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RAJIV GANDHI NATIONAL UNIVERSITY OF LAW, PUNJAB



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RAJESH BINDAL
Judge

SUPREME COURT OF INDIA
TILAK MARG
NEW DELHI - 110 001

# FOREWORD

*It gives me immense pleasure to pen the Foreword to Volume XI, Issue II of the "**RGNUL Financial and Mercantile Law Review**", a distinguished scholarly journal that has anchored itself at the confluence of intellectual rigor and practical jurisprudence. The interplay of law, policy, and academia forms the bedrock of a vibrant and progressive legal system. As the world witnesses a rapid evolution in socio-economic paradigms, the role of legal academia becomes paramount in providing the intellectual foundation for transformative jurisprudence.*

*This Issue is yet another testament to its excellence, as it delves into pertinent and complex areas of legal study with profound insights and analytical depth. I extend my earnest appreciation to Prof. (Dr.) Anand Pawar, Editor-in-Chief, and Mr. Yuvraj Mathur, Managing Editor, for their commendable leadership and vision in steering this distinguished journal toward continued success. Their efforts, along with the dedication of the editorial board, have elevated RFMLR into a platform of unparalleled repute.*

*This Volume presents an intellectually stimulating array of articles that address some of the most pressing issues in the contemporary legal landscape. The unprecedented proliferation of the fantasy sports industry in India is scrutinized through a comparative lens, offering insights drawn from jurisdictions such as the USA, UK, and Australia. Further, the integration of Artificial Intelligence into corporate governance structures is explored with commendable depth, addressing critical concerns of liability and deployment while envisioning regulatory paradigms aligned with India's socio-economic context.*

*Equally noteworthy is the examination of Standard Essential Patents, which unpacks the complexities of intellectual property and competition law, balancing the imperatives of innovation with the tenets of market fairness. The discourse on dispute resolution revisits the critical facets of arbitration jurisprudence, offering an incisive critique of its perceived cost-efficiency and analyzing the Supreme Court's rulings on default rules governing arbitration contracts. The phenomenon of "finfluencers" and their impact on financial markets is explored through the lens of regulatory accountability, drawing upon comparative analyses from global jurisdictions to recommend robust safeguards for investor protection and enhanced financial literacy.*

*Contd...2/-*

RAJESH BINDAL
Judge

SUPREME COURT OF INDIA
TILAK MARG
NEW DELHI - 110 001



*Each article reflects the authors' scholarly rigor and the editorial board's diligent curation. This volume, by dissecting the interplay of legal principles with technological and economic advancements, underscores the necessity for an adaptive and resilient legal framework in an increasingly globalized world.*

*It is heartening to note that RFMLR, through its steadfast dedication to academic excellence, continues to serve as a beacon for practitioners, academicians, and policymakers alike. I extend my congratulations to the authors for their thought-provoking contributions and to the editorial board for their unwavering commitment to uphold the journal's illustrious legacy.*

*I have no doubt that this issue will enrich its readers and inspire them to engage deeply with the multifaceted challenges of financial and mercantile law. May this volume serve as an invaluable repository of legal thought, fortifying the foundation of a progressive and dynamic legal system.*

[Justice Rajesh Bindal]

# EDITORIAL NOTE

It is with immense pride and profound gratitude that I present to you Volume XI, Issue II of the RGNUL Financial and Mercantile Law Review (RFMLR). This biannual, double-blind peer-reviewed journal has, over the years, riveted its position as an epitome of scholarly excellence, consistently ranking among the top ten law reviews in India for the past five years. Such recognition is a testament not only to the intellectual rigor and dedication of its Editorial and Peer Review Boards but also to the unwavering support of our revered Advisory Board and contributors, whose legal erudition knows no bounds.

At its core, RFMLR is a confluence of academic brilliance and an unwavering commitment to excellence. It serves as a cornerstone for pioneering legal discourse, navigating the ever-evolving landscape of financial and mercantile laws. The journal has been a beacon of intellectual integrity, offering authors the prestige of being indexed on leading platforms such as *HeinOnline, Manupatra, and SCC Online*. The highly competitive selection process ensures that only the most exceptional and innovative scholarship graces its pages, underscoring its reputation as a publication of unparalleled esteem.

Our gratitude extends to the legal luminaries who serve on the Peer Review and Advisory Boards. Their discerning perspectives, drawn from jurisdictions both domestic and international, enrich this journal considerably. Such contributions elevate RFMLR to a stature where it is not merely referenced but revered by academics, practitioners, and members of the judiciary alike. This interplay of intellectual diversity and global insights is the cornerstone of our enduring legacy.

The evolution of corporate and commercial laws mirrors the dynamic interplay of technological innovation, societal transformation, and economic growth. Recent years have witnessed a seismic shift in corporate governance, with a recalibration toward sustainability, inclusivity, and the safeguarding of public interest. Blockchain, artificial intelligence, and data privacy are no longer peripheral concerns, rather they are the fulcrum upon which modern commercial law pivots. These developments demand not only adaptation but foresight—qualities that this journal strives to encapsulate through every edition.

The articles featured in this Issue reflect the zeitgeist of contemporary legal discourse. They delve into critical themes such as the economic and procedural efficiency of arbitration, the legal intricacies of algorithmic sentience, and the increasing regulatory challenges posed by fintech innovations and the fantasy sports industry. At the heart of these explorations lies a shared pursuit: harmonizing innovation with accountability. Whether addressing the regulatory vacuum surrounding financial influencers or probing the nuanced interplay between patents and fair competition, these contributions illuminate the multifaceted challenges and opportunities shaping today's legal ecosystem.

Through these scholarly endeavors, RFMLR aspires to foster a deeper understanding of how law must evolve to accommodate the shifting contours of global commerce. The emphasis on corporate sustainability, digital competition, and the ethical implications of emerging technologies underscores the necessity for continuous legal recalibration. Each article is not merely an academic exercise but a clarion call for legal frameworks that are as dynamic and resilient as the markets they seek to regulate.

As we celebrate the publication of this issue, I extend my heartfelt thanks to our Patrons, the Advisory and Peer Review Boards, and the Editorial Board for their indefatigable efforts. It is their vision, combined with the exceptional contributions of our authors, that has made RFMLR a touchstone for scholarly excellence. To our readers, I extend an invitation to engage with these articles not merely as passive consumers but as active participants in a dialogue that shapes the future of financial and mercantile jurisprudence.

In an era where law and commerce are inextricably intertwined, RFMLR remains committed to its mission of bridging the gap between theoretical innovation and practical application. With every edition, we strive to illuminate the path forward, inspiring thought leadership and fostering a community of scholars and practitioners devoted to the pursuit of justice and progress.

With gratitude and unwavering optimism!

YUVRAJ MATHUR
Managing Editor
RGNUL Financial and Mercantile Law Review

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# I. ARBITRATION IS CHEAPER THAN LITIGATION: AN INDIAN PERSPECTIVE

1. Meenal Garg*

ABSTRACT

The recent Expert Level Committee Report on Arbitration has recommended that the Fourth Schedule should be deleted from the Arbitration and Conciliation Act, 1996. This has sparked a debate amongst scholars and jurists as to whether arbitration is a costly affair in India and if yes, whether the Fourth Schedule has been able to solve this problem or not. It is in this background, that this paper compares the arbitrator fee payable as per the Fourth Schedule vis-à-vis the court fee payable when litigating the same dispute and argues that the Fourth Schedule should be retained. The reason for the same is that the Fourth Schedule provides for a ceiling limit for payment of arbitrator fee which is absent in court fee legislations of most states across India. It further dispels the myth that arbitration is a costly affair and opines that arbitration is factually cheaper than litigation in case of high value disputes.

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## I. INTRODUCTION

High costs have remained a primary concern while opting for arbitration around the globe. India has not been a stranger to this cost problem.[1] The 2014 Report by the Law Commission of India had recognized this problem in the Indian context and had recommended the insertion of the

* The author specialises in commercial dispute resolution and arbitration and is currently a practicing advocate at Punjab & Haryana High Court. Views stated in this paper are personal.

[1] Constantine Partasides QC et al, *Redfern and Hunter on International Arbitration* (6th edn OUP Oxford 2015) 36.

Fourth Schedule[2] in the Arbitration and Conciliation Act, 1996 (hereinafter "**Act**").[3] Briefly, the said Fourth Schedule of the Act[4] prescribes an ad valorem arbitrator/arbitral tribunal fee depending on the claim amount involved with a maximum ceiling limit.

In spite of the insertion of the said Schedule, high costs continued to remain a cause of concern for the Indian arbitration landscape. Thereafter, the 2017 High Level Committee Report recommended usage of third-party funding in the Indian arbitration landscape to combat this cost problem.[5] However, recently, the 2024 Expert Committee Report has recommended the deletion of the Fourth Schedule from the Act citing that the Fourth Schedule has not solved the problem of high costs associated with arbitration.[6] Another recent development following the aforementioned report has been a recent office memorandum by the Government of India restricting arbitration to disputes with value less than Rs. 10 crores.[7]

The present paper aims to comment upon the aforementioned recommendation of deletion of the Fourth Schedule from the Act and argues that the Fourth Schedule must be retained in the Act. It is noteworthy to mention that this paper does not criticise the reasoning of the Expert Committee for the said recommendation and instead compares the cost of

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[2] Law Commission of India, "246th Report on Amendments to the Arbitration and Conciliation Act 1996" (August 2014) 10-12.
[3] Arbitration and Conciliation Act, 1996.
[4] ibid sch 4.
[5] Justice B.N. Srikrishna, "Report of the High Level Committee to Review the Institutionalisation of Arbitration Mechanism in India" (July 2017) 43-44.
[6] T.K. Viswanathan, "Report of the Expert Committee to Examine the Working of the Arbitration Law and Recommend Reforms in the Arbitration and Conciliation Act 1996 to Make it Alternative in the Letter and Spirit" (February 2024) 32.
[7] Ministry of Finance, *Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement* (3 June 2024) <https://doe.gov.in/files/circulars_document/Guidelines_for_Arbitration_and_Mediation_in_Contracts_of_Domestic_Public_Procurement.pdf> accessed 23 August 2024.

resolving a dispute through litigation and arbitration and opines that adoption of arbitration by paying the arbitrator fee as per the Fourth Schedule reduces dispute resolution costs. The aforesaid enquiry would not only be useful for the parties, in-house counsel and dispute resolution advocates (for adopting a suitable course of dispute resolution) but the same would also be relevant for the legislature and the policy maker to decide in which direction the nation's dispute resolution policy needs to be directed. The present paper would also demonstrate that restricting arbitration to low-value claims would actually be counterproductive and in complete ignorance of the cost-benefit of arbitration in case of high-value disputes.

The present paper is divided into five parts. Part I of this paper is the Introduction, which sets out the objective of the present paper and the methodology followed by the authors. Part II of this paper traces the historical background of the Fourth Schedule of the Act, its contemporary usage and the contemporary jurisprudence regarding the same. Part III of this paper lays down the jurisprudence and methodology for payment of court fees that is paid at the time of litigating a dispute in an Indian court. Part IV of this paper lays down the parameters and assumptions and in light of these assumptions compares the cost of litigation and arbitration of a dispute. Part V of the paper analyses the findings arrived in Part IV of the paper and concludes that the Fourth Schedule of the Act results in a scenario wherein in high value monetary claims, arbitration is factually cheaper than litigating the same dispute before an Indian court and hence, it would be beneficial for the Indian dispute resolution landscape that the Fourth Schedule is retained in the Act.

## II. CONTEMPORARY JURISPRUDENCE REGARDING THE FOURTH SCHEDULE

As already stated above, the Fourth Schedule came into existence on the recommendation of the Law Commission of India to address the problem of high fees charged by the arbitrators at the contemporaneous time.[8] The said Schedule was to apply to domestic arbitrations. Furthermore, the Commission at the time of recommending the insertion of the Fourth Schedule recommended that the said Schedule should be revised periodically at regular intervals of 3-4 years.[9] However, the said Schedule has not been amended till date.

It is also pertinent to mention that in cases wherein the appointment of the arbitrator was to be made by the High Court, the High Court was empowered to make appropriate rules for determination of fees of the arbitrator so appointed in accordance with the fee schedule prescribed in the Fourth Schedule of the Act.[10] Table 1 depicts the current Fourth Schedule of the Act:

**Table 1: Fourth Schedule of the Arbitration and Conciliation Act 1996**

| Sum in dispute | Model Fee |
|---|---|
| Upto Rs. 5,00,000 | Rs. 45,000 |

[8] Law Commission of India (n 2).
[9] ibid 11-12.
[10] Arbitration and Conciliation Act 1996, s 11(14).

| | |
|---|---|
| Above Rs. 5,00,000 and up to Rs. 20,00,000 | Rs. 45,000 plus 3.5 per cent of the claim amount over and above Rs. 5,00,000 |
| Above Rs. 20,00,000 and up to Rs. 1,00,00,000 | Rs. 97,500 plus 3 per cent of the claim amount over and above Rs. 20,00,000 |
| Above Rs. 1,00,00,000 and up to Rs. 10,00,00,000 | Rs. 3,37,500 plus 1 per cent of the claim amount over and above Rs. 1,00,00,000 |
| Above Rs. 10,00,00,000 and up to Rs. 20,00,00,000 | Rs. 12,37,500 plus 0.75 per cent of the claim amount over and above Rs. 10,00,00,000 |
| Above Rs. 20,00,00,000 | Rs. 19,87,500 plus 0.5 per cent of the claim amount over and above Rs. 20,00,00,000 with a ceiling limit of Rs. 30,00,000 |

As evident from the aforementioned Table 1, the arbitrator fee is an ad valorem fee based on the sum involved in a dispute. Furthermore, the note to the Fourth Schedule of the Act provides that in case of an arbitral tribunal comprising of a sole arbitrator, he/she shall be entitled to an additional amount of 25 per cent over and above the fee payable as per the Fourth Schedule of the Act.[11] Furthermore, the Supreme Court in *ONGC Ltd. v. Afcons Gunanusa JV*[12] (hereinafter "**Afcons**") has held that in case of more than one arbitrator,

[11] Arbitration and Conciliation Act 1996, sch 4.
[12] ONGC Ltd v. Afcons Gunanusa JV (2024) 4 SCC 481 (SC).

each arbitrator would be payable the fee calculated as per the Fourth Schedule of the Act.[13] In other words, in case of a multi-member arbitral tribunal, every arbitrator would be entitled to the same amount of fee as calculated in accordance with the Fourth Schedule of the Act. After the insertion of the Fourth Schedule of the Act, there are primarily three scenarios in which the said Schedule can be made applicable to a dispute referred to arbitration.

The first scenario is wherein the parties in the arbitration agreement prescribe that the fees of the arbitrator shall be paid as per the Fourth Schedule of the Act. This is in accordance with the observations of the Supreme Court in ***Afcons*** wherein it has been held that the Act upholds party autonomy and hence, the parties can prescribe any fee for the arbitrator before the existence of the dispute or after the existence of the dispute.[14]

The second scenario is that instead of the parties prescribing the fee of the arbitrator, they may appoint an arbitral institution whose rules may prescribe the fee of the arbitrator as per the Fourth Schedule of the Act. In this respect, some Indian arbitral institutions like MCIA,[15] IAMC,[16] NPAC[17] etc. prescribe their fee schedules on the basis of the Fourth Schedule of the Act with certain modifications.

The third scenario is that in a case where the appointment of the arbitrator is made by the High Court under Section 11(6) of the Act,[18] the High

[13] ibid [186].
[14] ibid [91.1].
[15] 'MCIA Schedule of Fees' (*Mumbai Centre for International Arbitration*) <https://mcia.org.in/mcia-schedule-of-fees/> accessed 23 August 2024.
[16] 'Fee Schedule' (*IAMC Hyderabad*) <https://iamch.org.in/arbitration/fees> accessed 23 August 2024.
[17] 'Rules of Arbitration for Nani Palkhivala Arbitration Centre' (*Nani Palkhivala Arbitration Centre*) <https://www.nparbitration.net/Documents/pdf/NPAC-Rules-Book.pdf> accessed 23 August 2024.
[18] Arbitration and Conciliation Act 1996, s 11(6).

Court may prescribe rules under Section 11(14) of the Act[19] for fixation of fees of the arbitrator on the basis of the Fourth Schedule of the Act. In this respect, certain High Courts, like the Bombay High Court, have framed the Bombay High Court (Fee Payable to Arbitrators) Rules, 2018 as per which the arbitrators appointed by the Bombay High Court shall be payable as per the prescribed fee as per the Schedule given in the Rules which is basically the Fourth Schedule of the Act.[20] Another important aspect with respect to the third scenario is that in the practical experience of the authors, many High Courts instead of framing specific rules, often state in the appointment order itself that the fees of the arbitrator so appointed shall be in accordance with the Fourth Schedule of the Act.

It is imperative to mention here that no empirical research has been carried till date regarding the popularity and usage of the above three scenarios of prescribing arbitrator fees as per the Fourth Schedule of the Act. However, in the personal experience of the authors, the most common application of the Fourth Schedule is through the High Court rules and orders, followed by institutional arbitration rules and the least used alternative is prescription of arbitrator fees by the parties themselves. Moreover, since ad hoc arbitration is preferred over institutional arbitration in India,[21] most of the arbitrators/arbitral tribunals are appointed by the Court and their fees is prescribed through the Fourth Schedule of the Act.

It is also pertinent to mention herein that the Act does not fix any specific time limit for the payment of arbitrator fee. Section 31(8) of the Act gives the arbitrator power to determine the costs including its own fee.[22]

[19] ibid s 11(14).
[20] Bombay High Court (Fee Payable to Arbitrators) Rules 2018, pt. 4(a).
[21] Justice B.N. Srikrishna (n 5) 3.
[22] Arbitration and Conciliation Act 1996, s 31(8).

However, as per Section 38(1) of the Act, the arbitrator has the power to call for an advance as deposit towards fees and expenses of the arbitrator.[23] Moreover, as per Section 38(2) of the Act, such deposit is to be equally shared by the parties.[24] Practically, it is seen that where the arbitral fee is to be determined as per the Fourth Schedule of the Act, the arbitral tribunal by exercising its power under Section 38 of the Act[25] call for a deposit of their fee at a preliminary stage. However, the proportion of such deposits and the manner of payment depends upon the discretion of the arbitrator.

Hence, from the aforementioned discussion, it can be seen that the Fourth Schedule of the Act forms an important part of the current Indian arbitral landscape as it is the most common way of fixing the arbitrator fee for arbitrations seated in India. With this background, it would be prudent to turn to the payment of court fee in the Indian litigation system for an effective comparison.

## III. UNDERSTANDING THE CONCEPT OF COURT FEE IN INDIA

The Court Fees Act, 1870[26] governs the basic principles of payment of court fee in India. Section 6 of the act provides that no documents that are chargeable to fee under the First and the Second Schedule of the Act shall be filed before any court of law unless the proper fee has been paid on such document.[27]

[23] ibid s 38(1).
[24] ibid s 38(2).
[25] ibid s 38.
[26] The Court Fees Act 1870.
[27] ibid s 6.

The First Schedule of the Court Fees Act, 1870 provides for an ad valorem fee whereas the Second Schedule of the Court Fees Act provides for a fixed fee. Since arbitration claims usually involve monetary claims, an ad valorem fee is payable on the same as per Article 1 of the First Schedule[28] if the same are preferred as a suit before an Indian Court.

Before discussing the First Schedule of the Court Fees Act, it is worthwhile to mention herein that the states have powers to amend the schedules of the Court Fees Act.[29] This implies that while the basic principles of the Court Fees Act remain the same across India, the quantum of the court fee payable on a sum in dispute varies from state to state. Therefore, for the purposes of the present paper, the author would be referring to the Schedules of the Rajasthan Court Fees and Suits Valuation Act, 1961 (hereinafter "**Rajasthan Court Fees Act**").[30] Table 2 states the court fee payable on a plaint[31] as per the said Rajasthan Court Fees Act.

**Table 2: Court Fee Payable as per the Rajasthan Court Fees and Suits Valuation Act, 1961**

| Sum in dispute (in INR) | Amount of Court Fee (INR) |
|---|---|
| Upto 15,000 | 2.5% of amount involved |
| Between 15,000-75,000 | 375 + 7.5% of claim over and above 15,000 |
| Between 75,000-2,50,000 | 4,875 + 7% of claim over and above 75,000 |

[28] ibid art 1 sch 1.
[29] Law Commission of India, "189th Report on Revision of Court Fees Structure" (February 2004) 60.
[30] The Rajasthan Court Fees and Suits Valuation Act 1961.
[31] Code of Civil Procedure 1908, s 26(1).

| | |
|---|---|
| Between 2,50,000-5,00,000 | 17,125+6.5% of claim over and above 2,50,000 |
| Between 5,00,000-7,50,000 | 33,375+6% of claim over and above 5,00,000 |
| Between 7,50,000-10,00,000 | 48,375+5.5% of claim over and above 7,50,000 |
| Between 10,00,000-15,00,000 | 62,125 + 5% of claim over and above 10,00,000 |
| Between 15,00,000-20,00,000 | 87,125 + 4.5% of claim over and above 15,00,000 |
| Between 20,00,000-25,00,000 | 1,09,625 + 4% of claim over and above 20,00,000 |
| Between 25,00,000-30,00,000 | 1,29,625+ 3.5% of claim over and above 30,00,000 |
| Between 30,00,000-40,00,000 | 1,47,125+3% of claim over and above 30,00,000 |
| Between 40,00,000-1,00,00,000 | 1,77,125+ 2.5% of claim over and above 40,00,000 |
| Between 1,00,00,000-1,50,00,000 | 3,27,125+ 2% of claim over and above 1,00,00,000 |
| Between 1,50,00,000-2,00,00,000 | 4,27,125+ 1.5% of claim over and above 1,50,00,000 |

| | |
|---|---|
| Between 2,00,00,000-3,00,00,000 | 5,02,125+ 1% of claim over and above 2,00,00,000 |
| Above 3,00,00,000 | 6,02,125+0.5% of claim over and above 3,00,00,000 |

The Law Commission of India in its 128th Report observed that the rationale for levy of court fee is that a civil litigant must bear the cost of administration.[32] In other words, while litigating a dispute, the litigant pays the cost that the state bears for creation of a justice administration infrastructure, appointment of judges, support staff etc.

It is also pertinent to mention herein that where there is a deficiency of court fee at the time of presentment of plaint, the Court has the power to reject the plaint,[33] however before rejecting such plaint, the Court usually gives an opportunity to the litigant to pay the deficient court fee before proceeding with the case.[34]

The aforesaid implies that although at the initial stage the plaint may be presented with a deficit court fee, the same has to be eventually rectified and the same is a necessary pre-condition for the adjudication of the dispute raised in such a plaint. As already stated above, non-payment of the requisite court fee would lead to summary rejection of the plaint as it is assumed that the litigant is not bearing the costs of administration and hence, it is not worth the time and efforts of the state dispute resolution machinery (i.e. courts) to adjudicate on such a plaint.

[32] Law Commission of India, "128th Report on Cost of Litigation" (1988) 47-48.
[33] Code of Civil Procedure 1908, order VII rule 11(c).
[34] ibid s 149.

With the aforementioned backdrop of the arbitrator fee and court fee legal landscape in India, the stage is now set to compare the costs that a party may incur while arbitrating a dispute vis-à-vis litigating the same dispute.

## IV. COMPARISON OF COSTS PAYABLE IN ARBITRATION VIS-À-VIS LITIGATION

### A. Comparing Costs

Before proceeding with the analysis, it would be prudent to lay down the assumptions and parameters for the present analysis. Firstly, the present analysis proceeds on the assumption that the costs of administration of justice i.e. the arbitrator fee (in case of arbitration) and court fee (in case of litigation) are the most significant components of costs of litigation and hence, the same are the subject matter of the present paper. Secondly, it is presumed that the difference in other components of cost of litigation in arbitrating a dispute vis-à-vis litigating the same dispute is negligible. In this, respect, the Law Commission of India had identified various heads of costs of litigation such as travelling expenses, advocate fees etc.[35] By assuming these costs as virtually the same across litigation and arbitration implies that the decision of litigating or arbitrating a dispute would be dependent upon the court fee/arbitrator fee payable on the same. Thirdly, it is assumed that the arbitrator fee is payable as per the Fourth Schedule of the Act since it is the most common way of determining the arbitrator fee in India. Fourthly, it is assumed that the entire arbitrator fee is called at a preliminary stage by the arbitrator under Section 38 of the Act and such deposit is duly paid by both the parties in equal share. Fifthly, only monetary claims are considered in the present paper and non-monetary claims such as injunctions, specific performance etc.

[35] Law Commission of India (n 32) 11.

have not been considered for calculation purposes. Sixthly, it is presumed that there are no set-offs or counterclaims by the counter party for ease of calculation purposes.

To start with the analysis, it is assumed that there is a dispute between A and B arising out of a breach of contract by B. It is further assumed that A has both the options i.e. either refer the dispute to arbitration or litigate the same before the competent court in India. It may further be assumed that the claims of A are genuine and hence, it would be entitled to refund of costs after the adjudication of the claims. Now, the arbitrator fee (in case of sole arbitrator) and the court fee (in case of litigation) would increase with the increase in claim. Therefore, Table 3 shows the comparison of arbitrator fee payable in case of a sole arbitrator vis-à-vis the court fee payable in case of litigation qua an increase in the claims of A against B:

**Table 3: Arbitration fee payable in case of a sole arbitrator vis-à-vis court fee payable**

| **Amount of Claim (in INR)**<br><br>**(1)** | **Arbitrator fee payable as per the Fourth Schedule**[36]<br><br>**(2)** | **A's share of arbitrator fee**<br><br>**(3)** | **Court fee payable as per the Rajasthan Court Fees and Suits Valuation Act, 1961**<br><br>**(4)** |
|---|---|---|---|
| 5,00,000 | 56,250 | 28,125 | 33,375 |
| 20,00,000 | 1,21,875 | 60,938 | 1,09,625 |

[36] Arbitration and Conciliation Act 1996, 4th Schd.

| | | | |
|---|---|---|---|
| 1,00,00,000 | 4,21,875 | 2,10,938 | 3,27,125 |
| 10,00,00,000 | 15,46,875 | 7,73,438 | 9,52,125 |
| 20,00,00,000 | 24,84,375 | 12,42,188 | 14,52,125 |
| 30,00,00,000 | 31,09,375 | 15,54,688 | 19,52,125 |
| 40,00,00,000 | 37,34,375 | 18,67,188 | 24,52,125 |
| 50,00,00,000 | 37,50,000 | 18,75,000 | 29,52,125 |
| 75,00,00,000 | 37,50,000 | 18,75,000 | 42,02,125 |
| 100,00,00,000 | 37,50,000 | 18,75,000 | 54,52,125 |
| 150,00,00,000 | 37,50,000 | 18,75,000 | 79,52,125 |
| 200,00,00,000 | 37,50,000 | 18,75,000 | 1,04,52,125 |
| 250,00,00,000 | 37,50,000 | 18,75,000 | 1,29,52,125 |

A comparison of column (3) and column (4) of the Table 3 above, shows that irrespective of the amount of claim involved, arbitration is always cheaper than litigation provided that B pays its share of fee. Furthermore, a comparison of column (2) and column (4) of Table 3 shows that even if B does not pay its share of arbitrator fee and the entire burden for payment of arbitrator fee falls on A, arbitration would still be the cheaper option for claims exceeding Rs. 75,00,000 (seventy-five crores rupees). The reason for the same is that after a certain threshold the ceiling limit under the Fourth Schedule of the Act gets triggered freezing the arbitrator fee to Rs. 37,50,000 (thirty-seven lacs fifty thousand rupees) irrespective of the value of claim. However, there is no such ceiling limit under the Rajasthan Court Fees Act making arbitration a cheaper option for high value claims.

Carrying forward with the above simulation, it would also be useful to compare the arbitrator fee vis-à-vis court fee payable in case the arbitral tribunal comprises of three arbitrators instead of a sole arbitrator. Therefore, keeping in mind the same assumptions as had been set out in case of a sole arbitrator, the following Table depicts the comparison of arbitrator fee payable in case of three-member arbitral tribunal vis-à-vis court fee payable on the same dispute:

**Table 4: Arbitration fee payable in case of a three-member arbitral tribunal vis-à-vis court fee payable**

| **Amount of Claim (in INR)** **(1)** | **Arbitrator fee payable as per the Fourth Schedule[37]** **(2)** | **A's share of arbitrator fee** **(3)** | **Court fee payable as per the Rajasthan Court Fees and Suits Valuation Act, 1961** **(4)** |
|---|---|---|---|
| 5,00,000 | 1,35,000 | 67,500 | 33,375 |
| 20,00,000 | 2,92,500 | 1,46,250 | 1,09,625 |
| 1,00,00,000 | 10,12,500 | 5,06,250 | 3,27,125 |
| 10,00,00,000 | 37,12,500 | 18,56,250 | 9,52,125 |
| 20,00,00,000 | 59,62,500 | 29,81,250 | 14,52,125 |

[37] The arbitrator fee has been calculated on the basis of the Fourth Schedule of the Arbitration and Conciliation Act, 1996 and the same has been multiplied by a factor of 3 (three) since the arbitral tribunal consists of three arbitrators.

| | | | |
|---|---|---|---|
| 30,00,00,000 | 74,62,500 | 37,31,250 | 19,52,125 |
| 40,00,00,000 | 89,62,500 | 44,81,250 | 24,52,125 |
| 50,00,00,000 | 90,00,000 | 45,00,000 | 29,52,125 |
| 75,00,00,000 | 90,00,000 | 45,00,000 | 42,02,125 |
| 100,00,00,000 | 90,00,000 | 45,00,000 | 54,52,125 |
| 150,00,00,000 | 90,00,000 | 45,00,000 | 79,52,125 |
| 200,00,00,000 | 90,00,000 | 45,00,000 | 1,04,52,125 |
| 250,00,00,000 | 90,00,000 | 45,00,000 | 1,29,52,125 |

A comparison of column (3) and (4) of Table 4 above shows that adjudication by a three-member arbitral tribunal is certainly more expensive than litigating the same dispute because the arbitrator fee as per the Fourth Schedule of the Act increases three fold. Therefore, arbitration by a three-member arbitral tribunal is not recommended for small and medium value disputes. Furthermore, it is seen that once the value of claim reaches reach Rs. 100,00,00,000 (one hundred crores rupees), arbitration by a three-member arbitral tribunal becomes cheaper than litigation provided that B also pays its share of arbitrator fee. A comparison of column (2) and column (4) of Table 4 above shows that even if B does not pay its share of arbitrator fee and the entire burden of arbitrator fee falls upon A, then arbitration becomes cheaper for claims upwards of Rs. 200,00,00,000 (two hundred crores rupees). It is evident that the reason for arbitration being cheaper than litigation again seems to be the ceiling limit under the Fourth Schedule of the Act which is absent under the Rajasthan Court Fees Act.

Another aspect that needs to be noted here is that while in litigation the entire burden of payment of court fee is to be discharged at the time of presentment of plaint, it is practically seen that some arbitrators also allow for payment of arbitrator fee in instalments which saves the litigant from bearing the entire cost burden at the very inception of the arbitration proceedings. This implies that non-payment of the requisite court fee would effectively stall the litigation until the deficiency is not made good whereas by paying the arbitrator fee in instalments, the arbitration proceedings can continue without any interruptions. Thus, the flexibility in payment of arbitrator fee vis-à-vis payment of court fee at the inception of legal proceedings also makes arbitration a more viable alternative than litigation.

Thus, the above analysis has shown that in case of a sole arbitrator, arbitration will always be cheaper than litigation provided that the costs of arbitration are equally shared by both the parties. It can be further seen that even if the entire burden of cost is borne by the claimant, even then arbitration would be cheaper than litigation for high value claims. Furthermore, the primary reason for arbitration being cheaper than litigation seems to be the presence of a ceiling limit while calculating arbitrator fee which is absent in case of court fee.

B. Addressing Potential Criticisms and Limitations

While the aforementioned analysis gives a general idea as to how and when arbitration is cheaper than litigation, the same is not free from limitations and criticism. The present part of the paper will attempt to address the potential criticisms and identify limitations of the present analysis.

The first criticism could be against the choice of Rajasthan Court Fees and Suits Valuation Act, 1961 as the basis for comparing court fee and

arbitrator fee. In this respect, it is stated that most of the states such as Andhra Pradesh,[38] Delhi,[39] Himachal Pradesh,[40] Tamil Nadu[41] etc. have an ad valorem court fee schedule that do not have a ceiling limit for payment of court fee. This implies that the findings arrived in this paper that arbitration is cheaper than litigation for high value claims equally applies to the aforementioned states though the value of claim when arbitration becomes cheaper than litigation may differ depending upon the court fee schedule of the state concerned. It is also worthwhile to mention herein that during research it was found that court fee schedules of states like Gujarat,[42] West Bengal,[43] Maharashtra[44] etc. provide for an upper ceiling limit while calculating court fee. Thus, the findings of this paper will not apply to such states.

The next criticism that may be made against the present paper is that the arbitrator fee is not always decided as per the Fourth Schedule of the Act. As already discussed in Part II of the present paper, parties by agreement can also prescribe the arbitrator fee of the arbitrator. Thus, theoretically, the parties can agree on any amount or methodology for calculation of the arbitrator fee that may or may not be in consonance with the Fourth Schedule of the Act. In this respect, it is stated that the purpose of taking Fourth Schedule of the Act as the basis of comparison was that both the Fourth Schedule of the Act and the court fees are fixed by the states and hence, a comparison of the same provides an insight into the dispute resolution policy of the state. With that

[38] The Andhra Pradesh Court-Fees and Suits Valuation Act 1956, art 1 sch 1.
[39] The Court Fees Act 1870, art 1 sch 1.
[40] The Himachal Pradesh Court Fees Act 1968, art 1 sch 1.
[41] The Tamil Nadu Court-Fees and Suits Valuation Act 1955, art 1 sch 1.
[42] The Gujarat Court-Fees Act 2004, 1 sch 1.
[43] The West Bengal Court-Fees Act 1970, art 1 sch 1.
[44] The Maharashtra Court-Fees Act 1959, art 1 sch 1.

being said, it is undeniable that the parties do have the right to fix arbitrator fee by agreement.[45]

However, that does not necessarily mean that arbitration would be more expensive than litigation. In fact, logic would dictate that rational parties would always agree for an arbitrator fee which is lower than the court fee payable in order to save costs. In other words, assuming that the parties fix the arbitrator fee by agreement and not by the Fourth Schedule of the Act, still the parties would always agree to a fee which is lower than the court fee otherwise the parties would have preferred to litigate their dispute instead of opting for arbitration.

The next criticism could be that the present analysis does not consider the counterclaims of the opposite party. In this respect, as per ***Afcons*** a counter claim is considered as a separate proceeding for payment of arbitrator fee.[46] Similarly, as per Indian law, court fee is separately payable on counter claim.[47] Therefore, the aforementioned analysis is equally applicable to a counter claim wherein depending upon the value of counter-claim; arbitration would become cheaper than litigation in case of high value counter-claims.

The next criticism can be that the aforementioned analysis assumes that the claims of the claimant are genuine and that it would be entitled to refund of all costs after the adjudication of its claims, which is not always the case. In this respect, it is stated that a prudent litigant would always do a proper analysis of its claims and it is only after doing a cost-benefit analysis would institute arbitration/litigation against another party.

[45] ONGC Ltd v. Afcons Gunanusa JV (2024) 4 SCC 481, [91.1].
[46] ibid (162-67).
[47] The Court Fees Act 1870, art 1 sch 1.

In light of the aforementioned discussion, it is evident that in states where there is no ceiling limit on court fee; parties should ideally opt for arbitration for high value disputes. Moreover, in an ideal scenario, parties should agree for appointment of sole arbitrator and it is only in extremely high stake and complex disputes should the parties prefer a three-member arbitral tribunal. Moreover, the parties should make use of the flexibility of the Act to persuade the arbitrators or agree amongst themselves that the entire arbitral fee shall not be payable at the very inception of the proceedings and arbitrator fee may be payable in instalments. Such a flexibility also promotes the economic viability of arbitration as a mode of dispute resolution vis-à-vis litigation.

## V. CONCLUSION

The above discuss has shown that arbitration being an expensive mode of dispute resolution is a myth and is in fact a cheaper mode of dispute resolution as compared to litigation in India. This finding is in light of the fact that there is a ceiling limit for payment of arbitrator fee which is usually absent in case of court fee payable in various states across India.

It is recognised that the Fourth Schedule of the Act was enacted to standardize payment of arbitrator fee across India and also to address the cost problem associated with arbitrating a dispute in India. It is acknowledged that the Fourth Schedule of the Act seems to be the most common manner of fixing/determining the fee of arbitrator or the arbitral tribunal, as the case may be.

With respect to court fee which is payable at the time of instituting a suit, it was seen that every state has power to determine the court fee payable in that state. It was further seen that the general principle across India is

payment of ad valorem court fee depending upon the value of claim involved in a dispute. Furthermore, it was observed that generally, there seems to be no upper ceiling limit for payment of court fee thereby implying that for high stake disputes, excessive court fee may be payable under the Indian law.

Next, a comparison of arbitrator fee and court fee qua the same dispute revealed that generally, arbitration by a sole arbitrator would be a cheaper option for litigating a dispute provided that both the parties bear the arbitrator fee equally. Even otherwise, it was seen that even if the burden of the entire arbitrator fee falls on the claimant, arbitration would still be the cheaper option for high value disputes because of the ceiling limit provided in the Fourth Schedule of the Act.

It is undeniable that some states do have a ceiling on court fee as well, however, unlike arbitration, the said position is not uniform across India. It is pertinent to mention that the present paper has not advocated for any policy changes or amendments in existing laws. The present paper should be viewed as an eye-opener for litigants to choose the proper forum for dispute resolution while saving costs. The present paper is also an eye-opener for the legislature to take appropriate steps for steering its dispute resolution policy.

At the first instance, this paper has impliedly shown that the Government of India's decision to restrict arbitration to low value disputes (and thereby litigating high value disputes)[48] would actually result in higher costs to the parties rather than cost-saving. In other words, by choosing to arbitrate low value disputes while litigating high value disputes would effectively deny it the cost savings of arbitration.

[48] Office Memorandum (n 7).

Moreover, this paper has sufficiently demonstrated that as the laws stand currently, Fourth Schedule should be retained in the Act and the contrary might be counter-productive for the Indian arbitration landscape. After all, this paper has (to some extent) dispelled the popular myth that arbitration is expensive and has shown that arbitration is indeed cheaper than litigation.

# II. RP GARG V. THE CHIEF MANAGER, TELECOM DEPARTMENT, 2024 INSC 743: IS S. 31(7)(B) ARBITRATION ACT A DEFAULT RULE?

- Badrinath Srinivasan*

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## I. INTRODUCTION

This case comment evaluates the recent decision of the Supreme Court of India *RP Garg v. The Chief Manager, Telecom Department*.[1] The decision addresses a nuanced aspect of the law regarding interest in arbitrations and provides an opportunity to discuss about the nature of rules of contract law in the context of Section 31(7) of the Arbitration and Conciliation Act, 1996.

Section 31(7) has been amended since its enactment. The provision as it stands today contains two clauses. Section 31(7)(a) deals with pre-award interest and Section 31(7)(b) concerns post-award interest. Insofar as party autonomy is concerned, there is a difference between both these provisions, which has been brought out in the judgment of the Supreme Court in *RP Garg*.

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## II. FACTS AND PROCEDURAL HISTORY

An agreement was executed on 17 October 1997 between the appellant, a contractor, and the Haryana Telecom Department ("Telecom Department") for trenching and laying underground cables. Clause 1(iv) of the agreement between the Telecom Department and the appellant provided:

"*No interest will be payable on the earnest money or security deposit amount or any amount payable to the contractor under the contract.*"

Disputes arose between the parties, and the arbitrator passed the arbitral award on 08.03.2001. The arbitrator allowed the appellant's claim but disallowed the appellant's claim for interest by relying on the aforesaid clause barring interest.

While pursuing the execution of the arbitral award, the appellant claimed post-award interest on the amount awarded. The court executing the award rejected the same. On appeal, the District Court allowed the appeal and directed payment of post-award interest at 18% per annum. The Telecom Department filed a revision petition before the High Court, which was allowed. The award holder filed a petition for special leave before the Supreme Court.

## III. DECISION OF THE COURT

The Supreme Court held that the statutory scheme of Section 31(7) created a distinction between pre-award and post-award interest: a grant of pre-award interest under Section 31(7)(a) of the Arbitration Act by the arbitral tribunal is subject to an agreement between the parties. On the other hand, the

grant of post-award interest to the award holder is not subject to any agreement between the parties.[2]

The court stressed on the use of the expression "unless otherwise agreed by the parties" in Section 31(7)(a) and its absence in Section 31(7)(b) thereby signifying the absence of party autonomy as it relates to post-award interest.[3] Accordingly, the court held that in the absence of a determination by the arbitral tribunal, the interest rate as specified in the Arbitration Act, that is, 18% per annum, prevailed.

The court relied on the decision of the Supreme Court *in Morgan Securities & Credits (P) Ltd. v. Videocon Industries Ltd*[4] and distinguished *Jaiprakash Associates Ltd. v. Tehri Hydro Development Corporation (India) Ltd*.[5] a decision of a three-judge Bench of the Supreme Court, on the ground that *Jaiprakash Associates* dealt with pre-award and not post-award interest.[6]

## IV. COMMENT

This comment addresses two aspects: first, unlike how the Supreme Court held in *Morgan Securities*, the court was correct in *RP Garg* in holding that while Section 31(7)(a) reflected party autonomy in having an agreement contrary to the provision, Section 31(7)(b) did not admit such power of the parties. Second, Section 31(7)(b) should not always be construed as a mandatory rule but as a sticky default rule.

In *RP Garg*, the Supreme Court quoted extensively the judgment of the Supreme Court in *Morgan Securities*, where the court distinguished

[2] R.P. Garg v. Telecom Department [2024] SCC OnLine SC 2928 [9].
[3] ibid.
[4] Morgan Securities & Credits (P) Ltd. v. Videocon Industries Ltd. (2023) 1 SCC 602.
[5] Jaiprakash Associates Ltd. v. Tehri Hydro Development Corpn. (India) Ltd (2019) 17 SCC 786 (SC).
[6] R.P. Garg v. Telecom Department [2024] SCC OnLine SC 2928 [13] 2.

between Section 31(7)(a) and 31(7)(b), in terms of "discretion" to an arbitral tribunal. According to the court, while Section 31(7)(a) granted considerable discretion to grant pre-award interest, it was "against the grain of statutory interpretation"[7] to construe Section 31(7)(b) as having reduced that discretion when it came to post-award interest.

Rather than couching the rationale in terms of discretion, it would have been appropriate for the court to have construed the sub-clauses from the point of view of default rules and party autonomy.

A default rule is a rule which could be contracted around by parties to an agreement. Such a provision typically contains language that allows parties to contract around the rule, such as "unless otherwise agreed between the parties", which expression is found in Section 31(7)(a). Thus, there is an explicit marker that this provision is a default rule. These types of rules of contract law containing the explicit marker are known as explicit default rules. Implicit default rules, on the other hand, are default rules that do not contain the explicit marker. Examples of such rules include sections 33, 134, 135, 13,9, and 141 of the Indian Contract Act, 1872.[8]

So, when Section 31(7)(a) provides that an arbitral tribunal may include pre-award interest on the sum for which award is made, except where parties have otherwise agreed. If a clause in the agreement, such as the one in the agreement in the case, bars payment of interest, such bar would operate to contract around the default rule contained in terms of Section 31(7)(a). This position has been upheld in multiple judgments of the Supreme Court

[7] [2023] 1 SCC 601 (SC) [25].
[8] Corporation Bank v. Mohandas Baliga [1992] SCC OnLine Kar 314 (KHC).

including that of a three judge Bench in *Union of India v. Bright Power Projects (India) Pvt. Ltd.*[9]

On the other hand, Section 31(7)(b) does not contain a marker such as "unless otherwise agreed by the parties". Therefore, literally, Section 31(7)(b) could be considered as a provision barring contracting around or contracting out of post-award interest.

This difference has been brought out by the Supreme Court in *RP Garg*, where the court held: "*In other words, clause (b) does not give the parties the right to "contract out" interest for the post-award period.*"[10] Hence, Section 31(7)(a) is a default rule, while Section 31(7)(b) is not.

There is reason for this treatment in the statute, although not borne explicitly in these judgments. When a judgment or an award holds certain amount as due in relation to a contract, the amounts due under the contract merges with the judgment/ award and ceases to be mere contractual dues: such amounts become due under the judgment/ award.[11] Therefore, the interest rate to be paid under the judgment could not have been the contractual interest rate.

Such is the position not only under the 1996 Act but also in its earlier avatar, the Arbitration Act, 1940. Section 29 thereof read: "*Where and in so far is an award is for the payment of money the Court may in the decree order interest, from the date of the decree at such rate as the Court deems*

[9] Union of India v. Bright Power Projects (India) (P) Ltd (2015) 9 SCC 695 (SC). *See also*, Pam Developments Private Limited v. The State of West Bengal, MANU/SC/0933/2024; Oriental Structural Engineers Private Limited v. State of Kerala, 2021:INSC:269; Union of India v. Ambica Construction, MANU/SC/0309/2016.

[10] R.P. Garg v. Telecom Department [2024] SCC OnLine SC 2928 [11].

[11] In re Sneyd; Ex p Fewings (1883) 25 Ch D 338, reiterated in Economic Life Assurance Society v. Usborne [1902] AC 147; First National Bank v. D-G of Fair Trading [2002] 1 AC 481; Standard Chartered Bank v. Ceylon Petroleum Corporation [2011] EWHC 2094 (Comm).

*reasonable, to be paid on the principal sum as adjudged by the award and confirmed by the decree*."

Post-award interest is a matter of discretion of the court/ arbitral tribunal. Therefore, the contractual interest rate may not bind the tribunal. If the post-award interest provided under the statute[12] is lower than the contractual rate, the statutory rate would prevail and if the statutory rate is more, such rate will prevail over the contractual rate.[13]

The second point this case comment addresses is whether Section 31(7)(b) should always be construed as a mandatory rule. There could be situations where holding that Section 31(7)(b) absolutely restricts contracting around would do a serious injustice to party autonomy.

For instance, take a situation where two sophisticated commercial parties enter into a standstill agreement after an arbitral award has been rendered. A standstill agreement is an agreement to stop the limitation period from running or in some cases, extend the limitation period for the purposes of preserving or freezing the rights of the parties and their enforceability for a limited time in order to enable them to solve the dispute amicably either by themselves or through settlement mechanisms such as conciliation, mediation, etc. Imagine that in such a standstill agreement, they agree that parties will attempt to resolve their dispute through conciliation/ mediation for six months.

[12] Section 31(7)(b) pegs the post-award "interest at the rate of two per cent. higher than the current rate of interest prevalent on the date of award" and the explanation therein defines "current rate of interest" "as assigned to it under clause (b) of section 2 of the Interest Act, 1978". Section 2(b) of the Interest Act, 1978 defines the expression as "the highest of the maximum rates at which interest may be aid on different classes of deposits (other than those maintained in savings account or those maintained by charitable or religious institutions) by different classes of scheduled banks in accordance with the directions given or issued to banking companies generally by the Reserve Bank of India under the Banking Regulation Act, 1949 (10 of 1949)."

[13] Standard Chartered Bank v. Ceylon Petroleum Corporation [2011] EWHC 2094.

They also agree that for the period of three months or pendency of mediation/ conciliation, whichever is later, no interest on the arbitral award would be claimed.

Now, assume that having attempted to resolve the dispute through, say, conciliation, but have failed in doing so within the three-month period. Both parties challenge the award, which fails. One of the parties files a petition for the execution of the award while claiming post-award interest, including for the three-month period they agreed not to claim interest. Is it right on the part of the execution petitioner to claim interest for that three-month period after having committed through an agreement not to charge such interest? Hence, it would not be correct to construe Section 31(7)(b) as a mandatory rule in all circumstances, especially when the provision does not seek to protect against any internality[14] or externality.[15]

Generally, party sophistication may have a role to play in the context of construing a legal provision as a default or a mandatory rule. Absent statutory objective of guarding against an internality or an externality, in appropriate circumstances, courts should not resist from holding provisions like Section 31(7)(b) as default rules. However, such contracting around should not be easily read in, unless specifically made by the parties. Sticky default rules are default rules which make it difficult for parties to contract around.[16]

[14] Zamir and Ian Ayres, 'A Theory of Mandatory Rules: Typology, Policy and Design' (2020) 99(283) TLR 287.
[15] Eyal Zamir and Ian Ayres, 'A Theory of Mandatory Rules: Typology, Policy and Design' (2020) 99(283) TLR 287.
[16] Eyal Zamir, 'Default Rules: Theoretical Foundations'in Chen-Wishart, Mindy and Saprai, Prince (eds), *Research Handbook on the Philosophy of Contract Law*, (Edward Elgar Publishing 2022).

Provisions like Section 31(7)(b) should, in apt situations, be construed as sticky default rules so that the intent to contract around is explicit. Clearly, whether parties can agree on applicable interest post-judgment or post-award should be a matter of comprehensive study.

## V. CONCLUSION

As per the statute, the jurisdiction of the arbitral tribunal regarding post-award interest cannot be circumscribed by an agreement between the parties. But arbitration is a dispute resolution process built on party consensus. In appropriate situations, parties should have the right to determine even the post-award interest. However, such a right to agree on an interest rate (post-award) different from the statutory rate should not be easily presumed. There should be an explicit agreement marking such departure, and such an agreement should not be unreasonable.

# III. THE RISE OF FINFLUENCERS: REGULATORY STRATEGIES BY SEBI AND INTERNATIONAL PERSPECTIVES

- Sakshi Gupta and Soumil Sharma*

ABSTRACT

This paper discusses the rise of and regulation of Indian financial influencers, or "finfluencers," and sheds light on their influence on retail investors, through interaction with the social media platforms like Instagram and YouTube. The paper starts with the rise of finfluencers in India, the impact of COVID-19 on the same, and highlights their role in increasing awareness about financial knowledge in India. The paper then highlights the risks and concerns posed by the rise of finfluencers, by discussing how they mislead and manipulate their views resulting in financial and well as non-financial harms. The author then put forth their revenue generation models, by dividing them into four categories. The author tries to dissect all the current Indian laws and addresses the challenges by comparing them to international best practices of the U.S.A., U.K., E.U., and Australia. The authors propose that clarity of definitions, a structured registration process, transparency mandating, and best international practices be adopted to enhance SEBI's regulatory framework. In particular, the recommendations for balancing investor protection with financial education, making technological enforcement, introducing accountability mechanisms, and getting a better regulatory landscape that safeguards retail investors but also gives room to responsible financial education in India, are the need of the hour. The authors have also proposed a draft regulatory framework for governing the landscape concerning finfluencers.

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## I. INTRODUCTION

The inadvertent rise of the finfluencers, or financial influencers, has completely overhauled the engagement of retail investors with that of the financial markets. These financial gurus engage with their audiences through Instagram, YouTube, Telegram, and X (formerly Twitter) to impart investment education, stock or mutual fund recommendations, and financial knowledge with the help of content like reels, YouTube videos, posts, etc.[1] They democratise access to financial knowledge by educating their viewers about complex financial products, thereby bridging the gap between these heavy concepts and the average investors. As there are no mechanisms to check the authenticity of their knowledge and the quality of their advice, this raises genuine concerns about misinformation and market manipulation. Some of them act as financial educators while others engage in promoting financial products for undisclosed commissions, some of them also provide investment advice in the garb of investment education for undisclosed commissions. This blurs the line between independent advice and paid promotions.

The retail investor participation in India is the highest globally. As per the economic survey 2023-24, the registered investor base at the National Stock Exchange ("**NSE**") has tripled from March 2020 to March 2024 to 9.2 crore, potentially translating into 20% of Indian households are now channeling their household savings into financial markets.[2] This raise also led to the risk of unregulated financial advice resulting in misinformation and conflict of interest. As per the Advertising Standards Council of India

[1] Tamra Manfredo, 'How to Make $1 Million in Thirty Seconds or Less: The Need for Regulations on Finfluencers' (*Social Science Research Network* 15 December 2022) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4398463> accessed 29 September 2024.

[2] *Economic Survey 2023-24,* (Government of India, Ministry of Finance 2024) 67, para 2.78.

("**ASCI**"), many retail investors face difficulty in understanding the difference between promotional and unbiased content, making them vulnerable to misleading financial advice.[3] All these factors underscore the regulatory intervention by the Securities and Exchange Board of India ("**SEBI**") to protect its aim of safeguarding investors and market integrity.

COVID-19 gave momentum to these finfluencers. During the pandemic, retail investors rely majorly on these finfluencers to gain prompt financial knowledge. Since then, the regulators have realised that unqualified finfluencers can harm the interests of these investors through their advice. Finfluencers have remained unregulated in India as of today. Except for ASCI, which issued updated guidelines for influencer advertising in 2023.[4] After the publication of the Report on Retail Distribution and Digitalization[5] by the International Organisation of Securities Commission. The report recommends the adoption of regulatory measures by the members to counter the risks and challenges due to the digitalization of retail marketing and distribution. Taking note of this, SEBI released a consultation paper, open for public comments.[6] Soon after this, in June 2024, the SEBI approved norms to regulate finfluencers.

The approach of the SEBI resembles those adopted by other international regulators such as the United States Stock Exchange

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[3] ASCI, *Guidelines for Influencer Advertising in Digital Media* (2021) <https://www.ascionline.in> accessed 29 September 2024.

[4] ibid.

[5] International Organization of Securities Commission, *Report on Retail Distribution and Digitalisation* (Oct. 2022) <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD715.pdf> accessed 29 September 2024.

[6] SEBI, *Consultation paper on Association of SEBI Registered Intermediaries/Regulated Entities with unregistered Entities* (25 Aug. 2023) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-association-of-sebi-registered-intermediaries-regulated-entities-with-unregistered-entities-including-finfluencers-_75932.html> accessed 29 September 2024.

Commission ("**SEC**") and the European Securities and Markets Authority ("**ESMA**"), by obliging the finfluencers to provide necessary disclosures. But on contrary to other developed nations, India has a very big chunk of financially illiterate population including retail investors and decentralized nature of digital platforms (Telegram case), equipping SEBI with the unique set of challenges to deal with.

The objective of this paper is to critically evaluate the regulatory framework of SEBI to govern the finfluencers, with emphasis on its goal to protect the retail investors and need for fostering them with required financial education. With the help of the comparative analysis of international regulatory models, the author will propose the set of recommendations at the end of the paper for SEBI to enhance its oversight while fostering innovation. The ultimate aim is to develop a marketplace which not only curbs misinformation but also promotes responsible financial education amongst the investors, catering to the evolving digital trends.

## II. RISE OF FINFLUENCERS

The rise of finfluencers is closely knitted to the rise in retail investors, the COVID-19 pandemic, social media, and the increase in the number of stock broking apps, such as Zerodha, AngleOne, etc., have eased the efforts of investors to make investments. The rise in social media supplemented the access to free financial education for a broader audience, which was once available only to registered financial advisors. Platforms such as Instagram, X (formerly Twitter), YouTube, Telegram, and Facebook have enabled the finfluencers to breakdown complex financial concepts into simpler ones for the general public, especially in a country like India where financial literacy is considerably low. With the help of these contents, personal finance and

investing have become significantly easier for the financially illiterate population. The shift from traditional investment advisors to finfluencers is because of the accessibility to free investment advice available across social media platforms, thereby eradicating the high consultation fees paid to investment advisers. This advent of social media has created billion-dollar finfluencing industry wherein corporates pay these creators according to their followings and engagement in such platforms to promote their brand and marketable products.[7]

These finfluencers significantly impact the trading decisions of the investors with their influence. They shape their investing preferences and trading patterns by distilling the information that reaches to their followers, as a result, they synchronise the bunch of traders, which significantly influences the stock price movements. Although this phenomenon is not a fresh one, earlier the opinions of analysts who appeared on news channels like CNBC have also caused temporary movements in the stock prices of the company without impacting their prospects and fundamentals.[8] Indeed, research published in 1990 by Wall Street Journal's Heard on the Street section has quantified that the recommendations of analysts have significantly affected the stock prices between 1982 and 1985.[9]

Another factor that contributed to the rise of finfluencers, particularly in India, is that most of them upload their content in regional/local languages.[10]

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[7] Sue S Guan, 'The Rise of the Finfluencer' (2022) 19 N.Y.U Journal of Law and Business 491, 500.
[8] Utkarsh Gupta & Sumangala Bhargava, 'In the Realm of Finfluencers: Understanding the Indian Framework, Regulations, and Future Trends' (2023) 13 Nirma U LJ 51.
[9] Sue S Guan, 'The Rise of the Finfluencer' (2022) 19 N.Y.U Journal of Law and Business 491, 500.
[10] Bussiness Today, 'Rise of the Finfluencers' (*Business Today* 2021) <https://www.businesstoday.in/interactive/immersive/rise-of-the-finfluencers> accessed 17 October 2024.

Although the urban population mostly speaks and works in the English language, the rural population finds it easier to communicate in the local language. Therefore, the finfluencers who communicate in the local languages to their followers are able to drive financial education to far-reaching audiences.[11] Apart from other requirements of financially illiterate population, finfluencers also use other methods like comedy or their past experiences to ensure the traffic of followers comes back again.[12] One finfluencer, Sharan Hegde, uses comedy to deliver content and parallelly entertains its audience.[13]

## III. CHALLENGES AND RISKS POSED BY FINFLUENCERS

The popularity of finfluencers can be both a boon and a bane to the financial markets and retail investors. While on the one hand, they make financial information more accessible, on the other hand, since they are neither licensed nor qualified, they might act as a bull in chinese shops by posing challenges like misleading their followers by risking their capital, engaging themselves in stock manipulation by apprising their followers to buy them which increase the value of those stock and in turn decrease the stock prices of the rival companies.[14]

To escape regulatory mechanisms, these finfluencers often use various methods such as the use of coded language and the setting up of partnerships with registered analysts. For example, on YouTube, they use phrases such as *"Machli Marr Gayi"* (fish is dead) to indicate a fall in prices and *"Murgi Khaa*

[11] ibid.
[12] K Ramaswamy, 'Finfluencers in India: New Paradigms of Financial Trust and Authority' in S De, A Arya, M Young, D Ramesh, and J Pal (eds), Social Media and Society in India (University of Michigan Press 2023) 133–140.
[13] ibid.
[14] Aryaman Dubey, 'The Impact of Finfluencers in Corporate Governance in India: Comparative Analysis of Company Law Perspective and the Need for SEBI Regulation' (2024) IV Indian Journal of Integrated Research in Law.

*Rahe Hai"* (We're having chicken) to indicate a rise in prices.[15] In addition to this, for the purpose of gaining unlawful financial benefits, these finfluencers tend to deliver biased advice to their audience. For example, many finfluencers such as Ankur Warikoo and Akshar Shrivastava had advised investing in the firm 'Vauld', which went bankrupt, resulting in significant losses for many people. Also, PR Sundar, another notable finfluencer, was accused of sharing images of only profitable trades and erasing the loss-making transactions.[16] It is pertinent to note that not all investments will generate returns, some may result to losses also. It should be the obligation of these finfluencers to warn their audience of associated risks also.[17] Many notable celebrities and finfluencers, nowadays are also promoting products that are harmful to our health, for example, soft drinks, and also promoting betting and casino applications.[18] Thus, the investors should do proper due diligence on their part before investing their money also to avoid losses thereto.

### A. Practices of Finfluencers: How do they make money

The paper divides finfluencers into four categories[19] based on the different parameters. These are as follows:

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[15] Asha Menon, 'From "Machli" to "Murgi" and "Chai": Finfluencers Work out Cryptic Phrases to Escape SEBI Glare' (*Money control* 5 June 2023) <https://www.moneycontrol.com/news/business/markets/machli-or-murgi-finfluencers-devise-innovative-ways-to-get-around-sebi-glare-10746731.html> accessed 17 October 2024.

[16] Suryansh, 'Need for Regulation of "Finfluencers" by SEBI' (*Live Law* 18 July 2023) <https://www.livelaw.in/lawschoolcolumn/finfluencers-sebi-stock-market-reserve-bank-of-india-advertising-standards-council-of-india-hnlu-232998> accessed 17 October 2024.

[17] ibid.

[18] ibid.

[19] Felix Pflücke, 'Regulating Finfluencers' (28 November 2022) 11(6) Journal of European Consumer and Market Law 212.

- Social media serves as the best platform for finfluencers to discuss and spread their well-intentioned strategies.[20] The model is simple; viewers get free content and finfluencers generate revenue with more views, for example, Instagram or YouTube AdSense. The problems lie in the fact that their content does not provide a complete picture of associated risks, and innocent viewers act upon the misleading advice to invest their savings, without considering the financial advice tailored to their financial situation thus leading to losses.[21] The harm in case consumer lose their lifetime savings is not limited to only financial aspects but also goes beyond unquantifiable measures such as emotional and psychological well-being.[22]

- The decisions and strategies of finfluencers may also be driven by mala fide intentions, with the contract of difference ("**CFD**") trading, meme stock, or cryptocurrency gaining specific traction. Some evidences suggests that finfluencers advertise financial products for their own benefit, going beyond advertisement revenue.[23] In such cases they implement 'pump and dump' schemes wherein these finfluencers encourage their followers to invest, suddenly increasing the stock prices. Once prices reach a certain level, these finfluencers sell their already held

[20] Cathie Armour, 'Regulatory risk and finfluencer engagement for company directors' (*Australian Securities & Investment Commission* November 2021) accessed 18 October 2024.
[21] European Securities and Markets Authority, 'ESMA Highlights Risks to Retail Investors of Social Media Driven Share Trading (ESMA70-155-11809)' (*European Securities and Markets Authority* 17 February 2021) <https://www.esma.europa.eu/press-news/esma-news/esma-highlights-risks-retail-investors-social-media-driven-share-trading> accessed 18 October 2024.
[22] OECD, 'Measuring consumer detriment and the impact of consumer policy' (*OECD* 9 April 2020) <https://one.oecd.org/document/DSTI/CP(2019)13/FINAL/En/pdf#:~:text=Measuring%20consumer%20detriment%20is%20a,to%20'Measure%20consumer%20detriment> accessed 18 October 2024.
[23] James D Cox, Robert William Hillman and Donald C Langevoort, *Securities Regulation: Cases and Materials* (10th edn., Aspen Publishing 2006) 712–714.

shares causing a sudden decrease in the prices of shares.[24] Followers who invest late have to suffer losses, while finfluencers gain undue profits. Due to the mala fide intentions of finfluencers, the audience may suffer the loss of invested capital, generally due to unawareness of risk factors attached to such volatile assets, accompanied by non-financial harms also.[25]

- Another way finfluencers generate revenue is by advertising their one-on-one coaching sessions, courses, books, etc., with the promise that purchasing these services will help them generate future returns, whereas, the underlying objective might only be to generate revenue by advertising products.[26] The recommendations of finfluencers are driven by natural bias due to which a conflict of interest persists. This presents a great risk for the buyers of these services because these finfluencers offering them might not be trained investment professionals and these services might not suit the financial risk profile of the buyers, therefore, buyers suffer from financial as well as non-financial harms.[27]

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[24] Abhijeet Kumar, 'Explained: What Is Pump and Dump Scheme in Stock Market and How to Be Safe' (*Business Standard India* 5 June 2024) <https://www.business-standard.com/markets/news/explained-what-is-pump-and-dump-scheme-in-stock-market-and-how-to-be-safe-124060500381_1.html> accessed 18 October 2024.

[25] European Securities and Markets Authority, 'ESMA Highlights Risks to Retail Investors of Social Media Driven Share Trading (ESMA70-155-11809)' (*European Securities and Markets Authority* 17 February 2021) <https://www.esma.europa.eu/press-news/esma-news/esma-highlights-risks-retail-investors-social-media-driven-share-trading> accessed 18 October 2024.

[26] Dutch Authority for the Financial Markets (AFM), 'The pitfalls of "finfluencing": Exploratory study by the AFM into investor protection requirements relating to social media posts' (*AFM* December 2021) <https://www.afm.nl/~/profmedia/files/publicaties/2021/pitfalls-of-finfluencing.pdf?sc_lang=en> accessed 18 October 2024.

[27] European Securities and Markets Authority, 'ESMA Highlights Risks to Retail Investors of Social Media Driven Share Trading (ESMA70-155-11809)' (*European Securities and Markets Authority* 17 February 2021) <https://www.esma.europa.eu/press-news/esma-news/esma-highlights-risks-retail-investors-social-media-driven-share-trading> accessed 18 October 2024.

- Finfluencers collaborate with third parties to provide affiliate links to their viewers and receive a commission for every sign-up through these links.[28] These affiliate links could be for any online broker or other trading platforms these finfluencers have partnered with.[29] Third-party affiliate links could also gain more sign-ups by luring viewers for giveaways, by giving free stock or some credit to start investing.[30] Some of the finfluencers also receive a commission as per the amount of investment their viewers have invested in these broking platforms. This commission-based system has led to an increase in the advertisement of high-risk financial products like CFDs, which are highly unregulated in India.[31] The studies suggest that 74-89% of investors may lose their money while trading into CFDs, thus the financial harm can be the biggest factor here.[32] The real issue that comes into consideration with regards to this matter is that neither the finfluencers nor the viewers are aware of the associated

[28] SEBI, *Consultation paper on Association of SEBI Registered Intermediaries/Regulated Entities with unregistered Entities* (25 August 2023) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-association-of-sebi-registered-intermediaries-regulated-entities-with-unregistered-entities-including-finfluencers-_75932.html> accessed 29 September 2024.

[29] Bussiness Today, 'Rise of the Finfluencers' (*Business Today* 2021) <https://www.businesstoday.in/interactive/immersive/rise-of-the-finfluencers> accessed 17 October 2024.

[30] Dutch Authority for the Financial Markets (AFM), 'The pitfalls of "finfluencing": Exploratory study by the AFM into investor protection requirements relating to social media posts' (*AFM* December 2021) <https://www.afm.nl/~/profmedia/files/publicaties/2021/pitfalls-of-finfluencing.pdf?sc_lang=en> accessed 18 October 2024.

[31] Bajaj Broking Team, 'Contract for Difference (CFD) Trading: Meaning, Working, Advantages and Risks | Bajaj Broking' (*Bajajbroking.in* 2024) <https://www.bajajbroking.in/blog/what-is-cfd-trading-and-how-it-works> accessed 19 October 2024.

[32] European Securities and Markets Authority (ESMA), 'Additional information on the agreed product intervention measures relating to contracts for differences and binary options (ESMA35-43-1000)' (ESMA 27 March 2018) <https://www.esma.europa.eu/sites/default/files/library/esma35-43-1000_additional_information_on_the_agreed_product_intervention_measures_relating_to_contracts_for_differences_and_binary_options.pdf> last accessed 19 October 2024.

risks for signing up on these third-party platforms, where the biggest risk might be fraud by which viewers suffer through financial as well as non-financial harm.

Therefore, with the above information, we can clearly understand the reason behind finfluencers posting content on social media. In all the categories, the viewers suffer from either financial or non-financial harm. In all ways possible innocent illiterate investors get into the trap of these finfluencers, turning into the exploitation of their financial savings. SEBI in its 2023 consultation paper has recognised four sources of income for finfluencers from an advertiser: referral fee for usage, non-cash benefits, direct compensation from the social media or other platform, or income from a profit-sharing model with the product, channel, platform or services.[33] The above-mentioned categories can broadly include all sources of income of finfluencers identified by the SEBI.

## IV. REGULATORY FRAMEWORK IN INDIA AGAINST FINFLUENCERS

SEBI regulates the Indian capital market by issuing rules and regulations as and when the need arises.[34] Supreme Court has said that one of the roles of the SEBI is to ensure investors' confidence through effective regulatory mechanisms.[35] The regulatory challenge present on the face of the

[33] Malini Mukherjee, 'SEBI's Finfluencer Legal Framework: Gaps in Enforcement and Investor Education - IndiaCorpLaw' (*IndiaCorpLaw* 20 August 2024) <https://indiacorplaw.in/2024/08/sebis-finfluencer-legal-framework-gaps-in-enforcement-and-investor-education.html> accessed 24 October 2024.
[34] G Sabarinathan, 'SEBI's Regulation of the Indian Securities Market: A Critical Review of the Major Developments' (2010) 35 Vikalpa: The Journal for Decision Makers 13.
[35] N. Narayanan v. SEBI (2013) 12 SCC 152.

SEBI right now is to regulate finfluencers, whose presence is all over the internet social media platforms.

### A. Consultation paper by SEBI.

SEBI on August 25, 2023 issued a "*Consultation Paper on Association of SEBI Registered Intermediaries/Regulated Entities with Unregistered Entities (including finfluencers)*",[36] this consultation paper aims to regulate finfluencers on three main aspects, those are, the obligation for registration and disclosure, the association of registered entities with that of unregistered entities (including finfluencers), and punishment against misleading advice.[37] The consultation paper ensured that the *"No SEBI registered entities including their agents or representatives, shall not either directly or indirectly, engage in any manner, whether monetary or non-monetary, with unregistered entities (including finfluencers)."* SEBI also said that any entity registered with SEBI, ant stock exchange, or Association of Mutal Fund of India ("**AMFI**") shall not share any confidential information with any unregistered entity.[38] On top of this SEBI called for the registration of the unregistered entity (including finfluencers) with the SEBI by furnishing the requisite information and all necessary disclosures.[39] Registered finfluencers shall have to display their

[36] SEBI, *Consultation paper on Association of SEBI Registered Intermediaries/Regulated Entities with unregistered Entities* (25 Aug. 2023) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-association-of-sebi-registered-intermediaries-regulated-entities-with-unregistered-entities-including-finfluencers-_75932.html> accessed 29 September 2024.

[37] Sara Sundaram, 'From Likes to Licenses: Regulating Finfluencers amidst Stricter Norms' (*Cyril Amarchand Mangaldas* 29 August 2024) <https://corporate.cyrilamarchandblogs.com/2024/08/from-likes-to-licenses-regulating-finfluencers-amidst-stricter-norms/> accessed 22 October 2024.

[38] SEBI, *Consultation paper on Association of SEBI Registered Intermediaries/Regulated Entities with unregistered Entities* (25 Aug. 2023) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-association-of-sebi-registered-intermediaries-regulated-entities-with-unregistered-entities-including-finfluencers-_75932.html> accessed 29 September 2024.

[39] ibid.

contact number, grievance redressal helpline, and necessary disclosures and disclaimers on all posts, and has to comply with all the rules and regulations made by SEBI.[40] The consultation paper suggested that SEBI can take necessary enforcement actions including filing a case under Section 420 of the Indian Penal Code, 1860 ("**IPC**") for fraud or impersonation.[41]

SEBI has released these regulations as an interim measure, up to the time it formulates permanent measures and amends necessary statutes to regulate the activities of finfluencers. This consultation will put these finfluencers under the watch of SEBI, and give SEBI liberty to monitor their actions so that they cannot harm the investors further. This blanket restriction on the association of unregistered entities with that of registered ones may be detrimental by limiting the availability of investment advice to the general public.[42] SEBI can take into account the Australian model wherein Australian Financial Services ("**AFS**") licensees can hire finfluencers and work with them, as long as they regularly audit and train them.[43] The finfluencers in Australia if hired, have to comply with the same rules and obligations as that of AFS licensees and in case of any misconduct, the AFS licensees are held liable on the part of finfluencers, by this way interest of the investors are protected in consonance with maintenance of the opportunistic alliance.[44] Similarly in India, Registered Investment Advisers ("**RIA**") can work with the

[40] ibid.
[41] ibid.
[42] Aryaman Dubey, 'The Impact of Finfluencers in Corporate Governance in India: Comparative Analysis of Company Law Perspective and the Need for SEBI Regulation' (2024) IV Indian Journal of Integrated Research in Law.
[43] Shaswat Kashyap and Harshal Chhabra, 'Navigating Finfluencers Regulations: A Deep Dive into Australia's Landscape' (*Global Business Law Review Blog – SCCLP* 28 February 2024) <https://gblrscclp.in/2024/02/28/navigating-finfluencers-regulations-a-deep-dive-into-australias-landscape/> accessed 22 October 2024.
[44] Karsen Haseler, 'AFS Licensees Beware of Finfluencers' (*Mondaq.com* 2023) <https://www.mondaq.com/australia/consumer-law/1320434/afs-licensees-beware-of-finfluencers> accessed 22 October 2024.

finfluencers, on the lines of the Australian model. SEBI should consider taking these steps.

### B. Proposals Approved by SEBI on Association of Regulated Entities With that of Unregistered Entities.

On June 27, 2024, SEBI held its 206th board meeting in which it approved the measures outlined in the 2023 consultation paper. SEBI has clarified that it will not restrict the association of regulated entities or its agents with any person who is solely providing education or services that are not linked to the advice or recommendation related to securities.[45] The SEBI has clarified that finfluencers are "*Financial influencers, commonly called 'finfluencers', are persons who provide information and/or advice/recommendations on various financial topics such as investing in securities, personal finance, banking products, insurance, real estate investment, etc. through their engaging stories, messages, reels and videos on various social/digital media platforms/channels such as Instagram, Facebook, YouTube, LinkedIn, Twitter, etc., and have the ability to influence the financial decisions of their followers*."[46] The proposals (PR 12/2024) approved by the SEBI in its Board meeting are:

- Any entities or persons or association of persons regulated by SEBI must refrain from forming any type of association with any person who directly or indirectly provides any kind of advice or makes an explicit claim of

[45] SEBI, *Proposal on association of persons regulated by the SEBI and the agents of such persons with persons who directly or indirectly provide advice or recommendations without being registered with SEBI or make any implicit or explicit claim of return or performance in respect of or related to a security or securities under the purview of SEBI* (27 June 2024) <https://www.sebi.gov.in/sebi_data/meetingfiles/jul-2024/1719916854117_1.pdf> accessed 23 October 2024.
[46] ibid.

return/recommendation of any kind of securities. The prohibited associations are financial transactions, sharing of IT systems, client referrals, etc.[47] (7.1)

- This restriction does not apply to individuals, permitted by the SEBI, solely dedicated to investor education including those who refrain from offering advice, recommendations, or making claims about returns or performance related to securities.[48] (7.4)

- The restriction also does not apply to associations through specified digital platforms having preventive or curative mechanisms to ensure that the platform is not used for providing advice, or claims of returns/performance in place.[49] (7.5)

This move by SEBI aims to reduce the dissemination of biased and misleading financial information drastically. This is a significant move towards investor protection and enhancing the transparency of the financial system.[50] The obligations will incidentally increase the diligence requirements of the unregistered entities. Also, the use of expressions like "any other associations of similar nature and character" to be refrained by regulated entities. Thus, the SEBI has made the definition of unregulated entities more inclusive, which is not limited to just social media finfluencers, but also

[47] ibid.
[48] ibid.
[49] ibid.
[50] Taxmann, '[Analysis] SEBI's New Regulations on Finfluencers – Protecting Investors from Unregistered Advisors' (*Taxmann Blog*3 September 2024) <https://www.taxmann.com/post/blog/analysis-sebis-new-regulations-on-finfluencers-protecting-investors-from-unregistered-advisors> accessed 23 October 2024.

includes any association or person that indulges in a similar kind of business as finfluencers.[51]

There are also many downsides to the proposed obligations as there will be serious risks in the implementation of the same. Challenges such as increased diligence have the taken by the regulated entities like stock brokers or mutual funds companies before onboarding new customers. They have to be more vigilant whether the proposed customer is a prudent individual or a finfluencer. But the question that arises is what if the concerned customer is someone who is operating from the platforms that provide anonymity like Telegram? In such cases, the diligence will become extremely difficult. Furthermore, even in the case these regulated entities identify that the concerned customer is finfluencer, even in such cases they have to check whether that person is registered or not. Therefore, the degree of diligence is the requirement for which the SEBI should provide further clarifications.

### C. Finfluencers under SEBI (Investment Advisers) Regulation, 2013.

In India, Investment Advisers are regulated by the SEBI (Investment Advisers) Regulation, 2013 ("**IA Regulations**").[52] As per regulation 2(m), "investment adviser means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called."[53] As per this definition, the

[51] Sara Sundaram, 'From Likes to Licenses: Regulating Finfluencers amidst Stricter Norms' (*Cyril Amarchand Mangaldas* 29 August 2024) <https://corporate.cyrilamarchandblogs.com/2024/08/from-likes-to-licenses-regulating-finfluencers-amidst-stricter-norms/> accessed 22 October 2024.
[52] Securities and Exchange Board of India (Investment Advisers) Regulations 2013 (India).
[53] Securities and Exchange Board of India (Investment Advisers) Regulations 2013 (India), reg 2(m).

requirement of "consideration" is a prerequisite to be called an investment adviser. By this logic, finfluencers cannot fall under the mentioned definition as they do not take direct consideration for their advice. Their income sources are ad revenue or sponsorships etc. But some finfluencers provide courses or services where they directly charge money, in these aspects they take direct consideration, therefore, they fall under the term investment advisers under section 2(m).[54] The recent legal framework by SEBI mandates the finfluencers to register as investment advisers, thus, we can say that SEBI has already interpreted the finfluencers under IA regulations as investment advisers, and the only differentiation is made as a registered investment adviser and unregistered investment adviser.

Also, as per regulation 2(l)[55] of the IA regulation which defines investment advice, it specifically excludes advice made through electronic or digital media that is widely available to the public. Therefore, any advice given by the finfluencer through its digital media to the larger public is excluded from the ambit of investment advice under IA regulation. This provision needs amendment to comply with the recent framework of SEBI on finfluencers.

### D. Effect of PFUTP Regulations on Finfluencers.

Section 12A of the SEBI Act, 1992, "*prohibits persons from directly or indirectly engaging in any manipulative or deceptive trading of securities.*"[56] This section directly aims at the power of SEBI to regulate

[54] SEBI, 'SEBI | Interim Order Cum SCN in the Matter of Unregistered Investment Advisory Activities of Mohammad Nasiruddin Ansari/ Baap of Chart' (*Sebi.gov.in* 2023) <https://www.sebi.gov.in/enforcement/orders/oct-2023/interim-order-cum-scn-in-the-matter-of-unregistered-investment-advisory-activities-of-mohammad-nasiruddin-ansari-baap-of-chart_78333.html> accessed 6 November 2024.

[55] Securities and Exchange Board of India (Investment Advisers) Regulations 2013 (India), reg 2(l).

[56] Securities and Exchange Board of India Act 1992, s 12A.

finfluencers indulging in fraudulent or unfair trade practices. This can be supplemented by SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003[57] ("**PFUTP Regulation**"), which provides powers to SEBI to penalise and order relating to unfair trade practices.[58]

Latest amendment under Section 4(2)(k) of the PFUTP Regulation has included the dissemination of information through any media that which disseminator knows or believes to be untrue and employs it in a reckless or careless manner.[59] The new provision requires that the disseminator be "reckless" when committing any wrong.[60] The term reckless has been interpreted by the USA court in a precise manner as "an extreme departure from the standards of ordinary care."[61]

The main challenge with PFUTP Regulation is that it is silent on whether the investor has suffered financial losses from misinformation by disseminators. There might be a possibility that the investor has suffered a financial loss, but that might not be related to the misinformation. The USA laws are clear on this part where the caution of loss is essential for establishing the liability of finfluencers for disseminating misinformation.[62] In the USA the "caution of loss" is provided under section 21D(b)(4) of the Securities

[57] Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices) Regulations 2003.
[58] Soumyarendra Barik, 'Got wrong financial advice from an influencer online? Sebi has noticed and is doing something about it' (*The Indian Express* 18 November 2022) <https://indianexpress.com/article/explained/explained-economics/financial-advice-social-media-sebi-guidelines-explained-8275470/> accessed 23 October 2024.
[59] Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices) Regulations 2003, reg 4(2)(k).
[60] Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) (Amendment) Regulations 2022.
[61] Sundstrand Corp. v. Sun Chemical Corp. Feb. 23, 1977. 553 F.2d 1033. (USA)
[62] Meiring de Villiers, 'Rule 10b-5 Meets Wagon Mound: A New Perspective on Loss Causation' (2022) 23(2) Minn. J.L. Sci. & Tech.

Exchange Act, 1934.[63] "Loss caution" states that the plaintiff's economic loss must have a direct nexus between the misstatement and the economic loss.[64]

Since no Indian law talks about "loss caution" every finfluencer disseminating misinformation will be punished under PFUTP regulation, irrespective of whether the investor suffered losses due to the misinformation or not.[65] Thus, it is a need of an hour to codify "loss caution" provisions under the Indian laws to uphold the principles of equity while deciding the issue.

Under regulation 21D(b)(4) of the PFUTP Regulations, misstatement can influence the investment decisions of the investors. Therefore, misstatement has to be substantial enough to be considered material so that "there should be the likelihood that the reasonable investor should consider it while making investment decision".[66] If the misstatements artificially inflate the prices, then we can say that it was material enough. However, PFUTP regulation is silent on this aspect.

SEBI in the case of *Stock Recommendation using the Social Media Channel Telegram* (popularly known as 'Telegram case') has passed an interim order wherein upon the receipt of the complaint that the Telegram group was involved in the stock price manipulation, SEBI imposed the blanket

[63] Securities Exchange Act of 1934 (US), s 21D(b)(4).
[64] Dura Pharmaceuticals v. Broudo 6 WYO. L. REV. 623, 628 (2006). (USA)
[65] Akshat Sharma & Mayank Gandhi, 'Deciphering Indian & USA Securities Laws -A Future Roadmap to Regulate Finfluencers in India' (*NLIU-Trilegal Summit on Corporate and Commercial Laws* 2023) <https://cbcl.nliu.ac.in/wp-content/uploads/2023/04/FINAL-Compiled-Manuscripts_Trilegal-Summit-Book-2023.pdf> accessed 23 October 2024.
[66] Allan Horwich, 'AN INQUIRY into the PERCEPTION of MATERIALITY as an ELEMENT of SCIENTER under SEC RULE 10b-5' (*Northwestern Pritzker School of Law Scholarly Commons* 2018) <https://scholarlycommons.law.northwestern.edu/facultyworkingpapers/15/> accessed 23 October 2024.

ban on the trading in Indian stock market by the admins of the group and also directed them to distribute the unlawful profits made by them.[67]

### E. ASCI Guidelines for Influencer Advertising in Digital Media.

ASCI on June 1, 2021, issued 'Guidelines for Influencer Advertising in Digital Media' ("**Influencer Guidelines**").[68] The aim of these guidelines is the proper disclosure of the promotional content and necessary due diligence about the advertised product.[69] The necessary information provided in the Influencer Guidelines is as follows:

- It defines "influencer" as a person who: (a) has access to the audience on social media, and (b) who has the power to affect the opinion of the audience about a '*product, service, brand, or experience*'.[70] This definition also includes 'virtual influencers who are computer generated people or avatars who have realistic characteristics, features, and personalities of humans and behave similarly as humans.[71] Thus, ASCI has tried to make this definition more inclusive so that any class or category of influencer if emerges in the future, can be interpreted under this definition. The SEBI has also, in its June 2024 framework on finfluencers, adopted the same definition of influencers.

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[67] SEBI, *Interim Order in the matter of Stock Recommendations using Social Media channel Telegram* (12 Jan. 2022) <https://www.sebi.gov.in/enforcement/orders/jan-2022/interim-order-in-the-matter-of-stock-recommendations-using-social-media-channel-telegram_55305.html> accessed 23 October 2024.

[68] ASCI, *Guidelines for Influencer Advertising in Digital Media* (2021) <https://www.ascionline.in> accessed 29 September 2024.

[69] Isheta T Batra and Sherry Shukla, 'An Insight into ASCI Guidelines for Social Media Influencers' (*Mondaq.com*2023) <https://www.mondaq.com/india/social-media/1361274/an-insight-into-asci-guidelines-for-social-media-influencers> accessed 23 October 2024.

[70] June, 'A&P Partners' (*A&P Partners*June 2021) <https://www.anppartners.in/blog/ascis-guidelines-for-influencer-advertising-on-digital-media> accessed 24 October 2024.

[71] ASCI, *Guidelines for Influencer Advertising in Digital Media* (2021) <https://www.ascionline.in> accessed 29 September 2024.

- The Guidelines require influencers to make necessary disclosures before the audience and should also disclose any material connection between advertisers and influencers.[72] The material connection is inclusive of benefits and incentives, either monetary or other compensation, which can affect the credibility of advertisement made by the influencers.[73] The influencer must inform the audience whether the influencer is advertising the product, goods, or service because of the material connection or otherwise.[74] This will give free choice to the consumers either to buy the product or not advertised by these influencers.

- Before making any representations, the influencers providing any advice on investment relating to any banking, financial service, or insurance sector ("**BFSI**") must be registered with SEBI and meet the required qualifications.[75]

- The finfluencer must display their registration details in the advertisement of the product, service, brand, or experience.[76]

- Before promoting or endorsing any product or service, the influencers must do a proper due diligence so that they can substantiate the claims they

[72] ibid.
[73] ibid.
[74] Malini Mukherjee, 'SEBI's Finfluencer Legal Framework: Gaps in Enforcement and Investor Education - IndiaCorpLaw' (*IndiaCorpLaw* 20 August 2024) <https://indiacorplaw.in/2024/08/sebis-finfluencer-legal-framework-gaps-in-enforcement-and-investor-education.html> accessed 24 October 2024.
[75] ASCI, *Guidelines for Influencer Advertising in Digital Media* (2021) Addendum II <https://www.ascionline.in> accessed 29 September 2024.
[76] Malini Mukherjee, 'SEBI's Finfluencer Legal Framework: Gaps in Enforcement and Investor Education - IndiaCorpLaw' (*IndiaCorpLaw* 20 August 2024) <https://indiacorplaw.in/2024/08/sebis-finfluencer-legal-framework-gaps-in-enforcement-and-investor-education.html> accessed 24 October 2024.

will be making in their content. It also protects the influencers from future liabilities.[77]

## V. INTERNATIONAL PERSPECTIVE

Financial authorities in the US, UK, EU, and Australia are paying more attention to regulating social media endorsements of financial products, especially when those endorsements involve financial influencers, or "finfluencers." These influencers, who have sizable fan bases on social media sites like YouTube, Instagram, and TikTok, have become well-known for endorsing a range of financial goods and services. Regulators are proactively addressing the increasing dangers connected with the promotion of high-risk financial products, like cryptoassets, which are frequently advocated by influencers, in response to worries about consumer harm. This increase in regulatory focus comes after many high-profile incidents in which consumers lost a lot of money on products that were advertised online.

### A. United Kingdom

In the UK, the *Financial Conduct Authority* ("**FCA**") is making a concerted effort to stop unlawful and noncompliant financial advertisements on social media. The FCA is extending its guidance to make sure that financial promotions on social media sites like Instagram and Twitter adhere to current regulatory norms in response to the sharp rise in online financial advertisements. Ads aimed at younger, more impressionable consumers—who frequently place a great deal of trust in influencers—are especially targeted by the new regulations. The FCA's revised guidance attempts to address gaps,

[77] Isheta T Batra and Sherry Shukla, 'An Insight into ASCI Guidelines for Social Media Influencers' (*Mondaq.com*2023) <https://www.mondaq.com/india/social-media/1361274/an-insight-into-asci-guidelines-for-social-media-influencers> accessed 23 October 2024.

especially when promotional material fails to adequately explain the related investment risks[78]. The objective is to make sure that risk disclosures are obvious and conspicuous, especially in situations where there is little space to give complete context, like in short-form pieces.

### B. European Union

To make sure that credit institutions and investment firms adhere to the MiFID II rules for marketing communications, *the European Securities and Markets Authority* ("**ESMA**") in the EU has started a single supervisory action[79]. With an emphasis on protecting younger and less seasoned investors who could look to influencers for financial advice, this program primarily targets social media and influencer-driven advertisements. Although the EU does not have any rules specifically addressing influencer marketing, the Digital Services Act ("**DSA**") and other consumer protection laws are being used to increase online advertising's transparency. In order to address concerns about transparency, the DSA makes sure that online ads are properly marked as such and that users are given sufficient information about the advertiser behind the offer.

### C. United States

*The SEC* in the US has taken a particularly active role in controlling influencers' promotion of cryptocurrency assets. In one prominent instance, reality TV personality Kim Kardashian was fined $1.26 million for improperly

[78] Emily Barret and Nikki Johnston, 'Likes to liability: UK FCA cracks down on 'finfluencers' <https://www.aoshearman.com/en/insights/ao-shearman-on-investigations/likes-to-liability-uk-fca-cracks-down-on-finfluencers> accessed 5 November 2024.

[79] EY, 'Financial Compliance Requirements for Finfluencers' (EY, 2023) https://www.ey.com/en_ch/insights/law/financial-compliance-requirements-for-finfluencers accessed 5 November 2024.

declaring her payments while endorsing EthereumMax ("**EMAX**") coins[80]. Actress Lindsay Lohan and YouTuber Jake Paul are among the other celebrities the SEC has prosecuted with illegally marketing cryptoasset securities[81]. The SEC revised its Investment Advisers Act marketing standards to include more precise guidelines regarding testimonials and endorsements in response to these concerns. To guarantee that investors are fully aware of any potential drawbacks, the revised regulations mandate that the substantial risks connected to financial products that are being offered be mentioned. The Federal Trade Commission ("**FTC**") has also tightened the rules surrounding endorsements by releasing updated guidelines to meet the expanding role of influencers in marketing[82].

The Federal Trade Commission ("**FTC**") in the United States regulates social media influencers in accordance with two main sets of rules: "*Disclosures 101 for Social Media Influencers" and "Guides Concerning the Use of Endorsements and Testimonials in Advertising.*" According to these rules, influencers must reveal any significant relationships—whether financial, familial, or professional—that they may have with the businesses whose goods they promote. Influencers are also forbidden from making false statements, either explicitly or implicitly, regarding the goods or services they support, and they are required to reveal any payment or other benefits they

[80] US Securities and Exchange Commission, 'SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security' (SEC Press Release No 2022-183, 3 October 2022) https://www.sec.gov/newsroom/press-releases/2022-183 accessed 5 November 2024.
[81] US Securities and Exchange Commission, 'SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency' (SEC Press Release No 2023-59, 17 April 2023) https://www.sec.gov/newsroom/press-releases/2023-59 accessed 28 November 2024.
[82] US Federal Trade Commission, 'Endorsements, Influencers, and Reviews' (FTC, 2024) https://www.ftc.gov/business-guidance/advertising-marketing/endorsements-influencers-reviews accessed 5 November 2024.

may have received in return for their endorsements. It is anticipated that these guidelines will also apply to financial product endorsements.

In 2022, the SEC proposed changes to its investment advisor marketing regulations for *regulated Investment Advisors (IAs*). As a result of these amendments, IAs must make sure that all third-party testimonials, endorsements, and promotional activities adhere to complete disclosure guidelines, which include disclosing any payment received for such efforts.

The self-regulatory *Financial Industry Regulatory Authority* ("**FINRA**") has also released guidelines for broking firms. These companies are advised by FINRA to evaluate the backgrounds of possible social media influencers, offer suitable training, establish acceptable and unacceptable behaviour, and keep thorough records of influencer interactions and activity pertaining to referral programs. The goal of this regulatory monitoring structure is to guarantee that influencer marketing, especially in the financial services industry, continues to be open, moral, and in accordance with accepted norms.

### D. Australia

*The Australian Securities and Investments Commission (ASIC)* keeps a careful eye on online conversations about financial products that influencers advocate or debate. Its main goal is to find and deal with any instances of financial advice or services that are unlicensed, misleading, or deceptive. Operating a financial services business without an Australian Financial Services (AFS) licence is prohibited by the Corporations Act 2001, unless the person is authorised to act as a representative of an AFS licensee or is exempt. Serious consequences, including as up to five years in prison for people and hefty fines for corporations that can amount to millions of dollars, can follow

violations of these rules. When ASIC thinks it is in the public interest to pursue enforcement action, especially when it comes to consumer protection or market integrity, it does so. Additionally, ASIC has developed a precise methodology for determining whether or not an influencer's counsel meets legal requirements for financial product advising.

There may be a possible conflict of interest if the influencer's pay or perks are contingent on customer actions, such purchases, sign-ups, or other behaviours. In that scenario, the guidance might be considered financial product advice. ASIC evaluates the whole message that an influencer's content conveys, taking into account elements including the advice's presentation and whether it qualifies for an AFS License ("**AFSL**").[83]

ASIC published Information Sheet INFO 269, titled "Discussing financial products and services online,[84] *"on March 21, 2022, to provide guidance to influencers and AFS licensees who work with them. The definition of "dealing by arranging"* (which includes activities like facilitating the purchase or sale of financial products), examples of misleading or deceptive conduct, which is illegal in relation to financial services, and examples of what constitutes financial product advice are all included in this document. As a useful manual, INFO 269 offers a code of behaviour for influencers, suggests certain disclosure procedures, promotes due research, and advises exercising caution when giving financial advice. Promoting appropriate and knowledgeable behaviour in online financial talks is the aim.

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[83] Michael Chhaya, Eugenia Kolivos and Kendra Turner 'The Rise and Regulation of Finfluencers' The Australian Journal of Financial Planning.

[84] ASIC, 'Discussing Financial Products and Services Online' (*asic.gov.au* March 2022) <https://asic.gov.au/regulatory-resources/financial-services/giving-financial-product-advice/discussing-financial-products-and-services-online/> accessed 29 October 2024.

ASIC's regulatory position is unambiguous: unlicensed influencers must restrict their content to factual information, and if their recommendations have the potential to sway investment decisions, they should carefully consider obtaining an AFS licence or becoming an authorised representative of an AFS licensee. Influencers should only endorse financial goods after gaining a comprehensive grasp of them, the regulator stresses. This entails being cautious when talking about high-risk items, making sure that any claims are true and supported by evidence, and declaring any possible conflicts of interest. The total impression that an influencer's content makes, taking into consideration the context and surrounding circumstances, determines whether or not it qualifies as financial product advise.

*ASIC v. Scholz*,[85] a landmark decision, made it clear that talking about financial products on social media might make someone a "financial services business" for the Corporations Act 2001. The Act's definition of financial product advice, which encompasses any recommendations or remarks meant to sway consumers' decisions about financial products, was emphasised by this ruling.

To put it briefly, the purpose of ASIC's regulatory framework for influencers is to guarantee that online financial conversations are carried out in an ethical, transparent, and law-abiding manner. ASIC seeks to safeguard customers and uphold the integrity of financial markets by encouraging thorough content examination, advocating appropriate disclosures, and making sure influencers are aware of the legal ramifications of their recommendations.

[85] ASIC v. Scholz [2022] FCA 43.

## VI. SUGGESTIONS AND CONCLUSION

Regulators are stepping up their efforts to shield consumers from possible harm as the promotion of financial products on social media keeps growing. Regulators hope to establish a framework that guarantees accountability and openness in the marketing of financial goods by concentrating on influencers. Enforcing rules pertaining to transparency, risk communication, and influencers' moral need to offer fair and honest counsel are crucial to these initiatives. It will be essential for institutions and financial influencers to remain aware and adhere to these revised requirements as the regulatory environment changes. By doing this, companies can support a more accountable and open approach to financial promotions, eventually protecting consumers' interests.

The Securities and Exchange Board of India (SEBI) ought to think about clarifying what constitutes "investment advice" in the Investment Advisors Regulations, taking inspiration from the Australian regulatory framework and acknowledging that a large number of financial influencers (finfluencers) give more weight to educational content than to direct investment advice. A more comprehensive and sophisticated definition would make a distinction between instructional content and counsel meant to sway investment decisions. As long as their content doesn't veer into giving out specific investment advice, this would allow influencers to offer beneficial financial education without running the danger of excessive responsibility.

SEBI's recently released Consultation Paper prohibits investment advisors from collaborating with influencers. This extensive ban may be seen as a preventative measure, but it may also unintentionally make it more difficult for the general population to receive financial education and

information. Australian Financial Services (AFS) licensees, on the other hand, are free to work with influencers as long as they actively monitor and assess the content created. Influencers must be rigorously monitored by AFS licensees to make sure their content complies with legal requirements. Influencers are bound by the same compliance standards under this model since they represent the licensees as authorised representatives. This regulatory framework preserves equilibrium between investor protection and cooperation opportunities. SEBI should think about taking a similar tack, which would provide strong regulatory monitoring while permitting a strategic partnership between influencers and financial advisors. Such a strategy would achieve a balance between risk management and encouraging fruitful partnerships in financial education.

Non-binding guidelines on best practices for financial product promotion have been released by the Australian Securities and Investments Commission (ASIC). This guideline emphasises how crucial it is to present a fair assessment of the financial goods being advertised, including important details about costs, features, risks, returns, and suitable disclaimers. In order to keep their content accessible and intelligible to a wide audience, influencers are also encouraged to refrain from using excessively technical jargon. Furthermore, a tertiary degree (a diploma is a minimum need) and required financial product training are among the qualifications that ASIC mandates AFS licensees fulfill. This legal system guarantees that those involved in financial advertising possess the necessary knowledge and skills to offer precise, consumer-friendly advice. As the issue receives more regulatory attention, the Australian Competition and Consumer Commission ("**ACCC**") has also started to look for false endorsements and testimonies from social media influencers. ASIC's proactive approach and the increased scrutiny

indicate that Australia may soon step up its investigations and enforcement efforts in this field. As it modifies its own framework to handle the difficulties presented by influencers, SEBI may learn a lot from this changing regulatory environment.

### A. Tailored Approach for SEBI: Defining Clear Categories and Guidelines

Regulatory agencies such as SEBI (Securities and Exchange Board of India) should establish a required registration and licensing system for Finfluencers in order to better control this market. This would have several benefits:

- **Accountability and Compliance:** Because Finfluencers would be subject to license revocation for noncompliance with restrictions, they would be held responsible for their conduct. An incentive for responsible behaviour would result from this.
- **Investor Confidence:** Retail investors would be reassured that influencers are acting legally and in accordance with securities legislation if only licensed and regulated individuals were permitted to offer financial advice. This would significantly increase investor trust.

SEBI may modify the Australian model to meet the unique difficulties of the Indian market as it re-examines its regulatory strategy for influencers. Creating two separate groups within the regulatory framework—Registered Investment Advisors (RIAs) and unregistered financial advisors—is one possible remedy. While unregistered financial advisors, like influencers, would just need to comply with minimum disclosure and due diligence requirements, registered advisors (RIAs) would need to meet strict qualification and regulatory standards. By making this difference, SEBI would

be better able to control the various levels of risk connected to various financial advice kinds.

The definition of "investment advisor" might be changed to better define the range of advising services. Those who offer advice in exchange for payment and those who get paid in response to their audience's activities or behaviour (e.g., affiliate marketing, referrals, or performance-linked incentives) should be included in this.

In order to protect investor interests and control market development, SEBI could create a new categorisation for influencers within the more expansive definition of financial intermediaries by utilising its authority under Section 11(1) of the SEBI Act. This would guarantee that the regulatory framework successfully protects investor interests while enabling SEBI to create customised recommendations that take into consideration the special characteristics of influencer-driven financial advice.

In conclusion, SEBI may improve its approach to regulating influencers by learning from international best practices, especially the Australian model. SEBI can create an atmosphere that promotes the ethical use of social media for financial education while simultaneously shielding customers from possible hazards by enacting a more adaptable and thorough regulatory framework.

India can draft its own regulatory framework for governing finfluencers. The following essentials are recommended to be incorporated:

- **Definition of Finfluencers:** To withstand judicial and regulatory scrutiny, the term "finfluencer" needs to be defined precisely. It should cover

any medium used to provide financial and investment-related advice to the general public, such as websites, social media, and other mass media.

- **Class Action Claims:** The pump and dump scheme affects a large number of investors. Under the 'Fraud-on-the-market' theory (USA), the reliance on the class action claim is placed more. Thus, adopting this theory into Indian Securities Law will ease the class of investors to claim their rights as they only have to prove that misstatement by finfluencers has led to inflated prices. Here the onus of proof on the plaintiff will be less and the judge will focus more on the present fraud, intention of the defendant, and harm caused.

- **Mutual Collaboration of Registered Entities with Finfluencers:** SEBI can take into account the Australian model wherein Australian Financial Services (AFS) licensees can hire finfluencers and work with them, as long as they regularly audit and train them. The finfluencers in Australia if hired, have to comply with the same rules and obligations as that of AFS licensees and in case of any misconduct, the AFS licensees are held liable on the part of finfluencers, by this way interest of the investors is protected in consonance with maintenance of the opportunistic alliance. Similarly in India, Registered Investment Advisers (RIA) can work with the finfluencers, on the lines of the Australian model. SEBI should consider taking these steps.

- **Disclosure Requirements:** All forms of content distributed by financial influencers, such as commercials, promotional materials, social media posts, celebrity endorsements, and media broadcasts that support certain financial products or investment strategies, must be covered by an extensive code of behaviour. This guarantees that the code's scope encompasses all possible channels for disseminating financial advice. This would entail having to reveal any possible conflicts of interest and any links

with businesses that are mentioned in their material. Additionally, remuneration arrangements like affiliate marketing agreements or sponsorships should be transparent. With these disclosures, viewers would be better equipped to evaluate the caliber of the counsel they get and make more educated judgements. In order to inform viewers of the inherent dangers associated with any investment opportunity, influencers should also be obliged to add risk warnings on all of their content.

- **Consumer Protection:** It is unclear if it is reasonable to expect regulators to shield consumers from their vulnerability given the shorter attention spans of the digital age and the propensity of consumers to believe information that is presented in an aesthetically pleasing way, particularly on social media. Any code of conduct must guarantee that the information offered by financial influencers is accurate, fair, and supported by data that can be independently verified.

- **Formal Registration process for finfluencers:** SEBI currently lacks this system. SEBI should implement such a system, ideally with requirements such as obtaining a Certified Financial Planner ("**CFP**") certification or passing an aptitude test. This would ensure that Finfluencers meet a minimum level of competence, thereby increasing the trustworthiness of the information they provide to investors.

- **Morality Compass test:** The code of conduct can incorporate this straightforward yet powerful ethical principle. Influencers should not be allowed to give investment advice to others if they would not personally implement it (for example, they would not suggest the same investment to a family member). This test ensures the integrity of the suggestions by acting as a moral compass.

- **Technological Framework for Regulatory Enforcement:** The ability of financial authorities to use cutting-edge technical tools for real-time market surveillance and data analysis will be essential to effective regulation. To safeguard consumers, regulators need to be able to evaluate financial advice from influencers, spot possible dangers, and act quickly. In addition to sophisticated technology infrastructure, this calls for the know-how to convert complicated data into useful insights. Social media companies and SEBI should work together to combat false information and guarantee that financial material is accurate and not deceptive.
- **Accountability and Enforcement:** Regulations should guarantee prompt and effective accountability for influencers who violate the code of conduct. This includes creating strong enforcement systems to deal with infractions quickly and shield customers from dangerous advice.

- **Learning from International Counterparts:** In order to adopt efficient regulatory measures and shared best practices, SEBI should interact with its international counterparts. Fostering a reliable and vibrant financial environment in India would require creating a regulatory framework that supports a flourishing financial ecosystem, encourages Fintech innovation, and protects investors.

Social media companies themselves must actively participate in holding Finfluencers responsible and enforcing regulations. This entails combating deceptive or fraudulent tactics and advancing financial education and literacy to assist people in making better financial decisions.

Influencers' actions in the securities market are not addressed by SEBI's current regulatory framework, which mostly concentrates on punishing fraudulent acts after the fact. The regulation of their specialised

activities is lacking, which makes it difficult to effectively monitor influencers who are becoming more and more significant in influencing Indians' financial literacy. The impact of misstatements is one of the many unanswered concerns caused by the lack of precise, well-defined regulations. The ambiguity of current rules, which demand evidence of loss causation and materiality, may lead to excessively broad interpretations that unfairly punish influencers whose remarks did not cause harm.

Additionally, there is a lack of clarity regarding the regulatory position on *anti-touting,* a sector that is ready for regulation and involves the promotion of particular securities or investments without enough transparency. These issues could be resolved and investors could be protected with a clear disclosure requirement for finfluencers. The encouragement of class-action lawsuits in securities fraud instances involving Finfluencers is another important suggestion. For investors who might have lost money, this could reduce the load on individual claimants and provide more effective legal recourse.

In conclusion, the regulatory gap of finfluencers in India's financial ecosystem must be filled. Finfluencer behaviour can be appropriately controlled by enacting precise and unambiguous laws, protecting ordinary investors from needless dangers. Ultimately, a strong regulatory framework will benefit all market participants by promoting a more open, responsible, and reliable financial environment.

# IV. FANTASY SPORTS INDUSTRY IN INDIA: FILLING THE REGULATORY VOID

- Divyansh Bhansali and Srinjoy Debnath*

ABSTRACT

In the last few years, the fantasy sports industry has witnessed major growth in India. The online fantasy sports industry like any other sector has its own unique challenges. Currently, the industry is governed by The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules of 2023 which was notified last year. However, these rules are yet to be implemented and are inadequate to deal with the challenges posed by the industry. This paper tries to fill the regulatory void in the online fantasy sports industry by drawing from global best practices on regulation of online fantasy sports especially the USA, the UK and Australia. It provides a few guidelines for sector-specific regulation of online fantasy sports in India which will help in mitigating unique challenges associated with the industry.

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## I. INTRODUCTION

The Indian gaming market is growing with each passing day. As per a report, the Indian gaming market is estimated at $2.6B at the end of 2022 and is projected to go up to $8.6B in 2027.[1] With the aim of regulating the growing industry, the Indian Government notified the Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules of 2023 on 6th April 2023. The Amendment introduced a self-regulatory body that was tasked with approving real money games and making relevant rules along with creating a Grievance Redressal Mechanism.[2] However, the government has recently expressed its intention to move away from the self-regulatory model of governance and is looking to establish an independent regulator for online gaming.[3]

At the forefront of the real money games, is the fantasy sports industry which is actively gaining traction in the Indian market. Loosely, fantasy sports can be defined as online contests in which participants assemble their virtual teams of real players of a professional sport and these teams compete on the real-world performance of the players, based on which the participants win or lose.[4] This may be taken as working definition

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[1] 'India: Gaming Industry Market Size 2027' (*Statista*) <https://www.statista.com/statistics/740983/india-gaming-industry-market-size/> accessed 22 March 2024.

[2] Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules of 2023.

[3] Himanshi Lohchab, 'NLU Preparing Recommendations for a Online Gaming Regulator, to Submit to MeitY Soon' *The Economic Times* (25 March 2024) <https://economictimes.indiatimes.com/tech/technology/govt-plans-independent-regulator-for-online-gaming/articleshow/108754450.cms?from=mdr> accessed 6 April 2024.

[4] Federation of Indian Fantasy Sports and Deloitte, 'Fantasy Sports: Creating a virtuous cycle of sports development' (2022) 11 <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/technology-media-telecommunications/in-tmt-fantasy-sports-industry-report-noexp.pdf> accessed 16 November 2024.

for understanding fantasy sports for now, though a more technical definition will be provided later in the paper for regulatory purposes. For better understanding, we can take example of Dream11 which is an online fantasy sports platform providing fantasy contests for cricket and other games.[5] Here participants make virtual teams of 11 players for cricket tournaments, playing from both the competing real-world teams, and win rewards based on fantasy points earned by each player for their real-world performance.

In this study, we shall focus on the regulation of Fantasy Sports as this form of real-money games is unique in that it depends heavily on the performance of real-life players and teams. This factor brings forth unique challenges like insider trading that are not present in other forms of real money games. While there have been a lot of debate on whether fantasy sports are games of skill or chance,[6] there has not been a comprehensive study on how the sector should be regulated. As multiple courts in India have already decided upon the legality of Fantasy Sports,[7] this paper only briefly discusses this aspect and does not focus much on the nature of Fantasy Sports and their legal status in India. Assuming that these are games of skill, it moves on and focus on filling the void in literature on the potential regulation of Fantasy Sports in India.

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[5] Dream11, (*Home Page* 2024) < https://www.dream11.com/> accessed 16 November 2024.

[6] Anthony N. Cabot et al., Alex Rodriguez, A Monkey, and the Game oJ Scrabble: The Hazard of Using Illogic to Define Legality of Games of Mixed Skill and Chance, 57 DRAKE L. REV. 383, 393; Nathan Rott, 'Skill Or Chance? Question Looms Over Fantasy Sports Industry' *NPR* (25 November 2015) <https://www.npr.org/2015/11/25/457279313/skill-or-chance-question-looms-over-fantasy-sports-industry> accessed 11 January 2024.

[7] Varun Gumber v. UT of Chandigarh & Ors., 2017 SCC OnLine P&H 5372; Gurdeep Singh Sachar v. Union of India, 2019 SCC OnLine Bom 13059; Chandresh Shukla v. State of Rajasthan & Ors., D.B. Civil Writ Petition No. 6653/2019; Avinash Mehrotra v. The State of Rajasthan & Ors., SLP (Civil) Diary No.(s) 18478/2020.

This paper shall draw from global best practices on the regulation of fantasy sports and recommend a unique model of regulation. Specifically, we look at the regulations in USA, both at the federal and the state levels, UK and Australia where Fantasy Sports is legal and is subject to comprehensive regulations. In order to do the same, this paper is divided as follows: Part II shall discuss the jurisprudence surrounding their legality and existing regulation in India and identify the problems with it; Part III shall discuss the global best practices on the regulation of fantasy sports; Part IV shall draw from the global best practices to suggest appropriate regulations for the sector.

## II. JURISPRUDENCE AND REGULATION IN INDIA

Online Fantasy Gaming Market is taking big leaps in India with growing technological percolation.[8] However, concerns regarding their legality have always been raised as they involve prediction and staking money. This chapter goes on to outline their legality by briefly tracing the debate between game of chance vs game of skill in India and then fitting fantasy sports in it. The second section discusses the regulatory framework issued by the Central government for online gaming market and the third section shows how the current regulatory framework is inadequate to deal with the domain of fantasy gaming.

### A. Status of Fantasy Sports in India

#### *1. Game of Skill v. Game of Chance*

[8] Niti Aayog 'Guiding Principles for the Uniform National-level Regulation of Online Fantasy Sports Platforms in India: Draft for Discussion' (2020), 1 < https://www.niti.gov.in/sites/default/files/2023-03/Guiding-Principles-for-the-Uniform-National-Level-Regulation-of-Online-Fantasy.pdf> accessed 22 March 2024.

From the British era gambling has been prohibited in India by the Public Gambling Act of 1867.[9] However, this prohibition excludes games of *'mere skill'* that can be legally played under Section 12 of the Act.[10] After independence, the subjects of 'gambling and betting' were included in entry 34 of the State List recognizing exclusive jurisdiction of the states to regulate these activities.[11] Since then, most states have enacted their own legislations to regulate the field and they have taken the Public Gambling Act of 1867 as their model. Hence, in most states, though 'betting and gambling are prohibited, they have created an exception for games of *'mere skill.'*[12]

This exception created for mere skill has led to number of cases and wealth of jurisprudence in the country as operators of variety of games have reached the courts to get legal validity under it. The Supreme Court since 1950s has interpreted games of *'mere skill'* as a game dominated by the element of skill.[13] The Indian courts in various cases has adopted this preponderance of skill test which is used by the US courts to evaluate games as game of chance or skill.[14] Applying this test, they have held, rummy, horse racing, etc. as legally permissible to play and have kept them out of the ambit of prohibitory laws which ban gambling.[15] They reason that every

[9] Public Gambling Act 1867.
[10] ibid, s 12.
[11] The Constitution of India 1950, Schedule VII List I, entry 34.
[12] Aayush Kapoor, 'The gambling law review: India' (2023) Shardul Amarchand Mangaldas <https://www.amsshardul.com/insight/the-gambling-law-review-india/> accessed 15 November 2024.
[13] State of Bombay v. R.M.D. Chamarbaugwala, AIR 1957 SC 699.
[14] Gowree Gokhale and Rishabh Sharma, 'The 'Skill' Element in Fantasy Sports Games' Nisith Desai Associates <https://www.nishithdesai.com/Content/document/pdf/Articles/180406_A_Legality_of_Fantasy_Sports_India.pdf> accessed 16 November 2023.
[15] State of Andhra Pradesh v. K. Satyanarayana, AIR 1968 SC 825; Dr. K.R. Lakshmanan v. State of Tamil Nadu, AIR 1996 SC 1153.

game has some inherent element of chance included in it and just because of this reason, it cannot be all together prohibited.[16] Any game which passes the preponderance of skill test is permissible and providing services to play it is constitutionally protected right under Article 19(1)(g).[17]

### *2. Fantasy Sports as Games of Skill*

This reasoning has been extended to fantasy sports provided through online platforms as well. In series of cases, the Punjab & Haryana, Rajasthan, and the Bombay High Courts have held them to be a game of skill satisfying the preponderance of skill test.[18] The Supreme Court has heard several appeals against these decisions of the High Courts dismissed them.[19] In *Avinash Mehrotra,* while dismissing the SLP against Rajasthan High Court judgment of *Chandresh Sankhla,* the Supreme Court noted that the issue of legal validity of Fantasy Sports has been no longer *res integra*. It noted that the prior dismissal of SLPs against the Bombay and Punjab & Haryana Hight Court judgments have settled that the Fantasy Sports have preponderance of skill involved and hence, fall under the exception of games of mere skill.[20]

It is observed by courts in these cases that playing Fantasy Sports involves a level of skill and judgment. It involves selection of players, analysis of their performance, consideration of rules of fantasy sports, etc.[21]

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[16] Satyanarayan (n 8).
[17] Chamarbaugwala (n 7); All India Gaming Federation v. State of Karnataka, AIR 2022 SCC OnLine Kar 435.
[18] Varun Gumber (n 7); Gurdeep Singh Sachar (n 7); Chandresh Shukla (n 7).
[19] Varun Gumber v. Union of India, in SLP (Criminal) Diary No. 35191/2019; Gurdeep Singh Sachar v. Union of India and Ors. in SLP(Crl) No. 11445/2019; Gurdeep Singh Sachar v. Union of India, Criminal Public Interest Litigation (St.) No. 22 of 2019; Avinash Mehrotra (n 7).
[20] Avinash Mehrotra (n 7).
[21] Varun Gumber (n 7); Gurdeep Singh Sachar (n 7).

Also, players cannot be from a single real-world team which requires great skills in their selection, and a host of other statistics about a player and team has to be considered for making a fantasy team. Playing conditions, past track record and current form of the team and the player, all play a major role in making the judgment. Hence, fantasy sports are a game of skill and permissible in India.[22]

However, it is always a question of fact whether a game has predominant element of skill or not and it has to be decided on a case-to-case basis. But those fantasy sports platforms which fulfil this criterion cannot be prohibited just because the fact that they can be played online and such online apps/websites have now made it easy for people to access them which is leading to problems of addiction, monetary loss, user harm, etc.[23]

### *3. Uneven Legal Landscape*

Though recognized by courts as games of skill, Fantasy Sports does not enjoy uniform legal status across the country. As noted earlier, gambling and betting is a subject under exclusive jurisdiction of the states. Many states have adopted the model of Public Gambling Act of 1867, some states have taken a different approach. The states of Orissa, Assam, Andhra Pradesh, and Telangana do not recognize the exception *mere skill* and prohibits all gaming activities in which money or an article of value is staked, notwithstanding any amount of skill involved.[24] This creates an

[22] Varun Gumber (n 7).
[23] Law and Technology Society, 'Panel I: Online Gaming Regulation in India', *Consilience 2023: Event Report* (2023) 8 <https://www.ijlt.in/_files/ugd/066049_54b16e8338464046a7c7a85b23efad31.pdf> accessed 13 January 2024.
[24] Odisha Prevention of Gambling Act 1955; Assam Game and Betting Act 1970; Andhra Pradesh Gaming Act, 1974; Telangana Gaming Act, 1974.

uneven legal landscape for Online Fantasy Sports across the country as they are not allowed to operate in these states.

This prohibition on operation of Fantasy Sports severely hinders the capacity of the residents of these states to participate in these games which are otherwise legal and allowed to operate in rest of the country. It also hinders the growth potential of the Fantasy Sports Industry and results in economic and revenue loss for the country. Moreover, this complete ban and lack of regulation of online gaming space allows illegal platforms to seep in that may harm consumer interests. Because these game operators may operate remotely, the state will not be able to enforce the prohibition properly. These problems arising from difference in legal status of Fantasy Sports across states are similar to that which stem from different regulatory regimes in some states. These are the primary reasons for which the authors endorse a regulatory spearheaded by center and not states. This is discussed later in the paper; however, here, it is sufficient to note that the difference in legal status hinders growth of the industry and also is not in interests of consumers.

Also, it is difficult to see how a complete prohibition on games of skill, that are constitutionally protected under Article 19(1)(g), is justified as meeting the reasonability requirement under Article 19(6).[25] However, the constitutionality of these prohibitions is outside the purview of this paper and, we move on to the regulatory framework for Fantasy Sports in India with assumption that they are games of skill and legal in majority of states.

### B. Current Regulatory Framework

[25] The Constitution of India 1950, art 19.

As seen from the previous section, Fantasy Sports fall under the exception of games of mere skill and are legal in most states. Therefore, outrightly banning them is not an option. But they call for a more nuanced approach from the government for their regulation to mitigate the risks associated with them.[26] This sub-section delineates upon the existing regulations governing Fantasy Sports in the country. It takes into account efforts both at state and central level to regulate the industry.

### *1. State-Level Laws*

The regulatory landscape for Fantasy Sports, and online gaming generally, varies across states. As noted previously, in some states like Telangana and Orissa, etc. they are completely banned and not allowed to operate, so no regulatory regime exist there. In most other states they are governed by existing gambling and betting that were enacted in pre-internet era and do not provide much for specific regulation of Fantasy Sports.[27] However, a few states such as Nagaland and Sikkim have enacted separate legislations to introduce a licensing regime for online gaming.

Sikkim requires online gaming operators to obtain a license before offering games of skill or chance in the State through the internet.[28] However, the laws in Sikkim do not differentiate between games of skill and chance and subjects all online games to the same regulations. This is not a good approach as the level of risk involved is substantially more in cases of games of chance and therefore, they should be treated differently.

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[26] ibid.

[27] Ranjana Adhikari, 'Gambling Laws and Regulations: India 2025' (*iclg.com*, 19 November 2024) <https://iclg.com/practice-areas/gambling-laws-and-regulations/india#:~:text=The%20Allahabad%20High%20Court%20in,of%20skill%20and%20not%20gambling.&text=On%20the%20other%20hand%2C%20the,the%20High%20Court%20of%20Gujarat.> accessed 19 November 2024.

[28] Sikkim Online Gaming (Regulation) Act 2008.

The distinction is present in the *Nagaland Online Games of Skill Act, 2016*[29] that had introduced a licensing regime for operators providing games of skill. The license is granted after checking the relevant documents of the operator like Random Number Generation (RNG) certification and software certification of the operator. However, the law in the present form does not provide adequate protection for industry specific concerns related to Online Fantasy Sports such as Addiction, experienced players taking advantage of novice players who run the risk of huge financial losses, among others.

In this regard, it is the *Rajasthan Virtual Online Sports (Regulation) Bill, 2022*[30] provides a licensing regime for Virtual Online Sports including Fantasy Sports. The inclusion of a legislative definition of Fantasy Sports and the formation of a commission for overlooking the same are welcome steps of this bill. However, the bill suffers from the same problem as the Rules made by the center (discussed later) as it leaves too much power in the hands of the Self-Regulatory Body and do not lay down concrete standards. Further, the Bill has not been passed by the state legislature till date.

### *2. Central-Level Regulations*

The account in previous section highlighted that there is no regulating regime for Fantasy Sports in most states. Laws there were enacted in pre-internet era and are inadequate to tackle the challenges presented by the online gaming market. Further, the unevenness in legal regime across states hindered the efficient operations of online gaming platforms including Fantasy Sports. The industry and market called for uniform central regulations to tackle the challenges provided by online

[29] Nagaland Online Games of Skill Act 2016.
[30] Rajasthan Virtual Online Sports (Regulation) Bill 2022.

gaming. Responding to these demands, the government amended, *The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021*[31] in April 2023 to bring under the regulatory ambit online gaming including online fantasy sports.

The main highlight of the amendment, *inter alia*, was the introduction of a self-regulatory regime for the online gaming industry. The new rules proposed to establish Self-Regulatory Bodies ("**SRBs**"), the approval of which will be necessary for online real money games to operate. [32] The SRBs have to primarily assess these gaming platforms on the criteria that the game does not involve wagering and is compliant with rules 3 and 4 requiring them to conduct due diligence, law relating to competence to contract and framework established by the SRB to verify them. [33]

The rules introduced the requirement to conduct due diligence for the online gaming intermediary platforms regarding games hosted on their platforms. The service providers are also required to inform the users about the rules and regulations of their platform, its privacy policy, user agreement, etc.[34] The online gaming intermediaries need to further ensure that no online game which is not permissible is provided or advertised through their platform.[35]

The real-money games are required to undertake further precautionary measures by appointing Chief Compliance Officer, Nodal Contact officer and Resident Grievance Officer and setup appropriate

[31] The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules of 2023.
[32] The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules 2021, rule 2(qc) & 4A.
[33] ibid, rule 4A.
[34] ibid, rule 3.
[35] ibid, rule 3(1)(a).

mechanism to receive complaints, and complete voluntary user verification using mobile number, among other things.[36] In addition to the general publishing requirements under rule 3, they are also required to publish their policy regarding deposit and withdrawal of money form, measures to protect those deposits, KYC information, and framework made by the SRBs for their verification and functioning.[37] Further, before accepting any deposit, online real money game providers are required to conduct user verification in accordance with Guidelines applicable for RBI-regulated entities.[38] They are also not allowed to finance their users by way of credit to play the game.[39]

Apart from these rules, the SRBs need to further develop the framework for approval and governance of permissible online games. The framework should ensure that the games not a threat to national security, and should include safeguards against user harm, child-protection measures, and measures directed towards prevention of addiction and financial loss and financial fraud.[40]

### C. Persisting Problems

The previous sections detailed the current legal as well regulatory landscape prevailing in India with regard to Fantasy Sports and also highlighted the efforts made to introduce reforms in the field. However, the current regulatory framework is vastly inadequate to address the challenges posed by Online Fantasy Sports.

[36] ibid, rule 4.
[37] ibid.
[38] ibid.
[39] ibid.
[40] ibid, Rule 4A.

### *1. Inadequate Regulations*

As has been discussed earlier, most of the states govern fantasy sports under pre-internet era laws that do not adequately address the unique problems of Online Gaming. The few states like Nagaland and Sikkim that do govern online gaming through specific legislation do not adequately address the unique challenges posed by Fantasy Sports like addiction, insider trading, chances of fraud among others. The proposed Rajasthan Bill is also inadequate because it provides too much discretion to the self-regulatory body setup. Further, as a result of varied legislations and laws in different states, the cost of compliance substantially increases for the Fantasy Sports operators which includes the cost of obtaining licenses in different states. Also, it becomes difficult enforce these regulations optimally specially when online gaming operators provide their services remotely from other jurisdictions.

To address these problems, the introduction of rules for Online real money games by the Centre is a step in the right direction. However, the rules lack the necessary powers to address some of the unique challenges posed by Fantasy Sports. The SRBs that are supposed to be set up under the rules have not been established even after almost 2 years from notification of the rules.[41] The rules also leave a lot of discretion in the hands of the SRBs in terms of developing framework to deal with framework for the online gaming platforms. As seen from the previous sub-section, it is for the SRB to create framework for verification of games and ensure that they are

[41] www.ETGovernment.com, 'Govt Mulls over Setting up Independent Regulator for Online Gaming - ET Government' (*ETGovernment.com*) <https://government.economictimes.indiatimes.com/news/governance/govt-mulls-over-setting-up-independent-regulator-for-online-gaming/108760311> accessed 23 November 2024.

not causing user harm and are protecting against addiction and financial losses. Except for the general criteria that the games should not be in form of wager, the Government has not provided any set criteria on which online real-money games need to be evaluated. Nor has it provided any fixed definition of what wagering is, how to determine it. Given the complex nature of Fantasy Sports formats, a deep analysis of each is required to evaluate whether they are a game of skill and includes wager on any outcome or not. Most of these requirements are left for the SRB to determine.

### *2. Legal Challenges to Central Regulation*

Apart from these, there are legal challenges to the rules introduce by the Central Government. The Central Government had introduced these rules in exercise of its powers under the Information Technology Act, 2000.[42] However, concerns have been raised regarding the competence of the Central Government to regulate Online Games as they fall under exclusive jurisdiction of the states under Entry 34 of the State List under the category of *Gambling and Betting.*[43] Therefore, the Central Government does not have the power to make these rules.

On the other hand, it has been argued by supporters of the Central regulation that the Centre is only regulating games of skill so it will not fall under *"Gambling and Betting."*[44] Online gaming will fall under Entry 31 of the Union List that gives power to the Centre to legislate upon

[42] The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules 2021.
[43] Shrutanjaya Bhardwaj, 'Regulating the Online Gaming Industry: Legislative and Executive Competence' (2023) 5 Nat'l LU Delhi Stud LJ 216 <https://heinonline.org/HOL/Page?handle=hein.journals/nludslj2023&collection=journals&id=222&startid=&endid=235> accessed 19 November 2024.
[44] ibid.

*"Telephones, wireless, broadcasting and other like forms of Communication"*. As these games are usually played by players sitting in different states, it can also fall under Entry 42 of the Union List that provides power to the Centre to legislate upon *"Inter-State Trade and Commerce."*[45]

For the purposes of this paper, it is not necessary to delve into the constitutionality of the rules. However, the authors endorse the view that the Centre has competence to promulgate the rules for regulation of online gaming as has been discussed by other authors.[46] We discuss the detailed reasons for central regulation of Online Fantasy Sports in Chapter 4.

### *3. Looking Forward*

Recently the Government is looking to move away from the proposed self-regulatory model to a more direct governmental regulation through an independent regulator. This shift in Government's stance comes after the proposals received for SRBs are found to be extremely industry dominated which could not have worked as a neutral body.[47] Hence, the MeitY is looking to form a new framework with independent educationists, psychologists and experts from other relevant fields.[48] Further, multiple forms of real-money games exist that are very different from each other, one of them is fantasy sports which also have a variety of formats.[49] The

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[45] ibid.

[46] ibid; Tanisha Khanna, Aarushi Jain & Gowree Gokhale, 'The Time for a Central Law for India's Online Gaming Industry is now' (4 March 2022) Nisith Desai Associates <https://nishithdesai.com/SectionCategory/33/Gaming-Law Wrap/12/45/GamingLawWrap/5394/1.html> accessed 19 November 2024.

[47] Lohchab (n 3).

[48] 'No SRO for Online Gaming, Govt to Act as Regulator' (*Financialexpress*, 12 February 2024) <https://www.financialexpress.com/business/brandwagon-no-sro-for-online-gaming-govt-to-act-as-regulator-3391156/> accessed 6 April 2024.

[49] Anthony N. Cabot & Louis v. Csoka, 'Fantasy Sports: One Form of Mainstream Wagering in the United States' (2007) 40 J Marshall L Rev 1195, 1208.

skill factor in different forms of the game may be different and consequently, certain formats of the same game may be games of skill while others are a game of chance. Therefore, setting out an umbrella regulation for all online real money games is not sufficient and the Government needs to come up with specialized regulations for different forms of real money games.

Further, there are unique consumer protection challenges like insider trading[50] in the fantasy sports industry that the current rules at the Centre or the state level laws completely overlook. The problem of insider trading creeps in because the Employees in the Fantasy Sports Operators may have access to information like the teams selected by the players for a specific contest which an outsider would not have access to. Now, if the employee is also allowed to participate in the same contest after having access to teams made by different contestants, then they may be able to manipulate the contest in their favour. A similar allegation was raised against an employee of DraftKings who had allegedly won $350,000 using information that was not available in public.[51]

These problems are unique to the industry and the Consumer Protection Act may not be sufficient to address these specific needs. Given the nature of the industry and the potential of large risks, the Government needs to come up with broad guidelines that the SRBs or the proposed

[50] Marc Edelman, 'The Daily Fantasy Sports Scandal: Why Insider Trading May Be Just Tip Of The Iceberg For DraftKings' (*Forbes*) <https://www.forbes.com/sites/marcedelman/2015/10/15/the-daily-fantasy-sports-scandal-why-insider-trading-may-be-just-tip-of-the-iceberg-for-draftkings/> accessed 22 March 2024.

[51] Joe Drape and Jacqueline Williams, 'Scandal Erupts in Unregulated World of Fantasy Sports' *The New York Times* (5 October 2015) <https://www.nytimes.com/2015/10/06/sports/fanduel-draftkings-fantasy-employees-bet-rivals.html> accessed 20 November 2024.

independent regulator need to keep in mind before drafting the specific rules for fantasy sports. Therefore, a detailed regulatory regime is imperative for consumer protection and the growth of this industry. A broad set of guidelines will also help the SRBs/Independent Regulator operate and draft specific rules.

In the following Part, we shall look at the regulatory regimes followed by different countries to regulate online gaming, especially fantasy sports. We shall specifically focus on the best practices that suit the socio-legal landscape of India.

## III. GLOBAL BEST PRACTICES ON REGULATION OF FANTASY SPORTS

From the last part it is clear that fantasy sports are permissible to operate in India as these are considered games of skill. However, there is a need to regulate them and bring their activities under governmental oversight to mitigate the risks associated. Many countries where fantasy sports are allowed to operate have realized the need to tackle the problems associated with them and have created extensive regulations to control the activities of online gaming industry, including the fantasy sports industry, to curb their negative impacts.

This Part looks at a few such regulatory regimes developed in different jurisdictions to identify and analyze best practices from there to see their suitability and incorporate them in the Indian regime. It primarily considers the regulations of the U.S.A., the U.K., and Australia, as these have a large fantasy sports market and have developed extensive regulations for monitoring the industry to reduce the risks associated with it.

### A. USA

The USA has a huge market for fantasy sports. The huge market has led to regulation of the fantasy sports industry. There is a two-tier of regulatory regime governing Fantasy Sports in the USA, one at the state and another on the federal level. In Sub-section I we discuss the federal law that provides a few conditions on fantasy sports that a game operator has to adhere to. Sub-Section II points out some of the problems that are prevalent in the Fantasy Sports industry and the relevant state regulations that tackle the same.

### *1. Federal Law: An Exception for Fantasy Sports*

Congress passed the *Unlawful Internet Gambling Enforcement Act, 2006* ("UIGEA") to regulate gambling on the Internet. UIGEA explicitly exempted seven activities that closely resembled gambling from the purview of this act. Among the seven activities were Commodity trading, share trading, insurance, and fantasy sports among others.[52] Therefore, fantasy sports were legalized and were held as not gambling as per the federal legislation subject to a few conditions. The conditions are: (1) Prizes and awards must be declared and should be made known to the participants before the game and the value of prizes must not depend on the number of participants or the amount of fees paid by those participants; (2) Winning outcomes must reflect the knowledge and skill of the participants; (3) Winnings should not be based on the score or performance of a single individual in a match or a sporting event or a single real-world team.[53] However, there are other concerns related to the fantasy sports industry like the possibility of insider trading, consumer protection, and addiction among others, for which, the states have adopted various regulatory regimes which

[52] 31 U.S.C. §5362 (1)(E)(i)-(viii)
[53] ibid.

shall be discussed in the next sub-section.

### *2. State Laws: Insights for Consumer Protection*

In this subsection, we shall *firstly*, look at some of the problems that have been identified in the fantasy sports sector in the USA; *Secondly*, go over the different state regulations on fantasy sports to understand how they tackle the problems. The US state laws provide some great insights for promoting consumer protection and preventing consumer harm.

### *3. The Problems*

Supporters of the Fantasy Sports industry have often argued that participating in fantasy sports is similar to trading shares in the stock market.[54] The similarity with the stock market, however, brings with it the similar problem of insider trading. An allegation of insider trading (as has been discussed in Chapter II) was levelled against an employee of DraftKings which is one of the biggest fantasy sports companies in the USA.[55] Along similar lines, a report highlighted that only a small fraction of the participants who are the experts in the game win the greatest number of games and win big money while the beginners are usually the losers.[56] Although this supports the skill element of the game, this raises consumer protection concerns where a few experts can exploit beginner or amateur players.

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[54] Muralee Das, "International Regulation of Fantasy Sports: Comparative Legal Analysis of United States, Australian, and Asian Laws" (2018) 8 UNLV Gaming Law Journal 93.
[55] 'Scandal Erupts in Unregulated World of Fantasy Sports - The New York Times' <https://www.nytimes.com/2015/10/06/sports/fanduel-draftkings-fantasy-employees-bet-rivals.html> accessed 17 November 2024.
[56] 'All the Reasons You (Probably) Won't Win Money Playing Daily Fantasy Sports - The Washington Post' <https://www.washingtonpost.com/news/the-switch/wp/2015/10/12/all-the-reasons-you-probably-wont-win-money-playing-daily-fantasy-sports/> accessed 17 November 2024.

The above report is also in contrast to how fantasy sports manufacturers often advertise their contests by promoting the idea that any casual sports fan can win big fat cheques by playing fantasy sports. This raises concerns about deceptive advertisement and unfair trade practices.

### *4. The Regulatory Frameworks*

The state of Massachusetts provides a well-rounded regulatory mechanism to tackle at least some of the above-stated problems.[57] The regulations provide a minimum age restriction of 21 for fantasy sports.[58] It also provides for restrictions on the advertising practices of daily fantasy sports[59] and the amount of money a particular individual can deposit in their fantasy sports account.[60] It also provides a strict ban on the participation of employees and other affiliates of fantasy sports companies in in the games offered by these companies either directly or indirectly through the account of some other persons.[61] Along similar lines, it mandates fantasy sports companies to have separate contests for beginners and experienced players. An experienced player is not allowed to participate in the beginners' contest either directly or through some other person.[62] This more or less takes care of the unique challenges mentioned in the previous part on "problems."

Virginia also regulates fantasy sports under *The Fantasy Contests Act*. It requires Fantasy Sports operators to have a license from a Government Department and a registration fee of $50,000 for the license. The conditions for getting a license require the operator to have a certain

[57] Daily Fantasy Sports Contest Operators in Massachusetts, 940 MASS. CODE REGS. 34.00 (2016).
[58] ibid 34.
[59] ibid 34.07-34.09.
[60] ibid 34.10(6).
[61] ibid 34.12.
[62] ibid 34.12(6).

age verification policy[63] and require the funds deposited by the participants to be separate from the company's operating funds.[64]

US has an elaborated regulatory framework as web of different state and federal laws dedicated specifically to monitor the activities of fantasy sports. It provides a few important lessons to tackle some deep-rooted problems with the fantasy sports leading to unfair activities and consumer exploitation.

## B. UK

### *1. Regulatory Body and Licensing Regime*

In UK the fantasy sports are considered as gambling and come under the regulatory ambit of the Gambling Act 2005.[65] More specifically they are considered as pool betting under Section 12 of the Act.[66] *In pool betting the stakes are pooled and the amount of money won by the successful customers is calculated by dividing the total pool (minus commission) by the number of winners.* As the fantasy sports follow a similar format they are covered under this definition.[67]

The Gambling Act establishes the Gambling Commission which is the overarching body for regulating gambling activities in UK.[68] Unlike self-regulatory approach proposed in India, the UK regime envisages strict governmental regulation of the sector.

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[63] Code of Virginia 2022, § 59.1-557.
[64] ibid.
[65] Gambling Act 2005.
[66] ibid, s 12.
[67] 'Remote pool betting licence' (*Gambling Commission*, 9 February 2023) <https://www.gamblingcommission.gov.uk/licensees-and-businesses/licences-and-fees/remote-pool-betting-licence> accessed 17 November 2024.
[68] Gambling Act 2005, s 20.

Every operator providing any form of gambling services is required to obtain license from the commission and without such license providing and advertising such services is an offence and is dealt with strict penal actions.[69] Online fantasy sports platforms are required to obtain remote pool betting license before providing their services in UK. This is regardless of whether the operations of the platform are conducted from the territory of UK or outside. The operator needs to pay application fee for applying for the license and after obtaining the license, the operators are required to pay annual fee for holding the license. These fees are calculated according to size of the operator based on gross yield from services provided.[70]

To obtain license, the operators are required to furnish host of details about their business and types of services provided. They relate to finance and investment details, business structure, compliance details, software information, system diagram (working of the game from registration to end delivery support), rules of the game, data hosting information, terms and conditions, etc.[71] The applicant is also required to provide an address in the UK.[72] The Commission assesses the application and after the evaluating its suitability grants license.[73] Information of the licensed operators is added in

[69] 'Do I need a licence?', (*Gambling Commission,* 23 December 2022) <https://www.gamblingcommission.gov.uk/licensees-and-businesses/page/do-i-need-a-licence> accessed 17 November 2024.
[70] Remote pool betting licence (n 62).
[71] 'What you need to send us when you apply for an operating licence' (*Gambling Commission,* 9 January 2024) <https://www.gamblingcommission.gov.uk/licensees-and-businesses/guide/what-you-need-to-send-us-when-you-apply-for-an-operating-licence> accessed 17 November 2024.
[72] Gambling Act 2005, s 69; 'How we assess operating licence applications' (*Gambling Commission,* 7 June 2021) <https://www.gamblingcommission.gov.uk/licensees-and-businesses/guide/page/how-we-assess-operating-licence-applications> accessed 17 November 2024.
[73] ibid.

the public register and is displayed on the Commission's website.[74] If the Commission denies any application it has to provide reasons for such denial and an appeal may be made against its decision.[75]

A license holder, such as online fantasy gaming operator, is required to comply with the conditions prescribed by the Commission. The operator has to display the license status and number on its platform.[76] It has to comply with all the technical standards issued by the Commission with regard to the software used.[77] The operators are required to provide services in confirmation with other applicable laws including the anti-money laundering, and consumer protection laws.

### *2. Consumer Protection*

The license holders are also required to take steps and implement practices that promote consumer welfare and reduce the risk of money laundering and are required to report any criminal activities promptly.[78] Further, they are under obligation to report any security breach in their software which threatens the consumer data privacy or other software malfunctions relating to wrong distribution of prices to the Commission. Also, any information which influences the business operations of the operator shall be communicated to the Commission along with the

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[74] 'Public registers and datasets' (*Gambling Commission*) <https://www.gamblingcommission.gov.uk/public-register> accessed 17 November 2024.
[75] 'Appeal against a decision made about your licence or application' (*Gambling Commission,* 7 June 2021) < https://www.gamblingcommission.gov.uk/licensees-and-businesses/guide/page/appeal-against-a-decision-made-about-your-licence-or-application> accessed 17 November 2024.
[76] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Operating License Conditions, condition 8.
[77] ibid, condition 2.3.1.
[78] ibid, condition 3, 7, 12, & 15.

information about any legal or regulatory proceeding involving the operator.[79]

The operators are required to provide the consumers with proper information regarding rules of the game and shall communicate to them all the information regarding deposits and withdrawal of money along with the details required from the consumers for undertaking these actions.[80] Before providing services, the operators are required to undertake consumer identity verification in accordance with the rules.[81] If there are more than one account of a consumer, operator is required to identify them, impose limits on them as required by the rules and monitor them aggregately.[82] They are also required to keep record of all the games played, bets made, winnings, payments made and other information about the game on their platform.[83] The money received from the consumers shall be kept in separate account and all the information about its security and shall be provided to the consumers.[84] The operators also need to identify underage users and disable their accounts.[85]

Along with the above requirements, the operators shall make policy and take steps to provide the consumers the option of self-exclusion and if this option is exercised by the consumer, then restrict their account and

[79] ibid, condition 15.
[80] ibid, 7, 17; Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Code of Practice provisions, provision 4.2.9.
[81] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Operating License Conditions, condition 17.
[82] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Code of Practice provisions, provision 3.9.
[83] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Operating License Conditions, condition 13.
[84] ibid, condition 4.
[85] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Code of Practice provisions, provision 3.2.8, 3.2.11.

avoid any targeted advertising to them.[86] Also, the operators are required to provide credit to the consumers for playing in responsible manner in accordance with the limits imposed by the rules and any bonus or incentive provided to the consumer shall also not be disproportionate and shall follow guidelines by the Commission.[87] The operators are required to have effective complaint mechanisms and shall have arrangements to resolve the grievances through ADR systems. Also, the operators are obligated to advertise their platform in accordance with the guidelines prescribed by the Commission.[88]

### *3. Assessment and Oversight*

There are regular assessments undertaken by the Commission to ensure that the conditions are being followed. The operators are required to file periodic reports such as annual financial statements, and other records with the Commission.[89] They are under general obligation to co-operate with the Commission and are required to furnish any information as demanded by it. With help of these regular updates, the Commission is able to evaluate the effectiveness of the regulations and identifies potential risks in the system and mitigate them.[90]

UK has one of the most extensive regulatory regimes for gaming industry and presents itself as one of the most efficacious systems with centralized control. It provides many lessons for the Indian framework which is still in nascent stage and adopting the best practices from the UK

[86] ibid, provision 3.5.
[87] ibid, provision 3.7.
[88] ibid, provision 5.1.
[89] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Operating License Conditions, provision 13.
[90] Licence Conditions and Codes of Practice (Version Effective from 31 October 2023), Code of Practice provisions, provision 1.1.

can be beneficial for the country's gaming sector, including online fantasy sports.

### C. AUSTRALIA

Australia is one of the biggest, most liberal and mature legal regulatory regimes for the gaming industry.[91] It offers a few useful insights for regulation of online gaming industry and these can be particularly significant for developing a regulatory framework for Indian fantasy sports industry.

Australia has a two-tiered system for gaming regulations in which operators are required to comply with national (federal laws) at first tier and with the different state laws at the second tier.[92] The *Interactive Gambling Act, 2001* (IGA) was enacted to regulate internet-based gambling at the central level.[93] Australian Media and Communications Authority (ACMA) is the body charged under the Act to regulate internet-based gambling.[94] Most of the gambling services provided through internet are prohibited under the Act, however exception is made for placing bets through wagering services on sports events.[95] These permitted activities are regulated under the Act and need to comply with the rules and regulations under the Act for providing services. Though there is a little debate, fantasy sports are

[91] Das (n 51) 103; Eric L. Windholz, 'Fantasy sports in Australia: co-regulation and commercial accommodation' (2021) 21 The International Sports Law Journal 154, 163 <https://link.springer.com/article/10.1007/s40318-021-00187-x> accessed 17 November 2024.
[92] Windholz (n 86), 157.
[93] Interactive Gambling Act 2001.
[94] Das (n 51) 105.
[95] Interactive Gambling Act 2001, s 8A.

generally considered to be falling under the sport event wagering exception of the IGA and permitted under the Australian regime.[96]

Keeping this debate aside, the Australian regime provides a few important insights for regulation of fantasy sports. The extensive policy research done in Australia helps to provide a good working definition of the fantasy sports. In 2015 review of the IGA, the report defined fantasy sports as "*a game where participants assemble imaginary or virtual teams of real players of a professional sport. These teams compete based on the statistical performance of those players in actual games."* It further distinguishes different formats of the game and says *"traditional fantasy sports are contested across a long time period (typically a season) across a number of formats. Daily fantasy sports, or DFS, are contested across a shorter period (typically a day or a week)."*[97] This definition can be used with suitable modifications for determining the gaming formats falling under the category of fantasy sports.

Further, Australia presents a unique hybrid model of polycentric regulatory mechanisms, especially for the fantasy sports.[98] The responsibility is shared by government both at central and provincial level, industry stakeholders and governing bodies of different sports. Under this model, the gaming service providers are under broader control of state authorities and require license from these authorities to provide their

[96] Australian Gov't, Dep't of Broadband, Communications and the Digital Economy, 'Final Report 2012: Review of the Interactive Gambling Act 2001' (2012) 154-155 <https://www.responsiblegambling.vic.gov.au/__data/assets/pdf_file/0003/23718/Final_Report_-_Review_of_the_Interactive_Gambling_Act_2001-2012.pdf> accessed 17 November 2024.

[97] Australian Gov't Dep't of Social Services, 'Review of Illegal Offshore Wagering' (2015) 5 <https://www.dss.gov.au/communities-and-vulnerable-people/ programmes-services/gambling/review-of-illegal-offshore-wagering> accessed 17 November 2024.

[98] Windholz (n 86), 163.

services.[99] However, the industry is free to make its own code and set standards for itself. These standards are to be registered with the ACMA and the government authority will only step in to regulate the service providers where there is no industry code or the code failed.[100] This presents a unique picture where government provides a flexible framework in which the industry can self-regulate itself.

Further, the sport governing bodies are made co- or quasi-regulators of the industry and the fantasy sports platforms are required to get approvals from and sign an information-sharing agreement with these to operate. The sport governing bodies levy fee in respect of this.[101] This is efficient way to regulate as these provide the sport governing bodies with the resources and data to monitor the integrity of fantasy sport. The experience and skills of the bodies are utilized to keep the sector in check and at the same time government resources are freed as the operators pay for these.[102] There are possibilities of the collaboration between sport governing bodies and the fantasy sport companies extending beyond what is required by law such as to share statistics and for promotional purposes. Concerns are also raised with these extended collaborations. But keeping the question of close-knit collaborations aside, the regulatory framework involving sport governing bodies is effective and efficient as it decentralizes the framework and also helps in channelizing the expertise of these bodies.[103]

Apart from this, the service providers are also required to follow the self-exclusionary laws in place which allows individuals to exclude themselves from these gaming activities. They are required to put in place

[99] Interactive Gambling Act 2001, s 104.
[100] ibid, Part 4.
[101] Windholz (n 86), 163.
[102] ibid, 164.
[103] ibid.

measures to not provide or advertise their services to individuals who are registered in self-exclusion register.[104] Also, the service providers are under obligation to advertise their services in accordance with the laws and abide by other applicable laws in providing such services.[105] ACMA is empowered to undertake penal actions if the rules are contravened in any manner.[106] Australia with its extensive and mature regulatory framework, makes for a good case to look for guidance in developing our own regulations.

### *1. Summing Up*

From the foregoing discussion, we get an idea about the problems and risks that are unique to the industry like insider trading, addiction, chances of experts exploiting novice players, among others. The experiences from the US, the UK, and Australia can help us address these problems and serve as a good guide for the modelling our own regulations. India currently lacks a regulatory regime that can bring uniformity in the industry and ensure consumer protection. The insights provided by the comparative analysis of different regimes is good starting point to create a regulatory framework in India.

## IV. RECOMMENDATIONS

From the discussions in Part II, it is well established that fantasy sports are games of skill. Nonetheless, strict regulations are required over the industry to tackle the problems and risks associated with it as highlighted in the paper above. Currently, the Indian regulatory framework

[104] Interactive Gambling Act 2001, Part 7B.
[105] Windholz (n 86), 157.
[106] Interactive Gambling Act 2001, Part 3.

is very uneven. In some states Fantasy Sports is prohibited all together, some states like Nagaland and Sikkim have their specific legislations to govern online gaming including Fantasy Sports, and in most states the legislations in the field are from pre-internet era and do not adequately regulate the Fantasy Sports sector. The newly introduced Online Gaming Rules which propose a self-regulatory regime for the governance of the sector lacks any teeth to provide strict regulation for the sector and leaves too much for the SRBs to decide on. Even the state-level regulations where ever they are present, do not adequately address the problems presented by Online Fantasy Sports, as highlighted in previous sections.

As seen in the above comparative analysis of foreign jurisdictions, the regulation of fantasy sports requires a nuanced approach with appropriate governmental oversight. This chapter after taking into account the proposed Indian frameworks and insights from the regulatory regimes of other jurisdictions recommends overhaul and development of the Indian regulatory structure to best suit the needs of the industry and socio-legal context of the country.

### A. Defining Fantasy Sports

Fantasy sports present unique challenges as compared to other online real-money games because of their special connection with the real-world games and because of risks associated with them. However, to combat these risks and regulate fantasy sports, it is first important to define them and preciously point out what all games will fall under its definition.

As discussed, the Australian system provides a good definition for these purposes as it covers both traditional fantasy sports formats, which are contested over longer durations and modern shorter formation such as Daily

Fantasy Sports (DFS).[107] It defines it as a game where participants assemble imaginary/virtual teams of real players which compete based on statistical performance of those players in actual games. Similarly, the proposed Rajasthan Bill for regulation of Fantasy Sports define it as:

> *"Fantasy Sports" means any Online Competition in which a contest is offered by the Fantasy Sports Platform where users are permitted to emulate selectors, coaches, captains of online teams, consisting of real-life players or teams, that compete against online teams of other users with-results tabulated on the basis of statistics generated by the real-life sportspersons in officially sanctioned sports matches, including but not limited to, pay-to-participate variants where users pay Entry Fee to participate in the contest on the basis that the contest's aggregate Prize Monies and Awards are contributed to by all the participating users;*[108]

This definition further defines Fantasy Sports in more specificity than the Australian definition, and is suitable to include wide variety of Fantasy Sports formats offered. *It is recommended that this definition should be adopted to define online fantasy sports in India as distinct real-money gaming format, which should be subject to specialized regulatory regime as suggested below. Hence, any game that falls under the above definition, is provided through online means, and involves dealing in real-money in any manner shall be defined as Online Real-Money Fantasy Sport (ORMFS).*

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[107] Australian Gov't Dep't of Social Services, 'Review of Illegal Offshore Wagering' (2015) 5 <https://www.dss.gov.au/communities-and-vulnerable-people/ programmes-services/gambling/review-of-illegal-offshore-wagering> accessed 17 November 2024.
[108] Rajasthan Virtual Online Sports (Regulation) Bill 2022, s 2(k).

### B. Regulating ORMFS

The ORMFSs shall be subject to a different and nuanced regulatory regime for their unique nature. The different models of regulation utilized the world over have both centralizing and decentralizing features, aim to exercise different levels of control over the service providers, combine the expertise of various stakeholders to monitor and facilitate fantasy sports, and provide for different levels of user protection and support.

After taking into account all these, the authors endorse a centralized regulatory framework, framed by the Central Government, for online Fantasy Sports in India. This will create a uniform licensing regime which will reduce the compliance cost for the operators. Further, a central regulatory regime will protect all the players of fantasy sports across the countries in a uniform manner which is necessary as players from different states compete with each other in Online Fantasy Sports. Apart from these, it is difficult for states to enforce their rules as the Fantasy Sports operators might be operating from a different state. The Centralized regulation model in the UK provides a good guidance for this.

In view of the above, three sets of recommendations are provided below: *first* for the formation and composition of regulatory bodies, *second* for developing a licensing regime for ORMFS and *third* for making broader guidelines for the licensed ORMFSs. Some of these provisions are already present in the current central regulation and some of the state laws. However, for effective protection of the Fantasy Sports players, it is necessary to have all the guidelines laid down below.

The current intention of the Government to move towards an independent regulator is the correct approach for this industry as the self-

regulatory body would have been prone to heavy influence of big industry players. Although the industry is in nascent stages, the possibility of a few industry players controlling the self-regulatory bodies could have later led to antitrust issues. Heavy industrial influence at regulatory is also not in best interests of the consumers. Hence, an independent regulator should be set up for regulating online games with a dedicated wing for online fantasy sports.

The present 2023 amendment rules already have provisions mandating the inclusion of independent experts in the field of public policy, and civil societies among others in the SRB.[109] However, the framework misses out on the importance of having a statistician on board for evaluating the probabilities in the game to determine whether the game is a game of skill or not. It also misses out on the inclusion of sports governing bodies which is important in view of the dependence of fantasy sports on real-life sporting events. Similar representation of sports governing bodies is present in the Australian regulatory framework as discussed earlier. The emphasis on independence of these members cannot be overstated for keeping aside any vested interests that might affect the working of the industry. Hence special provisions need to be incorporated to ensure independence of the members. When the independent regulator is set up, these problems should be addressed.

In view of the same, the following recommendations are being provided to the Government on the composition of regulatory bodies for the fantasy sports industry and providing broad working guidelines for it:

[109] The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules of 2023, rule 4A.

- An Independent regulatory body should be setup for the online gaming market with a special wing for regulating ORMFSs with industry stakeholders as well as independent experts in the fields of statistics, law, governance, technology, and civil societies working for the cause of responsible gaming.
- The special wing for ORMFSs should also have members from sport governing bodies like BCCI, and AIFF among others.
- The independent members should be appointed in consultation with the industry stakeholders. The exercise of appointment of independent members shall ensure that the members so appointed enjoy complete independence and work in the best interest of the public.

### C. Licensing Regime

The present rules require the service providers to seek approval for every new online real money game from the SRB.[110] However, the present rules do not provide any guidelines as to how such approvals should be given and what are requirements needs to be fulfilled for getting such approvals. It is also unclear as to whether new formats of the same fantasy sport will be considered as a separate real money game or as part of the same game. Keeping these in mind, we herein propose a two-prong licensing regime where the fantasy sport service provider has to obtain a separate license for running business in India (Service Provider License) and specific license for each separate format of a game (Game Operating License) from the independent regulator. A similar licensing regime is present in the United Kingdom as has been discussed earlier.

[110] ibid.

The Service Provider License will help the regulator monitor the service providing company and make sure that they are not engaging in any unfair practices. On the other hand, the game operating license will make sure that every format of an existing game as well as new games are weighed according to the probabilities involved in it so that it does not violate the skill-test. In the following para, we provide a few broad guidelines and a few specific details around which these licenses should be granted.

The ministry should provide the regulator with the following broad guidelines for licensing within which the regulator should frame its detailed rules:

- No fantasy Sports service provider shall provide its services for ORMFS without a license from the regulator.
- The regulator should provide two kinds of license: 1) Service Provider License, 2) Game Operating License
- Each Fantasy Sports service provider shall require a service provider license.
- Every new format of the ORMFS provided by a service provider shall require a separate gaming license.
- For a service provider license, the operator shall provide details about the services that it is providing, the structure of its business, details on its investments, and other financial details and other relevant compliance details required, including office address within the territory of India. Whether it has adequate KYC mechanisms and protection to restrict underage players.
- For a Game Operating License, the following details shall be provided: information about the software used, system diagram,

rules of the game, statistical data used and its mode of data analysis, terms and conditions, and details of other relevant compliances and its service provider license.

- The regulator shall evaluate the gaming format based on the predominant factor test and should check that the game fulfills the requirements of all the other rules applicable.

### D. Obligations of ORMFS

Apart from the licensing regime, the regulator need to actively monitor the functioning of the service providers to mitigate the risks associated with fantasy gaming. As and when the the independent regulator is established, the ORMFS wing should frame guidelines on the obligations of the fantasy sports industry. In the following paragraph, we have provided a non-exhaustive list of obligations that the regulator should require the service providers to comply with. These are provided keeping in mind the specific risks associated with the industry such as insider trading, money laundering, the possibility of a few experts exploiting novice players, misleading advertisements and addiction. Apart from these, online fantasy sports are heavily dependent on technology and software innovation which needs to be monitored by the regulator.

The regulator should further provide the following guidelines and check that the following are being met by the license holders:

- No employee of the service providers shall be allowed to play ORMFS either directly or indirectly through someone else's account.
- The money deposited by the participants shall be kept in a separate account from the ones where the company operating money is being held.

- The regulator should provide technical guidelines for the software used for the operation of the fantasy sport which shall be complied by the license holder.
- The service provider must keep records of all the games played, bets made by the participants, winnings, deposits and withdrawals, and other relevant information about their gaming services.
- There shall be separate Tier of games for experts, intermediate and beginner players and it should be ensured that players from different tiers are not competing against each other.
- There should be a limit on the amount of money that can be deposited by a participant in a day/week/month and credit shall not be provided to any participants.
- The service providers shall comply with the standards set by the regulator on advertisements and shall not engage in misleading advertisements.
- The service provider shall annually submit reports to the regulator on their financial details.
- The service provider shall be under a general obligation to cooperate with the regulator and provide any additional information as required by the regulator.

## V. CONCLUSION

The fantasy sports industry in India is at a pivotal crossroads, with its rapid growth bringing immense economic potential alongside significant regulatory challenges. As highlighted in this paper, while fantasy sports have been classified as games of skill and enjoy legal recognition in most Indian states, the absence of a comprehensive, centralized regulatory framework has led to inconsistencies and inefficiencies in governance. This

regulatory void not only hinders the industry's potential but also exposes consumers to risks such as financial exploitation, addiction, insider trading, and inadequate grievance redressal mechanisms.

Drawing from global best practices in jurisdictions such as the USA, the UK, and Australia, it becomes evident that a well-structured regulatory regime can balance innovation with protection. For India, a centralized regulatory authority specifically tailored for fantasy sports is essential to address the fragmented state-level legal landscape. Such a body would ensure uniform licensing, monitor adherence to consumer protection standards, and provide clarity to operators and consumers alike. A two-tiered licensing regime—one for service providers and another for individual game formats—has been recommended to ensure thorough vetting and adaptability to the evolving nature of the industry.

Furthermore, strict regulations on key issues such as employee participation, financial transparency, tiered competition levels for players, and advertising standards will enhance the integrity of the industry. The introduction of safeguards, such as limits on monetary deposits and mechanisms to prevent underage participation, will address concerns about addiction and financial harm. These measures, combined with robust grievance redressal systems and compliance monitoring, will foster consumer trust and ensure fairness in the industry.

An effective regulatory framework will not only protect consumers but also create an equitable playing field for operators, driving healthy competition and innovation. Moreover, by incorporating insights from international regulatory models and tailoring them to India’s socio-economic context, the country can set a global precedent in fantasy sports governance. The proposed regulatory approach ensures that the fantasy sports industry thrives sustainably while safeguarding the interests of all

stakeholders. By addressing the challenges with foresight and a commitment to responsible growth, India can position itself as a global leader in this dynamic sector, promoting economic development, consumer welfare, and technological innovation in equal measure. We hope that these recommendations will be a good stepping stone for further research and effective regulation in this field.

# V. SENTIENT ALGORITHMS AND CORPORATE LAW: A LEGAL ODYSSEY TO THE NEW AGE OF INTELLIGENT ENTERPRISES

- Devansh Lunawat and Swastika Saxena*

ABSTRACT

As humanity challenges itself to turn seemingly impossible imaginations into reality, the evolution of Artificial Intelligence ("**AI**") is sending shockwaves through the fabric of society, impacting corporations and legal frameworks. The paper attempts to understand the implications of incorporating AI into the corporate structure with a multidisciplinary approach. The first part of the paper traces the timeline from the genesis of AI to the current state of affairs. The paper delves into understanding the technological intricacies to demystify the question, "What is AI?". The second part unfolds by exploring the possibilities of incorporating AI in corporations and boardrooms at different levels of autonomy. After observing the existing paradigms and future trajectories, it can be discerned that corporate funding for AI integration is poised for an exponential curve. The third part analyses the existing corporate law principles, assessing their adequacy to sufficiently guide the directors in utilising the emerging technology. Notably, the existing Companies Act, 2013 lacks explicitprovisions for AI, thereby precluding the appointment of AI as a director or distinct entity. However, the use of AI at assisted autonomy levels can be accommodated under the current framework. The section further explores the "liability gaps" existing in the current legal framework for ascertaining the contractual and extra-contractual liability of corporations fordamages stemming from AI utilisation. The final part proposes prospective regulatory solutions, drawing inspiration from the analysis of technological aspects, judicial pronouncements, and committee reports to guide the effective governance of AI. The authors advocate for exploring regulatory frameworks with an understanding of the development and deployment of AI systems. This paper contributes to the existing literature by elucidating AI'simplications for corporations, offering prospective solutions within the Indian contex, and showcasing the different mechanisms employed by AI systems and their implications for addressing the challenges and exploring solutions.

**Keywords**: Artificial Intelligence, Neural Networks, Liability Gaps, Corporate Law, Boardroom

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## I. INTRODUCTION

All different classes of tools have influenced and molded human destiny. Fire, wheels, electricity, the Guttenberg press, and the invention of semiconductors have paved the way for new epochs. These tools have assisted or augmented human intelligence. However, none of these tools can be regarded as intelligent. This is meant to change with the emergence of Artificial Intelligence ("**AI**"), marking a fresh era characterized not only by machines assisting human beings but rather by *human-machine partnerships*.

This path of AI development paved the way for the fourth industrial revolution with its fair share of risks and opportunities.[1] The potential that AI holds is also home to socio-economic risks and novel challenges that are yet to be addressed.[2] The integration and consolidation of AI framework are currently in their nascent stage,[3] and with the smooth innovation at every

[1] The UNESCO Courier, 'The Fourth Revolution' <https://courier.unesco.org/en/articles/fourth-revolution> accessed 4 September 2023

[2] Deirdre Ahern, 'The Impact of AI on Corporate Law and Corporate Governance' <http://www.tara.tcd.ie/bitstream/handle/2262/101064/AI%20AND%20CORPORATE%20LAW%20.pdf?sequence=1&#:~:text=As%20AI%20gains%20agency%2C%20the,business%20models%2C%20culture%20and%20systems> accessed 6 September 2023.

[3] Tim Fountaine and others, 'Getting AI to Scale' (2021) 99(3) Harv Bus Rev 116.

corner, integration of AI into numerous sectors is taking place rapidly.[4] In the coherence of the corporate landscape, wherein each characteristic should reflect a strategic decision, a novel form of overlap is taking center stage: an imbrication between AI and the pivotal foundation of corporate governance, as the main actors in the corporate industry try to bring this overlap of algorithmic and human intellect to the daily affairs of the company.[5]

The paper critically analyzes the feasibility of inducing AI in corporate law in essence with the current Indian legal standing. It is pertinent to address these issues at the earliest, given that several industries that AI has already captured, such as production, management, and marketing. Extensive rounds of deliberation and introspection are needed to ensure the smooth evolution of corporate law for tackling novel issues posed by AI.

## II. PART I: INGENUITY OF MANKIND AND THE GENESIS OF AI

### A. The Road Towards Creation of Intelligence

The aspirations of intelligent machines that can complete tasks with the same dexterity as humans can be traced long back in history. Hephaestus, the divine blacksmith in Greek mythology, forged robots that were capable of performing human tasks.[6]

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[4] Wenjun Shen, 'Analysis of the application of artificial intelligence technology in the protection of corporate governance rights and interests' *Frontiers* (12 September 2022) <https://www.frontiersin.org/articles/10.3389/fpsyg.2022.966689/full> accessed 6 September 2023.

[5] Sara Castellanos, 'Microsoft AI Ethicist Guide Businesses on Responsible Algorithm Design' *The Wall Street Journal* (18 October 2018) <https://www.wsj.com/articles/microsoft-ai-ethicist-guides-businesses-on-responsible-algorithm-design-1539881902> accessed 12 September 2023.

[6] Alex Shashkevich, 'Stanford researcher examines earliest concepts of artificial intelligence, robots in ancient myths' *Stanford News* (28 February 2019)

Ada Lovelace and Charles Babbage developed the *Analytical Engine*, a computational machine capable of performing any algebraic work, thereby marking the advent of an age characterised by information technology.[7] The questions, *"What is intelligence?"* and *"What makes humans intelligent?"* remain unanswered; therefore, classifying machines as intelligent has remained a matter of debate.

The same was simplified by Alan Turing in the paper titled *"Computing Machinery and Intelligence*," proposing that the intelligence of a machine shall not be deciphered by analysing the functioning or mechanisms by which it produces the intelligence, but instead by the manifestation of intelligence (known as the Turning Test), i.e., the capacity of the machine to reflect intelligent behaviour not distinctive from that of humans, regardless of the mechanism it utilizes for generating the outcomes.[8] Thus, as per the Turing Test, ChatGPT is intelligent not because of the technology it utilizes to generate the text, but instead because the text generated is *humanlike*, and is difficult for a stranger to identify whether the text was generated by a machine or a human.

The term AI was coined at the Dartmouth Conference of 1956, and is known as the official birthplace of AI.[9] Cognitive scientists Allen Newell and Herbert Simon posited in the conference that human intelligence is essentially a symbol manipulation.[10] Based on this understanding of intelligence (also

<https://news.stanford.edu/2019/%2002/28/ancient-myths-reveal-early-fantasies-artificial-life/> accessed 18 September 2023.

[7] Laura Tripaldi, *Parallel Minds* (Urbanomic Media Ltd. 2022) 53 6.

[8] J.F. Pagel, 'Internet Dreaming-Is the Web Conscious?' in Jayne Gackenbach and Jonathan Brown (eds), *Boundaries of Self and Reality Online* (Academic Press 2017) 282, 295.

[9] Roberto Cordeschi, 'AI Turns Fifty: Revisiting Its Origins' (2007) 21 4 Applied Artificial Intelligence 259, 259.

[10] Luis M. AUGUSTO, 'From Symbols to Knowledge Systems: A. Newell and H.A. Simon's Contribution to Symbolic AI' (2021) 2 1 J. Knowl. Struct. Syst. 29, 56.

known as *the physical symbol system hypothesis*) they created two computer programs, namely *Logic Theorist*, which had reasoning ability along with the generation of proofs for mathematical theorems[11], and *General Problem Solver*, which can solve logical problems.[12]

However, in the late 1960s, it became clear that certain skills, such as walking, that can be performed by humans effortlessly cannot be replicated by these machines. In contrast, skills considered difficult by humans such as playing chess and drug discovery, can be performed by machines easily. In the words of Steven Pinker, *"The main lesson of thirty-five years of AI research is that the hard problems are easy and the easy problems are hard,"*[13] a phenomenon also known as *Moravec's paradox.*[14]

To solve such problems, a new approach to AI development was adopted, known as *connectionism*.[15] This approach proposes the creation of models, known as neural networks or artificial neural networks ("**ANN**") that resemble the central nervous system of the human brain for modeling perception and cognition.[16] Research by David Rumelhart and James McClelland in the 1980s demonstrated a range of psychological phenomena

[11] A. Newell and H. Simon, 'The logic theory machine--A complex information processing system' (1956) 2 IRE Transactions on Information Theory 61, 79.
[12] Parijat Banerjee, 'When Milliseconds Cost Millions: Opportunity and Risk of Generative AI' *Forbes* (3 November 2023) <https://www.forbes.com/sites/forbesfinancecouncil/2023/11/03/when-milliseconds-cost-millions-opportunity-and-risk-of-generative-ai/?sh=754044882930> accessed 14 November 2023.
[13] Parijat Banerjee, 'When Milliseconds Cost Millions: Opportunity and Risk of Generative AI' *Forbes* (3 November 2023) <https://www.forbes.com/sites/forbesfinancecouncil/2023/11/03/when-milliseconds-cost-millions-opportunity-and-risk-of-generative-ai/?sh=754044882930> accessed 14 November 2023.
[14] Anmol Arora, 'Moravec's paradox and the fear of job automation in health care' (2023) The Lancet.
[15] Bart Custers and others (eds.), *Law and Artificial Intelligence: Regulating AI and Applying AI in Legal Practice* (T.M.C Asser Press 2022) 58.
[16] ibid.

that can be demonstrated by ANN models.[17]

Neural networks paved the way for *deep learning,* which is a technique used for teaching computers to process data in a way processed by human brains. These deep neural networks can reach or even outperform human performance in certain tasks. In 1977, DeepMind, IBM's supercomputer, beat legendary chess player Gary Kasparov.[18] Numerous breakthroughs such as driverless cars, Google Translate, Siri, and Alexa are a direct result of innovations in *deep neural networks* ("**DNNs**").[19]

Transformer architecture is considered to be the most significant innovations in deep neural networks, discussed in a paper released in 2017 titled *"Attention is All You Need"* by Ashish Vaswani et al. The generative AI (as employed in ChatGPT, Stable Diffusion, and Midjourney and so on) can be traced directly to the creation of transformers.[20]

With the advent of robust foundational models entering practical applications, a tangible enthusiasm is arising regarding the corporate utilization of AI.[21] The notion that AI could become essential to numerous

[17] D.E. Rumelhart and others, A General Framework for Parallel Distributed Processing in *Parallel Distributed Processing: Explorations in the Microstructure of Cognition: Foundations*, (MIT Press 1987) 45, 76.

[18] Will Knight, 'Defeated Chess Champ Garry Kasparov Has Made Peace with AI' *Wired* (21 February 2021) <https://www.wired.com/story/defeated-chess-champ-garry-kasparov-made-peace-ai/> accessed 13 November 2023.

[19] Erik Brynjolfsson and Andrew McAfee, 'The Business of Artificial Intelligence' *Harvard Business Review* (18 July 2017) <https://hbr.org/2017/07/the-business-of-artificial-intelligence > accessed 28 September 2023.

[20] Rob Toews, 'Transformers Revolutionised AI. What Will Replace Them?', *Forbes* (3 September 2023) <https://www.forbes.com/sites/robtoews/2023/09/03/transformers-revolutionized-ai-what-will-replace-them/?sh=71cfe36e9c1f >accessed 17 November 2023.

[21] Wharton Online, 'How Do Businesses Use Artificial Intelligence?' <https://online.wharton.upenn.edu/blog/how-do-businesses-use-artificial-intelligence/ >accessed 26 September 2023.

facets of the corporate domain is no longer beyond contemplation.[22] AI already plays a crucial role in a company's management.[23]

Today, big tech companies and researchers are in a race to create Artificial General Intelligence ("**AGI**"). Even though there are competing definitions of AGI, one widely adopted view defines AGI as AI systems that are capable of understanding the world, learning, and applying knowledge for accomplishing broad-ranging tasks[24] and *"are generally smarter than humans."*[25]

### B. Exploring the Technical Aspects of AI

This section attempts to understand the building blocks of AI for realising answering, where does AI fit in the legal domain? In the words of Prof. John McCarthy, who is considered to have coined the term, AI can be understood as *"the science and engineering of making intelligent machines."*[26] The European Parliament, in furtherance of enacting the AI Act has defined AI as *"[An] 'artificial intelligence system' (AI system) means a machine-based system that is designed to operate with varying levels of autonomy and that can, for explicit or implicit objectives, generate outputs such as predictions, recommendations, or decisions, that influence physical or*

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[22] 'Artificial Intelligence is permeating business at last' *The Economist* (6 January 2022) <https://www.economist.com/business/2022/12/06/artificial-intelligence-is-permeating-business-at-last>accessed 26 September 2023.

[23] Vegard Kolbjørnsrud and others, 'How Artificial Intelligence Will Redefine Management' *Harvard Business Review* (2 November 2016) <https://hbr.org/2016/11/how-artificial-intelligence-will-redefine-management >accessed 28 September 2023.

[24] Gartner Glossary, <https://www.gartner.com/en/information-technology/glossary/artificial-general-intelligence-agi > accessed 28 September, 2023.

[25] OpenAI, 'Planning for AGI and Beyond' <https://openai.com/blog/planning-for-agi-and-beyond> accessed 29 September, 2023.

[26] Christopher Manning, 'Artificial Intelligence Definitions', *Stanford University Human-Centered Artificial Intelligence* (September 2020) <https://hai.stanford.edu/sites/default/files/2020-09/AI-Definitions-HAI.pdf> accessed 2 November 2023.

*virtual environments."*[27]

For the past half-century, machines have failed to demonstrate intelligence. They have been operating on precisely defined code. For example, a traditional computer program can identify an image of a cat only if the same image has been stored in its database (i.e., the requirement exact inputs and outputs). Thus, computer programs are considered static and rigid, unable to adapt to imprecise inputs and lacking the conceptual clarity exhibited by humans. Thus, the aspects that truly differentiate AI as a technology from its predecessors are:

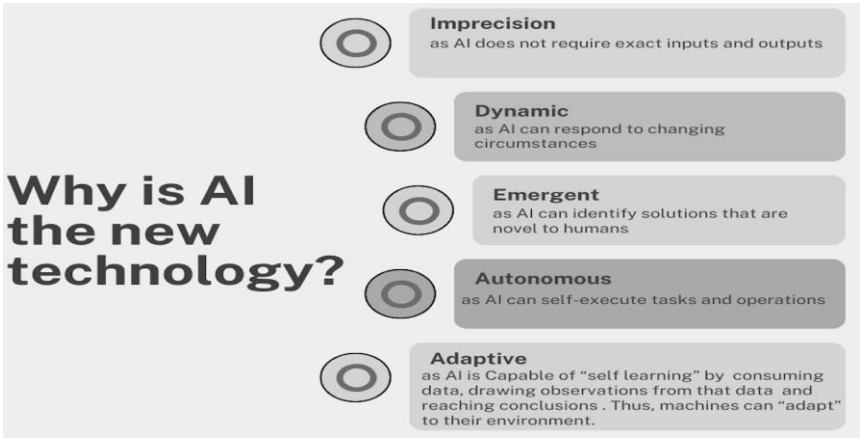


*Figure 1: Characteristics of AI (Source: Author)*

A better understanding of AI can be gathered by understanding the components that make it possible.[28] The various components of AI are

[27] Artificial Intelligence Act 2021, art. 3

[28] AI is a broad term and includes different techniques for the development of intelligent machines. The scope of this section is limited to understanding the technology behind AI systems developed using machine learning (ML).

illustrated in the figure below:

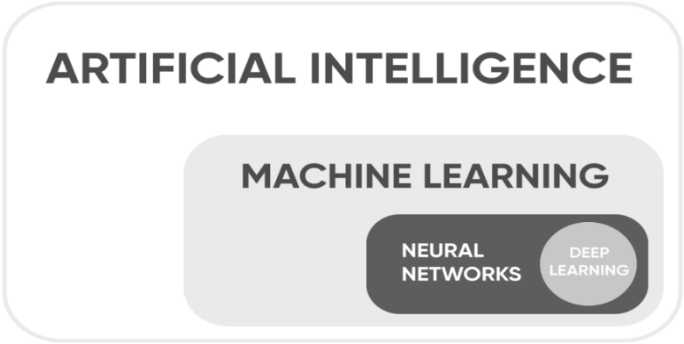


*Figure 2: Various components of AI (Source: Active Wizards)*[29]

***Machine Learning (ML)*:** The building blocks of every program (app or website) that we currently use are algorithms. *Algorithms* can be understood as step-by-step instructions for completing a task.[30] The learning techniques employed by AI are based on these algorithms, known as *machine learning algorithms.* ML algorithms function by *"learning*" the patterns from data and generating output[31] unlike classical algorithms that function on strictly coded inputs and outputs.[32]

At present, a widely used method of ML is by developing *neural networks*.[33] They are networks designed to mimic the structure of the human brain. Technique for development of AI by utilising large neural networks is

[29] Active Wizards, 'Artificial Intelligence vs. Machine Learning vs. Deep Learning: What is the Difference?' <https://activewizards.com/blog/artificial-intelligence-vs-machine-learning-vs-deep-learning-what-is-the-difference/ >accessed 4 November 2023.
[30] Wired, 'Harvard Professor Explains Algorithms in 5 Levels of Difficulty' <https://www.youtube.com/watch?v=fkIvmfqX-t0 > accessed 26 November 2023.
[31] Microsoft Azure, 'Machine learning algorithms: An introduction to the math and logic behind machine learning', <https://azure.microsoft.com/en-us/resources/cloud-computing-dictionary/what-are-machine-learning-algorithms >accessed 9 December 2023.
[32] Srinivas Rao, 'How does the ML algorithm differ from the Traditional Algorithm?' *Medium* (17 March 2020) <https://medium.com/@raosrinivas2580/how-does-the-ml-algorithm-differ-from-the-traditional-algorithm-b7c3a2799e10 > accessed 7 December, 2023.
[33] IBM, 'What is a neural network?' <https://www.ibm.com/topics/neural-networks>accessed 6 December 2023.

known as *deep learning*.[34] Deep learning through neural networks captures complex relationships. ML using neural networks creates approximations i.e., statistically generating the most probable outcome based on the data provided to it.

These neural networks develop models (a route for approximating) known as *ML models or AI models.*[35] Therefore, a neural network stores the training on images of animals for further recognition of them. For example, in each task to identify a cat, ML would implement 'learning' acquired by identifying the characteristics of a cat from provided dataset.

It must be noted that the learning mechanism employed by a model is somewhat *"opaque"* i.e., the lack of transparency as they use billions of variables at a time, making it impossible to observe the means employed by a model to learn as well as to generate outputs.[36]

Different goals and functions require different training techniques. There are three major techniques used for ML:

***Supervised Learning:*** It is used for applications that require a desired output for each set of inputs by creating a model that can predict outputs in

[34] IBM, 'What is deep learning?', <https://www.ibm.com/topics/deep-learning#:~:text=the%20next%20step-,What%20is%20deep%20learning%3F,from%20large%20amounts%20of%20data> accessed 6 December 2023.

[35] Microsoft, 'What is a machine learning model?', <https://learn.microsoft.com/en-us/windows/ai/windows-ml/what-is-a-machine-learning-model >accessed 12 December 2023.

[36] François Candeldon, 'AI Can Be Both Accurate and Transparent' *Harvard Business Review* (12 May 2023) <https://hbr.org/2023/05/ai-can-be-both-accurate-and-transparent >accessed 12 December 2023.

response to novel inputs.[37] While training ML models, data is to be labeled.[38] For example, to develop a program that requires teaching a model to identify different animals, the developers label images (*such as "dog", "tiger", "cat", etc.*). The model then on its own identifies the pattern for each labelled image, such as learning that a cat has whiskers; the tiger has a different skin, and so on. Subsequently, whenever a tiger is to be identified, the model compares the provided image with what it has learned (from the training data) to generate output.

***Unsupervised Learning***: This technique is employed for instances involving troves of unlabelled and unclassified data and the goal is to identify the hidden patterns.[39] Usually, there is no definite desired output. For example, a developer may feed trillions of financial transactions to an ML model so that it can identify hidden patterns and generate useful insights. However, in this case, the model requires *fine-tuning,* i.e., a method to train the model to focus on certain characteristics of the data to generate the output, such as fine-tuning an algorithm to focus more on the transaction value than other variables such as the name of the payee or his bank account.

***Reinforcement Learning***: In this case, an AI functions as an *"agent"* in a controlled environment, observing and recording its responses to its environment and learning in the process.[40] Observation by the AI creates a model that generates output based on the parameters (the environment)

[37] Iqbal H. Sarker, 'Cybersecurity data science: an overview from machine learning perspective' (2020) 7 J Big Data 12, 29.
[38] Sara Brown, 'Machine Learning, explained' *Ideas Made to Matter MIT Management Sloan School* (21 April 2021) <https://mitsloan.mit.edu/ideas-made-to-matter/machine-learning-explained >accessed 13 September 2023.
[39] Michael Lee and others, 'Current and Future Applications of Machine Learning for the US Army' (2018) Computational and Information Sciences Directorate, ARL, 26.
[40] Daniel Huttenlocher and others, *The Age of AI: And Our Human Future* (John Murray Press 2021) 265-67.

provided to the model. One of the notable examples of AI built on reinforcement learning is AlphaGo, developed by DeepMind, an AI capable of playing a board game named Go.[41] In 2016, it defeated the Go champion Lee Sedol.[42]

For development of AlphaGo, *Firstly*, the model was coded with the rules and parameters of the game (such as how the pieces on the board are allowed to move). This step entails setting up the environment or real-world simulation. *Secondly*, the model is trained on datasets, which in this case were the previous games that were played by humans. *Lastly*, the model is given a task to play against itself and learn from trial and error.

At the heart of the last step lays a reward function.[43] The reward function acts as the North Star for the model which in this case was winning. Therefore, each step taken by AlphaGo that led to victory was marked as correct (reward), and others that led to defeat were marked as incorrect (punishment). In this way, the model learns to output decisions that lead to reward, in our case winning the board game. Reinforcement learning is employed for developing self-driving cars, robots, etc.

From the above analysis, it can be observed that the development of AI broadly includes two phases viz., firstly, the training phase, where an AI creates a model to itself by learning from the data provided and secondly, the inference phase, which involves giving output based on the model developed

[41] Google Deepmind, 'AlphaGo' <https://deepmind.google/technologies/alphago/ >accessed 9 November 2023.
[42] Christopher Moyer, 'How Google's AlphaGo Beat a Go World Champion' *The Atlantic* (28 March 2016) <https://www.theatlantic.com/technology/archive/2016/03/the-invisible-opponent/475611/>accessed 9 November 2023.
[43] David Silver and others, 'Mastering the game of Go with deep neural networks and tree search' (2016) 529 Nature 484, 489.

in the training phase.[44]

A detailed and conceptual understanding of AI development and deployment is crucial for understanding the nature of the problems posed by AI as well as for discovering prospective solutions.

## III. PART- II: AI & CORPORATE MANAGEMENT

### A. Utilizing AI in Corporate Realm

The importance of AI has skyrocketed in recent times, pervading through the domains of corporate law[45] from being utilized for significant decision-making within boardrooms to the scrupulous compliance of the regulatory regime in order to uphold ethical corporate governance.[46] AI in this quest can streamline transparency, accountability and responsibility[47] in corporate law.

The recent Gartner study indicates a threefold increase in technology investments, including AI, with the percentage rising from 1.3% (2017-2020) to a projected 12% by 2025.[48] The study substantiates the multifaceted role that AI can play in strategic decision making in corporate boardrooms for a

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[44] Michael Copeland, 'What's the Difference between Deep Learning Training and Inference?' (*Nvidia Blogs,* 22 August 2016) <https://blogs.nvidia.com/blog/difference-deep-learning-training-inference-ai/ >accessed 18 November 2023.

[45] Thomson Reuters, 'Embracing the AI revolution: Transforming corporate legal work with generative technology'<https://legal.thomsonreuters.com/blog/the-new-era-redefining-how-corporate-in-house-legal-professionals-do-their-work/#:~:text=It%20is%20transforming%20the%20way,as%20document%20review%20and%20research> accessed 19 November 2023.

[46] Jingchen Zhao, 'Artificial Intelligence and Corporate Decisions: Fantasy, Reality or Destiny' (2022) 71 4 Cath. U. L. Rev 663, 672-73.

[47] Deloitte, 'Transparency and Responsibility in Artificial Intelligence: A call for explainable AI' <https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/innovatie/deloitte-nl-innovation-bringing-transparency-and-ethics-into-ai.pdf> accessed 22 November 2023.

[48] MIT Professional Education, 'Artificial Intelligence a threat to the legal sector?' <https://professionalprograms.mit.edu/blog/technology/artificial-intelligence-a-threat-to-the-legal-sector/> accessed 16 November 2023.

promising future ahead, with a convergence of technology and legal intricacies.[49]

To enhance business operations, AI is being incorporated in thousands of areas ranging from data analysis, to storing and segregation of massive databases to support strategic decision-making. Across the globe, AI through its Natural Language Processing ("**NLP**")[50] serves to advance both communication and comprehension. In the sphere of human resources, AI acts in the supporting capacity by aiding in optimal recruitment and management strategies.[51]

Furthermore, AI's exponential influence in diverse sectors such as supply chain optimization, financial analysis, personalized marketing, risk assessment and making informed board decisions, is a sight to behold.[52] These applications highlight the potential of bringing efficiency and innovation in the corporate spectrum.[53]

Large corporations such as McKinsey, Bain and BCG have already incorporated AI to assist them with their management models.[54] Additionally,

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[49] Deirdre Ahern, 'The Impact of AI on Corporate Law and Corporate Governance' <http://www.tara.tcd.ie/bitstream/handle/2262/101064/AI%20AND%20CORPORATE%20LAW%20.pdf?sequence=1&#:~:text=As%20AI%20gains%20agency%2C%20the,business%20models%2C%20culture%20and%20systems> accessed 6 September 2023.

[50] D Khurana and others, 'Natural language processing: state of the art, current trends and challenges' (2023) 82 Multimed Tools Appl.

[51] Scott Likens and Nicole Wakefield, 'Do you have an "early days" generative AI strategy?' *PwC* (7 December 2023) <https://www.pwc.com/gx/en/issues/technology/early-days-generative-ai-strategy.html> accessed 9 December 2023.

[52] Ekkehard Ernst and others, 'The economics of artificial intelligence: Implications for the future of work' (*International Labour Organisation, 2018)* <https://www.ilo.org/wcmsp5/groups/public/---dgreports/---cabinet/documents/publication/wcms_647306.pdf> accessed 18 November 2023.

[53] Holly J. Gregory, 'AI and the Role of the Board of Directors' *Harvard Law School Forum on Corporate Governance* (7 October 2023) <https://corpgov.law.harvard.edu/2023/10/07/ai-and-the-role-of-the-board-of-directors/> accessed 4 December 2023.

[54] Vinod Mahanta, 'Top consulting firms invest big in AI solutions' *The Economic Times* (21 September 2023) < https://economictimes.indiatimes.com/news/company/corporate-

using AI to decide on investments in a financial product of a company is also witnessed in many nations.[55] Relatively, one specific contemporary use of governance intelligence is reflected in streamlining due diligence procedures in Mergers and Acquisitions ("**M&A**").[56] Both procedures are considered to be equally important for the board resolution of the acquiring entity, which requires symphonized efforts from all legal experts, accountants, professionals, investment bankers and company personnel.[57] The amalgamation of AI into these processes makes the probability of achieving precise negotiation results, accurate valuation and a tailored deal scheme, very productive for the company. Furthermore, the directors of the company use AI to check audit reports, profile investors and determine the most optimal supply and demand structure in the market.[58]

Justice Kohli, in a very recent event that celebrated the first anniversary of 'i-Amicus', an artificial intelligence-based platform incorporated by the ICICI Bank, that provides information to customers about disputes related to banking, highlighted that "*AI is a game-changer in the legal*

trends/top-consulting-firms-invest-big-in-ai-solutions/articleshow/103819069.cms> accessed 11 December 2023.

[55] Everis, 'Artificial Intelligence in the Financial Sector' <https://www.nttdata.com/global/en/-/media/nttdataglobal/1_files/services/data-and-intelligence/artificial_intelligence_in_the_financial_sector.pdf?rev=704e0e643b6b4f3bbd1ef22b04cdcd3e> accessed 19 November 2023.

[56] Satu Teerikangas, 'Systems Intelligence in Mergers and Acquisitions a Myth or Reality?' in Raimo P. Hamalainen and ESA Saarinen (eds.), *Systems Intelligence– Discovering a Hidden Competence in Human Action and Organizational Life, Helsinki University of Technology: Systems Analysis Laboratory Research Reports* (2004) 3.

[57] Jay Bhavesh Parekh, 'Understanding Legalities – Mergers, Acquisitions and Combinations' <https://www.icsi.edu/media/webmodules/CSJ/May/17ArticleJayBhaveshParekh.pdf> accessed 29 November 2023.

[58] Chartered Professional Accountants of Canada and American Institute of CPAs, 'The Data-Driven Audit: How Automation and AI are Changing the Audit and the Role of the Auditor' <
https://us.aicpa.org/content/dam/aicpa/interestareas/frc/assuranceadvisoryservices/downloadabledocuments/the-data-driven-audit.pdf> accessed 11 December 2023.

*field, and has the potential to revolutionize the way lawyers work*."[59]

It is an undeniable fact that in the business world, AI systems can be proved to be of extreme assistance in the decision-making process at the management level, while in actuality, only a few corporations worldwide have incorporated AI by granting it the power to make decisions akin to their human counterparts. The corporate investment in AI is increasing at a staggering pace (Figure 3 below) as an increasing number of corporates embed AI in their corporate structure (Figure 4 below).

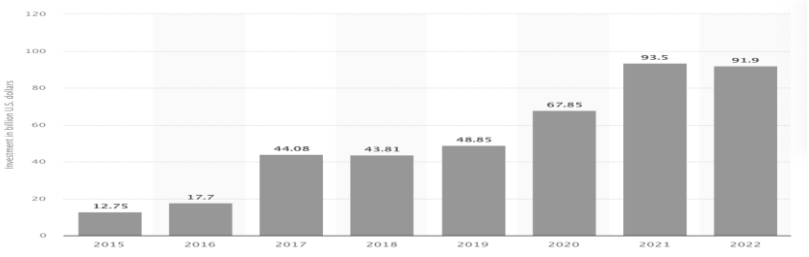


*Figure3: Global total corporate investment in AI from 2015 – 2022 (Source: Statista)*[60]

[59] Awstika Das, 'AI is a Game-Changer in Legal Field: Justice Hima Kohli on Why Artificial Intelligence Does not Pose a Threat, But an Opportunity' *LiveLaw* (12 February 2023) <https://www-livelaw-in.elibrarynlunagpur.remotexs.in/top-stories/artificial-intelligence-threat-opportunity-game-changer-supreme-court-judge-hima-kohli-221379?infinitescroll=1 >accessed 22 November, 2023.

[60] Statista, 'Global total corporate artificial intelligence (AI) investment from 2015 to 2022' <https://www.statista.com/statistics/941137/ai-investment-and-funding-worldwide/> accessed 9 December 2023.

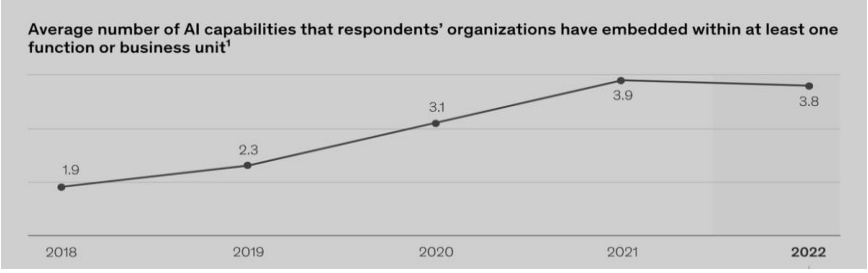


*Figure 4: Showcasing the increase in the use of AI by corporates (Source: McKinsey and Co.[61]).*

The application of what is referred to as "*artificial governance intelligence"*[62], whether used merely as a supplementary tool for directors, raises novel corporate law concerns that necessitate a comprehensive legal examination.

### B. Subsuming AI in Corporates at Different Levels of Autonomy

Incorporating AI in corporation is not merely limited to boardroom management but is beneficial in expanding the efficiency of various departments in a corporation depending upon the autonomy level of an AI.

A 2023 survey conducted on governance professionals (100 members of the Society of Corporate Governance) displayed that 42% of the professionals used AI for sales and marketing tasks and 35% accepted the use of AI for product development. They used it for risk-management, board functions, policies and training[63] Others deployed AI for accounting,

[61] Quantum Black AI by McKinsey, 'The state of AI in 2022-and a half decade in review' <https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai-in-2022-and-a-half-decade-in-review >accessed 11 December 2023.
[62] Floris Mertens, 'The use of artificial intelligence in Corporate Decision-making at Board Level: A preliminary legal analysis' <https://financiallawinstitute.ugent.be/wp-content/uploads/2023/11/2023-01.pdf> accessed 19 November 2023.
[63] Carey Oven, 'AI in Corporate Boardrooms' (2023) WSJ.

financing, legal compliances and human resources.

In order to incorporate AI in the above-mentioned capacities to assist the corporation, there are different levels of automation of AI depending upon the corporate structure and the legal framework of the country.

'*Autonomy'* in general could be defined as a state of self-governing[64] and when the idea gets associated with an AI, it could be expanded to mean a *"technology that permits artificial intelligence functionalities to their maximum capacity, resulting in much speedier response to a given issue, without human intervention"*.[65] Earlier, the degree of autonomy was not attributed to the machine intelligence of AI, however, with the complex decisions undertaken by the organizations today, allowing the utilization of AI with a certain level of autonomy has become significant.

The research conducted by Nalder (2017), Armour and Eidenmueller (2019)[66] segregated the synergic intelligence associated with an AI into five broad categories: ***assisted intelligence, augmented intelligence, amplified intelligence, autonomous intelligence, and autopoietic intelligence[67]***. However, autonomy can be broadly categorised into three levels: assisted intelligence, augmented intelligence and autonomous intelligence.[68]

With the emergence of AI in corporate dynamics, conventional

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[64] Carina Prunkl, 'Human autonomy in the age of artificial intelligence' <https://philarchive.org/archive/PRUHAI> accessed 28 November 2023.

[65]'Autonomous Artificial Intelligence Guide: The future of AI'<https://www.algotive.ai/blog/autonomous-artificial-intelligence-guide-the-future-of-ai> accessed 28 November, 2023.

[66] Hilb Michael, 'Toward artificial governance? The role of artificial intelligence in shaping the future of corporate governance' (2020) JMG.

[67] ibid.

[68] Xiaofeng Gao and others, 'Effects of Augmented-Reality-Based Assisting Interfaces on Drivers Object-wise Situational Awareness in Highly Autonomous Vehicles' (2022) IEEE Intelligent Vehicles Symposium (IV), Aachen, Germany, 563, 572.

practices conducted on the board would fade away gradually. The three forms in which AI has been visualized to show its competency as a boon to the corporate world are ***firstly,*** Assisted AI,[69] where the final decider to a particular matter is the board only, but some sort of reliance on limited information could be attributed to AI, without enhancing decision-making.

***Secondly***, the augmented level is where the final decision-making is still with the human directors within the board, but where AI's particular input improves the board's or requisite authority's final decisions.[70] AI systems in such capacity refine policy insights, leading to joint decision-making by directors and AI.

A 2017 McKinsey study sheds light on the stance that automation can potentially hike productivity on global standards by 0.8 to 1.4 percent annually,[71] offering a significant rise in economy and business levels. A prime example is the integration of VITAL as a director, where it was compulsory to consult this AI system for certain investment decisions.

Finally, there is ***Autonomous AI***, where the AI system independently makes decisions without human intervention. The key governance powers are delegated by the company officials to AI to incorporate it with complete

[69]Arto Laitinen and Otto Sahlgren, 'AI Systems and Respect for Human Autonomy' (2021) Front. Artif. Intell. 4.

[70]'Artificial Intelligence, Autonomy, and Augmentation', Applied Research Laboratory for Intelligence and Security <https://www.arlis.umd.edu/our-mission/artificial-intelligence-autonomy-and-augmentation >accessed 28 November 2023.

[71]'A Future that Works; Automation, Employment, And Productivity (2017) McKinsey Global Institute <https://www.mckinsey.com/~/media/mckinsey/featured%20insights/Digital%20Disruption/Harnessing%20automation%20for%20a%20future%20that%20works/MGI-A-future-that-works-Executive-summary.ashx >accessed 28 November 2023.

autonomy.[72] For instance, a robo-director may be appointed in a boardroom with the delegated duties of human directors or a robo-taxi that is operated at the full discretion of the AI installed.

Identifying the autonomy levels at which these AIs operate is critical for development of regulations and resolving disputes concerning corporate liability.

### C. Boardroom Dynamics and Decision-Making

There is no specific definition of artificial intelligence as a whole[73] therefore it can be interpreted based on either *"symbolic rules (knowledge-based systems) or a numeric model (data-based or ML systems)."*[74]

AI stands at an integral pivot in the corporate boardroom, profoundly for the decision-making aspect.[75] Corporate decision-making involves choosing from various options related to the primary duties of board members and key managers[76] of the company which range from strategy building, monitoring, and supervision to the daily affairs of the company. All these actions have already incorporated computer systems and other technological

[72] 'Artificial Intelligence and Autonomous Systems', The Grainger College of Engineering Electrical & Computer Engineering <https://ece.illinois.edu/research/crosscutting-themes/aias>accessed 29 November 2023.

[73]Damodar Singh and Rishika Seal, 'Legal Definition of Artificial Intelligence' (2019) 10 Supremo Amicus 87.

[74]Bernhard G. Humm and others, 'New directions for applied knowledge-based AI and machine learning' (2022) 46 65 Informatik Spektrum 65, 78.

[75]Gloria Phillips and Lakhmi C. Jain, 'Artificial Intelligence for Decision Making' (2006) 4252 Knowledge-Based Intelligent Information and Engineering Systems, 10th International Conference, UK.

[76]'Information Systems for Business and Beyond', <https://ecampusontario.pressbooks.pub/informationsystemscdn/chapter/12-3-managerial-decision-making/> accessed 21 November 2023.

means for several decades to aid the corporate decision-making.[77]

Today, AI has been instrumental in effecting real-time data tracking, quick data retrieval, and analysis of market trends and financial forecasting, threat identification, logistics analysis[78] and aiding directors in strategic decision-making.[79] Worldwide companies like Merck Pharmaceuticals, Amazon, Goldman Sachs and several more have integrated AI for identifying market risks, business opportunities and to ensuring due diligence.[80]

It is extremely significant to note that the process of decision-making embodies huge amounts of data to be recorded, depending upon the kind of decision to be arrived at.[81] Now, in comparison to a human mind that cannot process large amounts of data beyond a certain limit for a given decision, and directors being unaware of the market analytics generally, AI and computers shall prove to be handy in such circumstances with the retrieval of information being pulled off in seconds to improve the decision-making, ultimately.[82]

The duty of decision-making is shouldered on the various stakeholders and shareholders of the company where the latter is acknowledged for the role

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[77] D.L. Olson and J.F. Courtney, 'Decision Support Models and Expert Systems' (1992) 13 New York, Macmillan, 418.

[78] 'The Transformative Role of Data and AI in Corporate Governance' <https://www.linkedin.com/pulse/transformative-role-data-ai-corporate-governance-permutableai/> accessed 22 November 2023.

[79] Wenjun Shen, 'Analysis of the application of artificial intelligence technology in the protection of corporate governance rights and interests' (2022) 13 Front. Psychol.

[80] Michael R. Siebecker, 'Making Corporations More Humane Through Artificial Intelligence' (2019) 45 1 The Journal of Corporation Law 97.

[81] T.A. LIEDONG and others, 'Information and nonmarket strategy: Conceptualizing the interrelationship between big data and corporate political activity' (2020) 157 Technol Forecast Soc Change, 1,12.

[82] Sally Jo Cunningham and others, 'Applications of Machine Learning in Information Retrieval' <https://www.cs.waikato.ac.nz/~ihw/papers/00-SJC-JL-IHW-Applicationml.pdf>accessed 23 November 2023.

in the matters of investments and voting rights,[83] while the former keeping the focus on the decisions related to the contractual obligations of the corporation, thus, both of them comprise the brain of the corporation. Precisely, with the help of AI, decisions can be devoid of partial uncertainties.[84] Thus, the replacement of a human mind by an AI in a corporation cannot be termed as unrealistic in the near future. Corporations require independent thinking among board members so that a majority consensus can be countered to ensure sound judgment.[85] Therefore, due to time constraints or reluctance to scrutinize the management decision, AI- generated outcomes can help reach alternative options.

In general, AI systems are alien to groupthink, except when biased data is stored externally.[86] Independent human directors are not just associated with the board of one company, they can be a part of other boards[87] as well which does not permit them to critically analyze the data and relevant information necessary to conclude on a short notice, and therefore, AI can be of great help, in quickly bifurcating the crucial information as a prerequisite for the task.[88]

It is an undeniable fact that AI machines are unaffected by partiality and so the output generated is not generally tainted by friendship or other

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[83] Adam Winkler, 'Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History' (2004) 67 4 LCP, 109, 133.

[84]Ann-Kristin Weiser and Georg von Krogh, 'Artificial intelligence and radical uncertainty' (2023) EMR.

[85]Reyes Calderon and others, 'Understanding Independence: Board of Directors and CSR' (2020) 11 Front. Psychol.

[86]A. Kamalnath, 'The Perennial Quest for Board Independence - Artificial Intelligence to the Rescue?' (2019) 83 52 Alb. L. Rev.

[87]Jaspal Singh Dhanjal, 'Independent Directors' in *Patiala Chapter of NIRC of ICSI* <https://www.icsi.edu/media/filer_public/78/8b/788b6cf7-7e67-4131-b883-fe4292b4c475/independent_director_under_companies_act_2013.pdf>accessed 25th November 2023.

[88] Xiuli Cui and others, 'Can Application of Artificial Intelligence in Enterprises Promote the Corporate Governance?' (2022) 10 Front. Environ. Sci.

factors, thereby, ensuring independent decisions for the board.[89] However, one cannot claim that it is shielded from all sorts of external and internal factors.

National laws concerning corporate functions differ with the change in the country, specifically when it comes to roles and responsibilities being assigned to the board.[90] However, there is an amalgamation of three main roles of the board viz. supervisor/co-creator, supporter or co-director and controller/coach are generally present in corporate structures.[91]

A ***Supervisory role*** within a corporation would specifically deal with the execution and monitoring of the functions to ensure ethical and legal compliance with the statutory rules. The decision-making process with such types of roles revolves around ensuring designing, selecting and implementing the best course of action**.** Another role caters to ***the Co-creator/co-director*** and focuses upon the other functions of the company which involves dealing with leadership, carving corporate strategies and designing objectives having a mix of innovation, creativity and collaboration within a corporation. The third type of company function could be captured as a ***Supporter/coach*** role where the directors are responsible for recruitment and coaching of the team by adhering to the concept of credibility, authority and objectivity. Thus, directors working in this capacity take decisions related to executive appointments, compensation and composition of the board of the company and

[89] Jacques Bughin and others, 'Artificial Intelligence the next digital frontier?' *McKinsey Global Institute* (2017) <https://www.mckinsey.com/~/media/mckinsey/industries/advanced%20electronics/our%20insights/how%20artificial%20intelligence%20can%20deliver%20real%20value%20to%20companies/mgi-artificial-intelligence-discussion-paper.ashx >accessed 27 November 2023.

[90] The Institute of Company Secretaries of India <https://www.icsi.edu/ccgrt/research/bare-acts/other-countrys-corporate-laws/ >accessed 27 November 2023.

[91] Bart Custers and Eduard Fosch-Villaronga (eds), *'Law and Artificial Intelligence' (T.M.C. Asser Press 2022) 35.*

AI could really strengthen the structure.[92]

### D. Paradigms of AI incorporation in Boards

A jargon of AI being used directly in the corporate realm was witnessed in 2014 when the Hong Kong-based venture capital group "*Deep Knowledge Ventures"* appointed the first robo- director to its board and named it "VITAL" (*Validating Investment Tool for Advancing Life Sciences*)[93] majorly for the automation of due-diligence, retrieve extensive datasets and analysis of trends beyond human expertise. It is pertinent to mention that 'VITAL' was an observer director with voting rights, to be exercised only in the circumstances of deciding whether the firm was to invest in another company or not.[94] Additionally, with the suggestions of VITAL, the firm invested in a few biotech start-ups such as Pathway Pharmaceuticals and In Silico Medicine.[95] Several companies, such as Tietoevry (incorporated Alicia T as a member of the board to take forth a business unit driven by data) and Salesforce, have concretely incorporated AI systems into their boards.[96]

A few nations where the adoption of AI as directors was supportive of

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[92] Bart Custers and Eduard Fosch-Villaronga (eds), *'Law and Artificial Intelligence' (T.M.C. Asser Press 2022) 35.*

[93] Adyasha Mohanty, 'Artificial Intelligence and Corporate Law for Board of Directors: Indian Perspective' *MNLU ACCLR Blog* (29 May 2019)< https://mnluacclrblog.home.blog/2019/05/29/artificial-intelligence-and-corporate-law-for-board-of-directors-indian-perspective/> accessed 17 December 2023.

[94] Rob Wile, 'A Venture Capital Firm Just Named An Algorithm To Its Board of Directors – Here's What It Actually Does' *Business Insider* (13 May 2014) < https://www.businessinsider.com/vital-named-to-board-2014-5?international=true&r=US&IR=T> accessed 27 November 2023.

[95]Biogerontology Research Foundation, 'Deep Knowledge Ventures announces New Investment Fund for Life Sciences and Aging Research' <www.eurekalert.org/news-releases/831727 >accessed 18 November 2023.

[96] Yun Park, 'Companies Grapple With Limits in Bringing AI Into the Boardroom' *BlumergLaw* (11 August, 2023)<https://news.bloomberglaw.com/artificial-intelligence/companies-grapple-with-limits-in-bringing-ai-into-the-boardroom >accessed 18 November 2023.

the legal framework have begun deploying AI for assistance in corporate decision-making.[97] However, it is imperative to note that the present legislative background does not allow the appointment of an artificial intelligence entity as a director on boards.[98]

### E. Legislative Design and Corporate Law: Paperwork

AI is transforming corporate law from paperwork and legislative compliances into machine-readable legislation and NLP. This will alter the perspective on compliance and will convert reporting efficiently.[99] In nations where mandatory paper-based filings are required, AI can prove to be a beneficial tool of aid, especially where the 2020 pandemic accelerated the need for digitization[100]. Conventionally, all the tasks performed by a competent company secretary and tasks such as incorporating the company can now be easily performed by an AI aiding in data retrieval procedures for the promoters during establishment,[101] thus, simplifying compliance procedure. For instance, in the UK, a five-year '*Digital First strategy'* along with '*Natural Voice Language'* [102] (a form of voice recognition) is being adopted by Companies House to streamline customer services. All the steps

[97] ibid.
[98] Alžběta Krausová, 'Intersections between Law and Artificial Intelligence' (2017) 27 1 IJC 55, 68.
[99] Marcel Froehlich, 'Enabling RegTech Upfront: Unambiguous Machine-Readable Legislation' in Janos Barberis, Douglas W Arner and Ross P Buckley (eds), The RegTech (Wiley Online Books 2019).
[100] Rahul De and others, 'Impact of digital surge during Covid-19 pandemic: A viewpoint on research and practice' (2020) 55 Int J Inf Manage.
[101] Karunjit Singh, 'Artificial Intelligence system likely to ease name registration process for companies' *The Economic Times* (18 May 2019) <https://economictimes.indiatimes.com/news/economy/policy/artificial-intelligence-system-likely-to-ease-name-registration-process-for-companies/articleshow/69382285.cms >accessed 19 November 2023.
[102] Deirdre Ahern, 'The Impact of AI on Corporate Law and Corporate Governance' <http://www.tara.tcd.ie/bitstream/handle/2262/101064/AI%20AND%20CORPORATE%20LAW%20.pdf?sequence=1&#:~:text=As%20AI%20gains%20agency%2C%20the,business%20models%2C%20culture%20and%20systems> accessed 6 September 2023.

involved are made automatic with the AI recognizing the intent of the customer to incorporate his/her company and providing them with a link on SMS for the same.[103] If AI is deployed in registration offices, the accuracy of the information and documents submitted could be checked instantaneously, while smart contracts can automate the issuance of incorporation certificates. Such an application of AI is prevalent in developed countries and is yet to be used by developing nations.

## IV. PART III - COMPETENCY OF LEGAL FRAMEWORK: A CRITICAL ANALYSIS

### A. Scope of AI Amalgamation

Post the analysis of the Companies Act, 2013 it is evident that the Indian legal framework is not competent to fully accommodate AI's potential.[104] The existing law cannot address the issues revolving around AI-generated decisions, the after effects of such incorporation, the transparency of algorithmic patterns, and the liability of harm caused as a result.[105]

It is significant to understand that an AI lacks the emotions that distinguishes it with human intelligence.[106] AI does not understand the

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[103] Laura Boardman, 'Companies House: building a more rewarding workplace for Digital, Data and Technology Professionals' (*Digital People*, 23 August, 2019) <https://digitalpeople.blog.gov.uk/2019/08/23/companies-house-building-a-more-rewarding-workplace-for-digital-data-and-technology-professionals/#:~:text=We%20are%20committed%20to%20being,provides%20company%20data%20for%20free> accessed 20th November, 2023.

[104] Shaoshan Liu, 'India's AI Regulation Dilemma' *The Diplomat* (27 October 2023) <https://thediplomat.com/2023/10/indias-ai-regulation-dilemma/ > accessed on 29 November 2023.

[105] Aashira Baburaj, 'Artificial Intelligence v Intuitive Decision Making: How far can it transform corporate governance?' 8 2 TGLR.

[106] Angela Koenig, 'Why AI is Not Like Human Intelligence' *Neuroscience News* (21 November 2023) <https://neurosciencenews.com/ai-human-intelligence-25234/ > accessed 30 November 2023.

connotation of a stakeholder's interests or the shareholder's benefit in the decision-making.[107] AI functions in accordance with data and instructions[108] thereby lacking the quality of differentiating between good and bad faith[109] unless trained for some specific individual. The sole guidance that AI acts upon is human coding, learning and training, that makes it an unbiased decision-maker.[110] However, one cannot deny the fact that the algorithm or the data inserted into the system may reflect the bias of the person who has developed the system, in the form of personal or social bias.[111]

The current legislative norms do not take these biases under their scope. Furthermore, the duties like care and loyalty under Section 166 of the Companies Act, 2013, are beyond the scope of AI's capabilities. This leads to critical questions about the legality of using AI in corporate governance and accountability.

Section 2(10) of the Companies Act, 2013 defines the board of directors as a "*collective body of directors of the company*"[112] and thus, gives no specifications as to who shall be called as a director. However, a co-joint reading of Section 149 with the above-mentioned definition, it could be translated to mean that solely an individual can be inducted as a director and

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[107] Jingchen Zhao, 'Artificial Intelligence and Corporate Decisions: Fantasy, Reality or Destiny' (2022) 71 4 Cath. U. L. Rev 663, 672-73.
[108] Murat Kuzlu and others, 'Role of Artificial Intelligence in the Internet of Things (IoT) cybersecurity' (2021) 1 Discover Internet of Things.
[109] Kimberly Houser, 'Artificial Intelligence and The Struggle Between Good and Evil' (2021) 60 Washburn Law J. 1, 23.
[110] Elif Kartal, 'A Comprehensive Study on Bias in Artificial Intelligence Systems: Biased or Unbiased AI, That's the Question!' (2022) 18 1 IJIIT, 1, 23.
[111] Jake Silberg and James Manyika, 'Tackling bias in artificial intelligence (and in humans)' (*McKinsey Global Institute*, 6 June 2019) <https://www.mckinsey.com/featured-insights/artificial-intelligence/tackling-bias-in-artificial-intelligence-and-in-humans> accessed 2 December 2023.
[112] Companies Act 2013, s 2(10).

not an artificial person.[113] It could be argued that the intention behind this section must have been the concern regarding imposing liability on an artificial body. Subsequently, a mandatory requirement to be fulfilled is to secure a Director Identification Number ("**DIN**") from the government of India.[114] As only an individual could be eligible to become a director, AI directors are precluded from getting inducted. However, with the swift pace of development, the legal framework might allow some relaxation in the coming days.[115] Despite AI's internal inability to commit fraud, there is still the potential for it to be employed by human directors to escape the accountability for any harm caused to third parties.

Even in the absence of any specific law that regulates the incorporation of AI in the existing legal framework, AI could potentially be deployed for assistance to the human directors in complying with the Article of Association ("**AOA**") (Section 166(1))[116] by immediately processing the required data in adherence to the AOA. Other duties mentioned under Section 166 require the directors to act in good faith, not confuse personal interests with the interests of the company or avoid taking any undue advantage in company affairs.[117] Since, AI works on data and algorithmic rhythm, its decisions would not be hit by factors like power and friendship making them more objective and less erroneous.

However, all the decisions do not necessitate logical or objective reasoning but the interplay of intuitive thought, human acumen and emotions,

[113] Companies Act 2013, s 149.
[114] Companies Act 2013, s 154.
[115] Rudresh Mandal and Siddharth Sunil, 'The road not taken: Manoeuvring through the Indian Companies Act to enable AI directors' (2021) 21 1 OUCLJ, 95, 133.
[116] Abhinav Gupta, 'Bringing Artificial Intelligence to Boardroom' <https://cbcl.nliu.ac.in/company-law/bringing-artificial-intelligence-to-boardroom/> accessed 20 November 2023.
[117] Companies Act 2013, s 166.

an AI is not competent to accomplish, at least as of today.[118] Section 166(3) necessitates the directors to mandatorily exercise due diligence and reasonable care in their actions and to implement independent judgment.[119] Since, the datasets utilised for training an AI are selected by a human, thereby, the likelihood of it being tainted by human bias cannot be completely eliminated.

An AI system would prove to be of great aid in calling on the shareholders to pay the unpaid dues by invoking the powers of the board of directors listed in Section 179 by accurately figuring out if the shareholder is legally entitled to pay the amount. Matters associated with M&A (Section 179(3)) require scrutiny of the records, which also requires risk analysis that an AI on the board could achieve with high accuracy.[120] However, this power of investing or executing M&A or amalgamation schemes can be delegated only to the principal directors holding managerial positions, i.e., by a human and not an AI as per Section 2(53).[121] Thus, the present law does not permit the integration of AI into the status of directors of the board. Even the court in *In Re Central Calcutta Bank Ltd.*[122] declared that "*Directors cannot disinvest themselves of the responsibilities by delegating the whole management to the agent and abstaining from all enquiries,*" which essentially allows us to interpret that delegation of functions of the directors cannot be made to an AI but the utilization of AI systems in the supporting capacity can still be materialized.[123]

Corporate Governance standards are enshrined under Clause 49 of the

[118] Sayed Fayaz Ahmad and others, 'Impact of artificial intelligence on human loss in decision making, laziness and safety in education' (2023) 10 311 Humanit. soc. sci. commun.
[119] Companies Act 2013, s 166(3).
[120] Companies Act 2013, s 179.
[121] Companies Act 2013, s 2(53).
[122] *In Re: Central Calcutta Bank Ltd. v Unknown* [1959] AIR 625(Cal).
[123] Dinesh Kumar and others, 'Legal Analysis of Artificial Intelligence in Corporate Board Rooms' (2021) 12 7 TURCOMAT, 1516.

Equity Listing Agreement[124] for the companies that are to be listed. It requires the mandatory appointment of a minimum number of independent directors to the board,[125] again associating with the concept of independent individuals being eligible for the post, having no links with the employees or other shareholders of the company, to restore the equilibrium of having a neutral vision to a decision. An AI is not legally empowered for this role too, giving us a clear impression that current legal framework in India cannot yet accommodate advanced AI or robo-directors.

The ultimate aim of corporate law is to serve the goals of business and control arrangements for the participants of the organization.[126] At the same time, it is difficult to make algorithmic decision- making inherently transparent,[127] and therefore, it poses a hardship of imposing accountability. As noted above, the traditional corporate practices[128] and legal norms to comply with were framed with humans as the epicenter, leading to the current law being unprepared to deal with AI.

### B. The Conundrum of Imposing Liability

From boardrooms and numerous departments to robots utilised in manufacturing activities AI is being implemented at various capacities in organisations. Moreover, AI capabilities and software are delivered as good or service to personal consumers and businesses.

Contemporary corporate and liability regimes, originally structured for

[124] Equity Listing Agreement 2014, clause 49.
[125] Equity Listing Agreement 2014, clause 49.
[126] John Armour and Michael J. Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 3 Oxford Journal of Legal Studies, 429, 17.
[127] Andreas Tsamados, 'The ethics of algorithms: key problems and solutions' (2022) 37 AI Soc., 215, 224.
[128] M.N. Panini, 'Corporate Culture in India' (1988) 23 35 Economic and Political Weekly, 86.

human-related incidents, face issues in addressing 'liability gaps' for damages caused by AI, reminiscent of the 19th-century U.S. shift to tort law due to heavy machinery accidents that have been employed by various companies for quick decision-making. For example, Apple Inc. uses AI to determine the creditworthiness of an applicant to issue Apple Cards (credit cards in collaboration with Goldman Sachs). In the process, AI is also tasked with determining the credit limits.[129] Subsequently, the algorithms were accused of being "sexist" and "discriminatory" as women consistently received lower credit limits than their male counterparts.[130] More recently, the algorithm has been accused of discriminating against married women.[131] This trigger us to ponder upon the liability of an AI.

Debates continue to address liability concerns about AI-caused harm by providing a solution in the form of granting it legal personhood with human-like rights and duties, though this is yet to be embraced. The recent judgment of the UK Supreme Court that dealt with recognizing an AI system as the sole inventor in the patent application i.e., giving the connotation of a person as per Section 7 of the Patents Act 1977 of the UK[132] is significant. It was ruled that UK patent law could only be interpreted as "*An inventor within the meaning of the 1977 Act must be a natural person, and DABUS (the AI*

[129] Will Knight, 'The Apple Card Didn't 'See' Gender – and That's the Problem', *Wired* (19 November 2019) <https://rb.gy/0pcdq4> accessed 24 September 2023.
[130] Sanya Mansoor, 'A Viral Tweet Accused Apple's New Credit Card of Being 'Sexist'. Now New York State Regulators Are Investigating' *Time* (12 November 2019) <https://time.com/5724098/new-york-investigating-goldman-sachs-apple-card/> accessed 24 September 2023.
[131] Manson Lawlor, 'Class Action Accuses Apple and Goldman Sachs of Discriminating Against Married Women Who Apply for Apple Card' *ALM Law.com* (19 April 2023) <https://www.law.com/2023/04/19/class-action-accuses-apple-and-goldman-sachs-of-denying-credit-to-married-women-who-apply-for-apple-card/#:~:text=Apple%20and%20Goldman%20Sachs%20were,surfaced%20by%20Law.com%20Radar> accessed 25 September 2023.
[132] Patents Act 1977, s 7.

*system) is not a person at all, let alone a natural person as it is a machine*".[133] Thus, the application to grant patent rights and ownership to DABUS was rejected in various jurisdictions including the Australian High Court.[134] However, if AI is used as an aid to human inventors, a fresh perspective could be given.[135] Therefore, a strict interpretation of the term "*person or individual*" used in Companies Act, 2013 is unavoidable in the current times.

Uncertainties in targeting AI-related concerns emerge from areas like AI autonomy, opaque ML models, AI's evolving nature, and complex software-hardware interactions in autonomous vehicles and manufacturing robots. The cases giving rise to liability can usually be grouped under:

*(i) Contractual liability* arising from breach of contract. In such instances, the burden of proof is on the breaching party.

*(ii) Extra–contractual liability* arising from harm caused by conduct or negligence. In such instances, the burden of proof lies on the damaged party[136].

Thus, in the event a company is accused of discriminatory conduct (as in the Apple Card instance above), it might be difficult to prove the liability of the company, as due to the presence of AI algorithms, it might be difficult to ascertain whether the AI learned to discriminate based on the input data or

[133] Thaler v. Comptroller General of Patents, Designs and Trade Marks [2023] UKSC 49.
[134] Mark Marfe and Sarah Taylor, 'Australian High Court pulls plug on landmark DABUS AI patent application' (*Pinsent Masons*, 23 November, 2022) <https://www.pinsentmasons.com/out-law/news/australian-high-court-pulls-plug-on-landmark-dabus-ai-patent-application> accessed 13 December, 2023.
[135] Harry Muttock and Mark Marfe, 'AI cannot be an inventor under UK patent law, rules Supreme Court' <https://www.pinsentmasons.com/out-law/news/ai-cannot-inventor-under-uk-patent-law-rules-supreme-court > accessed 24 December 2023.
[136] Active Wizards, 'Artificial Intelligence vs. Machine Learning vs. Deep Learning: What is the Difference?' <https://activewizards.com/blog/artificial-intelligence-vs-machine-learning-vs-deep-learning-what-is-the-difference/ >accessed 4 November 2023.

whether it was one of the unintended and unrecognized properties of the model. In the latter case, the connection between the damage and the conduct of the bank is weak, as the bank cannot be held to have wilfully obstructed the grant of a credit card.

Another issue that arises is that determining liability in AI cases is complicated by the need to analyze proprietary training data and complex ML models beyond the grasp of a layman. Furthermore, AI used personally as software-only may not fall within the ambit of the Consumer Protection Act, 2019's definition of "product" thus, excluding it from "product defect" aspect in the Act.

However, liability is not so unclear when it comes to the standard of strict and absolute liability for it puts the accountability for the actions of the AI system upon the one who deploys it, by considering it just as a tool of convenience. It is an undisputable fact that some sort of human control will always be there in AI actions, even if the functions are devoid of any specific control, supervision or command, thus, the one who directs or utilizes it, is supposed to be liable.

In the landmark judgments of *In Re Caremark Int'l and Stone v. Ritter*,[137] the court held that "*only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.*"[138] However an exception to not imposing liability was also considered in these cases in the form of "*red flag*" liability where the accountability is imposed upon the board if they were aware of the internal inadequacies of the company actions and the illegality it

[137] Stone v Ritter [2006] 911 A.2d 362.
[138] In re Caremark Int'l, 698 A.2d 959 (Del. Ch. 1996).

would lead to and still opted for not rectifying the actions.[139]

In *AISC v. Rich***,** the court opined that decisions on contingent events always have a scope of error, an AI can safely eliminate in forecasting for products in market, thereby exonerating the director of any liability if the decision was an outcome of reliance on AI as per Australian corporate law.[140] However, the Indian legal system is silent on any such grounds which is a grave matter of concern.

Therefore, in order to make the legal system robust and AI-ready, it is essential that necessary amendments and regulations are ensured for safe development and deployment of AI as well as ensuring the AI acts as a tool for the benefit of humanity and not as an enabler of undesired events.

## V. PART IV - CONTEMPORARY DEVELOPMENTS AND THE WAY FORWARD

The revolutionary nature of AI poses legal concerns that are not addressed by current legislation. The lack of self-awareness and empathy in artificial intelligence makes it difficult to train AI with human ideals like fairness and good faith. AI development is expensive and generally entails post-deployment troubleshooting, but given the potential hazards of AI, this procedure should be more cautious. Pre-deployment auditing of AI for biases and norm adherence is critical, especially when utilized in business decision-making.

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[139] 'Autonomous Artificial Intelligence Guide: The future of AI'<https://www.algotive.ai/blog/autonomous-artificial-intelligence-guide-the-future-of-ai> accessed 28 November 2023.

[140]Samar Ashour, 'Artificial Intelligence in the Boardroom: An Outright Exposure to Directorial Liability?' (*Oxford Business Law Blog,* 12 October, 2020)<https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/10/artificial-intelligence-boardroom-outright-exposure-directorial> accessed 20 December 2023.

Other nations have taken the initial steps to regulate the AI industry. The *Ethics Guidelines for Trustworthy AI*[141] released by the High-Level Expert Group in the EU establishes seven requirements before any AI system can be deemed as *"trustworthy"*. One of the seven requirements includes the presence of human oversight and agency while dealing with the AI systems, thereby removing scenarios involving AI systems with high-level autonomy. Singapore's (IMDA) has created AI Verify, a governance framework and software toolkit for this purpose.[142] The 11 governance principles laid down are *"transparency, explainability, repeatability/reproducibility, safety, security, robustness, fairness, data governance, accountability, human agency and oversight, inclusive growth, societal and environmental well-being."*[143] The US has developed *Principles for Stewardship of AI Applications*[144] which emphasizes public participation and flexibility for adapting to rapid changes.

Entrepreneurs in business might have to face complexities in understanding the implications of the current legal regime when it comes to incorporating AI in the business models and processes. For such instance, the Canadian Securities Administrators' ("**CSA**") Regulatory Sandbox[145] was created to provide a pre-designed temporary solution of relief from the

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[141] *'Ethics guidelines for trustworthy AI'*, European Commission (2019).

[142] Infocomm Media Development authority, 'Artificial Intelligence in Singapore' <https://www.imda.gov.sg/about-imda/emerging-technologies-and-research/artificial-intelligence >accessed 22 December 2023.

[143] Cheryl Seah, 'Round Up of Significant Legal Developments in AI for 2023' (*Law Gazette* December 2023) <https://lawgazette.com.sg/feature/round-up-significant-legal-developments-ai/> accessed 25 December 2023.

[144] Executive Office of the President, Washington D.C., *'Memorandum for the Heads of Executive Departments and Agencies'* (17 November 2020) <https://www.whitehouse.gov/wp-content/uploads/2020/11/M-21-06.pdf> accessed 25 December 2023.

[145] Canadian Securities Administrators, 'The Canadian Securities Administrators Launches a Regulatory Sandbox Initiative'<https://www.securities-administrators.ca/news/the-canadian-securities-administrators-launches-a-regulatory-sandbox-initiative/ > accessed 23 November 2023.

compliance requirements of the Securities laws.

Meanwhile, it is also necessary to remove ambiguities and liability gaps so that the legal framework for regulating corporations remain robust and AI ready. Based on these cases, we are inclined towards using AI for the supportive role to reduce corruption within boards to a certain extent. Furthermore, the suggestions put forth by the European Parliament with respect to solving the issue of the liability of AI models are crucial here which advocate for conferring legal status to AI robots and attributing the liability for both civil and criminal actions upon the AI system. Additionally, a Report of Committees - D on cyber security and associated concerns discussed civil liability for AI, considering that AI systems are pumped up to make decisions independently by self-acquiring the necessary knowledge, leading to civil liability.[146] Even stakeholders involved should consider bestowing the status of legal personhood on AI systems, along with establishing an insurance or compensation fund for damages.

Corporate dynamics is heading towards a stakeholder-centric-approach and shareholder democracy where a direct incorporation of stakeholder's interests in the features of the AI inputs could be helpful. Thus, the risks associated with AI can be mitigated by placing a specialist executive in the form of a technology director who is responsible for accuracy and wholesomeness of the data quality used in AI.[147] Such a scenario necessitates a specific legal framework for AI liability.

Currently, India is amidst the wave of finding a comprehensive

[146] *'Report of Committee- D on Cyber Security, Safety, Legal and Ethical Issues'*, Ministry of Electronics and Information Technology.
[147] Joseph Lee and Peter Underwood, 'AI in the boardroom: Let the law be in the driving seat' (2021) ICCLJ.

framework for regulating AI. Under the existing corporate framework of India, only Assisted-AI can be utilised by boards corporate departments. Therefore, an AI cannot be granted the status of a *"person"* as required by the Companies Act, 2013. The corporations developing as well as deploying AI systems shall ensure compliance with The Digital Personal Data Protection Act, 2023[148] and the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 (SPDI Rules).[149] Ensuring the appropriateness of data sets utilized for training ML models is the first crucial step that corporations shall take for ensuring the development of responsible AI. This recommendation can also be traced in the report prepared by NITI Aayog titled *"Responsible AI: AI For All."*[150] Data is the backbone of AI.[151] Regulating how companies use data to train ML models is integral to developing responsible AI. Diverse datasets can help eliminate biases.

ML model training is quite prone to human biases. In supervised learning, data labelling can be affected by biases; in unsupervised learning, they influence algorithm fine-tuning based on developers' notions of 'correct' outcomes. Reinforcement learning requires an extreme form of caution in setting parameters and environments.[152] as the reward function, crucial in guiding AI learning, must be accurately defined. Therefore, understanding the

[148] Digital Personal Data Protection Act 2023.
[149] Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules (SPDI Rules) 2011.
[150] 'Responsible AI', Niti Ayog (February 2021) <https://www.niti.gov.in/sites/default/files/2021-02/Responsible-AI-22022021.pdf> accessed 25 December 2023.
[151] Bernard Marr, 'Why AI Would Be Nothing without Big Data' (2017) *Forbes* <https://www.forbes.com/sites/bernardmarr/2017/06/09/why-ai-would-be-nothing-without-big-data/?sh=3649a414f6d0 > accessed 21 December 2023.
[152] Richard S. Sutton and Andrew G. Barto, *Reinforcement Learning* (The MIT Press, Second Edition 2018).

nitty-gritty of the technology is one of the first steps that corporations shall ensure for the safe development and deployment of AI.

AI systems can arguably be described as a new species. These intelligent machines can neither be categorised as humans nor as classical machines. This requires an understanding of these systems from scratch for making corporate law AI ready and ensuring that AI is utilised for the benefit of mankind.

# VI. BALANCING INNOVATION AND FAIR PLAY: THE CASE FOR CCI'S ROLE IN PATENT REGULATION

- Utkarsh Sharma*

ABSTRACT

The Telefonaktiebolaget LM Ericsson v. Competition Commission of India (Ericsson II) judgment, the Delhi High Court (HC) has made a jurisdictional shift by limiting the jurisdiction of the Competition Commission of India (CCI) under the Competition Act, 2002 (Act) and giving primary jurisdiction to the Patent controller under the Patents Act 1970 in the matters pertaining to the grant of patents. This decision opens a pandora box of challenges, safeguarding the rights of a willing licensee against seeking injunctive relief by the Standard Essential Patent (SEP) holder being one of such challenges. This paper first discusses the importance of SEPs for any player in the market. It analyses how the courts have dealt with the issue of SEP holders seeking injunctive relief against a licensee in India vis-à-vis other jurisdictions. Further, this paper examines the latest ruling of Delhi HC limiting the jurisdiction of CCI and how it will negatively impact the rights of a licensee of SEPs by leaving them without adequate remedies. In conclusion, it is proposed that the court shall re-evaluate its ruling considering the market realities and legislative intent while dealing with the jurisdictional tussle between the Competition Act, 2002 and the Patents Act, 1970.

**Keywords**: Standard Essential Patents, Willing licensee, Abuse of dominance and Jurisdictional tussle

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## I. INTRODUCTION

The term 'patent' refers to a formal registration for an invention, which grants the right to individuals who invent or discover a new and useful process, product, article, or composition of matter, or any new and useful improvement thereof.[1] This privilege does not entail the right to utilize the invention; rather, it confers the power to prohibit others from making, using, importing, or selling patented inventions during its term. One type of Patent that has recently been in the news is the Standard Essential Patent (SEP)[2]. SEPs are those patents that are necessary to be used in order to meet a standard criterion laid down by a Standard-Setting Organization (SSO)[3]. SEPs are so important to a particular industry standard that using them necessitates patent infringement if no licensee is granted by the patent holder. These types of patents came into being to increase interoperability, especially in the arena of technology.[4]

With the rise of SEPs, the Competition Act, 2002, gains relevance as it regulates SEP holders, who often dominate the market due to the lack of alternatives for such patented technologies. A crucial area that competition law monitors is the pursuit of an injunction by a SEP holder against a SEP infringer. The Competition law, depending on various other factors often prohibits such conduct and it has been held to be an abuse of dominance under

[1] 'What is Patent' (*WIPO)*<*https://www.wipo.int/patents/en/*> accessed 15 March 2024.
[2] Ishan Sambhar, 'Concept of Standard Essential Patents' (*Mondaq,* 30 June 2020*)* < *https://www.mondaq.com/india/patent/954588/concept-of-standard-essential-patent*> accessed 15 March 2024.
[3] Jurgita Randakevičiūtė, *The Role of Standard-Setting Organizations with Regard to Balancing the Rights Between the Owners and the Users of Standard-Essential Patents* (Nomos Verlagsgesellschaft Mbh & Co 2015).
[4] 'Standard Essential Patents (SEPs): Fostering Innovation and Interoperability' (*Brainiac,* 15 April 2017) <https://brainiac.co.in/standard-essential-patents-seps-fostering-innovation-and-interoperability/> accessed 17 March 2024.

Article 102 of the Treaty of Functioning European Union (TFEU).[5] The situation regarding the seeking of injunctive relief by a SEP holder against an infringer was in its evolving stage in India and was governed under Section 4 of the Competition Act, 2002 (Competition Act) which prohibits abuse of dominant position.[6] However, in 2023, the Delhi High Court limited the applicability of competition law over matters pertaining to patents while giving the primary jurisdiction to the patent controller under the Patents Act 1970. The question now arises as to how the courts will deal with the SEP holders seeking injunctive relief against the infringers which may amount to abuse of dominance under the antitrust laws?

*Firstly*, the author will discuss what are SEPs and their significance for a player to enter or sustain in a market. *Secondly*, the global jurisprudence on the issue of SEP holders seeking injunctive relief against infringers will be discussed. *Thirdly* the author will examine the latest ruling of the Delhi HC *in Ericsson v. CCI*[7] judgement which has created a void as to how such conduct of SEP holders will be governed. *Fourthly*, the author will examine the Patents Act *vis-à-vis* Competition Act to assess whether it has the requisite power to deal with the issue at hand and *fifthly*, the author will analyze the rationale adopted by the court in reaching the conclusion of giving precedence to the patents act over competition act. Lastly, a conclusion will be drawn as to what shall be the way ahead.

[5] Treaty of Functioning European Union, art 102.
[6] Competition Act 2002, s 4.
[7] Telefonaktiebolaget LM Ericsson v. Competition Commission of India [2023] SCC Online Del 4078.

## II. STANDARD ESSENTIAL PATENTS AND THEIR SIGNIFICANCE

Standards refer to uniformity, having a quality of a certain specified benchmark. Imagining our lives without standards makes one realize the importance of the same. From the railway tracks laid down in a rural village to the most advanced technology that allows us to fly via airplanes, everything requires standards. With the advent of technology, standards have gained more significance as 'interoperability' became an important factor in the rapid growth of technology.

The importance of such standards can be better understood by an example. Imagine your smartphone's battery succumbs, leaving you in dire need of communication. Panic may rise as you contemplate the foreign SIM card clutched in your hand, unsure of its compatibility with your device. This predicament exemplifies the crucial role of smartphone standards in ensuring interoperability, a key driver of seamless user experience and efficient communication. Communication protocols, often resembling diverse languages, could prove incompatible, rendering the SIM card a useless artifact. Fortunately, the foresight of establishing and adhering to global standards like GSM and LTE safeguards against such disruptions. In this same scenario, empowered by interoperability, your phone and the local network would effortlessly engage in dialogue. The SIM card, no longer a foreign object, would seamlessly integrate, granting you instant access to communication lifelines. This sense of security and the ability to effortlessly connect are testaments to the invisible yet vital network of standards that underpins the smartphone ecosystem. Ultimately, these standards play an invaluable role in ensuring a smooth and unified user experience, keeping us connected and informed regardless of geographical boundaries.

The voluntary, nonprofit organizations known as Standard Development Organizations (SDO) oversee the standard-setting process. SDOs are associations or organizations, often of global magnitude, with a membership that includes a variety of stakeholders from the relevant industry. For instance, in the telecommunications industry, an SDO may include members from network operators, government regulatory bodies, and mobile technology users, such as phone manufacturers (Apple, Samsung, etc.) and technology developers (Nokia, Philips, etc.). The SDO is responsible for organizing and facilitating the process of standardization and development with the active participation and engagement of several stakeholders, including enterprises, academic institutions, researchers, etc. In order to meet the standards laid down by such SDOs, it is essential to obtain licenses from the Standard Essential Patents holders. As the above discussion showcases the importance of standards, especially in the technology industry, it becomes imperative for other players to obtain licenses for using such SEPs to enter or sustain in the market.

## III. SEP HOLDERS SEEKING INJUNCTION AGAINST INFRINGERS: A GLOBAL PERSPECTIVE

As discussed above, SEPs, due to their ubiquity, broad scope, and complex licensing landscape, are indeed prone to infringement. Companies implementing standards often walk a tightrope: complying with the standard set in the industry while potentially infringing on patents deemed essential. Standard-Essential Patent (SEP) holders are obligated to offer licenses on Fair, Reasonable, and Non-Discriminatory (FRAND) terms to ensure widespread access to essential technologies while maintaining fair competition. This obligation arises because SEPs, by definition, are patents essential to

implementing a technical standard, and withholding access could lead to anti-competitive practices.

Many times, the infringer is not even aware that they are infringing the SEP of the patent holder. To protect the rights of such parties who might have infringed such SEPs but are willing to obtain the license from SEP holders, competition law comes into the picture. Competition law keeps a check on the conduct of SEP holders with regard to licensing of their SEPs, often the act of seeking injunction by a SEP holder is considered an abuse of dominance as the objective behind such suit is not merely to prohibit infringement but to create an entry barrier for other players in the market.[8] SEP holders often seek injunctions against alleged infringers driven by economic and strategic considerations. Economically, they aim to maximize royalties by using the threat of injunctions as leverage, often pushing alleged infringers to agree to terms more favorable than what would typically be considered FRAND-compliant. This also helps protect the perceived value of their patents and ensures a steady revenue stream, justifying the significant investments made in research and development.

Strategically, injunctions allow SEP holders to limit competitors' access to critical technologies, delaying their market entry or expansion. Such actions can also strengthen their negotiating position, compelling alleged infringers to settle disputes quickly. Moreover, obtaining injunctions enhances their reputation, signaling to the market that unauthorized use of their SEPs will not be tolerated, thereby deterring potential future infringers. The position

[8] Renato Nazzini, 'Global licences under threat of injunctions: FRAND commitments, competition law, and jurisdictional battles' (2023) 11 (3) JAE<https://academic.oup.com/antitrust/article/11/3/427/7030759?login=false> accessed 18 March 2024.

of the European Union (EU) on this aspect can be discussed in two parts: 1) The Orange Book standard and 2) Post Orange Book standard.

### A. The Orange Book Standard[9]

A German court heard a defense that claimed requesting an injunction to stop patent infringement would be an abuse of a dominating position. This case dealt with a standard for Compact Discs Read-only Memory (CD-R), which had to have adhered to the requirements outlined in what is called the 'Orange book'. In this matter, the licensor, Philips, asserted that all producers or individuals offering CD-Rs were obliged to get a license from Philips for using its SEPs. Upon infringement, along with seeking damages, Philips also filed a lawsuit against many manufacturers who were producing CD-Rs for an injunction against such infringers. The manufacturers argued in their defense that Philips has a strong position in the markets for CDRs and that its actions in requesting an injunctive relief violated Article 102 of the TFEU as it amounted to abuse of dominance. In this case, the court observed that seeking an injunction by a SEP holder will amount to abuse of dominant position if two criteria are met. *Firstly*, the infringer had made an unconditional offer to obtain a license that the patent holder could not refuse without abusing its dominant position. *Secondly*, such terms included the infringers waiving their right to challenge the patent in question.

### B. A Shift in Approach: Huawei v. ZTE[10]

This case revolves around the licensing of its SEPs portfolio by Huawei to ZTE. The parties were unable to come to an agreement on fair,

[9] Manufacturers v. Philips case [2009] KZR 39/06 CD-R [BGH].
[10] Huawei Technologies Co. Ltd v. ZTE Corp. and ZTE Deutschland GmbH [2015] ECJ Case 170/13 477.

reasonable, and non-discriminatory[11]parameters for a patent licensing deal. Due to this, Huawei filed a complaint alleging patent infringement with the Landgericht Düsseldorf, the German Federal Court of Justice. ZTE argued that Huawei had breached Article 102 of the TFEU as it had abused its dominant position by seeking an injunction. ZTE further argued that it was a willing licensee. Due to the controversial nature of the issues at hand and the potential for differences in the approach of the EU Commission and the German courts, the Court paused the proceedings and sent five issues to the European Court of Justice. The Advocate General gave the Court an opinion in those proceedings as required by the Court of Justice's process, proposing what is described as a 'middle path' between the protection granted to a SEP holder and the licensees of such SEPs.

The Court of Justice upheld the aforementioned opinion and thus it aimed to balance the rights of SEP holders and the licensees. According to the Court of Justice, a SEP holder's reluctance to provide a license under FRAND conditions might theoretically be considered abuse under Article 102 of TFEU. Therefore, in theory, the abusive character of this kind of denial might be used as a defence against requests for prohibitory orders. The Court of Justice further decided that the fundamental rights of a SEP holder cannot be invalidated by his irreversible pledge to grant licenses to an SSO under FRAND terms. It does, however, nonetheless justify putting the owner of a SEP under pressure to follow specific guidelines when applying for an injunction against the alleged infringement or to have the infringing objects recalled. Subsequently, the Court of Justice delineated certain specific prerequisites that a SEP holder must satisfy to initiate a lawsuit for alleged

[11] Kirti Gupta, 'Frand' (*Concurrences)* <*https://www.concurrences.com/en/dictionary/frand#references*> accessed 19 March 2024.

infringement. In this instance, the court established requirements that a SEP holder must follow in order to avoid violating Article 102 of the TFEU when requesting an injunction against the SEP infringer. These conditions were:

- *Firstly*, the SEP holder needs to have a prior consultation with the infringer. It is the duty of the SEP holder to notify the infringer regarding the infringement and specify the manner in which the infringement is done.
- *Secondly*, once the infringer is aware of the infringement and agrees to obtain the license on the FRANDS terms, then the onus is on the SEP holder to present a written offer to the infringer on the FRANDS terms, which has to be in accordance with the commitment made by the SEP holder to the relevant SDO, along with the specific royalty amount and laying down the manner in which such amount has been calculated.
- *Thirdly*, in case there is no consensus reached between both parties for the licensing agreement, then an independent third party may take part to assist in reaching an agreement between both parties.
- *Lastly*, it was held that the negotiation between the SEP holder and the infringer does not restrict the right of the infringer to appeal against the legitimacy of the patents, or the right to challenge the same in the future irrespective of the agreement reached between the parties for the time being.

The analysis of these two landmark judgments showcases that the approach of courts has shifted from being more licensor-centric to more licensee-centric. This global jurisprudence plays in pivotal role in India as well and courts have often relied on these judgments to form their opinion. Further, Article 102 of TFUE which states that "Any abuse by one or more

undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States" may be different in terms of language from Section 4 of the Competition Act which deals with the abuse of dominant position, but the substantive principles align. As observed by the court in *Ericsson v CCI (2016)*,[12] a detailed analysis does suggest that the misuse of a dominating position as prohibited by Article 102 of the TFEU would also fall under Section 4 of the Competition Act. As a result, the EU courts' ruling has significant persuasive power in the Indian context.

## IV. DELHI HC'S RULING: DUST SETTLED OR STORM CREATED

The jurisdictional tussle between the Competition Act and Patent Act dates back to the year 2013, in the case of ***in re: Micromax Info and Telefonaktiebolaget Ericcson[13]***, informant i.e. Micromax alleged that Ericsson had abused its dominant position by charging exorbitant royalty rates for its SEPs. In this case, the court dealt with the application of the Competition Act vis a vis the Patent Act and held that the informant has every right to raise issues before the CCI. Thus, the court upheld the primary jurisdiction of CCI and observed that Section 62 of the Act[14] makes it clear that provisions of the Competition Act are in addition to and not in derogation of other existing laws. After this judgment, there were several cases before CCI and High Courts pertaining to the jurisdiction tussle between the

[12] Telefonaktiebolaget LM Ericsson v. Competition Commission of India [2016] SCC OnLine Del 1951.
[13]Micromax Informatics Limited v. Telefonaktiebolaget LM Ericsson [2013] SCC OnLine CCI 78.
[14] The Competition Act 2002, s 62.

Competition Act and Patent Act, and in all the judgments similar stance was reiterated e i.e. the Competition Act would take precedence over the Patent Act.

However, the landmark judgment of Delhi HC in the case Of ***Telefonaktiebolaget Lm Ericsson (Publ) v. CCI (2023)***[15] changed the settled position on the issue of jurisdiction tussle between the two Acts. The court ousted the primary jurisdiction of CCI under the Competition Act and observed that the Patent Act 1970 is an adequate law to deal with the issue of the rights of a patentee. In order to reach its decision, the court gave 3 major rationales:

**A. The Patent Act is a Special law in the Instant Matter**

The court observed that when the jurisdictional conflicts arise between the two special laws, factors such as subject matter, the intendment of the statutes in respect thereof, and the relevant provisions such as the non-obstante clause must be considered. The court extensively examined sections 3 and 4 of the Competition Act along with chapter XVI of the Patent Act[16] to reach the conclusion that the Patent Act is a special law in matters pertaining to the rights of the patentee and not the Competition Act.

**B. The Application of Lex Posterior Derogat Priori**

This legal principle translates to "A later law repeals an earlier law". The Patent Act was passed in the year 1970 whereas the Competition Act was enacted much later in 2002. However, the court pointed out that Chapter XVI of the Patents Act which is a code in itself dealing with the rights and duties

[15] Telefonaktiebolaget LM Ericsson v. Competition Commission of India [2023] SCC Online Del 4078.
[16] The Patents Act 1970, c XVI.

of patentees, was added to the Patents Act through the 2003 amendment [17] Therefore, the Patents Act becomes subsequent to the Competition Act and thus has the primary jurisdiction.

### C. The Legislative Intent Favours the Primary Jurisdiction of the Patents Act

The court reasoned that the fact that Chapter XVI was added to the Patents Act in 2003 which deals with the rights of a patentee showcases legislature in its wisdom had the intention to give primary jurisdiction to the Patent Act and not the Competition Act which was enacted in 2002. The court also overruled the 2016 judgment of the *Telefonaktiebolaget Lm Ericsson (PUBL) v. CCI*[18] where a single bench made a reference to sections 21 and 21A to give primary jurisdiction to the CCI under the Competition Act.

The aforementioned sections lay the provision of reference which can be made by statutory authority to CCI and vice versa in cases where there is an overlapping of the Competition Act with any other act. The court in its latest ruling in *Telefonaktiebolaget LM Ericsson (PUBL) v. CCI* explicitly held that sections 21 and 21A do not give primary jurisdiction to CCI to exercise powers that are indeed given to the patent controller under chapter XVI of the Patents Act. Hence, the court observed that it will not allow CCI to exercise power contrary to the legislative intent.

In the light of above factors, the court granted primary jurisdiction to the patent controller under the Patents Act while ignoring the complex issues that could arise by limiting the application of the Competition Act in cases of

[17] The Patents (Amendment) Act 2002.
[18] Telefonaktiebolaget LM Ericsson (PUBL) v. Competition Commission of India and Ors [2016] SCC OnLine Del 1951.

patents, the rights of a willing licensee against an injunction by SEP holder being one of such complex issues.

## V. ASSESSING THE ADEQUACY OF PATENT ACT IN GOVERNING THE CONDUCT OF SEP HOLDERS

As discussed above, the court has overlooked the wider implications of ousting the primary jurisdiction of the CCI with respect to the issues pertaining to the granting of patents. In such a situation when the Competition Act only has a secondary jurisdiction, the court has observed that the licensee can make an application to the controller under section 84 of the Patents Act[19] for a grant of compulsory licensing of SEPs. The author, however, contends that section 4 of the Competition Act cannot be substituted with section 84 of the Patents Act for twofold reasons:

### A. That the Power of CCI Under the Competition Act is Wider Than the Patent Controller's Power Under the Patents Act

The powers vested with the CCI and the Controller General of Patents, Designs, and Trademarks (CGPDTM) under the Competition Act 2002 and the Patent Act 1970, respectively, reflect the distinct regulatory objectives and contexts of competition law and intellectual property rights (IPR) protection.

The CCI is empowered to ensure fair competition and prevent anti-competitive practices in markets. The legal landscape surrounding rights and remedies encompasses two primary categories: '*in rem*' and '*in persona*'.[20] In the former, the rights pertain to claims enforceable against the world at large, usually concerning properties or broader societal interests. Under the

[19] The Patents Act, s 84.
[20] Alf Ross *The Theory of Rights In Rem* and Rights *In Personam* (Oxford University Press 2019) 228.

Competition Act 2002, relief falls within this domain. Accordingly, it possesses broad regulatory powers aimed at maintaining competitive environments. These powers include imposing penalties on entities engaged in anti-competitive conduct, ordering modifications or discontinuation of agreements that restrict competition, issuing cease and desist orders to halt anti-competitive behavior, and conducting investigations into suspected violations of competition law. The CCI's authority extends to addressing a wide range of practices, such as cartels, abuse of dominance, and anti-competitive mergers and acquisitions, with the overarching goal of fostering competitive markets and protecting consumer welfare.

Conversely, in-persona, rights are enforceable against specific individuals or entities, typically arising from contractual obligations or infringements of individual rights. The Patent Act grants such *persona* rights to patent holders, enabling them to pursue legal action against those who violate their exclusive patent rights. The role of the Patent Controller primarily revolves around the administration and regulation of intellectual property rights, particularly patents. While the Patent Controller has significant responsibilities in overseeing the patent application process, granting patents, and maintaining the patent registry, their powers concerning enforcement are relatively limited.

In summary, the Competition Act gives rights *in rem* whereas it is rights *in persona* under the Patents Act. This distinction underscores the differing scopes of enforceability: *in rem* rights address broader market concerns that aim to safeguard not just other players but also the competition in the market as well as the consumers, while *in persona* rights focuses on protecting individual interests against specific infringements. while the CCI possesses extensive powers to regulate and enforce the Competition Act,

including penalties, injunctions, and orders to promote competition, the powers of the Patent Controllers are more focused on the administration of patents and the limited grant of compulsory licenses to balance patent rights with public interests.

### B. That the Patent Act Gives Blanket Safety to the Patent Holders Against Compulsory Licensing for the 3 Years from the Date of Granting a Patent

Section 84 serves as a cornerstone in the Patents Act, specifying that compulsory licenses, allow third parties to utilize patented inventions without the consent of the patent holder. Such compulsory licenses can only be sought after an initial period of three years following the patent grant date. This provision is pivotal in balancing the interests of patent holders with those of promoting innovation and ensuring broader access to patented technologies. However, during the critical initial three-year window after acquiring a patent, there exists a notable concern regarding the behavior of SEP holders. These entities, holding patents essential for implementing industry standards, may potentially flout their commitments to FRAND licensing terms. By leveraging their temporary monopoly power, they might resist licensing their patents under equitable terms, thereby impeding competition and stifling market entry for other players. Moreover, during this nascent period of post-patent acquisition, there's a distinct possibility that SEP holders could resort to legal manoeuvres such as seeking injunctions against their competitors. By wielding the threat of legal action, they could effectively deter competitors from introducing alternative products or services, thereby consolidating their dominance, and potentially creating monopolistic market conditions.

It is important to note the disparity between the regulatory frameworks

governing patents and competition. While Section 84 of the Patents Act provides a specific provision regarding the timing of compulsory licensing, there's a noticeable absence of a similar safe harbour under Section 4 of the Competition Act 2002 thus making it competent to keep a check on the conduct of SEP holders. ousting the primary jurisdiction of the Competition Act leaves a regulatory gap, void in oversight, potentially enabling SEP holders to operate with greater latitude during the crucial initial three-year period. Given the significant implications for market dynamics and consumer welfare, diligent monitoring of SEP holder conduct is imperative. Without robust regulatory measures, there is a palpable risk of anti-competitive behaviour, including restricted market access, inflated prices for consumers, and inhibited technological progress. Hence, effective oversight mechanisms are essential to safeguarding the integrity of competitive markets and fostering innovation ecosystems conducive to broader societal benefit.

## VI. BEYOND THE BENCH: EXPLORING THE MISINTERPRETATION OF LAW

The recent judgment of Delhi HC in the case of *Telefonaktiebolaget Lm Ericsson (PUBL) v. CCI* has altered the settled position resulting in the ousting of the primary jurisdiction of the Competition Act. The rationale adopted by the court for giving precedence to the patent act has glaring gaps. Section 60 of the Competition Act[21] explicitly states that it shall have effect "notwithstanding anything inconsistent therewith contained in any other law for the time being in force" whereas section 62 of the Act states that the application of other laws is not barred since the Competition Act is in addition and not derogation of any other laws. A harmonious reading of these two

[21] The Competition Act 2002, s 60.

sections showcases the legislative intent of not barring jurisdiction of any other law such as the Patent Act, but expressly laying down the primary jurisdiction of the Competition Act via section 60 of the Act.

Further, the court relied on the legal principle of *lex posterior derogat priori* and observed that the amendment to the patent act came in 2003 which added chapter XVI to the original act and deals with the rights of a patentee, therefore it is subsequent to the Competition Act and will have precedence over it. The court here neglected another significant amendment which was made to the Competition Act in 2007[22] which added section 21 A to the original act. This section allows CCI to make reference to any other statutory authority when there is a proceeding before CCI that relates to another law for which such statutory authority is competent to act. This provision showcases that although the jurisdiction can be shifted from CCI to another statutory authority but the primary jurisdiction lies with CCI and since this amendment came in 2007, even the application of the abovementioned legal principle gives precedence to the Competition Act.

## VII. WAY AHEAD

The recent judgment of Delhi HC has opened a pandora box of challenges since the Patents Act is not substitutable with the Competition Act, leaving the licensees without adequate remedies. In light of these concerns, it is proposed that the court should reconsider the fundamental question of how these two statutes interact. Emphasizing the independent nature of the Competition Act, the suggestion is to avoid substituting the Competition Act with the Patents Act, as doing so could create numerous challenges, such as allowing SEP holders to abuse their dominance by getting injunctive orders

[22] The Competition (Amendment) Act 2007.

against the willing licensees. The author advocates for a more holistic approach where the court shall take into account the market realities and the practicality of its decisions, interpreting the Competition Act harmoniously with the Patents Act, while giving precedence to the former.