facebook: Investigating the Influence on Consumer Purchase Intention,* 4 ASIAN J. BUS. RES. 1, (2014).

[97] Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011.

the handling of personal data. The Personal Data Protection Bill, 2019 that addresses these issues is yet to be promulgated into a legislation.

At the outset, both parties had specified to the CCI that data sharing was not the purpose of the agreement. Further, they elucidated that only 'limited data' will be shared to carry out e-commerce transactions and the following data will be proportionate to the purpose.[98]

The parties did not specify what data amounts to 'limited data' raising fundamental privacy concerns. Commercial entities often collect and process what is known as 'personal data' as per India's Draft Personal Data Protection Bill, 2019. The Bill defines personal data as:[99]

> Data about or relating to a natural person who is directly or indirectly identifiable, having regard to any characteristic, trait, attribute or any other feature of the identity of such natural person, whether online or offline, or any combination of such features with any other information, and shall include any inference drawn from such data for the purpose of profiling.

It is important to have an overview of Facebook, Whatsapp, and Reliance Jio's current data-sharing policies to understand whether data sharing between these two entities is a foreseeable possibility. According to

[98] *Notice under Section 6(2) of the Competition Act, 2002 filed by Jaadhu Holdings LLC*, COMPETITION COMMISSION OF INDIA, (June 24, 2020), https://www.cci.gov.in/sites/default/files/Notice_order_document/order-747.pdf?download=1 ; Aditya Chunduru, *Facebook assures CCI its deal with Jio involves Exchange of only Limited Data*, MEDIANAMA, October 8, 2020, https://www.medianama.com/2020/10/223-cci-facebook-jaadhu-jio-platforms-limited-data/; Payaswini Upadhyay, *Data Sharing Not The Purpose Of the Deal, Reliance Jio, Facebook tells CCI*, BLOOMBERG QUINT (Oct. 7 2020), https://www.bloombergquint.com/law-and-policy/data-sharing-not-the-purpose-of-deal-reliance-jio-facebook-tell-cci.
[99] Personal Data Protection Bill, 2019, Clause 2(28).

Facebook's data policy, it engages in sharing certain consumer data with its third-party partners.[100] Third-party partners refer to entities that help Facebook provide and improve various Facebook business tools to grow their businesses.[101] The definition of third-party partners is broad and can be said to include Reliance-Jio's new venture JioMart. It aims to connect consumers to local *Kirana* shops and payments for these goods will be facilitated through WhatsApp Pay.[102] The data that will be shared by Facebook with 'partners offering goods and services in Facebook's product',[103] this includes information collected through Facebook profiles of users and other information necessary to complete the said transactions. WhatsApp's privacy policy also states that it engages in sharing and receiving consumer information to assist and operate Facebook's varied services and companies.[104] Further, WhatsApp's recent changes to its privacy policy make it evident that transaction and service data will be shared with Facebook.[105]

Further, Reliance Jio in its privacy policy states that it engages in collecting personal and non-personal data from consumers for a wide variety of purposes including analytics and reviews for improvement of service and improvement of user experiences by tailoring advertisements.[106] The policy

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[100] Data Policy, FACEBOOK, https://www.facebook.com/policy.php.
[101] Ariel Ezrachi and Viktoria HSE Robertson, *Competition, Market Power and Third-Party Tracking*, 42 WORLD COMPETITION 5, 7 (2019).
[102] Kalpana Pathak and Abhijit Ahaskar, *Reliance aims to embed Jiomart in Whatsapp*, LIVEMINT, (Jan. 18, 2021), https://www.livemint.com/companies/news/reliance-aims-to-embed-jiomart-in-whatsapp-11610929194919.html.
[103] *Security and Privacy*, *The Facebook Companies*, WHATSAPP, https://faq.whatsapp.com/general/security-and-privacy/the-facebook-companies.
[104] *Privacy Policy*, WHATSAPP, https://www.whatsapp.com/legal/updates/privacy-policy/?lang=en.
[105] *Id.*
[106] *Privacy Policy*, RELIANCE JIO, https://www.jio.com/en-in/privacy-policy.

goes on to state that "In a scenario where we or our assets are merged or acquired by the other business entity, or during restructuring of business or reorganization, we may have to share information provided by you with the other business entities."[107]

The above-mentioned privacy policies indicate that contrary to the claim that data sharing was not the purpose of the merger, consumer data will be shared between the two entities. The present SPDI Rules, 2011 merely require updating of privacy policies when sensitive personal data sharing terms change, this does not adequately safeguard an individual's personal data in case body corporates go back on their previously promised data-sharing agreements.

The loopholes in the present SPDI Rules, 2011, and the absence of a data protection framework can lead to multiple consumer harms such as loss of privacy, targeted advertisement and price discrimination.[108] Apart from the said concerns, competitive concerns may also arise, as WhatsApp hosts multiple business transactions on its platform, the said transaction details, according to its updated privacy policy, can be shared with Facebook, which in turn can share the said data with Reliance Jio without violating its own privacy policies and terms of service. WhatsApp's position as a platform for communication between various businesses and consumers across services can lead to it leveraging its market position to favour Reliance Jio's product JioMart which will be facilitated on WhatsApp, this can be done by sharing

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[107] *Id.*

[108] Micah Altman, Alexandra Wood, David R O'Brien, Urs Gasser, *Practical Approaches to Big Data Privacy Over Time*, 8 INTERNATIONAL DATA PRIVACY LAW 29, 38 (2018).

third party business details with JioMart in which Facebook, WhatsApp's parent company has a stake.

Incorporation of a dynamic analysis by competition authorities would benefit consumers in the long run[109] and ensure a more holistic approach to competition analysis. The dynamic analysis focuses on the future capabilities of entities and is therefore predictive in nature. In contrast, the focal point of static analysis of competition, especially in the case of mergers, is concentration in the market. As J. Gregory Sidak & David J. Teece observe, "such an analysis is unlikely to help consumers".[110] The dynamic analysis will allow regulators to examine the impact a merger will have on the privacy enjoyed by consumers and the use of consumer data.[111]

B. Facebook v. Bundeskartellamt [2020 - Germany]

In 2019, the EC initiated a formal investigation into Amazon's misuse of third-party seller data.[112] The FTC has also followed suit.[113] Amazon has been accused of using third-party seller data that it obtained as a marketplace,

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[109] Douglas H. Ginsburg and Joshua D. Wright, *Dynamic Analysis and the Limits of Antitrust Institutions,* 78 ANTITRUST L.J. (2012).

[110] J. Gregory Sidak & David J. Teece, *Dynamic Competition in Antitrust Law*, 5 J. COMPETITION LAW ECON. 581, 611 (2009).

[111] Andressa Lin Fidelis & Zeynep Ortaç, *Data-driven Mergers : A Call For Further Integration Of Dynamics Effects Into Competition Analysis* (2017), https://www.semanticscholar.org/paper/Data-driven-mergers-%3A-a-call-for-further-of-effects-Fidelis-Orta%C3%A7/78925edd4455c67e18be76e89cbf5aa8a0dd65cf.

[112] *Antitrust: Commission opens investigation into possible anti-competitive conduct of Amazon*, EUROPEAN COMMISSION, https://ec.europa.eu/commission/presscorner/detail/mt/ip_19_4291.

[113] Spencer Soper and Ben Brody, *Amazon Probed by U.S. Antitrust Officials Over Marketplace,* BLOOMBERG (Sept. 11, 2019), https://www.bloomberg.com/news/articles/2019-09-11/amazon-antitrust-probe-ftc-investigators-interview-merchants.

to boost its position in retail.[114] While Amazon has claimed that its internal policy prohibits the transfer of data from Amazon marketplace to its retail wing, in practice, the policy is often flouted.[115] There are numerous takeaways from the Facebook case that would come in handy to regulators in examining Amazon's practices. One of the most important is that competition authorities can and must use data protection obligations as a parameter while assessing an abuse of dominance.[116]

The recent decision of the Cartel Senate of Germany's Federal Court of Justice (**"FCJ"**) in *Facebook v. Bundeskartellamt*[117] provides an invaluable and novel means to prevent abusive practices such as the excessive collection of consumer data by dominant enterprises. The authors argue that the reasoning of this judgment if applied to the Amazon case can ensure that third-party seller data collected by Amazon marketplace is not transferred to Amazon retail. For this purpose, this section of the paper, will first analyse the Facebook decision and then delve into how data protection principles can be applied to the Amazon case.

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[114] Valentina Pop and Sam Schechner, *Amazon to Face Antitrust Charges From EU Over Treatment of Third-Party Sellers*, THE WALL STREET JOURNAL (June 11, 2020), https://www.wsj.com/articles/amazon-to-face-antitrust-charges-from-eu-over-treatment-of-third-party-sellers-11591871818.

[115] Dana Mattioli, *How Amazon Wins: By Steamrolling Rivals and Partners,* THE WALL STREET JOURNAL, (Dec. 22, 2020), https://www.wsj.com/articles/amazon-competition-shopify-wayfair-allbirds-antitrust-11608235127?mod=djemalertNEWS.

[116] Moncuit, *supra* note 4, at 29.

[117] Facebook v. Bundeskartellamt, KVR- 69/19 (2020), https://www.bundesgerichtshof.de/SharedDocs/Termine/DE/Termine/KVR69-19.html;jsessionid=F09CB5804920B1DDFF6B994C11C0E3D8.2_cid286?nn=11439166; Rupprecht Podszun, *Facebook Case: The Reasoning,* D' KART (Aug. 28, 2020), https://www.d-kart.de/en/blog/2020/08/28/facebook-case-the-reasoning/.

Facebook's terms and conditions of use permitted it to obtain data that consumers had given to Instagram, WhatsApp, and other services owned by Facebook; which *inter alia* included third-party websites that used Facebook Tools.[118] This data collected was then merged with personal data that was obtained on Facebook without further consent of users. The FCJ held that Facebook was undoubtedly in a dominant position in the market for social networks. By virtue of this position that Facebook occupied, it was able to impose unfair terms and conditions on consumers that were in violation of the GDPR.[119] This, in turn, was held to be an abuse of dominant position in contravention of Section 19(1) of the German Competition Act (**"GWB"**) which is pari materia to Article 102(a) Treaty on the Functioning of the European Union (**"TFEU"**).[120]

Central to the Court's finding was the interpretation of 'consent', a term that is frequently used in data protection laws. The GDPR recognizes consent as a legal ground[121] on which the processing of data can be conducted. As the terms and conditions were imposed as a result of Facebook's dominance, any consent to such conditions would be vitiated.[122] Such consent was found not to be free consent within the meaning of the GDPR. Working Party 29 had

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[118] Christophe Carugati, *The 2017 Facebook Saga: A Competition, Consumer and Data Protection Story*, 2 EUR. COMPETITION & REG. L. REV. 4 (2018).
[119] Fabiana Di Porto & Gustavo Ghidini, *Big Data Between Privacy And Competition : Dominance By Exploitation? Which Remedies?,* 23 ASCOLA, (2018), https://www.law.nyu.edu/sites/default/files/upload_documents/Di%20Porto%20and%20Ghidini.pdf; Maximilian N. Volmar & Katharina O. Helmdach, *Protecting Consumers And Their Data Through Competition Law? Rethinking Abuse Of Dominance In Light Of The Federal Cartel Office's Facebook Investigation*, 14 EUR. COMPET. J. 195, 202 (2018).
[120] *Supra* note 117.
[121] General Data Protection Regulations, 2016, art. 6(1)(a).
[122] *Article 29 Data Protection Working Party, Opinion 15/2011 on the definition of consent*, 01197/11/EN WP187 at 18 (July 13, 2011), https://ec.europa.eu/justice/article-29/documentation/opinion-recommendation/files/2011/wp187_en.pdf .

previously objected to WhatsApp's Terms of Service and Privacy Policy on the same grounds.[123]

Despite the FCJ's judgment, appearing to focus primarily on data protection, the Court has also adequately addressed the competition issues that arose. Super profiling and tracking[124] that is done by Facebook have been recognized as an indicator of market power.[125] Further, there are competitive harms that arise as a result of this which is in the form of exploitation of consumers[126] and exclusion of competitors.[127] It is important to recognize that the heart of this tracking is consumer data. In this case, the merging of data by Facebook would result in a significant increase in identity-based network effects. This would allow Facebook to cement its dominant position in the market for social networking, raising barriers to entry. The FCJ opined that harm is also caused to the online advertising market as Facebook can improve its targeted advertising service.

The EC has adopted similar reasoning as that of the FCJ though it did not do so explicitly. In the Google search case,[128] the restriction on data portability[129] that was imposed on users of Google's AdWords API was

[123] *Article 29, Data Protection Working Party, Objections to changes in the WhatsApp Terms of Service and Privacy Policy* (Oct. 24, 2017), https://ec.europa.eu/newsroom/just/document.cfm?doc_id=47964.

[124] Reuben Binnset al*, Measuring Third Party Tracker Power Across Web and Mobile,* 18 ACM TRANSACTIONS ON INTERNET TECHNOLOGY 27 (2018).

[125] OECD, *Big Data: Bringing Competition Policy to the Digital Era,* DAF/COMP/M (2016)2/ANN4/FINAL at 3 (26 Apr. 26, 2017); Fabiana Di Porto, *supra* note 116, at 5.

[126] Frank Pasquale, *Privacy, Antitrust, And Power*, 20 GEO. MASON L. REV 1016 (2013).

[127] Ariel Ezrachi and Viktoria HSE Robertson, *Competition, Market Power and Third-Party Tracking*, 42 WORLD COMPETITION 5, 7 (2019).

[128] Press Release 10/1624, *Antitrust: Commission Probes Allegations of Antitrust Violations by Google*, EUROPEAN COMMISSION (Nov. 30, 2010).

[129] General Data Protection Regulations, 2016, art. 20 & recital 68,

considered anti-competitive. Google restricted the transfer of advertisement campaigns from AdWords to other competing search advertising competitors. This restriction raised concerns of the EC as such restrictions would lead to high switching costs thereby creating a lock-in of advertisers as they would not be able to transfer certain data to Google's competitors. This lock-in would increase barriers to entry. Google submitted a commitment that it would remove the clauses in the agreement that restricted the right of portability. This illustrates that the EC has previously viewed violations of the GDPR as a violation of competition law when such practices lead to a distortion of competition in the market.[130] It is crucial to note that the GDPR was not in force at the time the matter was concluded. Furthermore, the right of data portability applies to personal data however the Regulation on the free flow of non-personal data[131] creates a right of data portability[132] over non-personal data as well.

C. Applying the Ratio in Facebook to Amazon's Misuse of Third-Party Seller Data

There are three prerequisites that emerge from the Facebook ratio that is necessary for a finding of exploitative abuse under Article 102 of the TFEU. Firstly, the entity in question must be dominant in the relevant market. Secondly, the privacy or data protection violation must flow from this

[130] Konstantina Bania, *The Role of Consumer Data In The Enforcement Of Eu Competition Law*, 14 EUR. COMPET. J. 38, 58 (2018); Aysem Diker Vanberg& Mehmet Bilal Ünver, *The Right To Data Portability In The GDPR and EU Competition Law: Odd Couple Or Dynamic Duo?,* 8 EUROPEAN JOURNAL OF LAW AND TECHNOLOGY (2017).
[131] *The Regulation on Free Flow of Non-personal Data Regulation* (EU) 2018/1807 (Nov. 14, 2018), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32018R1807
[132] Press Release, *Digital Single Market: Commission Guidance on Free Flow of Non-Personal Data*, EUROPEAN COMMISSION (May 29, 2019), https://ec.europa.eu/commission/presscorner/detail/en/IP_19_2749.

dominance and lastly, but most importantly, there must be competitive harm as a result of this act.

Amazon acts as a digital ecosystem[133] thus making it difficult to define the relevant market[134] and establish a finding of dominance. Competition authorities must be cognisant of the role that Amazon plays as a multi-sided platform. Multi-sided platforms have at least two distinct customer groups[135] and thus separate markets must be defined for each customer group.[136] In this case, the customers of the Amazon marketplace are buyers on one hand and third-party sellers on the other. If the relevant product market in the case is defined based on customer group, the market would be an online marketplace platform.[137] However, if a single market encompassing all customer groups is defined, the relevant market would be retail e-commerce.[138] Adopting such a definition would be to adopt an overly broad market definition thus making it almost impossible to establish a finding of dominance.

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133 Dr Christian Karbaum & Dr Max Schulz, *Ecosystems – New Challenges For Competition Law Enforcement*, *European Commission: Shaping Competition Policy In The Era Of Digitisation* p. 4, EUROPEAN COMMISSION (Sept. 30, 2018), https://ec.europa.eu/competition/information/digitisation_2018/contributions/glade_michel_wirtz.pdf.

134 *Antitrust and "Big Tech",* CONGRESSIONAL RESEARCH SERVICE (Sept. 11, 2019); Ashlyn Myers, *Amazon Doesn't Have an Antitrust Problem: An Antitrust Analysis of Amazon's Business Practices*, 41 HOUS. J. INT'L L. 387 (2019).

135 Nizar Abdelkafi et al., *Multi-Sided Platforms*, 29 ELECTRON MARKETS 553 (2019).

136 Sung Yoon Yang, *Rethinking Modes of Market Definition for Multi-Sided Platforms*, 4 INTERNATIONAL JOURNAL OF TRADE, ECONOMICS AND FINANCE, 164 (2018); Thomas Hoppner, *Defining Markets for Multi-Sided Platforms: The Case of Search Engines,* 38 WORLD COMPETITION, 349 (2015).

137 Jacques Crémer et al., *Competition Policy for the Digital Era: Final Report*, EUROPEAN COMMISSION (2019), http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf .

138 Ashlyn Myers, *supra* note 130, at 387.

The type of platform is an important factor that should be considered while deciding whether to define a separate market based on customer group.[139] When the platform is a matching platform with differentiated possibilities of substitution, a separate market approach should be applied. This approach has been adopted by the Bundeskartellamt in its proceedings against Amazon concerning its treatment of third-party sellers. It defined the relevant market as online marketplace services and found that Amazon was in a dominant position.[140]

Multiple antitrust regulators in the EU have also found Amazon to be dominant as a platform. The Italian Competition Authority in its investigation against Amazon for leveraging its position as a marketplace into the market for logistics found that Amazon was dominant in the market for e-commerce platforms.[141] The Austrian Competition Regulator[142] observed that irrespective of a precise market definition, Amazon occupies a position of relative market dominance. It took into consideration the role that Amazon plays as a gatekeeper and the absence of any real alternatives from the sellers' perspective.

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[139] Jens Uwe-Franck & Martin Pietz, *Market Definition Market Power in the Platform Economy*, CENTRE ON REGULATION IN EUROPE (2019), https://cerre.eu/wp-content/uploads/2020/05/report_cerre_market_definition_market_power_platform_economy.pdf.

[140] Amazon, B2 - 88/18, BUNDESKARTELLAMT (July 17, 2019), https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Fallberichte/Missbrauchsaufsicht/2019/B2-88-18.html;jsessionid=CADD9A91BACC6091246C10AD8696C001.1_cid381?nn=3600108.

[141] Italian Competition Authority Press Release, *A528 - Amazon: investigation launched on possible abuse of a dominant position in online marketplaces and logistic services* (Apr. 16, 2019), https://en.agcm.it/en/media/press-releases/2019/4/A528.

[142] Federal Competition Authority, *Amazon.de Marketplace*, ¶ 7 (July 17, 2019), https://www.bwb.gv.at/fileadmin/user_upload/Fallbericht_20190911_en.pdf.

Traditional theories of harm often do not work in the digital context. Most competition law regimes prohibit the exchange of competitively sensitive information between competitors as it facilitates concerted action among firms[143] resulting in anti-competitive effects. Information relating to prices and quantity fall within the ambit of sensitive commercial information.[144] When information exchanges relating to current and future price parameters take place it is likely to be viewed as anti-competitive.[145]

While the information relating to third-party sellers is competitively sensitive, the sharing of data by Amazon marketplace to Amazon retail may not fall within this theory of harm as Amazon retail falls within the umbrella brand of Amazon. The primary requirement is that the exchange of commercial information must take place between competitors as the assessment of its legality takes place under the framework of cartelization in most jurisdictions,[146] however, this is absent in the present case. In the *Google Shopping case,*[147] the EC ordered equal treatment of Google's own comparison shopping service and its competitors. While the ratio in this decision may seem more appealing to regulators due to the similarity in facts, it will not solve the problem of addressing Amazon's misuse of third-party seller data. This

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[143] Hercules Chemicals NV v. Commission of the European Communities, (T-7/89) [1991] ECR II-1711 ¶ 256 (17 December 1991).

[144] Sofia Competition Forum, *Guidelines on Information Exchange Between Competitors*, UNCTAD, https://unctad.org/system/files/non-official-document/ccpb_SCF_InfoSharing_en.pdf.

[145] United States v. Sinclair Broadcast Group, Inc., et al., ECF No. 1, No 1:18-cv-02609 (D.D.C. Nov. 13, 2018).

[146] OECD, *Information exchanges between Competitors under Competition Law*, DAF/COMP (2010)37 (July 11, 2011), http://www.oecd.org/competition/cartels/48379006.pdf.

[147] *Google Search (Shopping)*, Case at. 39740, ¶ 671, EUROPEAN COMMISSION (June 27, 2017), https://ec.europa.eu/competition/antitrust/cases/dec_docs/39740/39740_14996_3.pdf.

highlights the pretense of adopting a new theory of harm that factors in violation of data protection principles.[148]

The theory of harm that was adopted by the FCJ can be applied to this case. However, it is not as straightforward. Amazon marketplace cannot be held liable for non-compliance with the obligations of a controller under the GDPR as it applies to the processing of personal data.[149] However, the authors argue that Amazon's use of third-party seller data is in breach of its duties as an information fiduciary.[150] According to Balkin,[151] two requirements must be fulfilled to be termed as an information fiduciary. First, the relationship that exists must be one of trust, and second, the information should have been received during the subsistence of this relationship. Amazon marketplace fulfils both of these requirements.

In order to determine whether there exists a fiduciary relationship between parties, there must be an implicit or explicit invitation to trust. One factor that plays an important role in this context is the existence of

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[148] Preliminary Opinion of the European Data Protection Supervisor, *Privacy and Competitiveness in the Age of Big Data: The Interplay Between Data Protection, Competition Law and Consumer Protection in the Digital Economy*, ¶ 71 (March, 2014).

[149] General Data Protection Regulations, 2016, art. 1-4(1); Hoofnagle, C. J., Van der Sloot, B., & Zuiderveen Borgesius, *The European Union General Data Protection Regulation: What It Is and What It Means*, 28 INFORMATION & COMMUNICATIONS TECHNOLOGY LAW, 65- 98 (2019).

[150] Stigler Committee on Digital Platforms Final Report, STIGLER CENTER FOR THE STUDY OF THE ECONOMY AND THE STATE (Sept. 16, 2019), https://research.chicagobooth.edu/-/media/research/stigler/pdfs/digital-platforms---committee-report---stigler-center.pdf?la=en&hash=2D23583FF8BCC560B7FEF7A81E1F95C1DDC5225E.

[151] Jack M. Balkin, *Information Fiduciaries and the First Amendment* 49 UC DAVIS L. REV. 1185, 1209 (2016); Neil Richards & Woodrow Hartzog, *Taking Trust Seriously in Privacy Law* 19 STAN.TECH. L.REV. 431 (2016); Lindsey Barrett, *Confiding in Con Men: U.S. Privacy Law, the GDPR, and Information Fiduciaries*, 42 SEATTLE U. L. REV. 1057 (2019).

dependency.[152] As third-party sellers are highly dependent on the Amazon marketplace[153] as a channel through which they can reach consumers there is a heightened imbalance in power between the Amazon marketplace and the sellers. This was specifically pointed out by the Austrian FCA in its decision.[154] Due to this inherent vulnerability of third-party sellers, the law must impose fiduciary duties on Amazon.[155]

As Amazon has a fiduciary duty towards third-party sellers, therefore, it is immaterial that the data received by it is non-personal data. As an information fiduciary, Amazon marketplace has a duty to not to use data that was received by it as a marketplace to confer an undue advantage to its private label products. Such acts would be in contravention of its primary duty which is not to act adversely to the interests of third-party sellers.[156] Additionally, it would also amount to a breach of the duty to limit the sharing of data to a third party.[157]

While data protection and privacy laws must be applied as a parameter by competition regulators they must be mindful of the fact that a violation of the GDPR is not an automatic violation of Competition Law.[158] There are two

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[152] Jack M. Balkin, *The Fiduciary Model of Privacy*,134 HARV. L. REV. F 11 (2020) Claudia E. Haupt, *Platforms As Trustees: Information Fiduciaries And The Value Of Analogy*, 134 HARV. L. REV. F 34 (2020).
[153] *Supra* note 145.
[154] Federal Competition Authority, Amazon.de Marketplace ¶ 24 (July 17, 2019), https://www.bwb.gv.at/fileadmin/user_upload/Fallbericht_20190911_en.pdf.
[155] Lina M. Khan & David E. Pozen, *A Skeptical View of Information Fiduciaries*, 133 HARV. L. REV. 500 (2019).
[156] Jack M. Balkin, *supra* note 148.
[157] Ariel Dobkin, *Information Fiduciaries in Practice: Data Privacy and User Expectations*, 33 BERKELEY TECHNOL. LAW J. 3 (2018).
[158] Viktoria H.S.E. Robertson, *Excessive Data Collection: Privacy Considerations and Abuse of Dominance in the Era of Big Data*, 57 COMMON MARK. LAW REV. 161 (2020).

conditions for violations of privacy and data protection laws to constitute an abuse of dominance within the purview of competition law. First, the entity must be in a dominant position, and second, the end result of the acts that violate data protection principles must be a distortion of competition.[159]

Amazon marketplace plays a dual role of an intermediary that facilitates transactions between consumers and third-party sellers and at the same time, is a competitor of such sellers as it sells its own products on the platform. By self-preferencing[160] its private label products, Amazon violates platform neutrality.[161] It introduces competing products that do well on its marketplace based on the commercial information it obtains[162] thus, undercutting competitors. Due to the unique information that Amazon obtains as a platform, it has an unfair advantage which allows it to distort competition in two ways. First, it can drive out third-party sellers from the marketplace as it can sell the same product at a lower price[163] and source the product directly

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[159] Maximilian N. Volmar & Katharina O. Helmdach, *Protecting Consumers and Their Data Through Competition Law? Rethinking Abuse of Dominance in Light of The Federal Cartel Office's Facebook Investigation* 14 EUROPEAN COMP. JOURNAL 195 (2018).

[160] Inge Graef, *Differentiated Treatment in Platform-to-Business Relations: EU Competition Law and Economic Dependence*, 38 YEARBOOK OF EUROPEAN LAW 448 (2019).

[161] *Antitrust: Commission fines Google €2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping service*, Press Release, EUROPEAN COMMISSION (June 27, 2017); *Market Study On E-commerce In India Key Findings And Observations*, COMPETITION COMMISSION OF INDIA (2020), https://www.cci.gov.in/sites/default/files/whats_newdocument/Market-study-on-e-Commerce-in-India.pdf.

[162] UNCTAD Secretariat, *Note On Competition Issues In The Digital Economy*, ¶ 18 TD/B/C.I/CLP/54 (May 1, 2019).

[163] Lina M. Khan, *The Separation Of Platforms And Commerce*,119 COLUM. L. REV. 993 (2019); Feng Zhu & Qihong Liu, *Competing with Complementors: An Empirical Look at Amazon.com*, 39 STRATEGIC MANAGEMENT JOURNAL (2018); Jennifer Rankin, *Third-party sellers and Amazon - a double-edged sword in e-commerce,* THE GUARDIAN (June 23, 2015), https://www.theguardian.com/technology/2015/jun/23/amazon-marketplace-third-party-seller-faustian-pact; Dana Mattioli, *Amazon Scooped Up Data From Its Own Sellers to Launch Competing Products* WALL STREET JOURNAL (April 23, 2020),

from the manufacturer completely eliminating third-party sellers. While price competition is beneficial to consumers,[164] such tactics by Amazon reduce the incentives of third-party sellers to innovate, which is the second way in which there is a distortion of competition.[165]

VI. ANALYSING THE MEANS OF COMBATING PRIVACY CONCERNS THAT ARISE IN DIGITAL PLATFORM ECONOMIES

Most cases show that competition authorities are aware of the competitive advantage of data but, they fail to foresee the privacy harms that will be caused to consumers in the future as a result of the merger.[166] The best example of this is Facebook/WhatsApp merger.[167] While this approach in itself is a step in the right direction, it is still insufficient. Consumer harm in the form of reduced privacy or breach of data protection principles must be woven into competition analysis both in the case of mergers as well as abuse of dominance cases. This can be done by adopting a dynamic analysis that factors in future privacy concerns.

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https://www.wsj.com/articles/amazon-scooped-up-data-from-its-own-sellers-to-launch-competing-products-11587650015.

[164] Andrei Hagiu, Tat-HowTeh & Julian Wright, *Should Platforms Be Allowed to Sell on Their Own Marketplaces?* (June 15, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606055.

[165] Ben Bloodstein, *Amazon and Platform Antitrust*, 88 FORDHAM L. REV. 214 (2019).

[166] Anca D.Chirita, *Data-Driven Mergers Under EU Competition Law*, (July 13, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3199912*; Preliminary Opinion of the European Data Protection Supervisor, Privacy And Competitiveness In The Age Of Big Data: The Interplay Between Data Protection, Competition Law And Consumer Protection in the Digital Economy*, ¶ 64, EUROPEAN DATA PROTECTION SUPERVISOR (March, 2014), https://edps.europa.eu/sites/default/files/publication/14-03-26_competitition_law_big_data_en.pdf.

[167] European Commission, Case COMP/M.7217 Facebook/Whatsapp 3 October 2014, 2014/C 417/02.

The authors propose that if the below-mentioned conditions are met, competition authorities must simultaneously call for an investigation by data protection authorities into the merger/acquisition in the digital platform market. The conditions are:

1. There exists a digital platform/market that caters to different consumers and facilitates transactions between these two sets of consumers; and

2. The digital platform or entity is engaged in a zero-price market. That is, the platform does not charge its consumers in monetary terms; and

3. The digital platform relies on its acquisition of consumer data through various means to obtain revenue, either by engaging in targeted advertisements or selling the said data to third-party entities without the consent of the consumer.

The above-mentioned conditions have been observed to be recurring traits in digital platform mergers wherein subsequent privacy concerns arose and hence have been suggested as prerequisites before a privacy investigation is initiated.

However, such an approach is bound to result in jurisdictional conflict between competition regulators and data protection authorities. Competition authorities are also reluctant to examine privacy aspects as they are sectoral regulators and thus their powers are limited by the statute under which they are established. Examining privacy issues could amount to a transgression of their powers. The authors thus propose that while competition authorities must take into consideration privacy issues when such issues are identified a

separate investigation by privacy authorities must take place.[168] This will ensure that appropriate remedies will be applied by the respective authorities.[169]

For instance, in the US, there exists a patchwork framework for the regulation of privacy interests, wherein the FTC covers the regulatory gaps.[170] The FTC is also responsible for regulating unfair practices in the market. The authors suggest that along with investigating competition concerns, specifically for digital markets, a separate investigation must be initiated by the FTC simultaneously[171] to look at the privacy challenges that the merger/amalgamation poses.

In India, the Personal Data Protection Bill, 2019 is presently under consultation before the Joint Parliamentary Committee. Until the data protection authority is established, a separate privacy investigation wing must be established to look into privacy concerns arising in mergers or abuse of dominance cases in digital markets. However, once the Data Protection Authority (**"DPA"**) is established, this role should be taken over by the DPA. The DPA will be vested with the power to suggest regulatory safeguards such

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[168] OECD, *Consumer Data Rights and Competition - Background note,* ¶ 193, DAF/COMP (2020)1 (April 29, 2020); OECD, *Quality Considerations In Digital Zero-price Markets,* ¶ 145, DAF/COMP (2018)14 (Nov 28, 2018).
[169] Marco Botta & Klaus Wiedemann, *The Interaction of EU Competition, Consumer, and Data Protection Law in the Digital Economy: The Regulatory Dilemma in the Facebook Odyssey,* 64 THE ANTITRUST BULLETIN 428 (2019).
[170] U.S. SAFE WEB Act, Amendments of 2006.
[171] *Stigler Committee on Digital Platforms Final Report*, STIGLER CENTER FOR THE STUDY OF THE ECONOMY AND THE STATE (Sept. 16, 2019), https://research.chicagobooth.edu/-/media/research/stigler/pdfs/digital-platforms---committee-report---stigler-center.pdf?la=en&hash=2D23583FF8BCC560B7FEF7A81E1F95C1DDC5225E.

as a firewall or consent agreement between the merging entities to safeguard consumers against a threat of privacy or data breaches.

The EU has proposed a new competition regulation for digital markets in the form of the Digital Markets Act.[172] Marketplaces, social media platforms and search engines will fall within the ambit of this regulation. The Regulation goes a long way in preventing the misuse of consumer data by dominant platforms. It prevents the combining of user data obtained from the core business with different services carried out by the gatekeeper.[173] It also prevents a platform from using data obtained from its business users to undermine them.[174] The Regulation ensures that any planned acquisitions or mergers by such gatekeepers will have to be intimated to the EC irrespective of whether it meets the thresholds under Merger Regulations. This will ensure that data-intensive mergers undergo scrutiny by Competition authorities.

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[172] *Proposal for a Regulation Of The European Parliament And Of The Council on contestable and fair markets in the digital sector (Digital Markets Act),* EUROPEAN COMMISSION (Dec. 12, 2020). https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets_en; https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_2349.

[173] *Id.*, ¶ 36.

[174] *Id.*, ¶ 43.

X. INFORMATION TECHNOLOGY RULES 2021: ARE WE HEADING TOWARDS A DRACONIAN RULE?

- Shipra Tiwari and Kerti Sharma*

ABSTRACT

"If liberty means anything at all it means the right to tell people what they do not want to hear."

-George Orwell

Ever since the Information Technology (Guidelines for Intermediaries and Digital Media Ethics Code) Rules, 2021, were passed by the government of India, they have been a topic of discussion and have faced serious criticism for being violative of fundamental rights. While, with the increase in the overall internet accessibility and increase in cybercrimes, it is without a doubt true that the digital space does need to be regulated, the regulations need to be drafted in a manner that strikes a balance between the duty of the State to protect the citizens by way of drafting laws for the purpose, and the fundamental rights of the citizens. This paper provides an overview of the provisions of the IT Rules and analyses them on the touchstone of the constitutional provisions to test their validity. The authors aim to provide an alternate perspective, by comparing the Rules with international instruments and legislations regarding the control of media and user privacy, like the Cyber Security Law of People's Republic of China, and the General Data Protection Regulation of the European Union, in order to highlight the shortcomings of the Indian framework, and suggest how the authorities could oversee digital communications and content and protect the morality and security of the nation and its people, without overstepping the constitutional boundaries or violating the rights of the citizens.

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I. INTRODUCTION

Article 19(1)(a) of the Indian Constitution provides to all citizens the freedom of speech and expression, subject to reasonable restrictions stated under Article 19(2). The Information Technology (Guidelines for Intermediaries and Digital Media Ethics Code) Rules, 2021 (**"IT Intermediary Rules"** or **"Rules"**) impose additional hassles on the affected parties in terms of the restrictions. The Rules, supposedly lack teeth,[1] are unconstitutional, and are violative of Articles 19(1)(a) and 21 of the Indian Constitution, among other such constitutional irregularities. The Rules are formed to protect the interest of the parties affected by viewing or circulation of content on online platforms. Since their publication, these Rules have been the subject of condemnation by publishers and content producers. This article discusses these rules in light of their legal and constitutional validity. The

[1] Samanwaya Rautray, *Centre promises to tighten new digital media rules after Supreme Court says they lack teeth*, THE ECONOMIC TIMES (2021), https://economictimes.indiatimes.com/news/economy/policy/centre-promises-to-tighten-new-digital-media-rules-after-supreme-court-says-they-lack-teeth/articleshow/81359441.cms?from=mdr (last visited Mar 30, 2021).

recent incidents including the *boys' locker room,*[2] the *toolkit* case,[3] the abetment of suicide by an Instagram post,[4] the increased cases of obscene content, and many more such incidents highlighted the need for regulation on the online platforms circulating and publishing such objectionable information freely. The Central Government informed the Supreme Court that these rules are formed after various reported complaints and requests from the general public and politicians.[5]

II. BIRD'S EYE VIEW OF THE IT INTERMEDIARY RULES

A. Background

Owing to the increased reports of sexual harassment cases on the internet, the Apex Court in 2018, In *Re: Prajwala Letter*[6] stated in the order that the Central Government may frame necessary guidelines/Standard Operating Procedures and implement them within two weeks to eliminate child pornography, rape, and gang rape imagery, videos, sites, content hosting platforms, and other applications. Previously in 2015, pursuant to the

[2] Sidharth Ravi, *Bois Locker Room, a reflection of an existing mindset,* THE HINDU (2021), https://www.thehindu.com/news/cities/Delhi/bois-locker-room-a-reflectionof-an-existing-mindset/article31638044.ece (last visited Mar 30, 2021).

[3] *What is toolkit case and how it is related to farmers protest,* THE TIMES OF INDIA (2021), https://timesofindia.indiatimes.com/india/explained-what-is-toolkit-controversy-and-how-it-is-related-to-farmers-protests/articleshow/81046302.cms (last visited Mar 30, 2021).

[4] Chirali Sharma*, Girl Bizarrely Accused Of Abetment To Suicide In Bois Locker Room Case Over Instagram Post,* ED TIMES (2021), https://edtimes.in/girl-bizarrely-accused-of-abetment-to-suicide-in-bois-locker-room-case-over-instagram-post/ (last visited Mar 30, 2021).

[5] Debayan Roy, *Enacted IT Rules 2021 after receiving several complaints regarding content on OTT platforms: Centre's reply in plea for regulatory body,* BAR & BENCH (MARCH 23, 2021, 11:17 AM), https://www.barandbench.com/news/litigation/enacted-it-rules-2021-complaints-content-ott-platforms-centre

[6] In Re Prajwala Letter (Videos of Sexual Violence and Recommendations), (2018) 17 SCC 79.

directives given by the Apex Court, the government banned around 857 porn sites, particularly including child pornography.[7] The move was highly criticized on the ground of the lack of legislation to do so.[8] The Uttarakhand High Court, recently, reaffirmed the 2015 notification[9] and after giving directions, asked to ban child pornography.[10]

Further, in the *Tahseen S. Poonawalla case,*[11] the Apex Court highlighted the need for a regulation for the irresponsible and explosive messages circulated on social media platforms which lead to hatred and harming public peace.

Furthermore, the Ad-hoc committee report of Rajya Sabha about pornography on social media and its effect suggested the amendment of the Information Technology Act, 2000 (**"IT Act"**), and the Information Technology (Intermediaries guidelines) Rules, 2011 (**"2011 Intermediary Rules"**) to reduce and control the circulation of obscene content.[12]

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[7] Karthikeyan Hemalatha, *Porn ban: People will soon learn to circumvent ISPs and govt orders, expert says,* TIMES OF INDIA, (August 03,2015), https://m.timesofindia.com/tech-news/porn-ban-people-will-soon-learn-to-circumvent-isps-and-govt-orders-expert-says/articleshow/48320914.cms

[8] PTI, *857 porn sites banned in India; Govt plans ombudsman for Net content,* FINANCIAL EXPRESS, (January 28, 2020), https://www.financialexpress.com/industry/technology/porn-ban-in-india-sparks-censorship-debate/113070/

[9] *Supra* note 7.

[10] In Re, In the matter of, Incidence of Gange Rape in a Boarding School, situated in Bhauwala, District Dehradun v State of Uttrakhand, WP No. 158/2018.

[11] Tehseen S. Poonawalla v. Union of India, (2018) 9 SCC 501.

[12] *Report of The Adhoc Committee of The Rajya Sabha To Study The Alarming Issue Of Pornography On Social Media And Its Effect On Children And Society As A Whole*, PARLIAMENT OF INDIA (January 25, 2020), https://rajyasabha.nic.in/rsnew/Committee_site/Committee_File/ReportFile/71/140/0_2020_2_16.pdf.

These are a few instances among others, that lead to the implementation of the IT Intermediary Rules for the regulation of the online platforms including OTT, intermediary, etc.

B. IT INTERMEDIARY RULES

The new IT Intermediary Rules which amended the 2011 Intermediary Rules are discussed briefly, formed under Sections 69A, 79, and 89:

I. Due Diligence by the Intermediary

Rules 4-6 implement a duty on the intermediaries to implement due diligence in their functioning. These duties are:

The rules and regulations, privacy policy, and user agreement should explain to the user not to publish, modify, upload, display any information which comes under the heads mentioned under Section 4(1)(b). The intermediary may be asked to remove any information which comes under any of the said restrictions and may be asked to provide information about the disputed content by government order. The information of the identification of the first publisher shall be given by the social media intermediary, providing messaging services like WhatsApp, to the judicial officer on the order received under Section 69 of the Act. They are required to use technology-based measures which will help in disseminating the information promoting restricted information.

A Chief Compliance Officer, a Nodal Officer, and a Resident Grievance Officer shall be appointed within three months of the publication of such rules to ensure due diligence and publish a compliance report every six months. The cyber incidents are to be reported by them to the Indian

Computer Emergency Response Team following the policies and procedures as prescribed in the Information Technology (The Indian Computer Emergency Response Team and Manner of Performing Functions and Duties) Rules, 2013.

II. Code Of Ethics and Procedure and Safeguards about Digital/Online Media

As per Section 2(w) of the IT Act, 2000, the intermediaries are simply persons who facilitate the use of the internet. It includes cyber cafes, interactive websites like WordPress, blogs, web hosts, search engines like Google, Opera, etc. The functions of intermediaries are hosting content, collecting information, evaluating scattered information, facilitating communication and information exchange, aggregating information, providing access to the internet, etc.

The Rules state that when asked by the government order, they (intermediaries) must disclose the identity of the first originator of the information on their platform. The due diligence to be followed by the intermediaries to control the content has put a significant amount of obligation on them, but at the same time has infringed the privacy of the originator and freedom of expression of the publisher.

Publishers, as per Part III of the Rules, include: (i) news and current affairs content providers, and (ii) online curated content providers, such as the Leaflet, Livelaw, etc. Therefore, publishers mean all such publishers who operate in the territory of India or conduct the systematic business activity of making their content available in India. A Publisher shall be deemed to operate in the territory of India where such publisher has a physical presence in the

territory of India.[13] The Rules cover individual content producers like bloggers as well. In response to a plea filed in the Delhi High Court on May 31, the Court issued notice to a microblogging site for non-complying with the IT Intermediary Rules.[14]

Following is the structure for grievance mechanism for the said entities:

- Level I - Self-regulation by the applicable entity;
- Level II - Self-regulation by the self-regulating bodies of the applicable entities;
- Level III - Oversight mechanism by the Central Government.

Inter-Departmental Committee and an authorized officer as the Chairperson shall be appointed by the Ministry. The authorized officer will give notice to the applicable entity of the disputed content for the reply and the content will be subsequently reviewed by the inter-departmental committee.

Also, the authorized officer is required to submit the recommendation of the Committee along with the information available to the Secretary in the

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[13] Obhan & Associates, *India tightens the noose on intermediaries and social media platforms,* LEXOLOGY, (March 1 2021), https://www.lexology.com/library/detail.aspx?g=3737118d-e2bf-4377-ada2-39c7d8a36f7b.

[14] Rahul Srivastava, *On new IT rules, Twitter says it will strive to comply with applicable law in India,* INDIA TODAY, (May 27, 2021) https://www.indiatoday.in/technology/news/story/on-new-it-rules-twitter-says-it-will-strive-to-comply-with-applicable-law-in-india-1807716-2021-05-27.

Ministry of Information and Broadcasting (**"MIB"**), Government of India, and on his approval shall continue as per the directions.

III. Significant publisher and disclosure:

The significant publisher of the news and current affairs is required to notify the *broadcast seva* about the functioning and broadcasting in the territory of India for proper coordination and communication.

III. THE CONTROVERSY

The IT Intermediary Rules, essentially change the internet experience in India. They have the effect of bringing about governmental control, rather than regulation of social media, digital news platforms, and OTT platforms. Several of these rules are unconstitutional and violate the freedom of speech and the right to privacy of the users of these services.

A. Data Preservation and Traceability

Rule 3(1)(h) requires social media intermediaries to preserve data for 180 days. This information has to be preserved even after the user has deleted their account, for investigative purposes. Further, significant social media intermediaries are also required to allow their users to 'voluntarily' verify their accounts with appropriate mechanisms including their mobile numbers. The accounts so verified shall be indicated by a mark indicating such verification.[15]

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[15] Rule 4(7), The Information Technology (Intermediary Guidelines and Digital Media Ethics Code), Rules, 2021, PART II—Section 3—Sub-section (i), THE GAZETTE OF INDIA, GOVT. OF INDIA, available at https://www.meity.gov.in/writereaddata/files/Intermediary_Guidelines_and_Digital_Media_Ethics_Code_Rules-2021.pdf [Hereinafter *Intermediary Guidelines and Digital Media Ethics Code 2021*].

Instances of such 'voluntary' requirements becoming practically mandatory are not unknown to India. (For instance, although initially, *Aadhar* Cards were introduced as voluntary ID proof, yet activities like banking transactions, getting a sim card, etc, were linked to it in such a way that it was difficult to proceed in normal life without an *Aadhar* Card, thus, making it mandatory in effect.) This shall also enable the social media intermediaries to collect individual data via their respective government IDs. Therefore, these requirements, in the absence of data protection laws and oversight mechanisms regarding the working of surveillance in India, shall have severe implications on the privacy and anonymity of the social media users, where just recently, the Supreme Court had stated privacy to be a fundamental right.[16]

Rule 4(2) requires significant social media intermediaries to enable the tracing of the originator of information if required by a Court of competent jurisdiction or competent authority under Section 69 of the IT Act, thus putting an end to the system of end-to-end encryption if required.

End-to-end encryption (**"E2EE"**) is a technique employed by messaging apps where only the communicating parties have access to the messages exchanged between them. It prevents the internet service providers and other third parties from snooping into the information shared by the users. Social media platforms like WhatsApp use the system of end-to-end encryption, which allows the users to keep the integrity of their messages intact, while they communicate via the internet, which is otherwise considered an insecure public channel. Although the rules provide that such order shall only be passed for prevention, detection, investigation, prosecution, or

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[16] K.S. Puttaswamy v. Union of India, (2017) 10 SCC 641.

punishment of certain offenses that are specifically stated, the category of 'public order' is relatively broad and can be used to exercise arbitrary and whimsical actions. No doubt, this provision shall help in reducing the cases, and identifying the culprits of serious cyber offenses, but, at the same time, can be used to identify political dissenters and may be a threat to freedom of speech and right to dissent. This is contrary to the opinion of Delhi High Court, expressed in *Maqbool Fida Husain* v. *Rajkumar Pandey*[17] as,

> In a real democracy, the dissenter must feel at home and ought not to be nervously looking over his shoulder fearing captivity or bodily harm or economic and social sanctions for his unconventional or critical views. There should be freedom for the thought we hate. Freedom of speech has no meaning if there is no freedom after speech. The reality of democracy is to be measured by the extent of freedom and accommodation it extends.

B. 'Self-Regulation' and Content Blocking

The IT Intermediary Rules also regulate digital news media and OTT platforms, which before this, in the 2011 Intermediary Rules, were left out. The digital news media and OTT platforms are required to adhere to a Code of Conduct, provided in the Appendix to these rules. To ensure compliance with this code of conduct, the three-tier system discussed above includes a grievance redressal and appeal mechanism. This consists of a Grievance Officer at the first tier, the self-regulating body at the second tier, and an Inter-Departmental Committee constituted by the Ministry at the third tier. Under this mechanism, if the grievance officer is unable to provide the complainant

[17] Maqbool Fida Husain v. Rajkumar Pandey, 2008 SCC OnLine Del 562.

with a sufficient response, the complainant may appeal to the self-regulating body at tier II.

Now, as per Rule 11, this self-regulating body is supposed to be an independent body, headed by a retired judge of the Supreme Court or of a High Court, who shall be appointed from a panel prepared by the Ministry*,* and have other, not more than six members, from the field of media, broadcasting, technology, and entertainment. In case the applicable entity fails to comply with the guidance and advisory of the self-regulatory body within the stipulated time, the body may refer the matter to the Oversight Mechanism constituted under Rule 12. This Oversight Mechanism is the Inter-Departmental Committee, consisting of representatives from various ministries under the government and other organizations, including domain experts, that it may decide to include in the Committee, with an 'Authorized Officer' who shall be a member of the Ministry, designated by the Ministry, as its Chairperson. Therefore, while on the face of it, this mechanism may appear to be quite 'self-regulatory' with minimal government interference, on a deeper look, it is much more than that, keeping in mind the degree of control that the Ministry has over appointments in the 'self-regulating body'.

Furthermore, the action that can be taken by this Committee includes censoring the platform, asking the platform to reclassify ratings, and action under Section 69A(1) of the IT Act, on the mere ground that the Authorised Officer, on the recommendation of the committee, is satisfied that there is need for taking such action. Such action may be blocking concerning the content, subject to Section 69A(2), for reasons to be recorded in writing. Section 69A(2) provides that the procedure of such blocking, and the safeguards available against it, maybe as prescribed. This procedure has been prescribed

under the Information Technology (Procedure and Safeguards for Blocking for Access of Information by Public) Rules, 2009 (**"2009 Rules"**).

The Apex Court, in the case of *Shreya Singhal v. Union of India*,[18] not only declared Section 66A of the Act as unconstitutional but also upheld the constitutional validity of Section 69A, which was also challenged in the case. The reason provided by the Court for its decision was twofold. The Hon'ble Court noted that firstly, Section 69A is narrowly drawn, and contains several safeguards, unlike Section 66A, and secondly, the necessity envisaged in the section is on the grounds that are same as those envisaged under Article 19(2) of the Constitution of India, i.e. 'in the interest of sovereignty and integrity of India, defence of India, security of the State, friendly relations with foreign States or public order, or preventing incitement to the commission of any cognizable offence'. However, what the Hon'ble court might have overlooked, was the fact that while Article 19(2) of the Constitution lays down grounds on the basis of which the Parliament and the State Legislature are allowed to pass laws that restrict the freedom of speech and expression of the citizens, what Section 69A allows on the similar grounds is for the government, or an officer authorised by the government to interpret the grounds such as security of the State, etc, as per their own understanding, and direct blocking of content. The reasonable restrictions provided under the Constitution are quite subjective. The difference between the passing of a law in the Parliament, and the issuance of directions by an officer is that while a bill is heavily debated in the Parliament before it becomes a law, a

[18] Shreya Singhal v. Union of India, AIR 2015 SC 1523.

governmental guideline may be based solely on the whims and fancies of the authority.

Another anomaly in the blocking procedure is found under the 2009 Rules. Framed under Section 69A(2) of the IT Act, these rules provide the procedures and safeguards concerning blocking. According to the 2009 Rules, every request for blocking is supposed to be reviewed by the review committee before action is taken, the review committee comprises of designated officers and representatives from the Ministry of Law and Justice, Information and Broadcasting, Home Affairs, and the Indian Computer Emergency Response Team.[19] The rules also provide the stakeholders with the opportunity of hearing, and for deliberations by a reviewing committee, before any decision for blocking is made, as a safeguard against unwarranted blocking. However, under Rule 9, the competent authority can direct the intermediary to block access by the public to any information for forty-eight hours, before the notice is deliberated upon by the review committee, in 'emergency cases'. What constitutes an emergency is not defined and is left to be interpreted as per the wisdom of the relevant authorities. The rules also provide for the Department to record in writing the reasons for the issue of the direction of blocking of content, which may, as noted in the *Shreya Singhal* case, 'be assailed in a writ petition under Article 226 of the Constitution'.[20] Although this provision is supposed to be a safeguard against whimsical actions, the forty-eight hours of

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[19] Rule 7, The Information Technology (Procedure and safeguards for Blocking for access of Information by Public) Rules, 2009, PART II—Section 3—Sub-section (i), THE GAZETTE OF INDIA, GOVT. OF INDIA, available at https://www.meity.gov.in/writereaddata/files/Information%20Technology%20%28%20Procedure%20and%20safeguards%20for%20blocking%20for%20access%20of%20information%20by%20public%29%20Rules%2C%202009.pdf.

[20] *Supra* note 18.

unreviewed blocking, and the time taken to dispose of a writ petition, are enough to curb the voices of political dissenters or social movements that do not suit the government's interests. It is for these reasons that the constitutional validity of Section 69A and the action taken under the 2009 Rules, seem questionable.

This provision, and the misuse that may ensue thereof, becomes relevant in light of the Supreme Court judgment in *Indibly Creative (P) Ltd. v. the State of W.B.,*[21] wherein the Court stated that,

> The views of the writer of a play, the meter of a poet, or the sketches of a cartoonist may not be palatable to those who are criticized. Those who disagree have a simple expedient: of not watching a film, not turning the pages of the book, or not hearing what is not music to their ears. The Constitution does not permit those in authority who disagree to crush the freedom of others to believe, think and express.

At the point in time when India is not only a consumer but an active creator of original digital content released via OTT platforms, the opportunity could be used to monetize the growing OTT trend across the globe. In light of the South Korean model, where the government systematically works to realize the full potential of the *Hallyu* export market, building on USD 13.4 billion in export sales throughout the world in 2018-19, the increasing restrictions on the Indian content on these OTT platforms are not only a blow to the artistic freedom of content creators, and freedom of speech, but also a lost economic opportunity.[22]

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[21] Indibly Creative (P) Ltd. v. State of West Bengal, (2020) 12 SCC 436.

[22] *Korean Film Industry Generated USD 18.45 Billion in 2018*, MOTION PICTURE ASSOCIATION (December 12, 2019), https://www.mpa-apac.org/press/korean-film-industry-generated-usd-18-45-billion-in-2018/.

C. Constitutionality of the Rules

In addition to the above, the concern is that the rules have no legislative backing in regulating said media, this is exercising powers beyond the scope of the parent legislation. It has been held by the Supreme Court in the *State of Karnataka and Another v. Ganesh Kamath & Ors*[23] that, "It is a well-settled principle of interpretation of statutes that conferment of rulemaking power by an Act does not enable the rule making authority to make a rule which travels beyond the scope of the enabling Act or which is inconsistent therewith or repugnant thereto." A combined reading of Section 79(2) read with Section 89(2)(zg) makes it clear that the power of the Central Government is limited to prescribing guidelines related to the due diligence to be observed by the intermediaries while discharging its duties under the IT Act. However, the IT Intermediary Rules have imposed additional requirements and widened the ambit of requirements to be fulfilled by the intermediary.

Thus, the Rules extend the scope of the responsibilities of the intermediary and are ultra vires as an intermediary can act only after receiving an order from the court or a notification from the appropriate government or its agency. The intermediary is not required to exercise its discretion regarding the material which is to be removed or disabled.

Also, as per the Rules, the intermediaries are liable to follow the due diligence provisions which are similar to the provisions of due diligence attached in the 2011 Intermediary Rules. These principles under Rule 3(4) of the 2011 Intermediary Rules, were read down in *Shreya Singhal v. Union of*

[23] State of Karnataka and Another v. Ganesh Kamath & Ors., (1983 SCR (2) 665.

India,[24] to the extent that an intermediary would only be required to disable information that would be relatable to Article 19(2) of the Constitution.

Similarly, the IT Act does not provide any classification of intermediaries. Section 2(1)(w) of the Act defines an intermediary as "any person who on behalf of another person receives, stores or transmits that record or provides any service with respect to that record and includes telecom service providers, network service providers, internet service providers, web-hosting service providers, search engines, online payment sites, online-auction sites, online-market places and cyber cafes." Thus, all intermediaries are treated as a single undifferentiated entity that are subject to the same responsibilities and obligations. However, the new Rules have set up different categories of intermediaries like social media intermediaries,[25] and significant social media intermediaries.[26] This classification, in turn, subjects social media intermediaries with an extra set of obligations, and the scope of significant social media intermediaries' responsibilities also stands expanded. These new responsibilities find no basis in the parent act that does not classify intermediaries into different types.

Section 87(1) and Section 87(2)(z) and (zg), under which the Rules have been prescribed, do not give the Central Government the power to amend the definition of intermediaries as stated in the IT Act, or create any such classifications as the Rules have already done. Therefore, once again, it can be evidently seen that the Rules have gone beyond the parent legislation.

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[24] *Supra* note 18.
[25] Rule(2)(1)(w), Intermediary Guidelines and Digital Media Ethics Code 2021
[26] Rule(2)(1)(v), Intermediary Guidelines and Digital Media Ethics Code, 2021.

Secondly, Section 79 of the Act provides that subject to clauses (2) and (3) the intermediary shall not be liable to any content of the third-party hosted or published by it. Thus, providing a clear safeguard to the intermediary. Further, Section 79(2) of the Act states the grounds under which the said safeguard will be availed to the intermediary and Section 79(3) mentions the grounds when the intermediary may be held liable if the content is not taken down when they have the knowledge of its unlawfulness.

In *Shreya Singhal v. Union of India,*[27] the Supreme Court read down Section 79(3)(b) to mean that an "intermediary upon receiving actual knowledge from a court order or on being notified by the appropriate government or its agency that unlawful acts relatable to Article 19 (2) are going to be committed, fails to expeditiously remove or disable access to such material."

Thus, requiring the intermediary to apply their own mind in the regulation of data goes against the Court's interpretation in the *Shreya Singhal* judgment.

Also, as per the Rules, the responsibility of administering Part II of the Rules lies with the Ministry of Electronics and Information Technology. As per the Allocation of Business Rules, 1961, Digital Media is under the purview of the Ministry of Information and Broadcasting, while the entry 'Matters relating to Cyber Laws, administration of Information Technology Act 2000 (21 of 2000) and other IT related laws', which would include IT Act, 2000 and framing of rules under the said Act, would fall under the MeitY. While it may be argued that Digital Media, concerning the processing of content on digital

[27] *Supra* note 18.

media by publishers can be covered as an aspect of the wide scope of 'cyber crimes', digital media still falls under the ambit of Information and Broadcasting and any legislation or delegated legislation in the form of rules, under this legislation, can be enacted by the MIB. Therefore, the MeitY cannot legislate upon digital media as a delegate or otherwise, since it is the job of the MIB. Neither can the MIB, under the IT Act, act as a delegate and administer a part of it, since it is an accepted principle of law that what cannot be done directly, cannot be done indirectly. To regulate digital media, the MeitY would have to pass a law in the Parliament, under which it may require the MIB to consult the MeitY and other ministries, but the enacting body would still be the MIB. Not passing the law amounts to an abdication of the Parliament's legislative duties.

The Supreme Court, in various cases, has stated that if a rule goes beyond the rule-making powers conferred by the statute, and hence, the rule should be declared ultra vires. The basic test is to determine and consider the source of the power conferred upon the rule.[28] For a rule to have the effect of a statutory provision, two requirements should be fulfilled. Firstly, the rule must conform to the provision of the statute under which it is framed, and secondly, it must also come into the scope and purview of the rule-making power of the authority making the rule. If any one of the above two conditions is not fulfilled, the rule shall remain void.[29] The conferment of rule-making power by an Act does not enable the rule-making authority to make a rule which travels beyond the scope of the enabling Act or which is inconsistent therewith or repugnant thereto.[30] Hence, it is clear that the rules are beyond

[28] Union of India and Ors. v. S. Srinivasan, (2012) 7 SCC 683.
[29] General Officer Commanding-in-Chief v. Dr. Subhash Chandra Yadav, (1988) 2 SCC 351.
[30] State of Karnataka and Anr. v. S Ganesh Kamath and Ors., (1983) 2 SCC 402.

the scope of the purview of the IT Act and are ultra vires the parent act, therefore, are liable to be challenged in court on this ground.

IV. NON-COMPLIANCE OF THE RULES: THE OUTCOME

The tussle between Twitter India and the Indian government over the compliance of the Rules was all over the news in recent times, with speculations of Twitter facing a potential ban in the country and the platform's eventual loss of intermediary status.[31] The implication of losing the status of an intermediary can be understood by an analysis of the provisions of the IT Act, and Rule 7 of the IT Intermediary Rules.

The IT Act provides a safe harbor to the intermediaries in the form of Section 79. The section states that an intermediary shall not be made liable legally or otherwise, in the context of any third party communication, information, or data hosted on its platform, provided that the function of the intermediary is limited to providing access to a communication system over which such third party information is transmitted or temporarily stored or hosted; that the intermediary does not initiate the transmission or select the receiver or select or modify the information contained in such transmission; and that the intermediary follows due diligence in the discharge of its duties under the Act. Further, an intermediary is exempted from the protection of the safe harbour provision if it has, in any way, conspired, abetted, aided, or induced the commission of the unlawful act; or if upon the knowledge or upon

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[31] ANI, *Twitter loses intermediary status over non-compliance with new Rules: RPT,* BUSINESS STANDARD (June 16, 2021), https://www.business-standard.com/article/news-ani/twitter-loses-its-status-as-intermediary-platform-in-india-due-to-non-compliance-with-new-it-rules-121061600199_1.html.

being notified by the government that any data being hosted on the platform that the intermediary controls, is being used to perform the unlawful act, the intermediary fails to remove or block access to said material. The Act also provides that protection shall not be available to an intermediary in case it fails to observe any guidelines prescribed by the Central Government in this and 9(3), which adhere the digital news media and online publishers to adhere to a code of ethics prescribed by the Rules, being violative of Article 19(1)(a) of the Constitution. The Court noted that the Rules are 'manifestly unreasonable' and against the right to free speech of the citizens.[32]

V. INTERNET FREEDOM IN CHINA: TREADING A DANGEROUS PATH?

China, unlike democracies that try to advance the freedom and equality granted to its citizens, does not provide the same extent of freedom to its citizens. Deeply concerned with the protection of the monopoly of power, the Chinese Communist Party believes that giving the citizens as much freedom as in the democratic nations would threaten this monopoly. Specifically, over the past year, the country has been subject to a lot of criticism, both domestically and on an international level, after its endeavors to restrict the internet coverage of the coronavirus outbreak. Although these restrictions are a lot stricter and extensive in China, a comparative analysis of the recent incidents in China and India shows concerning similarities.

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[32] Sharmeen Hakeem, *IT Rules Manifestly Unreasonable; Bring Chilling Effect on Free Speech: Bombay High Court Stays Digital Media Code of Ethics Enforcement,* LIVELAW (August 14, 2021), https://www.livelaw.in/top-stories/it-rules-2021-manifestly-unreasonablebring-chilling-effect-on-free-speech-bombay-high-court-179590

For instance, in 2019, the 30th anniversary of the Tiananmen massacre, the Hong Kong protests, and an ongoing trade war with the United States of America were among the most heavily censored topics, taking information control on the internet to unprecedented levels in China. This resulted in large-scale content removal, website closures, and social media account deletions of people who spoke up on these topics online.[33] This brings to mind the withholding of around two hundred fifty Twitter accounts in India, including accounts of persons tweeting and retweeting about the ongoing farmers' protests in the country, on the request of the MeitY under Section 69A of the IT Act.

Further, it has been alleged that Chinese technology companies actively aid government surveillance over the citizens by developing mandatory and semi-mandatory propaganda and public health mobile applications that were found to be collecting user data and passing it on to the government authorities.[34] In India, during the coronavirus outbreak, the government made the installation of the *Aarogya Setu* mobile application mandatory, to trace and track the virus. However, concerns were raised over the issue of breach of users' privacy. In a review of twenty-five virus tracing apps, the Massachusetts Institute of Technology stated that the *Aarogya Setu* App "collects far more data than it needs". Although the government claims that the data collected by the application would not be viewed by anyone, other than those who are necessary, privacy preachers state that what is done with

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[33] Sarah Cook & Mai Truong, *China's Internet Freedom Hit a New Low in 2019 and The World Could Follow,* THE DIPLOMAT (November 19, 2019), https://thediplomat.com/2019/11/chinas-internet-freedom-hit-a-new-low-in-2019-and-the-world-could-follow/.

[34] China Freedom on the Net 2020, FREEDOM HOUSE, https://freedomhouse.org/country/china/freedom-net/2020, (last visited March 28, 2021).

the collected data is not known. Even the provisions of the new Rules make enough room for privacy violations and increased surveillance over the citizens. For instance, the provision for enabling the tracing of the originator of a message and the preservation of data for 180 days along with verification of user's social media accounts, under Rules 4 and 3 respectively. Along with allowing the government to peek into user communications on messaging applications, they also give the authorities access to the locations from which the messages are sent. Such rules not only pose a serious concern over the protection of the user's privacy but also enable unwarranted surveillance over them, which would be a violation of the Fundamental Rights guaranteed by the constitution.

The instances of the Chinese government shutting down internet services are not few. One of the longest such shutdowns was back in 2009, when authorities imposed a ten-month-long internet shutdown in Xinjiang, after ethnic violence in the capital Urumqi.[35] Similar instances of internet shutdown are not uncommon in India as well. For instance, the frequent internet blackouts in Jammu and Kashmir after the killing of Burhan Wani, and after the abrogation of the provisions of Article 370 of the Indian Constitution. A more recent example includes the internet shutdown in Haryana in the wake of the protest against the agriculture reforms- all this after the Supreme Court held in *Anuradha Bhasin and Ors. v. Union of India,*[36] that the freedom of speech and expression through the medium of the internet is an

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[35] Chris Hogg, *China restores Xinjiang Internet,* BBC NEWS (May 14, 2010), http://news.bbc.co.uk/2/hi/asia-pacific/8682145.stm.

[36] Anuradha Bhasin v. Union of India, (2020) 3 SCC 637.

integral part of Article 19(1)(a) and any restriction imposed thereof should be following Article 19(2) of the Constitution of India.

Chinese authorities, specifically after the Cybersecurity Law of 2017, pressure internet companies to actively censor content according to existing regulations or risk suspension, backlisting, closure, fines, or even prosecution of relevant personnel.[37] The country also made it mandatory for telecommunication companies to obtain facial scans of new internet or mobile phone users as part of the verification process a requirement that can also be found in the IT Intermediary Rules.[38]

Although the restrictions and regulations on the internet are admittedly more strict and extensive in China, the abovementioned recent incidents in India, along with the imposition of the new rules, are enough to instill a justified fear in the citizens of India, that the democracy is following up the path set by the Chinese government by increasingly curtailing freedom of speech and expression and privacy breaches through increased regulation of and interference with social media, OTT platforms, digital news media, and the internet in general.[39]

It is here that the new Rules come into the picture. The IT Intermediary Rules, under Rule 7, state that in instances where an intermediary fails to comply with the rules, the protection granted under Section 79 shall not be

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[37] Cybersecurity Law of the People's Republic of China, 2017, https://www.newamerica.org/cybersecurity-initiative/digichina/blog/translation-cybersecurity-law-peoples-republic-china/.

[38] AFP, *China Introduces Mandatory Face Scans for Phone Users*, THE HINDU (December 1, 2019), https://www.thehindu.com/news/international/china-introduces-mandatory-face-scans-for-phone-users/article30131810.ece.

[39] The Information technology Act, 2000, No. 21, Acts of Parliament, 2000 (lndia), § 79(2)(c).

applicable to them, and said intermediary would be liable under any law in force, including the IT Act and the Indian Penal Code, 1860.

Thus, the loss of intermediary status, which is resultant of non-compliance with the Rules, leads to the loss of protection granted to intermediaries under Section 79 of the Act. This leads to the intermediary being considered the publisher of all content on the platform and imposes upon it the liability for all content posted on its platform if such content is deemed unlawful.

VI. CHALLENGES TO THE RULES

Considering all the above, it is only understandable and expected that the Rules have been challenged in Courts by various platforms that it claims to cover, to settle the applicability and remove the ambiguity in them. Google, for example, appealed the Delhi High Court against an order of a single judge bench on the ground that it is classified as a social media intermediary and is required to comply with the Rules, whereas being a search engine, it considers itself not a subject to such compliances.[40]

Petitions have also been filed by the Wire,[41] the Quint,[42] etc., challenging the provisions of the Rules regulating digital news media and OTT

[40] Staff Reporter, *New IT Rules Don't Apply to Us, Google Tells Delhi High Court,* THE HINDU (July 2, 2021), https://www.thehindu.com/news/national/google-tells-hc-new-it-rules-not-applicable-to-its-search-engine/article34704908.ece.
[41] Livelaw News Network, *The Wire and Others move Delhi HC Challenging IT(Intermediary Guidelines and Digital Media Ethics Code), Rules, 2021,* LIVELAW (March 8, 2021), https://www.livelaw.in/top-stories/the-wire-moves-delhi-hc-challenging-itintermediary-guidelines-digital-media-ethics-coderules-2021-170905.
[42] Karan Tripathi, *Chilling Effect on Media': The Quint Challenges New IT Rules,* THE QUINT (March 19,2021), https://www.thequint.com/news/law/the-quint-challenges-new-it-rules-before-delhi-hc.

platforms, claiming that the rules impose upon them unreasonable restrictions that violate their freedom of speech and expression. A similar challenge has been made by the Press Trust of India as well.[43]

Even WhatsApp moved to the Delhi High Court against the traceability clause that requires it to break the end-to-end encryption that secures user communications, on the ground of it being violative of the people's right to privacy.[44]

Here, it becomes pertinent to note that the Bombay High Court, in a plea filed by AGIJ Promotion of Ninteenonea Media Pvt. Ltd., the company that runs the legal news portal the Leaflet, stayed the application of Rule 9(1) of the IT Intermediary Rules.

With the rapid pace of technological development and the internet becoming an indispensable part of the lives of people everywhere, the issue of the protection of user information and privacy, as well as the freedom of speech online has been a concern all around the world, and legislations regulating said aspects of the internet experience have been passed. Poland, for instance, proposed a law that criminalizes self-regulation by intermediaries. The country believes that the removal of content and regulation of free speech on social media platforms is not a function that the intermediaries should exercise, thus advocating for a 'free and transparent'

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[43] Sparsh Upadhyay, *Press Trust of India Moves Delhi High Court Challenging IT Rules 2021, Notice Issued,* LIVELAW (July 8, 2021), https://www.livelaw.in/news-updates/press-trust-of-india-delhi-high-court-challenging-it-rules-2021-notice-issued-177053.

[44] *Delhi Court Adjourn to August 27 WhatsApp's Plea Challenging Traceability Clause under New IT Rules as Violative of Right to Privacy*, LIVELAW (July 30, 2021), https://www.livelaw.in/news-updates/delhi-high-court-adjourns-whatsapps-plea-against-traceability-clause-under-new-it-rules-178461.

internet policy. Failure to restore deleted content and accounts could cost the intermediaries up to $13.4 million by way of fines.[45]

While India is enabling government-sanctioned privacy breaches by requiring intermediaries like WhatsApp to break their end to end encryption, the European Union's General Data Protection Regulations (**"GDPR"**) requires the Information Commissioner-an independent regulator, to make sure that the personal data of the citizens are protected and their privacy is maintained under transactions that occur between the member states, by way of granting the Information Commissioner various responsibilities[46] and powers[47] like ordering the data controller or processor to inform the data subject about personal data breach, carrying out data protection audits, warning the controller that the intended data processing is likely to breach the provisions of GDPR, etc. The same has also been reiterated in the UK Data Protection Act, 2018.[48] Further, the GDPR provides that where personal data of users is stored, it must be done so in a way that allows the identification of data subjects for a period no longer than is necessary for accomplishing the purpose for which the data was so processed.[49] The only case in which personal data can be stored for a longer period is in instances where it relates to the public interest, or scientific or historical research purposes, or statistical purposes, subject to technical and organizational measures as prescribed by national laws. The European Union Regulation also provides the data subjects

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[45] Adam Easton, *Poland proposes social media Free Speech Law*, BBC NEWS (January 15, 2021), https://www.bbc.com/news/technology-55678502.
[46] Article 57, L119, 4 May 2016, General Data Protection Regulation, 2016.
[47] Article 58, L119, 4 May 2016, General Data Protection Regulation, 2016.
[48] Article 115, UK Data Protection Act, 2018, available at https://www.legislation.gov.uk/ukpga/2018/12/contents/enacted.
[49] Article 5, L119, 4 May 2016, General Data Protection Regulation, 2016.

the right to object to the processing of personal information.[50] Processing includes collection, recording, storage, etc.[51] Under Article 21 of GDPR, the data subject can object to such processing at any stage, and the controller shall no longer proceed with the processing unless they demonstrate such 'compelling legitimate grounds' under which the processing overrides the interests, freedoms, and rights of the data subject, except when the processing is for direct marketing purposes, the controller shall, in no case, proceed with such purposes. In this light, the storage of user information for a period of one hundred and eighty days, irrespective of the purpose for which the information was collected under the IT Intermediary Rules, seems excessive. GDPR also emphasizes the lawfulness of data processing. It states that the purpose of such processing should be explicitly informed to the user, and be determined at the time of collection of the data.[52] It also categorically lays down the purposes for which processing would be considered lawful.[53] Although the Indian legislation does require the consent of the user to be taken before any processing, it does not, unlike the GDPR, define what consent means.

It must be kept in mind that while foreign legislations like GDPR state the right to protection of personal data as one of its objectives, the IT Act, and the Rules were not drafted for this purpose.[54] All this further strengthens the argument for the need for a data protection law in India.

VII. CONCLUSION

[50] Article 21, L119, 4 May 2016, General Data Protection Regulation, 2016.
[51] Article 4(2), L119, 4 May 2016, General Data Protection Regulation, 2016.
[52] Recital 39, L119, 4 May 2016, General Data Protection Regulation, 2016.
[53] Article 6, L119, 4 May 2016, General Data Protection Regulation, 2016.
[54] Article 1, L119, 4 May 2016, General Data Protection Regulation, 2016.

India is the world's largest democracy and in a time where democracies around the world are aiming to expand the scope of their citizen's freedoms and rights, the IT Intermediary Rules, are on the receiving end of large-scale outrage in the nation. It is clear from the provisions of these rules that the government has missed out on an opportunity for further betterment of the democratic rights of internet users. With the jurisprudence of rights of individuals on the internet evolving rapidly, the introduction of these intermediary rules, with their immoderate regulations and government interference, is like taking two steps back in catching up with this development.

Admittedly, the rise of internet coverage in the country has led to increased cases of illegal activities through the internet, including sexual harassment, pornography, and the spread of messages and content igniting communal violence. But in the absence of regulatory mechanisms, and due to the excessive interference on OTT platforms, we are of the view that these rules have far-reaching negative implications on the right to privacy, freedom of speech and expression, and access to information, alongside the above-mentioned constitutional irregularities.

While we agree that there is an urgent requirement for better regulation of these aspects of cyberspace, how these rules have been brought about, as well as their substance, beg urgent judicial review. What is required is the introduction of revised rules as the bill for deliberations in the Parliament and its subsequent enforcement as a law. The need for a data protection law becomes more highlighted in these circumstances. The formation of a regulatory body, to make sure that the data collected in compliance with such rules are used only for such verification purposes as mandated by the law, to

prevent an unwarranted breach of citizen's privacy is also vital. The authorities should be held accountable for the content takedowns or website blocks made at the request of the government, making the overall legislation more transparent, and ensuring that unwarranted and arbitrary actions are not taken to promote the government's propaganda and suppress any difference in opinion. Since time is of the essence in the spread of any political movement, cutting public access to any information or opinion of a political nature even for a few days could act as a tool to curb fair criticism or opposition of the government's policies. Inspiration could also be taken from international legislation like the European Union's GDPR, to ensure better protection of personal data and the fundamental right to privacy. The government could also set up a body specifically for monitoring and reporting misinformation trends and hate comments online. This would not only reduce the burden on the intermediaries but would also not require them to apply their minds in self-regulating the content posted on their platform.