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FOREWORD

The current moment is an opportune one to critically analyse the legal and regulatory developments surrounding corporate and commercial law in India. At the outset, the current incarnation of corporate legislation in the form of the Companies Act, 2013 is precisely a decade old. The users of corporate law, such as companies and their stakeholders, and the suppliers of the law, such as the legislature, the executive and the judiciary have been dealing with relative novel issues such as corporate social responsibility (CSR) and environmental, social and governance (ESG) considerations that strike at the root of the purpose of a corporation.

A parallel set of developments relate to the strengthening of the regulatory regime governing the securities markets. The Securities and Exchange Board of India (SEBI) has focused on its dual (and sometimes conflicting) objectives of promoting the development of the markets on the one hand and, at the same time, regulating the markets in the interests of investors on the other. The regulator has been at the forefront of introducing various market innovations to expand the pool of fund-raising mechanisms available to companies and also to amplify the investment opportunities available to funders. One area that has attracted a great deal of debates and discussions relates to the enforcement powers and prowess of SEBI in ensuring market integrity. Its actions relating to securities market offences such as insider trading and market manipulation have been under scrutiny not only by appellate authorities and courts, but also by market observers. This milieu calls for a more systematic analysis of the substantive law relating to market abuses and its enforcement as well.

End-game scenarios have acquired prominence as well, whether they relate to financial distress experienced by companies or the souring of relationships between corporate actors such as shareholders. In this regard, the enactment and implementation of the Insolvency and Bankruptcy Code, 2016 (IBC) is noteworthy. After a series of failed legislation dealing with financial distress, the IBC was enacted to bring about a sea change in the corporate insolvency process. While the legislation was the result of a meticulous law reform process, its implementation revealed considerable complexities that required the repeated intervention of the judiciary, including the Supreme Court. The Court was called upon to interpret several ambiguities that emanated in the legislation and answer constitutional questions relating to its provisions. In a few instances, the Court also exhorted Parliament to plug gaps, some of which were subsequently addressed.

When it comes to dispute resolution, the key developments in the law of arbitration have been closely watched by corporate players, both domestic and international. Questions relating to whether emergency arbitration is recognised under Indian arbitration law and the fate of unstamped arbitration agreements have been the subject matter of hard-fought litigation before the Indian judiciary. Finally, other areas such as competition law, taxation, and real estate round off the areas within the scope of financial and mercantile law that have lately received attention.

In such a context, the RGNUL Financial and Mercantile Law Review (RFMLR) has been playing a significant role in engaging in a scholarly discourse across several areas of the law that are important to businesses operating in India and elsewhere around the world. The upcoming Volume X Issue I also contains articles discussing niche issues in areas surrounding securities regulation (particularly insider trading), competition law, corporate

bonds, corporate insolvency, real estate, and dispute resolution. They would be of immense interest to researchers, students, practitioners, and policymakers alike. I am pleased to introduce the volume, and I hope you benefit from its wide array of articles.

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I. FINANCIAL SERVICE PROVIDERS UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

- Siddharth Srivastava, Raunak Rahangdale and Shikha Mohini*

ABSTRACT

Financial Service Providers ("**FSPs**") are the backbone of the economy of any country and hence their insolvency and resolution become a matter of public concern. Although much is known about the resolution and liquidation of a company in general, a lot remains unexplored in the domain of insolvency of FSPs. The authors via this article attempt to explore the above-stated and, in the process, have consolidated the laws and procedures surrounding the resolution of an FSP prior to and after the commencement of the Insolvency and Bankruptcy Code, 2016 ("**Code**"). Further, we analyze in detail the ratio laid down in the matters concerning the insolvency of Dewan Housing Finance Limited ("**DHFL**"), the first FSP to undergo insolvency under the Code. The insolvency of DHFL is of utmost importance for it went on to settle multiple legal principles in regard to the insolvency of FSPs and has paved the way for future FSP resolutions.

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* The authors are Partner, Principal Associate and Associate at Khaitan & Co. Views stated in this paper are personal.

I. BACKGROUND

The Indian economy is dominated by financial service providers (**"FSPs"**) led by banking institutions which are closely followed by insurance companies, non-banking financial companies, and mutual funds.[1] Many of these FSPs are responsible for critical functions fundamental to the economy of the country. At the time of the inception of the Insolvency and Bankruptcy Code, 2016 (**"the Code"**), the insolvency and liquidation of FSPs were not intended to be covered by the provisions of the Code. The rationale of the legislature behind such demarcation was rooted in the fundamental difference between other companies covered under the Code and FSPs, as other corporate debtors under the Code are engaged in independent business operations, whereas FSPs are engaged in services such as managing public funds, deposits, settlement and recording of monetary transactions, securities, and derivative contracts, etc.[2] If one has to gauge the effect of the failure of an FSP on the economy of a country, the failure of Lehman Brothers during the 2008 financial crisis in the United States can be seen as an appropriate example which left thousands bankrupt and jobless and wiped out the saving of millions of investors from the market. The article is an attempt to analyze the legal framework for the resolution of FSPs under IBC and other legal frameworks.

Within its purview FSPs include all non-banking financial companies, micro-financing companies, insurance companies, and depositories. Further,

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[1] Joyjayanti Chatterjee, 'The Case for a Specialised Resolution Law for Financial Institutions' (2018) NLS Bus L Rev 43 <https://www.nlsblr.com/_files/ugd/f10044_cc036a228ca1491db8b9663342dcba9f.pdf> accessed 14 January 2023.

[2] Debanshu Mukherjee and Aditya Ayachit, 'Resolution of Distressed Financial Institutions: An Overview of Recent Reforms in India' (2017) NLS Bus L Rev 129 <https://www.nlsblr.com/_files/ugd/f10044_e3a049486a3e4f07a8fb7f76cb0527fb.pdf> accessed 14 January 2023.

it is interesting to note that the definition of "corporate person" under the Code excludes FSPs and reads as follows:

> "corporate person" means a company as defined in clause (20) of section 2 of the Companies Act, 2013 (18 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider;[3]

This exclusion demonstrates that legislative intent was to keep FSPs out of the purview of the Code during its initiation.

A. What are FSPs?

As per section 2(17) of the Code, FSPs are defined as follows:

"financial service provider" means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator;

Further, "financial services" includes the following services under Section 2(16) of the Code:

- accepting of deposits;
- safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;
- effecting contracts of insurance;

[3] Insolvency and Bankruptcy Code 2016 (Act 31 of 2016) (IBC 2016), s 3(7).

- offering, managing;
- or agreeing to manage assets consisting of financial products belonging to another person;
- rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of–
    - buying, selling, or subscribing to, a financial product;
    - availing a financial service; or
    - exercising any right associated with a financial product or financial service;
- establishing or operating an investment scheme;
- maintaining or transferring records of ownership of a financial product;
- underwriting the issuance or subscription of a financial product; or
- selling, providing, or issuing stored value or payment instruments or providing payment services;

B. Pre-IBC Framework for Resolution of FSPs

Previously, the resolution of FSPs was governed under various legal frameworks however the said legislative frameworks remained ineffective and untested. Some of the said frameworks included the following:

- National Housing Bank Act, 1987- The National Housing Bank ("**NHB**") can file an application for winding up of a Housing Finance Company on

its inability to pay debt, in the exercise of its powers under the National Housing Bank Act, 1987.[4]

- Banking Regulation Act, 1949- For commercial banks, the Banking Regulation Act, 1949 provides for three types of resolution instruments:
  - mergers (including reconstruction);
  - acquisition of undertaking; and
  - court-ordered winding up (where RBI may be appointed as the liquidator).
- In cases of mergers, RBI may apply to the Central Government for a moratorium on a banking company and thereafter prepare a scheme for merger with any other banking institution. It is to be noted that RBI does not have the power for the resolution of public sector banks and they can only be wound up by an order of the Central Government.[5]
- Insurance Act, 1938- Under the Insurance Act, 1938, the Insurance Regulatory and Development Authority of India (**"IRDAI"**) may formulate and sanction a scheme of amalgamation and appoint an administrator for the management of the insurance business.[6] In the event of insolvency or non-compliance of the insurance company with the Insurance Act, 1938, the High Court/National Company Law Tribunal have also been empowered to wind up the company if its continued operation prejudices the policyholders.[7] Further, under Section 53 of the Insurance Act, insurance companies can apply for voluntary winding-up for effecting amalgamation or reconstruction or in the event it is unable to continue business on account of liabilities.[8] The IRDAI Act, 1999 also

[4] National Housing Bank Act 1987 (Act 53 of 1987), s 33B.
[5] The Banking Regulation Act. 1949 (Act 10 of 1949), s 45.
[6] The Insurance Act, 1938 (Act 4 of 1938), s 35-37A, 52A, 52C.
[7] ibid s 53.
[8] ibid s 54.

envisages (a) the appointment of an administrator by IRDAI, (b) winding up on the application of a requisite number of shareholders or policyholders and IRDAI under the Companies Act, 2013, and (c) amalgamation of the insurer with another insurer. Specifically, pursuant to the Life Insurance Corporation Act 1956, it is only the central government that can pass an order for the dissolution of LIC.[9]

Section 227 of the Code empowers the Central Government to notify FSPs for their insolvency and liquidation.[10] However, there were no unified and detailed guidelines for the resolution of the FSPs. In this regard, the Central Government brought forth the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (**"FSP Rules"**) three years post the introduction of the Code. The FSP Rules are applicable to financial service providers, as may be notified by the Central Government under Section 227 of the Code, from time to time, for their insolvency and liquidation proceedings.

II. TREATMENT OF FSPS UNDER THE CODE AND FSP RULES

The insolvency of an FSP differs from that of any other entity in that, vide the provision of Section 227 of the Code, only the Central Government may if it considers necessary, in consultation with the appropriate financial sector regulator, shall notify the insolvency or liquidation proceedings of a FSP or categories of FSPs. It is to be noted that as per the provisions of the Code, "financial sector regulator" shall mean an authority or body constituted under any law to regulate services or transactions of the financial sector and

[9] Life Insurance Corporation Act 1956 (Act 31 of 1956), s 38.
[10] IBC 2016, s 227.

includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government.[11]

The person carrying out the corporate insolvency resolution process (**"CIRP"**) and/or the liquidation of the FSP is known as an "Administrator" who under the FSP Rules has been endowed with the powers and functions of the insolvency professional (**"IP"**), interim resolution professional (**"IRP"**), resolution professional (**"RP"**), or the liquidator for the purpose of insolvency and liquidation proceedings of FSPs.[12] Further, as per Rule 9 of the FSP Rules, the Administrator shall also have the same duties, obligations, responsibilities, and rights as an IP, IRP, RP, and liquidator, as the case may be. The adjudicating authority may appoint or replace the administrator on an application made by the appropriate regulator.

As per the FSP Rules, the provisions of the Code pertaining to the CIRP of a corporate debtor shall mutatis mutandis apply to the insolvency resolution of FSPs with certain modifications including the following:

A. Corporate Insolvency Resolution Process

1. Initiation of CIRP

Insolvency proceedings against FSPs committing default under Section 4 of the Code can only be initiated on an application made by the appropriate regulator in a format provided under Form 1 of the FSP Rules. Such an application is to be treated in a manner akin to an application made

[11] IBC 2016, s 2(18).
[12] Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, G.S.R. 852(E), reg 3(a).

by a financial creditor under Section 7 of the Code. Upon admission of the application, the adjudicating authority shall appoint an individual of the choice of the regulators as the 'administrator' of the concerned FSP.[13]

2. *Moratorium*

An interim moratorium shall apply on the FSP from the date of filing of the CIRP application by the regulator till its admission or rejection. It may be noted that the license or registration of the FSP to engage in the business of providing financial services shall not be suspended or canceled both during the period of the interim moratorium and throughout the CIRP.[14]

3. *Advisory Committee*

Under the FSP Rules, the regulator has the discretion to constitute an advisory committee to advise the administrator on the operations of the FSP within 45 days of the insolvency commencement date. The advisory committee shall consist of three or more members who shall be persons of ability, integrity, and standing and having expertise or experience in finance, economics, accountancy, law, public policy, or any other profession in the area of financial services or risk management, administration, supervision or the resolution of FSPs. The regulator has been accorded the right to determine the terms and conditions of the members of the advisory committee along with the manner of conducting meetings and observance of rules and procedures.[15]

4. *Resolution Plan*

The resolution applicant shall include a statement justifying the requirement of its engagement in the business of the concerned FSP as per the

[13] ibid reg 5(a).
[14] ibid reg 5(b).
[15] ibid reg 5(c).

concerned law. The administrator upon approval of the resolution plan by the committee of creditors (**"CoC"**) shall apply to the appropriate financial regulator for a no-objection certificate (**"NOC"**) for the successful resolution applicant which shall be issued on the basis of 'fit and proper' criteria applicable to the business of the FSP. Such NOC shall be deemed to have been given if the regulator does not refuse the application within forty-five days of its receipt.[16]

B. Liquidation

Similar to CIRP, the liquidation process under the Code shall apply mutatis mutandis to an FSP with the following exceptions:

- the license of the concerned FSP shall not be canceled without affording an opportunity to the liquidator of being heard;
- the adjudicating authority shall provide the appropriate regulator an opportunity of being heard before passing an order for the following under the Code:
- liquidation of the FSP under Section 33; and
- dissolution of the FSP under Section 54.[17]

C. Voluntary Liquidation

The provisions of the Code for voluntary liquidation shall apply mutatis mutandis to FSPs but for the following:

- FSP to obtain prior permission from the concerned regulator for initiating voluntary liquidation proceedings under Section 59 of the Code;

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[16] ibid reg 5(d).
[17] ibid reg 7.

- the affidavit from the majority of directors as required under Section 59(3)(a) of the Code shall include a declaration that such appropriate permission has been obtained by the FSP from the concerned regulator; and
- the adjudicating authority shall provide the concerned regulator an opportunity of being heard before proceeding to issue an order for dissolution of the FSP under Section 59 of the Code.[18]

D. Third-Party Assets

Moratorium under the Rule 5 of the FSP Rules and Section 14 of the Code shall not apply to any third-party assets or properties in custody or possession of the FSP, including any funds, securities, and other assets required to be held in trust for third parties or depositors. The administrator shall take control and custody of such assets in a manner notified by the Central Government under Section 227.[19]

E. Claims by Depositors of FSPs

Under the Code, deposits are included within the ambit of "financial product" under Section 2(15) of the Code while the process of inter alia accepting deposits by an FSP along with safeguarding and administering assets consisting of financial products belonging to another person comes under the scope of "financial service" under Section 2(16) of the Code. The report of the 'Insolvency Law Committee for Notification of Financial Service Providers Under Section 227 of the Insolvency and Bankruptcy Code, 2016'

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[18] ibid reg 8.
[19] ibid reg 10.

dated 4 October 2019[20] (**"Report"**) specifically addressed that the amounts deposited by depositors with an FSP will be treated as financial debt and as such depositors of an FSP shall be classified as financial creditors and will be treated accordingly under the Code. The position of law in this regard has also been clarified by various judicial precedents to include depositors as financial creditors under the Code.

As such, the procedure for submission of claims by a depositor is identical to that of a financial creditor and covered under Regulation 8 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**"CIRP Regulations"**).[21] The procedure of the same may be encapsulated as follows:

- the depositor of an FSP shall submit a claim with proof to the interim resolution professional(**"IRP"**) in electronic form in Form C of the Schedule-I of the CIRP Regulations (claim may also be submitted as a class of financial creditors vide Form CA). The depositor may also submit supplementary documents or clarifications in support of the claim before the constitution of the CoC;
- the existence of a financial debt due to the depositors may be proved by:
    - the records available with an information utility, if any; or
    - other relevant documents, including:
    - financial contract supported by financial statements as evidence of the debt;

[20] Sub-committee of the Insolvency Law Committee, *Report of the sub-committee of the insolvency law committee for notification of financial service providers under section 227 of the Insolvency and Bankruptcy Code, 2016* (4 October 2019).
[21] The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), IBBI/2016-17/GN/REG004, reg 8.

- a record evidencing that the amounts committed by the financial creditor to the corporate debtor under a facility have been drawn by the corporate debtor;
- financial statements showing that the debt has not been paid; or
- an order of a court or tribunal that has adjudicated upon the non-payment of a debt, if any.
- Further, as per Regulation 10 of the CIRP Regulations, the IRP or RP may call for other evidence or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.[22]

In the event there are a large number of depositors constituting a class, they shall be appointed with an authorized representative in terms of Section 21(6A) of the Code who shall represent such class of depositors in the CoC of the FSP and vote on behalf of them to the extent of their voting share. The criteria for the appointment of the authorized representative is as follows –

- a trustee or agent shall be appointed to represent the depositors in the CoC if the terms of their deposits provide for such appointment;
- the NCLT shall appoint the authorized representative before the first meeting of the CoC on an application made by the IRP if the financial debt is owed to a class of creditors who exceed the specified number[23] as provided by the Insolvency and Bankruptcy Board of India; and

[22] Ibid reg 10.
[23] Insolvency and Bankruptcy Board of India, 'Appointment of Authorised Representative for Classes of Creditors under section 21 (6A) (b) of the Insolvency and Bankruptcy Code, 2016' (Circular dated 13 July 2018).

- wherein the financial creditors are represented by a guardian or administrator, the same shall act as the authorized representative for such class of creditors.

III. EXAMPLES OF INSOLVENCY OF FSPS UNDER THE CODE

Dewan Housing Finance Limited (**"DHFL"**) was the largest mortgage lender in the country and its insolvency was a big blow to the economy of the country along with affecting the public at large who had deposited their funds with DHFL. It was also the first FSP to be notified for insolvency resolution under Section 227 of the Code by the Reserve Bank of India. Prior to its insolvency, various lacunas remained regarding the insolvency of FSPs which were answered by the National Company Appellate Law Tribunal (**"NCLAT"**) in primarily three judgements-

- *Air Force Group Insurance Society v. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors. and Mr. Anup Kumar Shrivastava & Ors. v. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors.*, vide order passed on 27 January 2022[24] (**"DHFL Case 1"**);
- *Vinay Kumar Mittal & Ors. v. Dewan Housing Finance Corporation Limited & Ors.*, vide order passed on 27 January 2022[25] (**"DHFL Case 2"**); and

[24] *Air Force Group Insurance Society v. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors.*, Company Appeal (AT) (Insolvency) No. 546 and 552 of 2021 (NCLAT India).

[25] *Vinay Kumar Mittal & Ors. v. Dewan Housing Finance Corporation Limited & Ors.*, Company Appeal (AT) (Insolvency) No. 506 & 507 and 516 of 2021 (NCLAT India).

- *Mr. Raghu K S & Ors. v. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited*, dated 7 February 2022[26] (**"DHFL Case 3"**).

A. DHFL Case 1

1. Factual Background

The appellant was a group of depositors who had deposited their funds as fixed deposits with the FSP DHFL against whom CIRP was initiated in November 2019 under Rule 5 of the FSP Rules.

Subsequently, under the resolution process, the resolution plan put forth by Piramal Capital & Housing Finance Limited was approved by the CoC and thereafter approved by the adjudicating authority (**"Approval Order I"**). The Approval Order I further went on to make the following suggestions to the CoC-

- Enhance the percentage of the payment made to small investors under the resolution plan by about 40% i.e. the same payout as received by the secured Financial Creditors (**"FCs"**); and
- Repay the entire admitted claim amount of the Army Group Insurance Fund without any deduction and in the process treat them as a separate class or sub-class of creditors considering the nature of their duties.

The above suggestions were recommended considering the nature of the corporate debtor which was an FSP and had the savings of numerous investors including senior citizens who had dire need of the same, especially during the Covid-19 pandemic. Hence, the adjudicating authority stated in

[26] *Mr. Raghu K S & Ors. v. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation* Limited, Company Appeal (AT) (Insolvency) No. 538 of 2021 (NCLAT India).

favour of full repayment of the Army group's entire fund claims by taking into account the nature of their jobs which included protecting the country, risking and sacrificing their lives in order to keep the peace in the country.

The appellant which saved funds for officers of the air force, relying on the above had requested the CoC of DHFL for the reconsideration of the approved resolution plan, however the same was rejected by the CoC of DHFL by an 89.19% majority. Thereby, the appellant vides the present appeal challenged the Approval Order I contending that it would fall in the same class of creditors as the Army Group Insurance Fund and not providing the same is in contravention of the National Housing Bank Act, 1987 (**"NHB Act, 1987"**). It was also contended that the approved resolution plan gave the appellants the biggest haircut despite them being the most vulnerable class of creditors.

2. *Observation*

The NCLAT after due consideration of the submissions of all parties stated the following observations:

- In light of the Supreme Court's decision in *N. Raghvender v. State of Andhra Pradesh*[27] and *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India) Ltd.*,[28] it was held that the bank is not a trustee for the money deposited by the customers and that their relationship is that of a creditor and debtor. Since the FSP took fixed deposits from the appellants on agreed interest on the amount invested, their relationship was contractual in nature and that of a creditor and debtor. It was also observed that the appellants had not submitted any documentation or proof which had the effect of proving their assets were held in trust by DHFL. Hence,

[27] *N. Raghvender v. State of Andhra Pradesh*, 2021 SCC OnLine SC 1232.
[28] *Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Ltd.*, 2021 SCC OnLine SC 253.

the assets of the appellants cannot be protected under Rule 10 of the FSP Rules.

- In view of the Apex's court stance in *Essar Steel v. Satish Kumar Gupta and Ors (*"**Essar Steel**"),[29] the NCLAT reiterated that the CoC in its commercial wisdom may negotiate and accept the resolution plan involving differential payment to a different class of creditors along with differences in the distribution amounts between different classes. The approved resolution plan shall be binding on all parties including dissenting creditors and cannot be interfered with by the adjudicating authority. It was further noted that the limited judicial review that is available with respect to the decision of the CoC is to ensure that the CoC has taken into account all the factors required to maintain the going concern status of the corporate debtor, maximization of value of the assets and protection of the interests of all stakeholders, including operational creditors.
- Further, considering Essar Steel, the NCLAT stated that having participated in the insolvency resolution process, the appellants cannot challenge the actions of the CoC which is otherwise in compliance with the provisions of the Code. The NCLAT unequivocally stated that the task of the CoC members is to work towards the maximization of value for all stakeholders of the corporate debtor and not the depositors alone. The appellants who were financial creditors and hence a part of the CoC, by seeking payment outside the resolution plan are acting *in silo*. Such action is not only detrimental to the interest of other stakeholders but also against a holistic resolution for maximization of value and distribution of funds among other creditors.

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[29] *Essar Steel v. Satish Kumar Gupta and Ors*, (2020) 8 SCC 531.

- That in light of the decision of the Supreme Court *Innoventive Industries Limited v. ICICI Bank*,[30] *Rajendra K. Bhulla v. Maharashtra Housing and Development Authority & Ors.*[31] and *Principal Commissioner of Income Tax v. Monnet Ispat and Energy Limited,*[32] it is a settled principle that when two special statutes contain a non-obstante clause, the latter enacted statute shall prevail. Hence, in the event of any inconsistency between the provision of the Code and any other enactment, the provision of the Code will prevail including that over the NHB Act, 1987, and the Reserve Bank of India Act, 1934 (**"RBI Act, 1934"**).
- That, the Apex Court had in *Rajendra K Bhutta v. Maharashtra Housing and Area Development Authority and others* emphasized that Section 14 of the Code prohibits alienation, transfer, and disposal of any asset of the corporate debtor.[33] Since the Code is a time-bound process, every delay is detrimental and defeats the object behind imposing a moratorium which is to maintain the status quo for the corporate debtor for maximization of asset value and ensures recovery to the creditors of the corporate debtor. Therefore, any interest or fixed deposit payments made to the appellant during the moratorium of DHFL would violate Section 14 of the Code.
- The depositors of the DHFL stand on an equal footing with other financial creditors. They have already been provided with safeguards and representation under the Code by way of the appointment of an authorized representative for them and therefore there exists no rationale for treating them as a separate class with preferential treatment being accorded in the

[30] *Innoventive Industries Limited vs ICICI Bank*, (2018) 1 SCC 407.
[31] *Rajendra K. Bhulla v. Maharashtra Housing and Development Authority & Ors.*, (2020) 13 SCC 208
[32] *Principal Commissioner of Income Tax v. Monnet Ispat and Energy Limited*, (2018) 18 SCC 786.
[33] *Rajendra K Bhutta v Maharashtra Housing and Area Development Authority and others*, 2020 SCC online SC 292.

manner of distribution of funds. The appellate tribunal further reasoned that allowing the prayers of the appellant would subsequently invite similar claims for repayment of dues from other creditors including NCD holders, which would be damaging to the CIRP of DHFL. Further, any payments made to fixed deposit holders with matured deposits would provide them preference over depositors whose deposits are yet to mature, resulting in unequivocal treatment among similarly situated creditors. Therefore, no special dispensation can be provided outside of the mechanism/process of the Code in terms of the distribution of funds.

- That the powers of the adjudicating authorities under Section 60(5)(c) of the Code or Rule 11 of the NCLT Rules are limited in view of *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India)* Ltd[34] and *Ebix Singapore (P) Ltd. v. Committee of Creditors of Educomp*.[35] The powers of the adjudicating authorities are related to the broader compliance with the insolvency framework and its underlying objective, one of which is the timely resolution of the corporate debtor. The appellate authority can only examine the challenge based on the grounds listed in Section 61(3) of the Code, which are limited to matters "other than an enquiry into the autonomy or commercial wisdom of the dissenting financial creditors."
- Neither the NHB Act, 1987 nor the RBI Act, 1934 provides for full payment of the holders of fixed deposits. The stated acts merely envisage the cancellation of the license of the FSP in the event of non-payment, after providing it with an opportunity to present its case. Additionally, the above acts operate in ordinary circumstances wherein the FSP is not undergoing

[34] *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India) Ltd*, 2021 SCC OnLine 253.
[35] *Ebix Singapore (P) Ltd. v. Committee of Creditors of Educomp*, 2021 SCC OnLine SC 707.

insolvency. It is of utmost importance that once an FSP is admitted into insolvency, it is the Code that governs the entire process with respect to its resolution.

- Lastly, considering the decision of the Supreme Court in *Pratap Technocrats Private Limited v. Monitoring Committee of Reliance Infratel Limited & Anr.*,[36] the NCLAT stated that the adjudicating authorities are endowed with limited jurisdiction under the Code and cannot act as courts of equity.

3. Judgement

In view of the above observation, the NCLAT held that the adjudicating authority has limited powers to interfere with the commercial wisdom of the CoC and cannot exercise equitable jurisdiction to override the decision of the CoC. Therefore, the fixed deposits of the appellant made from the earnings of the employees cannot be a condition for interfering with the commercial wisdom of the CoC. It was further held that the allocation of recoveries to creditors of DHFL shall be based only on the approved resolution plan.

In terms of the appellant's contention of violation of the NHB Act, 1987, and the RBI Act, 1934, it was stated that insolvency proceedings were initiated against DHFL by the RBI due to its failure to meet the payment obligations. The NHB Act, 1987 and RBI Act, 1934 apply in normal circumstances wherein the FSP is solvent, however, it is a settled position of law that once a FSP is admitted to insolvency, it is the Code that is a comprehensive framework controlling the entire resolution process. Further,

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[36] *Pratap Technocrats Private Limited v. Monitoring Committee of Reliance Infratel Limited & Anr.*, 2021 SCC OnLine SC 569.

neither the NHB Act, 1987 nor the RBI Act, 1934 guarantee the full recovery of deposits, Hence, the creditors of DHFL cannot seek to enforce the provisions of the NHB Act, 1987 and the RBI Act, 1934 over and above the Code.

In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

B. DHFL Case 2

1. Factual Background

The appellant had filed the stated appeals on behalf of himself and 444 other individual depositors and other charitable trusts holding fixed deposits in the FSP. They were filed against a common order dated 7 June 2021 of the NCLT, Mumbai Bench (**"Approval Order II"**) which had declared the appellant's objections raised post the approval of the resolution plan as infructuous and had disposed off their interim applications with the following suggestions to the CoC:

- that the CoC should reconsider the distribution method, distribution amongst various members of the CoC under the approved resolution plan;
- that the amount allotted to public depositors, Fixed Deposit holders, and subscribers to NCDs may be increased to the level of secured FCs i.e. approximately 40% of the amount to be received by the FCs under the resolution plan;
- that the Successful Resolution Applicant, Piramal Capital & Housing Finance Limited does have to pay anything more than that committed under the approved resolution plan and only the inter se distribution of

resolution money amongst various creditors may be reconsidered by the CoC.

The appellant depositors contented that the Approval Order II was passed by the NCLT without delving into their contention that the appellants had deposited assets in trust with DHFL. They further submitted that the depositors could not be legally subjected to the resolution process and that the NCLT erred in approving the resolution plan without considering the objections of the appellant depositors.

2. *Observations*

The NCLAT after due consideration of the submissions of all parties stated the following observations:

- As stated in DHFL 1 and further relying on *K. Shashidhar v. Indian Overseas Bank*,[37] the NCLAT reiterated that neither the adjudicating authority i.e. the NCLT nor the appellate authority under the Code has the power to change the commercial wisdom of the CoC or interfere with the business or commercial decisions made. Their power for judicial review is limited to ensure that the CoC had taken into account factors required to keep the corporate debtor as a going concern and to maximize its assets. The NCLAT further cautioned the adjudicating authorities from granting reliefs that may run counter to the timelines under the IBC. If a judicial creation of a procedural or substantive remedy was not originally provided in the statute, providing of the same by the judiciary would violate the principle of separation of powers and could change the way the IBC framework was intended to work.

[37] *K. Shashidhar v. Indian Overseas Bank*, (2019)12 SCC 150.

- Similar to DHFL 1, the NCLAT herein observed that there was no provision either under the NHB Act, 1987 or the RBI Act, 1934, or any other law in force which mandated full payment to the depositors and that the stated acts only provided for the revocation of license in the event of non-payment by an FSP to the depositors.
- While reiterating the view laid down in several judgements e.g., *Innoventive Industries Limited, ICICI Bank and anr.*[38] and *The Directorate of Enforcement v. Sh. Manoj Kumar Agarwal and Ors.*,[39] the tribunal held that it is a settled position of law that a special statute enacted on a later date will prevail over the earlier statute, in the event both contain a non-obstante clause. Hence, Section 238 of the Code shall prevail over the NHB Act, 1987, NHB Directions, and the RBI Act, 1934.
- The NCLAT while relying on the Report cemented the position of depositors as financial creditors in the insolvency of an FSP. Additionally, in light of the law laid down in *Chitra Sharma v. Union of India*,[40] the tribunal held that during the pendency of the CIRP, the depositors cannot claim a disbursement since the same shall amount to preferential treatment to a particular class of creditors which is impermissible under the Code.
- On the combined reading of the FSP Rules, related provisions of the Code along with the various precedents under it, it becomes clear that it is the Code that provides for a detailed mechanism whereunder the claims of the creditors, including the depositors have been sufficiently dealt with. Accordingly, the interest of the depositors as a class of

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[38] *Innoventive Industries Limited, ICICI Bank and anr.*, (2018) 1 SCC 407.
[39] *The Directorate of Enforcement v. Sh. Manoj Kumar Agarwal and Ors.*, Company Appeal (AT) (Ins) No 2019 (NCLAT India).
[40] *Chitra Sharma v. Union of India*, (2018) 18 SCC 575.

creditors has been adequately represented and protected in the CIRP and is valid in law. Considering the above, the tribunal held that the claims of the appellants must be viewed only in terms of the statutory mechanism under IBC and the FSP Rules.

- The order emphasized that when a statute has conferred the power to do an act and has laid down the method in which the power is to be exercised, the doing of the said act in any other manner is prohibited. In terms of the Code, the minimum amount to be paid under the resolution plan to a creditor is the liquidation value. Hence, the depositors (herein the dissenting financial creditors) cannot seek an amount that is beyond the liquidation value of their debt as the same is provided in terms of the Code.
- The objections of the depositors on being dissatisfied with the distribution under the approved resolution plan were found to be not maintainable on the ground that the NCLT/NCLAT has been endowed with limited jurisdiction and cannot act as a court of equity or exercise plenary powers. It was thereby held that CoC's commercial or business decisions are not open to judicial review by the NCLT or NCLAT under the Code.

3. Judgement:

In view of the above observation, the appellate authority stated that the NCLT did not make a mistake in approving the resolution plan which proposed to dismiss the claims of deposit holders without paying them in full and that the same does not contravene the statutory provisions of the NHB Act, 1987 or the RBI Act, 1934. In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

C. DHFL Case 3

1. Factual Background

The facts of the present matter were similar to DHFL 1 and DHFL 2. The appellants had invested in the fixed deposit scheme of DHFL which had promised high-interest rates and security for the money and was given an AAA credit rating. Subsequently, DHFL was admitted into insolvency. The appellants were given the biggest haircut in terms of the distribution envisaged with only a sum equivalent to Rs. 1243 Crores (Rupees One Thousand Two Hundred Forty Three Crores Only) (23.08%) being allotted out of the admitted claim of Rs. 5375 Crores (Rupees Five Thousand Three Hundred and Seventy Five Crores Only). The allotted value fell short by a huge margin and was against the 40% (minimum) of the admitted claims agreed to be paid to secured financial creditors with a huge risk appetite.

Such action was opposed by the appellants via I.A. No 625/2021 preferred in C.P. (I.B)/ 4258/ (M.B.)/C-11/2019 which was disposed of by the NCLT with the direction of reconsideration to the CoC to enhance the payment to a minimum of 40% of the amount being paid to secured financial creditors in the resolution plan (**"Approval Order 3"**). Approval Order 3 was appealed against by the appellants under Section 60(5) of the Code who sought a declaration from the NCLAT to the effect that the resolution plan passed by the CoC was illegal and violative of the Code. Additionally, directions were also sought to the effect that the resolution plan be modified such that the fixed deposits of the appellants are refunded along with their interest in terms of the NHB Act.

2. *Observations*

The NCLAT considering the decision in DHFL Case 2 disposed of the appeals with the previous judgement being made part of the decision in DHFL Case 3.

IV. CONCLUSION

We have witnessed multiple FSPs running the risk of insolvency, various private banks undergoing forced mergers and presently, with the fears of recession looming ahead, it becomes increasingly imperative that the guidelines for the resolution of FSPs must be thought over and strengthened. As stated earlier, FSPs are crucial to the welfare of a country's economy and oversee the investments of multiple small investors. As such, it is to be noted that the regulators have been proactive in shielding their interests by foreseeing a procedure for the resolution of FSPs in the event of insolvency. Further, the NCLAT's decision in the DHFL cases has provided much-needed clarity with respect to the insolvency of an FSP. Most importantly, holding the Code above the provisions of any other statute in terms of the CIRP of an FSP shall go a long way in reducing the multiplicity of forums, preventing delays in FSP resolution, and conserving the fund value.

II. IS THE NATIONAL PENSION SYSTEM A ONE-WAY STREET?

- Pratham Darad*

ABSTRACT

A new constitutional showdown is brewing in a domain that is as much political as much social. National Pension System which was ushered in as an instrument of social and financial reform has become a cause for a standoff between Centre and States and which may sooner than later be resolved by judicial forums. This piece discusses the background because of which the Old Pension System was replaced by the New Pension System and issues such as who has the right over funds, is the PFRDA Act even applicable to States, and whether the stand of NPS Trust and PFRDA to not to return the contributory funds to States violates constitutional principles. These discussions are of utmost importance for a nation that will in a few years see a significant rise in the aging population and a stable social welfare system is a necessity rather than a choice.

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I. INTRODUCTION

Recent state elections have brought to light a government scheme after twenty years of it coming into force for the first time – National Pension System. This year itself state governments of Rajasthan, Chhattisgarh, Jharkhand, and Punjab have rolled back the scheme while the recently elected Himachal Pradesh government has promised to take similar action. However,

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at the same time, the Finance Minister of India has categorically said that the contributions made by these state governments and their employees to the National Pension System cannot be remitted back to the states even if they roll back the scheme. Thus, setting up the ground for a legal showdown between the Union and the State governments. This article does not intend to dwell on the politics and merit of these decisions but to understand the jurisprudence of the National Pension System and if it is headed to the Supreme Court sooner or later.

II. HISTORY OF THE OLD PENSION SYSTEM

The pension system of India is a legacy of British colonial rule. The Royal Commission of Civil Establishments first introduced a pension for government officials in 1881. In the following years, the pension system kept evolving especially based on reports like the Islington Commission Report of 1915, Montague-Chelmsford Report, and Lee Commission Report of 1924[1] and through the Government of India Act, 1919 and Government of India Act, 1935. Over the years pension was not only provided to Union and State Government employees but also to the employees of public sector undertakings.

Post-independence when India saw rapid increase and expansion of public sector undertakings, government jobs became one of the most sought-after employment opportunities for Indians. One of the main reasons for this was an assured pension to the employee as well as to their spouse and dependents. The pension amount during the period was determined based on

[1] East India (Civil Services in India), *Report of the Royal Commission on the Superior Civil Services in India* (27 March 1924) <https://www.upsc.gov.in/sites/default/files/Sl-019-RprtRoyalCmsnSuperiorCivilSerIndiaLeeComsnRprt-1924_0.pdf> accessed 15 February 2023.

the last-drawn salary of the employee. Further, employees were not required to make any contribution towards the pension corpus and the responsibility or the creation of the pension corpus and payment of the same lied solely on the employer or the government. These pension systems were called Defined Benefit Schemes (or commonly known as Old Pension Systems) as only the benefit to the employee was defined and even the same was indexed, that is, the benefit amount would revise with the change in inflation rate. However, by the late 1990s, it has become apparent that this Defined Benefit Scheme was fiscally unsustainable and a reform in the pension system of India had become inevitable.

III. PROJECT OASIS AND BHATTACHARYA COMMITTEE REPORT

In 1998, the Union Ministry of Social Justice and Empowerment appointed a committee under the Chairmanship of Dr. S.A. Dave, former SEBI and UTI Chairman. The Committee submitted its report on January 11, 2000, to the ministry titled 'Project OASIS (Old Age Social and Income Security) Report'.[2]The Report flagged the fiscally unsustainable old pension system ("**OPS**") and proposed a New Pension System (it has been rechristened as the National Pension System) which it defined as 'a pension system which can be used by individuals spread all over India, which enables them to attain old age security at the price of modest contribution rates through their working career. It is simple and convenient to use and has the capability for converting modest contributions into reasonably large and comfortable sums in an almost risk-

[2] Pension Fund Regulatory & Development Authority, *The Project OASIS Report* (11 January 2000) <https://www.pfrda.org.in/writereaddata/links/rep2d5d02004-a7c9-4875-be6e-f8b92744e210.pdf> accessed 15 February 2023.

free manner for old-age security.' Thus, the path towards Defined Contribution System for pension was laid down with this report.

This report was soon followed by an October 2003 Reserve Bank of India report titled 'Report of the Group to Study the Pension Liabilities of the State Governments' submitted by a committee headed by Mr. B.K. Bhattacharya.[3] The Report raised concern over the rapid increase in pension payments as compared to states' revenue receipts. The Report noted that a structural change in the pension system is not only required but the present system is also unsustainable. Thus, the report recommended that there is a need for a Defined Contribution scheme with contributions from both, the employee and the employer. The report also suggested that State Governments may adopt a hybrid of the Defined Contribution – Defined Benefit System which will be a contributory system with a guarantee of an appropriate level of pension fixed by individual state governments. However, what was clear was that a purely Defined Benefit scheme was no longer an option.

In essence, the two reports not only raised issues about the fiscally unsustainable OPS but made recommendations about the structure, investment policies, roles of various intermediaries, etc. which finally culminated in the National Pension System.

IV. INTRODUCTION OF THE NATIONAL PENSION SYSTEM

The Union Government introduced the New Pension System (as it was named then) through a notification on December 22, 2003, as a 'new

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[3] Reserve Bank of India, *Report of the Group to Study the Pension Liabilities of the State Governments* (14 October 2003) <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/51177.pdf> accessed 15 February 2023.

restructured defined contribution pension system'. The notification further provided that the 'system would be mandatory for all new recruits to the Central Government service from 1st of January 2004 (except the armed forces in the first stage)'.[4] In the following years, this National Pension System was extended to autonomous bodies, public sector undertakings, state governments, municipal bodies, and even individuals. In 2018, Tripura became one of the last states to adopt the National Pension System, with the only exception of Tamil Nadu (which has its own contributory pension system) and West Bengal. Today almost 1.5 crore citizens have subscribed to the National Pension System.

The Parliament in 2013 passed the Pension Fund Regulatory and Development Authority Act, 2013 ("**PFRDA Act**") which was the culmination of all the notifications issued since 2003 with respect to the National Pension System and also the formalization of the Pension Fund Regulatory and Development Authority, the regulator of the National Pension System. The structure of this new system is based on the recommendations of the OASIS Committee Report where it is the individuals who are at the center of the pension system. Thus, the concept of an individual pension account has been introduced in the PFRDA Act and has been defined as "an account of a subscriber, executed by a contract setting out the terms and conditions under the National Pension System."[5]

The definition is particularly important as under the new system it is the individuals who have the ultimate say on their funds, the fund managers who shall manage it, its deployment, and even its withdrawal. As the system

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[4] Ministry of Finance, *New Pension Scheme* (Notification Reference No. F. No. 5/7/2003-ECB&PR, 22 December 2003).
[5] Pension Fund Regulatory and Development Authority Act, 2013 (Act 23 of 2013) (PFRDA Act 2013), s 2(1)(e).

has evolved over the years, the subscribers (account holders who are identified as subscribers under the PFRDA Act)[6] can decide and modify every aspect of their account other than the contribution amount of their employers.

The right of the subscribers to make decisions about their pension extends to the right to decide the quantum of accumulated pension wealth[7] that shall be used by the subscribers to purchase the annuity and the type of the annuity which shall be purchased.[8]

However, clamors of the inadequacy of the pension amount soon started being raised by the subscribers. While the National Pension System reduced the fiscal burden on the government significantly, employees more often than not were left with pension amount which was lower than those provided in the Old Pension System. The mean expected level of an annuity can range from 34% to 42% of the last drawn salary.[9] It should further be noted that even the same reduces over time as the annuity amount remains constant, irrespective of change in inflation, whereas, under the OPS, the pension amount kept getting revised to factor in the inflation. Keeping the electoral politics aside, it was this inadequacy of pension amount which led to the demand for restoration of OPS in the first place and which as already mentioned, might lead to a constitutional standoff between the Centre and the States.

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[6] ibid s 2(1)(t).

[7] Pension Fund Regulatory and Development Authority (Exits and Withdrawals Under the National Pension System) Regulations, 2015, No. PFRDA/12/RGL/139/8─ (PFRDA Regulations, 2015), reg 2(1)(b).

[8] ibid reg 3 & reg 4.

[9] T.S. Vaidyanathan, 'Pension System: The old versus the new' *The Hindu Business Line* (1 June 2022) <https://www.thehindubusinessline.com/opinion/pension-system-the-old-versus-the-new/article65476009.ece> accessed 15 February 2023.

V. WHOSE MONEY IS IT ANYWAY?

As has been discussed above, the pension accounts of the subscribers have been formed pursuant to the contract signed between them. Finance Minister in her recent comments has relied upon this very factor to say that states cannot legally seek the money deposited by them in the account of their employees even if they reinstate the OPS. But is it really true that the state governments have no say on the funds contributed by them to their employees' accounts even if they are providing their employees an alternate option?

PFRDA (Exit and Withdrawals under the NPS) Regulations, 2015 provides family members of a deceased subscriber or a subscriber who has been invalidated or disabled during service an option to avail the additional pensionary benefits other than the National Pension System if provided by the Government or the employer.[10] However, in case such a subscriber or family members of the deceased subscriber avails such an option, the Government or the employer can adjust or seek transfer of part or full accumulated pension corpus of the subscriber to itself if the service rules provide so.

Even the Central Government through the Central Civil Services (Implementation of NPS) Rules, 2021 provides that in case the family of a subscriber is provided benefits under the Central Civil Services (Extraordinary Pension) Rules, 1939 or Central Civil Services (Pension) Rules, 1972 then the contribution of the Central Government and returns thereof in the accumulated pension wealth shall be transferred to the Central Government.[11]

[10] PFRDA Regulations 2015, reg 6(e).
[11] The Central Civil Services (Implementation of National Pension System) Rules, 2021, G.S.R 227 (E), rule 20(2).

Thus, not only the regulations of PFRDA but even the rules made by the Central Government itself provide an option to the employer to at least receive a part, if not the whole, of the corpus, contributed to the individual pension account of their employee.

However, it is not only these regulations and rules which allow employers to shift their employees out of the National Pension System to another scheme and receive corpus from the individual pension account of their employees. There are other instances as well.

A. Modification of December 22, 2003 notification by Court Orders

In the matter of *Parmanand Yadav v. Union of India,*[12] the petitioners filed a writ petition challenging their inclusion in the National Pension System contending that they had qualified for the exams prior to notification of the National Pension System on December 22, 2003, and it was only due to delay at the end of the Central Government that their appointment letter was issued after the notification. The writ was allowed by the High Court instructing the Central Government to provide benefits of the Old Pension System to the petitioners. Thus, the order effectively modified the December 22, 2003 notification which had provided that the National Pension System would be mandatory for all new recruits to the Central Government service from the 1st of January 2004. A similar order was issued by the Delhi High Court in *Tanaka Ram v. Union of India*,[13] and a Special Leave Petition[14] and a Review Petition[15] of the Central Government before the Supreme Court of India against the order have been dismissed. In fact, the Hon'ble Delhi High Court

[12] *Parmanand Yadav v. Union of India*, WP(C) 3834/2013.
[13] *Tanaka Ram v. Union of India*, 2019 SCC Online Del 6962.
[14] SLP (CC) Diary No 25228/2019.
[15] Review Petition No 2188/2020.

in *Shyam Kumar Choudhary v. Union of India*[16] opined that the benefit of the Old Pension System should be extended to all similarly placed employees.

The notification was further modified by the *Bharat Singh v. Union of India*[17] where the Hon'ble Delhi High Court held that the benefit of the Old Pension System should be extended to employees whose recruitment process had been initiated prior to December 31, 2003.

Thus, these orders effectively modified December 22, 2003 notification to provide that the National Pension System shall be applicable to the recruitment process which was initiated on or after January 01, 2004.

Consequently, to give effect to these orders of the Supreme Court and the High Courts, various ministries of the Central Government through circulars and office memorandums provided an option to their employees to exercise one time option to opt out of the National Pension System and enroll in Old Pension System.[18] These circulars and memorandums also provided that the contribution of the Central Government to the individual pension account of the subscribers shall be remitted to the Central Government while employees' contributions shall be credited to their individual General Provident Fund account.

Thus, the question that might need to be judicially determined with respect to the State's decision to provide benefits of the Old Pension System is how the same is different from the Court's own decision to allow benefits of the Old Pension System by modifying the original notification. Further, if

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[16] *Shyam Kumar Choudhary v. Union of India*, 2019 SCC Online Del 11891.
[17] *Bharat Singh v. Union of India*, 2021 SCC Online Del 5283.
[18] Department of Pension & PW, *Office Memorandum - Coverage under Central Civil Services (Pension) Rules, 1972* (O.M. No. 57/04/2019-P&PW(B), 17 February 2020) < https://documents.doptcirculars.nic.in/D3/D03ppw/54_04_2019_P_PW_B3hUVY.PDF> accessed 15 February 2023.

the Central Government can remit the contributions made by it while providing benefits of the Old Pension System why can't States do the same?

B. PFRDA Act and Government Sector Subscribers

PFRDA Act provided that the New Pension System shall be applicable to all the employees of the Central Government who were appointed on or after January 01, 2004.[19] The Act also clarified that the new pension system introduced in 2003 shall be deemed to be National Pension System.[20] The Act further provided that any State Government or administrator of a Union territory may, by notification, extend the National Pension System to its employees.[21] A question arises as to this aspect, whether the states are needed to issue notification again to extend the application of the National Pension System or whether the notification already issued by states prior to the enactment of the PFRDA Act is sufficient.

In this regard, it is particularly noteworthy that the 'Savings' section of the PFRDA Act provided that anything done or action taken by the Interim PFRDA or the Central Government shall be deemed to have been done or taken under the corresponding provisions of the PFRDA Act.[22] Thus, the prior notification of the Central Government and various ministries under it to extend NPS to its employees was saved by this section.

However, the 'Savings' section of the PFRDA Act does not save the prior notifications made by the State Governments and Union Territories. The

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[19] PFRDA Act 2013, s 12(3)(d).
[20] PFRDA Act 2013, s 20(1).
[21] PFRDA Act 2013, s 12(4).
[22] PFRDA Act 2013, s 56.

question, therefore is whether the notifications made by the State Governments prior to the enactment of this Act are valid or not.

Courts have in various instances held that in case a savings clause does not have specific saving actions initiated under previous legislation the same shall not be allowed to be continued.[23] However, a distinction from this principle was drawn by the Supreme Court in the matter of *Fibre Boards Pvt. Ltd. v. Commissioner of Income Tax, Bangalore*[24] where it was held that when a notification was brought in under a previous provision and the new enactment repeals the previous law but has a similar provision, then the notification shall be considered to be notified under the new law.

In the case of the National Pension System, the notification by State Governments was not under any Act, however, they were notified by the State based on their inherent power to determine service conditions of their employees. While it may be argued that based on the Supreme Court's interpretation these notifications should be considered to be notified under PFRDA Act itself. However, it is notable that several states like Goa,[25] Karnataka[26] , and Himachal Pradesh[27] have brought another notification after the enactment of the PFRDA Act to specifically provide that the extension of the National Pension System to their employees under relevant provisions of the PFRDA Act. Thus, it can be understood that at least several states are of

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[23] *Kolhapur Canesugar Works Ltd. v. Union of India*, (2000) 2 SCC 536.

[24] *Fibre Boards Pvt. Ltd. v. Commissioner of Income Tax, Bangalore*, (2015) 10 SCC 333.

[25] Department of Finance, Government of Goa (Notification No 12/4/2004-Fin(R&C)/Part-I, 19 September 2019) <https://goaprintingpress.gov.in/downloads/2122/2122-21-SI-OG-0.pdf> accessed 15 February 2023.

[26] Department of Finance, Government of Karnataka, *Changing the name of New Defined Contributory Pension Scheme to National Pension Scheme – reg.* (Notification No FD/113/PEN/2021 dated August 10, 2021).

[27] Finance (Pension) Department, Government of Himachal Pradesh (Notification No Fin (Pem) A (3)-1/2009, 24 September 2019).

the opinion that the notifications prior to the enactment PFRDA Act have not been saved.

Therefore, another question that may arise is whether the notification of some of these states with respect to the National Pension System, which has decided to restore the Old Pension System, are even legally valid.

VI. RIGHT OF STATE TO EXIT A CONTRACT

Under the present NPS Architecture, a State Government enters into an agreement with the NPS Trust. What is peculiar about this agreement is that the State Governments cannot modify or alter the terms of the agreement signed with NPS Trust without prior approval of the regulator, PFRDA.

It has also been reported that in case of any difference or dispute, the same shall be referred to PFRDA, who in turn shall appoint a sole arbitrator for the determination of the difference or dispute, and the determination of the sole arbitrator shall be final and binding.

The Supreme Court of India in the matter of *Perkins Eastman Architect DPC v. HSS (India) Ltd.*[28] has held that a party that has an interest in the outcome of the dispute should not have the sole right to appoint an arbitrator. The principle laid down by the Supreme Court is important to ensure the independence of the judicial process.

In the present instance, where States and NPS Trust have entered into an agreement it can be argued that the appointment of sole arbitrator is being done by PFRDA and thus, the principle laid down by the Supreme Court is not violated. However, a deeper look into the matter might show a totally different

[28] *Perkins Eastman Architect DPC v. HSS (India) Ltd.*, (2020) 20 SCC 760.

picture. PFRDA, unlike other regulators, undertakes the dual role of both, regulator of the National Pension System as well as settlor of NPS Trust. While in its role as regulator, it is supposed to be a neutral guardian of the system, it also appoints the trustees of the NPS Trust and it is under PFRDA's overall supervision that the NPS Trust works. Further, even the Chief Executive Officer of NPS Trust is appointed by PFRDA. Thus, the question that arises is whether in case the matter goes to arbitration can PFRDA really be considered independent from NPS Trust and be allowed to appoint the sole arbitrator.

Even otherwise there is the question is whether a State Government is bound by the agreement and cannot terminate the contract. It is an established principle of law that even a perpetual contract may be terminated and the party terminating the contract may be liable to pay damages to the other party. However, it cannot be anyone's case that a State Government once it has entered into an agreement cannot terminate the same by virtue of a change in its policy.

Additionally, pension by the State Government falls under Entry 42, List II, Schedule VII of the Constitution of India and thus, it falls under the exclusive domain of the State Government. Thus, any argument that the State Government cannot terminate the contract with the NPS Trust after entering into one will go against the constitutional ethos.

Therefore, Courts might have to determine the very nature of the relationship between the State Governments, NPS Trust, and PFRDA.

VII. CONCLUSION

The Centre and State relationship cannot be analyzed by being oblivious to the political relationship between them. However, it is also

important that the merits of different arguments are not lost in politics. Rather than being at loggerheads States and Centre should consider other options suggested by OASIS and Bhattacharya Committee Reports or maybe find an even better solution. India’s transition towards a developed economy will not be complete until we can create a robust social security architecture.

III. THE PARADOX BETWEEN SECTORAL REGULATION AND COMPETITION LAW: NEED OF EVOLVING A MODEL OF COOPERATION TO RESOLVE THE REGULATION/COMPETITION DICHOTOMY

- Mahimna Dave*

ABSTRACT

The constant rise in India of regulatory bodies overseeing economic reforms has resulted in multiple instances of jurisdictional overlay and inefficient results. This paper aims to analyse the inception of the proliferation of a sector-specific regime in India through a historical perspective. The article takes into account the challenging question concerning the relationship between sectoral regulations and competition law. It analyses the genesis of regulatory jurisprudence in the Indian context explaining the complementarities and contradictions of the same. Further, it elucidates how sectoral regulatory bodies circumscribe the role of the competition authority. In order to elaborate on the regulation/competition dichotomy, this article also takes into consideration two case laws, they are *Ericsson v. CCI* and *CCI v. Bharti Airtel and Ors*. Finally, the last section throws light on two internationally accepted models of the regulation/competition interface, specifically, the Exclusivity model and the Concurrent model; it describes their distinct features, the disadvantages they pose and suggests a novel way forward. Accordingly, the article proposes to expand the competition enforcement by adopting a "rule-making" approach in order to reduce the market-wide uncertainty, cost of litigation and reduce unexpected outcomes. The latter is founded on a hybrid-mutual-influence approach and intends to reduce the current inconsistencies existing between the regulatory and competition bodies in India.

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I. INTRODUCTION

"Victory comes from finding opportunities in problems."

As far as this article is concerned, both Competition law and Sectoral regulations are legal responses to economic problems, but the victory looks far-flung and remote. Economic regulation and competition policy are largely interdependent instruments of economic policy. However, they differ in aims and objectives resulting into an overlay problem. The then Chief Justice of the U.S. Supreme Court, Stephen G. Breyer, J. & Khan states, *"Antitrust is an alternative to regulation and where feasible, a better alternative"*[1] On the contrary, we have empirical studies and data in the field, which advocates the exclusivity of sectoral regulators like in the case of Australia.[2] The Australian Communications and Media Authority has formed the Digital Platform

[1]Breyer, S., *Regulation and Its Reforms,* (Harvard University Press 1984).
[2]OECD, 'OECD Reviews of Regulatory Reform: Australia 2010 Towards a Seamless National Economy' (2010) <https://read.oecd-ilibrary.org/governance/oecd-reviews-of-regulatory-reform-australia-2010_9789264067189-en#page3> accessed on 21 October 2021.

Regulators Forum (**"DG-REG"**) with the ACCC to ensure competition law enforcement and to conduct merger investigations and Ad Tech inquiries.[3] Thus, resulting in the following: (a) uncertainty regarding the choice of marketing regime; (b) an overlap of economic regulation and; (c) competition enforcement and jurisdictional a dichotomy between competition and regulation. This article offers a critical and detailed analysis of the relationship between competition and sector regulators in India also while keeping in mind various essential international developments.

A. Socialism in India:

Post-Independence from colonial rule, Indian political aspirations inspired by the doctrine of dirigisme (control of economic activity by the state) embarked upon a journey of devising a 'socialist mixed economy model' with the state in control over the economy. Socialism in India was also ingrained in the political movements founded prior to the Independence. And what we experienced post-independence was the Nehruvian socialist reconstruction of the economy with democratic means where state enjoyed the supreme regulatory powers over the complete economy of the nation.[4] This approach of regulating the economy brought several years of deep pervasive state interventions and regulations over a majority of socio-economic transactions. Moreover, the government exerted control over the exports and imports through licensing and quota regulations[5] (eliminating any foreign

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[3]Louise Klamka, Andrew Low, Amelia Douglass and Michelle Xu, 'Australian Approach to Digital Market, Global Competition Review' (2022) <https://globalcompetitionreview.com/guide/digital-markets-guide/second-edition/article/key-developments-in-australia> accessed 5 January 2023.

[4]Bhambri, C. P. (n.d.). *Nehru And Socialist Movement In India (1920-47)* (Indian Political Science Association 2021).

[5] S. Chakravarthy, 'From MRTP to the Competition Act, in Round Table, Competition Policy and Law: Discussion'[2007] 19 Indian Inst. Mgmt. Bangalore Mgmt. Rev. 432, 438.

competition) which in turn was later complemented by the high tariff walls.[6]

Understandably, this led to a rise in inflation rate, a rise in fiscal deficit, and an increase in adverse balance of payments.[7] Thus, this series of events eventually marked the requirement for structural adjustment programme in 1991 where India embarked upon a path to market Liberalization.[8]

B. Unregulated to Regulated Economies: *Rise of Sectoral Regulators*

The adoption of the liberalization, privatization, and globalization ("**LPG**") policy in 1991 proved to be a big step towards transforming the unregulated Indian economy into a regulated economy. Before 1991, public interest was served more through direct government involvement in most commercial transactions. Post 1991, in most sectors of the economy, the objective of protecting the public interest rested on laws governing competition and regulatory regimes.[9] The advent of liberalization, privatization, and globalization was accompanied by an increasingly receptive attitude towards the establishment of sectoral regulations and sectoral bodies to control various sectors and businesses coming up after the opening up of the economy. The necessity of formulating industry-specific governing statutes and governing bodies was to de-politicize the decision making at the central level and to ensure the independence, accountability and transparency

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[6]Singh, V. V. (n.d.). 'Regulatory management and reform in India – OECD' [2021] <https://www.oecd.org/gov/regulatory-policy/44925979.pdf> accessed 5 January 2023.

[7]Nayyar, Deepak. "India's Balance of Payments." (1982) 17(14/16) EPW http://www.jstor.org/stable/4370838 accessed 5 January 2023.

[8]Rahul Singh, "The Teeter-Totter of Regulation and Competition: Balancing the Indian Competition Commission with Sectoral Regulators" (2009) 8(1/3) WASH. U. GLOBAL STUD. L. REV. <https://openscholarship.wustl.edu/law_globalstudies/vol8/iss1/3> accessed 5 January 2023.

[9]Mehta, P., "Competition and Regulation in India, 2009 Leveraging Economic Growth Through Better Regulation OECD" (2009) <http://www.pradeepsmehta.com/pdf/Competition_and_Regulation_in_India2009_Leveraging_Economic_Growth_Through_Better_Regulation.pdf.> accesses 5 January 2023.

of the sector specific regulators. In order to restructure the market and to address such irregularities bodies like the Security Exchange Board of India (after 1992 Securities Scam),[10] Telecom Regulatory Authority of India, Competition Commission of India etc. were established. One of the first regulatory authorities in India, following the securities scandal was the Securities and Exchange Board of India under the SEBI Act, 1992.[11] But as a result of these above-mentioned irregularities in the system, it ostensibly led to the sudden proliferation of regulatory authorities causing frequent jurisdictional overlaps while dealing with the same aspects of technical, competition and commercial behaviour of sectors in the economy.

Sector-specific regulations present distinct challenges in competition law and policy because although their broad goals and objectives are the same i.e., to achieve allocative efficiency and promotion of welfare,[12] however the legislative mandates through which broad goals are achieved are very condescending to each other. While sector-specific regulators focus on creating an administrative machinery to resolve behavioural issues before the problem (ex-ante), Competition authorities (Competition Act, 2002)[13] under section 3 & 4 of the act addresses the problem ex-post[14] (save for the area of merger control under section 5 & 6 of the act) and describes how the conduct should be, in the backdrop of macro-economic conditions. Therefore, we can

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[10]Barua, Samir & Varma, Jayanth "Securities Scam Genesis, Mechanics and Impact' (1992) IIMA < https://journals.sagepub.com/doi/10.1177/0256090919930101> accessed 5 January 2023.

[11]Singh VV and Mitra S, "Regulatory Management and Reform in India - OECD" (2008) CUTS International <https://www.oecd.org/gov/regulatory-policy/44925979.pdf>> accessed 5 January 2023.

[12]*Brahm Dutt vs Union of India*, AIR 2005 SC 730.

[13]Competition Act 2002. (Competition Act)

[14]'Ex-post economic evaluation of competition policy enforcement: A review of the literature Fabienne Ilzkovitz and Adriaan Dierx DG Competition' (June 2015) < https://ec.europa.eu/competition/publications/reports/expost_evaluation_competition_policy_en.pdf> accessed 5 January 2023.

construe that competition law is majorly *reactive* whereas sectoral regulation is pro-active. Understandably, sector specific regulations and laws have blurred the distinction between ex-ante regulation and ex-post competition assessment, allowing many sectoral regulators to assume competition enforcement powers even in the absence of concrete provisions within their governing statutes.[15]

C. Broad Mandate Under Section 18 of the Competition Act, 2002

Section 18 of the Competition Act states that, "it shall be the duty of the Commission to eliminate practices having an adverse effect on competition, promote and sustain competition, protect the interests of consumers, and ensure freedom of trade carried on by other participants, in markets in India."[16] The duty casted upon the Commission under this section is extremely broad and can be traced in the preamble of the Competition Act, 2002.[17] The duty vested with the CCI, however, overlaps and sometimes falls short with the competition-related powers conferred on the sectoral regulators in the economy. This section was not drafted keeping in mind the existence of various provisions addressing the competition issues in various other sectoral regulations such as section 11(a) of the PNGRB Act, section 60 of the Electricity Act etc. Moreover, it brought every economic transaction in the Indian economy under the ambit of this section which resulted in a chaos of overlay.

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[15]Telecom Regulatory Authority of India, 'Regulatory Principles of Tariff Assessment' (Consultation Paper 3, 2017) <http://www.trai.gov.in/sites/default/files/Consultation_paper_03_17_feb_17_0.pdf> accessed 19 December 2017.>.
[16]Competition Act.
[17]Competition Act, preamble.

D. The Essence of Interface Between Commission and Sector Specific Regulator in India.

Section 60 of the act states that, the act will have an overriding effect over other legislations and will prevail above all other sector-specific statutes.[18] However, on the other hand, section 62[19] of the act declares that the act should be read in harmony with other statutes to avoid any scope of overlapping and conflicts.[20] Therefore, we can confer that, section 60 and 62 are paradoxical to each other in nature as section 60 administers supremacy of competition law wherein on the contrary, section 62 enunciates the principle of harmonious construction and complementarity between competition law and other sectoral-enactments leading to deep condescending legislative mandates between the two.

If the triumvirate of sections 18, 60, and 62 were not sufficiently puzzling, section 21 and 21 (A) makes it more puzzling by narrowing down the scope of inter-regulatory consultation and coordination under section 21[21] & 21 (A)[22] of the Competition Act. Section 21 and 21 (A) of the Act, describes the power of consultation and coordination between the competition regulatory body (CCI) and sector-specific regulator. Under the ambit of these two sections, both authorities are empowered to consult with each other and ask for views concerning competition, access to market, economy and technology whenever the need arises in the course of proceedings.[23] But these regulations are not mandatorily worded and are referential only when a

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[18]Competition Act, s 60.
[19]Competition Act, s 62.
[20]*Star India P. Ltd. v. The Telecom Regulatory Authority*, 146 (2008) DLT 455.
[21]Competition Act, s 21.
[22]Competition Act, s 21(A).
[23]Mancini, J. "Data Portability, interoperability and Digital Platform Competition: OECD Background Paper" (2021) *SSRN Electronic Journal* <https://doi.org/10.2139/ssrn.3862299> accessed 5 January 2023.

potential or past decision of the CCI or a sectoral regulator contradicts the other's governing statute.[24] It eventually, narrows down the scope of inter-regulatory consultation and coordination. Thus, leading towards the central question of this paper that, whether competition authorities or sector regulators should handle competition enforcement in the sectors.

This article offers a critical analysis of the relationship between competition authorities and sector-specific regulators. The focus of the article is on first, determining whether competition authorities or industry specific sector regulators should handle competition enforcement in the sector. Second*,* whether competition authorities (CCI) can or should engage in access, economic or technical regulation in the sector.

This research paper is divided into several parts and is structured as follows; part I establishes the background of the issue, part II introduces us to the problem at hand and describes the proximity between sectoral regulations and competition. It puts forward important issues underpinning the relationship between competition law and sectoral regulation. It further elaborates the differences in the approach of competition law and sectoral regulation. This part also explains the issue between sectoral regulations and competition law through a case study based upon the celebrated judgment of *Competition Commission of India v. Bharti Airtel Limited and Ors.*[25] Part III builds upon part II and proposes various models of operation for smooth interface between sectoral regulations and competition law. It further puts forward descriptive and normative justifications granting Competition Commission primacy over the sectoral regulators. It also proposes certain amendments and reforms under sectoral regulations which are aimed towards the formulation of legislative mechanisms directing an industry specific

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[24]Ministry of Corporate Affairs, 'Report of the Competition Law Review Committee' 2018.
[25]*Competition Commission of India v Bharti Airtel Ltd*., AIR 2019 SC 113.

competition regulation approach. Finally, part III offers a set of conclusions and argues that Commission has a robust legislative mechanism which ensures the ultimate goal of public good and consumer welfare.

II. NO MAN'S LAND: INTERFACE BETWEEN COMPETITION AND SECTORAL REGULATIONS.

A. Juxtaposition of Competition Law and Sectoral Regulations

The roles and goals of competition policy and sectoral regulations are complementary to each other, internationally. However, the legislative mandates and mechanisms exercised by them to resolve issues are contradictory,[26] which restricts them from achieving their shared concerns of economic efficiency, consumer welfare, and the public good. In light of this paper, we would like to put forward the complementarities and contradictions between competition and sectoral regulations.

1. *Two Conflicting Approaches:*

The initial distinction between regulation and competition law is based on the type of market failures they seek to address. Generally, competition policies are focused on ensuring the existence of fair competition, lower prices, consumer welfare, and protection[27] in the market by ensuring the non-existence of anti-competitive agreements,[28] market dominance,[29] and

[26]Anti-monopoly Law of the People's Republic of China 2022, s 33.
[27]Ashford, Nicholas & Ayers, Christine & Stone, R.F, "Using Regulation to Change the Market for Innovation" (2002) 9 Harvard Environ Law Rev < https://www.researchgate.net/publication/37592957_Using_Regulation_to_Change_the_Market_for_Innovation> accessed 5 January 2023.
[28]Competition Act.
[29]Ibid.

cartelization.[30] Competition policy relies upon its economy-wide approach to advocate consumer welfare, public interests, and ease of access to small businesses into the market. The above-mentioned aims and objectives of competition law are reflected in the preamble[31] and the provisions of the Competition Act.[32] Whereas, Sector-specific regulations create an administrative machinery that, makes changes in the market structure in order to address market failures.[33] Sector-specific regulations are based upon a very narrow perspective[34] restricted only towards a specific sector ensuring "what to do", "how to price products" and "barriers to entry" accompanied with "supply and quality of service." The application of sectoral regulations comes into the picture, only when independent nature of market mechanisms collapses and is replaced with direct control of the government over the level of production and pricing of the products.[35]

2. *Ex-ante versus Ex-post:*

The distinction between Competition regulations and sector-specific regulations is also based on the timings and frequency of their interventions. Sectoral regulations identify problems ex-ante whereas Competition

[30]Dunne, N., "Competition law and economic regulation: Making and managing markets" (2015) Cambridge University Press <http://dx.doi.org/10.1017/CBO9781107707481> accessed 21 October 2021.
[31]Competition Act, preamble.
[32]Competition Act, s 36(6).
[33]Richard A. Posner, "Theories of Economic Regulation", (2004) Working Paper, No. 41, Centre for Economic Analysis of Human Behaviour and Social Institutions. <https://www.nber.org/system/files/working_papers/w0041/w0041.pdf> accessed 22 October 2021.
[34]Pike, 'Working Party No. 2 on Competition and Regulation Independent Sector Regulators' (OECD, November 2021) <https://one.oecd.org/document/DAF/COMP/WP2(2019)3/en/pdf. > accessed 22 October 2021.
[35]Hewitt, G., 'Policy Roundtables Relationship between regulators and competition Authorities' (OECD1998) <https:<//www.oecd.org/competition/sectors/1920556.pdf.> accessed 30 November 2021.

regulations identifies problems ex-post (save for the area of merger control under section 5 & 6 of the act) in the backdrop of continuous market situations. Sectoral regulations by creating an administrative machinery try to address market failures in an ongoing manner or before the problem arises, which is generally known as "impact assessment". It primarily, focuses on examining the issues of technology & price, reducing the barriers to entry, and process in the industry regulated by it to limit the scope of friction and disbalance in the system. Sectoral regulators are committed towards taking necessary and proportionate actions where evidence exists and are directed towards potential infringement of the Regulations causing consumer harm. While Competition law identifies anti-competitive agreements ex-post in a sporadic fashion (competition agencies only intervenes when there exists cartelization or any anti-competitive agreement leading to abuse of dominance in the market). Understandably, competition agencies aim at protecting competition by preventing anticompetitive situations whereas sectoral regulators aim towards structuring the market in order to facilitate competition. According to Hüschelrath and Leheyda, ex-post evaluation (retrospective) is more relevant in competition policy as it is mainly used for the assessment of the decisions taken by the competition authorities and they can therefore contribute to improving the quality of these decisions which is the main output of competition agencies.[36] While ex-ante evaluations are considered to play a very minor role in the assessment of competition policy.[37] Ex-ante evaluation is only useful for short term evaluations of policy issues. But Competition policies (ex-post) identify problems only after they are committed and try to redress them retrospectively by imposing negative or reactive obligations that

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[36]Hüschelrath, Kai and Leheyda, Nina, 'A Methodology for the Evaluation of Competition Policy" (2010).
[37]D Neven and H Zenger, "Ex-post Evaluation of Enforcement: A Principal-Agent Perspective" (2008) 156 De Economist 477.

do not preclude market competition.[38] Furthermore, the Competition authorities are not directed towards granting damages or compensation to the plaintiff as the remedy, rather they are focused on enforcing economy-wide duties (consumer welfare and unfair transfer of wealth)[39] that, among other goals seek to promote competition across all the sectors of the economy. Conclusively, we can infer that competition law has a very profound approach, while sectoral regulations follow a very schematic approach concerning competition enforcement.

3. *Discrete Goals and Objectives*

Their goals of sectoral regulators and competition authorities may not be always aligned because sectoral regulators also pursue other goals, such as equity, safety or public health.[40] As a result, in some cases, regulation is not required to correct market failures but to achieve goals that may be in conflict with or considered more important than competition. For instance, the goal of pharmaceuticals regulators will be the availability of drugs all around the state at minimal price consideration rather than whether there is competition in the sale of that drug.[41] Thus, the objectives of the sectoral regulators and competition authorities may not be always congruent with each other.[42]

[38]Pierre Larrouche, 'Competition Law and Regulation in European Telecommunications' (2000) Hart 124.
[39]Hovenkamp, H. 'Federal antitrust policy the law of competition and its practice' (2020) 6 West Academic Publishing.
[40]OECD, 'Competition Enforcement and Regulatory Alternatives, OECD Competition Committee Discussion Paper' (2021) <http://oe.cd/cera. > accessed 5 January 2023.
[41]Dogan, S. and M. Lamley, "Antitrust Law and Regulatory Gaming" (2009) 87 Texas Law Review.
[42]'OECD Interactions between competition authorities and sector regulators, OECD Competition Policy Roundtable Background Note', (2022) <www.oecd.org/daf/competition/interactions-between-competition-authorities-and-sector-regulators-2022.pdf. > accessed 5 January 2023.

4. *Sectoral regulations delimit the scope of competition law?*

The predominant objectives of sectoral regulations being social sustainability, ecological sustainability, and collective good circumscribe the scope and application of competition enforcement.[43] In the case of the Electricity sector, the Rail sector or the Aviation sector the obligation towards the protection of the environment and sustainability can bar competition and encourage anti-competitive agreements.[44] The sectoral laws struggle in prioritising between the social duties and economic objectives enunciated in their governing statutes.[45] Moreover, the cross-border agreements entered by the government under the ambit of sectoral laws providing free services to the countries under the contract are also contemplated as practices discouraging economic efficiency and competition in the market.[46] In addition to it, the circumstances of fulfilling SDGs objectives, collective agreements related to environmental schemes, involving companies and other stakeholders can produce substantial benefits from an environmental perspective, while at the same time, they may have the potential to limit competition in the market.[47] For instance, in the Netherlands, an industry-wide agreement called "chicken for tomorrow" was initiated to improve the living standards of broiler chicken. In this agreement, the parties agreed to completely replace all regular chicken in the participating supermarkets with the new and more expensive product. The Dutch Competition Authority concluded that such agreements led to a reduction in consumer choice as these agreements removed certain products

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[43]CECED (Case COMP IV.F.1/36.718) Commission Decision 2000/475/EC (2000) OJ L 187/47.
[44]*Energy Watchdog & Ors. V CERC & Ors*., Civil Appeal Nos. 5399-5400 of 2016.
[45]2015 (6) SCALE 706.
[46]"Guidelines on Cross Border Trade of Electricity, Ministry of Power, Government of India" (2018) Government if India Ministry of Power.
[47]G. Geoffrey, 'The Rule of Ecological Law: The Legal Complement to Degrowth Economics, Sustainability' (2013), 5, 316-337.

from the market categorizing them as low in animal welfare and thus, violated Article 101(1) of the EU Competition law.[48]

Sectoral regulations inevitably create an anti-competitive scenario because sectoral regulations are formulated taking into consideration the integration of technical, economic, access regulations and monopoly restrictive regulations (non-competitive consideration). Sectoral regulations aim to create an efficient operability of the concerned sector which eventually fails to address the competition issues.[49] While on the contrary, competition laws apply the mechanism elaborated under section 3 and section 4 of the Competition Act[50] which relies upon the per se rule and the rule of reason respectively to analyse any practice as anti-competitive in nature.

Accordingly, what we can infer from here is that sectoral regulations and competition legislations are very conflicting regimes, and since, they were enacted to majorly address different subject areas their contradictions overpower their complementarities. Therefore, extending the limits of sectoral regulations in pursuance of addressing industry-specific competition issues is only going to lead towards "conflict of laws"[51] and a bad precedent for those sectoral regulators who also tries to extend their jurisdictional limit even when

[48]JP van der and others, "Valuing Sustainability? the ACM's Analysis of 'Chicken for Tomorrow' under Art. 101(3)" (2018) KCLB. <http://competitionlawblog.kluwercompetitionlaw.com/2015/02/18/valuing-sustainability-the-acms-analysis-of-chicken-for-tomorrow-under-art-1013/>>; accessed 6 January 2023.
[49]"Combating Anti-competitive Practices, *A Guide for Developing Economy Exporters,* International Trade Centre" <https://www.intracen.org/Combating-Anti-Competitive-Pracices/> accessed 12 November 2021.
[50]Breyer, S., *Regulation and Its Reforms,* (Harvard University Press 1984).
[51]Rheinstein, Max, Hay, Peter and Drobnig, Ulrich M. "Conflict of laws" (2018) Encyclopaedia Britannica <https://www.britannica.com/topic/conflict-of-laws.> accessed 28 November 2021.

their governing statutes are incapable of addressing competition matters.[52] The same was held true in the case of *Suo moto v. North Delhi Power Ltd. & BSES & Ors.,*[53] where the body authorized by the Electricity Act, 2003[54] tried to extend its jurisdiction in order to adjudicate a matter concerning anti-competitive agreements and cartelization.

Understandably now, it is simple to distinguish between competition law and sectoral regulation, but it may not be possible to delimit and classify every part of them in all stances – and, as a result, they may well create potential jurisdictional overlays and substantive conflicts (whether competition authorities or industry-specific sector regulator should handle competition enforcement in the sector). They may have common goals alongside contradictory enforcement and contradictory goals alongside common enforcement.[55], but in practice, it is very complex and if not resolved, leads to the following mentioned problems: -

- Creating market-wide uncertainty for businesses and investors.[56]
- Unclear roles and non-bifurcation of responsibilities and duties can encourage gamesmanship and forum shopping, leading to unethical gaining of litigation advantages.[57]

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[52] Pradeep S Mehta and Manish Agarwal, 'Time for a Functional Competition Policy and Law in India'(2006) CUTS International <http://www.cuts-international.org/pdf/compol.pdf> accessed 11 November 2021.
[53] *Ajitsingh Harnamsingh Gujral v State of Maharashtra*, MANU/CO/0077/2011.
[54] Electricity Act 2003. (Electricity Act).
[55] 'Enforcement experience in regulated sectors - International Competition Network Antitrust Enforcement in Regulated Sectors Working Group Subgroup' (2004) 2 ICN <https://centrocedec.files.wordpress.com/2015/07/enforcement-experience-in-regulated-sectors-2004.pdf> accessed 24 September 2021.
[56] Hellwig, M., *"*Competition Policy and Sector-specific Regulation for Network Industries*",* (2009) in Vives, X. (ed.), Competition Policy in the EU: Fifty Years on from the Treaty of Rome, OXFORD UNIVERSITY PRESS.
[57] Mullenix, Linda S., 'Gaming the System: Protecting Consumers from Unconscionable Contractual Forum Selection and Arbitration Clauses' (2015). 66 Hasting L.J. 719 <https://ssrn.com/abstract=2485848> accessed on 4 November 2021.

- Judicial bodies are burdened due to unspecified approaches adopted by competition law and several industry-specific regulations.
- Effectiveness of policies reduces.
- Ultimately, the burden is shifted onto the consumers as the products will become costlier owing to the increased compliance/ litigation cost born by firms due to lack of delineation of jurisdictional role between sectoral regulators and competition authorities.[58]
- It restricts the market to grow and explore organically.[59]

This problem gets more exemplified by the labyrinth of mandates enunciated in the Competition Act, 2002. The bona fide approach of the competition act towards the economy, persuades it to cover every economic transaction in an economy under its ambit which advances to jurisdictional muddy waters.[60] Thus, there is a need of evolving a model of operation conceptualized upon the idea of balance of power.[61] The paper in contemplation of evolving a model of operation advances toward a case study based on the classical judgments by the Supreme Court of India, and other courts which currently serve as the law addressing the issue of jurisdictional overlap between competition authorities and industry specific sectoral

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[58]Decker, C., 'Addressing Overlaps and Conflicts between Competition Authorities and Sectoral Regulators' (2013) <https://cutsccier.org/pdf/How_to_deal_with_the_overlaps_and_conflicts_between_competition_authority_sector_regulatorsChristopher-Decker.pptx> accessed 5 November 2021.

[59]Ian S Forrester, *'Sector-Specific Price Regulation or Antitrust Regulation—A Plague on Both Your Houses?'* in Claus-Dieter Ehlermann and Mel Marquis (eds); European Competition Law Annual 2007: A Reformed Approach to Article 82 EC (Hart Publishing 2008) 555.

[60]Nayar, Kanika*,* 'Jurisdiction of the CCI: Navigating Through Muddy Waters - Anti-trust/Competition Law' (*Mondaq*, 28 April. 2015) <https://www.mondaq.com/india/antitrust-eu-competition-/392738/jurisdiction-of-the-cci-navigating-through-muddy-waters.> accessed 28 November 2021.

[61]The Editors of Encyclopaedia. "Balance of power". (*Encyclopaedia Britannica*, 22 May. 2020) <https://www.britannica.com/topic/balance-of-power.> accessed 28 November 2021.

regulators in India.

B. The Regulation/Competition Dichotomy: "Case-by-Case" Comprehensive Study

According to Lord Hewart, the then Chief Justice of England, "Justice must not only be done but must also be seen to be done."[62] The statement has now started to make more sense in the arena of markets and economy. Prior to the evolution of an unregulated system of economies and "open economies", justice, equity & public good were only in the influences and mercy of the "invisible hand" which governed the complete market.[63] But it somehow failed to convey the visual representation of justice done in the minds of people, leading towards necessitating the need for formulating a consumer good ensuring authority. Therefore, keeping in mind the need of the modern economy, most of the modern economies all around the world established competition enforcement authorities to regulate transactions and arrangements so that "consumer welfare" can be enforced without causing any undesirable results.[64] Plausibly, the evolution of economies caused the proliferation of regulatory authorities as well in the market which led to overlapping of each other's jurisdictional rights making the government oscillate between poles of regulation and competition.

Since competition law and other sectoral regulations in India are still in the process of advancement,[65] there are no easy answers, which can readily

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[62] *R v Sussex Justices*, [1924] 1 KB 256.
[63] Viner, J. 'The Intellectual History of Laissez Faire' 3 THE JOURNAL OF LAW & ECONOMICS. <http://www.jstor.org/stable/724811.> accessed 5 November 2021.
[64] Cass R. Sunstein, 'Free Markets and Social Justice' (1997).
[65]Khan, A., Prasad, D., 'Mapping the Journey of Competition Analysis in India: From Precedence to Evidence' Kluwer Competition Law Blog, <http://competitionlawblog.kluwercompetitionlaw.com/2018/10/05/mapping-journey-competition-analysis-india-precedence-evidence/>. accessed 28 November 2021.

be given to the question of whether competition authorities or sectoral regulations should regulate competition enforcement in India. Therefore, it necessitates a scholarly case-by-case study of judgments pronounced by the courts in this sphere of law for getting a fair understanding of the issue.

1. *Neeraj Malhotra v. North Delhi Power Ltd.*

In the case concerning *Neeraj Malhotra v. NDPL*,[66] allegation of abuse of market dominance in violation of sections 3(4) and 4 was asserted by CCI against three power distributors namely; BSES Rajdhani Power, BSES Yamuna Power and North Delhi Power Ltd (**"NDPL"**).[67] The responding parties in the present case relying upon sections 60 and 174 of the Electricity Act contended that only the Delhi Electricity Regulatory Commission had jurisdiction to deal with the issue concerning anti-competitive arrangement of electricity distribution companies. However, the Delhi Electricity Regulatory Commission in the present matter agreed to vide letter dated 30.09.2009 held that the allegations of anti-competitive conduct will fall under the jurisdiction of the CCI.

In addition to that, the court while relying upon the doctrine of "generia specialibus non deroant" which means general provisions will not abrogate special provisions observed that so far as competition issues are concerned the Competition Act, 2002 is a specific law and will supersede the provisions of the Electricity Act, 2003.

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[66] *Shri Neeraj Malhotra, Advocate v. North Delhi Power Ltd. & Ors.*, case no 6/2009 .
[67] Electricity Act.

2. *WhatsApp Privacy Policy Case*

The WhatsApp privacy policy case of 2021[68] in which the CCI probed into the updated privacy policy of WhatsApp also raised issues challenging the jurisdiction of the CCI in matters concerning Big Data in absence of any data regulator in the country. In the present matter, CCI exercised its jurisdiction by relying upon sections 60 and 66 of the Act and held that the updated privacy policy of the WhatsApp which will lead to sharing of data with Facebook violates section 4 read with section 19 of the Act as WhatsApp is exerting its dominance in one market to enter another market. In response to this, WhatsApp and Facebook challenged the order of CCI in Delhi HC arguing that CCI has no jurisdiction in the matter as the matter is already pending before the Constitutional Court.[69] The division bench of Delhi HC in the present matter observed that the nature of disputes pending before the Supreme Court and CCI is very different and as there exists a prima facie case of abuse of dominance as per the DG's report, CCI is well within its jurisdictional power to take the cognizance of the matter.

3. *Ericsson Case*

In the case concerning, *Ericsson v. CCI*, Ericson[70] being a sole licensor in the technology of GSM (Global System for Mobile Communications) was alleged by the informant (Best IT World (India) Private Limited (iBall) for exercising the dominant position in the market in violation to section 4 of the competition act.[71] In response to it, Ericsson filed a petition in the Delhi High

[68] *In Re: Updated Terms of Service and Privacy Policy for WhatsApp Users,* Suo Moto Case No. 01 of 2021.
[69] *WhatsApp LLC v. Competition Commission of India,* W.P.(C) 4378/2021 & CM 13336/2021.
[70] *Telefonaktiebolaget LM Ericsson v. Competition Commission of India,* W.P.(C) 464/2014 & CM Nos. 911/2014 & 915/2014.
[71] Competition Act, s 4 (a).

Court challenging the jurisdiction of CCI over the matter. The major contention raised by Ericsson was that the CCI lacked jurisdiction because it was a patent dispute and accordingly should be adjudicated by the IP Authority Board solely. In response to it, CCI contended in front of the Delhi High Court that section 27 of the Patents Act (now omitted)[72] complemented the remedies provided under section 4 of the Competition Act in order to curb the anti-competitive practices. Thus, CCI has jurisdiction over this matter exclusively with respect to the analysis of whether Ericsson is exercising any *dominant position* in the relevant market or not?

The Delhi High Court made the following observations: -

- The statutes should not be dealt with in absolute isolation from one another.
- The spirit of every legislation is to protect the interest of consumers and economic efficiency.[73]
- The two laws may seem contradictory in a layman's eye, but they are formulated to protect common interests.[74]

The problem behind this case is not the outcome, but the act of CCI validating its jurisdiction in front of the High Court. Neither the Delhi High court nor the IP authority board under the Patents Act is designed to govern competition practices in the market. The Competition Commission of India

[72] The Patents Act 1970. (Patents Act)
[73] Sahithya Muralidhraran, "Ericsson v. Micromax – A Kick-Start to SEP-FRAND Antitrust Jurisprudence in India", (*Kluwer Competition Law Blog,* 2016) <http://competitionlawblog.kluwercompetitionlaw.com/2016/07/13/ericsson-v-micromax-a-kick-start-to-the-sep-frand-antitrust-jurisprudence-in-india/.> accessed 23 November 2021.
[74]Deepak Patel, "CCI and patent regulator can co-exist," (*Business Standard)*, <http://www.luthra.com/admin/article_images/Business-sandard-CCI-ptent.pdf.> accessed 28 November 2021.

was well within its jurisdiction under the purview of sections 3 and 4[75] of the Competition Act to deal with this matter solely. The Patents Act, 1970 does not cover the areas enunciated under sections 3 and 4 so therefore, the grounds on which the validity of CCI's jurisdiction is challenged is unreasonable. Understandably, these cases are only responsible for the rise in institutional degradation in our system of economy. The institutions rather than carrying out the functions for which they were instituted are occupied in activities rationalizing their existence to toss out their existential crises.

4. ***CCI v. Bharati Airtel & Ors.***

The Hon'ble Supreme Court of India in this case[76] finally, showed a middle path to resolve a long-debated issue of jurisdictional conflict between Competition authorities and sectoral regulators drawing reference from two U.S Supreme Court judgments namely, Credit Suisse Case[77] and the Verizon Communications case.[78] The facts of this case revolve around an agreement for POI's ("Point of Interconnections") between Reliance Jio Infocomm Limited (RJIL) and Airtel, Idea, and Vodafone for smooth interconnections.[79] RJIL through various letters filed to TRAI alleged that the augmentation of point of interconnections were not adequate for smooth functioning. In response to RJIL's allegation, the other parties (Bharati Airtel, Idea, and Vodafone) contended that the augmentation of POI's as specified in the agreement is sufficient and that the real cause of the lack of smooth interconnectivity is due to RJIL's free data/call service. TRAI after taking necessary steps, recommended that Airtel is in non-compliance with the terms

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[75] Competition Act, s 4.
[76] *Competition Commission of India v Bharti Airtel Ltd*., AIR 2019 SC 113.
[77] *Credit Suisse Sec. (USA) LLC v Billing* [551 U.S. 264].
[78] *Law Offices of Curtis v. Trinko* [540 US 398].
[79] Telecom Regulatory Authority of India Act 1997, s 13 r/w s 11(1) (b)(i), (ii), (iii), (iv) and (v).

and conditions of license and denial of interconnection to RJIL appears to be with an ulterior motive to stifle competition and is anti-consumer.

Furthermore, the CCI, acting on information filed by Reliance Jio Infocomm Limited (RJIL) took cognizance of the matter under Section 19(1) of the Competition Act, 2002,[80] ordered the Director General, CCI to investigate the alleged cartelization by Bharti Airtel Limited, Vodafone India Limited, Idea Cellular Limited and the Cellular Operators Association of India. It was alleged that OP (Opposing parties) had cartelized to deny Jio entry into the telecom sector by not providing it adequate Points of Interconnection resulting in call failures between Jio and other networks. The commission held that there exists a prima facie contravention of section 3 (3) of the competition act, as the Respondent service providers have entered into an agreement with Cellular Operators Association of India (COAI), forming an anti-competitive agreement, a cartel to deny POI's to RJIL.

The Bombay High Court in response to the writ petitions filed by Incumbent Dominant Operators IDO and COAI, ordered that CCI lacked jurisdiction under section 19 of the competition act, as the matter falls within the exclusive jurisdiction of another sectoral regulatory body namely, TRAI, and the CCI could exercise its jurisdiction only after the proceedings under the TRAI have concluded.[81] The Supreme Court also upheld the decision of the Bombay High Court recognizing the specialized nature of TRAI as a regulator and held that TRAI is better suited to decide such cases.

If we exhaustively, analyse this issue in relation to the above-

[80] Competition Act, s 19 (1).
[81] G. Geoffrey, 'The Rule of Ecological Law: The Legal Complement to Degrowth Economics, Sustainability' (2013), 5, 316-337.

mentioned judgment, there subsist certain blurred lines[82] concerning the jurisdictional interface between the competition authority and sectoral regulators; First, there are some sectoral regulators which do carry broad declarations pertaining to competition enforcement, but there are many legislations which do not mandate competition enforcement. Such judgments substantiate bad precedents as they promote sectoral regulators to expand their horizon of competition enforcement without having any legislative backing in their governing statutes. Second, such legislation have blurred the distinction between ex-ante regulation and ex-post competition assessment, allowing for potential conflicts between these regulators and the CCI. Third, it should be recognized that the primary matter of grievance reported by the informant (**"RJIL"**) in the above case, primarily, relates to cartelization and anti-competitive behaviour, amounting to violations under section 3 of the act. In this regard, it must be noted that none of the areas covered Under Section 3 of the Act are covered by TRAI in its mandate as a sector regulator for TSP. TRAI is incapable of arriving at a determination as to whether ITO's have entered into an anti-competitive agreement to deny PIO's to RJIL under section 3 of the act. Thus, it is only within the mandate of the CCI to adjudicate matters pertaining to cartelization and anti-competitive conduct.

It should also be noted that there are no easy answers, which can readily provide a solution to these blurred lines. As the economy matures, competition concerns will become more important for two reasons. First, a sophisticated economy will have far more products, enterprises, and geographical markets.[83] As new markets grow and deepen, the sheer

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[82] AZB & Partners, "Role of CCI in Regulated Sectors: Overlapping Jurisdictions", (*AZB Partners & Solicitors)* <https://www.azbpartners.com/bank/role-of-cci-in-regulated-sectors-overlapping-jurisdictions/.> accessed 25 November 2021.

[83] Levitt, T. "The globalization of Markets" (2014). HARVARD BUSINESS REVIEW <https://hbr.org/1983/05/the-globalization-of-markets.> accessed 15 November 2021.

magnitude of activity in competition law goes up. Second, competitive pressures are limited in an unsophisticated market as there is a slow pace of creative destruction. As the economy gains complexity, there is greater competitive pressure. When it becomes harder for firms to make profits, there is a greater temptation to resort to anti-competitive practices of various kinds. Parallelly, as the CCI's advocacy efforts bear fruit and more people learn about the importance of free and fair markets and the approach shifts from complaints to genuine information, stakeholders will bring more cases of anti-competitive action to the CCI's attention. For these reasons, the salience of competition law and the magnitude of the CCI's activity must go up.[84]

Therefore, we need to look forward to some new evolving models of operations creating a balance of power between competition authorities and sectoral regulators. The determination of the model primarily depends upon various factors: experience, practical application, institutional culture, choices made by politicians and policymakers.[85] To put this discussion forward, the next section of this article reviews various models of operation along with various practices adopted by countries internationally: exclusivity model, concurrency model, etc. in order to identify, which model suits Indian institutional and demographic framework the best.

III. MODEL OF COOPERATION AND THE WAY FORWARD

It should be noted at the outset that there is no perfect model based on exact science. Consequently, it becomes very necessary to have a dynamic

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[84] Ministry of Corporate Affairs. (n.d.). *Report of the Competition Law Review Committee.*, <https://www.ies.gov.in/pdfs/Report-Competition-CLRC.pdf.> accessed 14 November 2021.

[85] Dabbah, M. M. 'The Relationship Between Competition Authorities and Sector Regulators'. (2011) 70(1) Camb La J. < https://www.cambridge.org/core/journals/cambridge-law-journal/article/abs/relationship-between-competition-authorities-and-sector-regulators/1E3B8CD329DA1972E33E302438B9C3BD#access-block> accessed 15 November 2021.

approach while determining the model of operation. As we are currently, in the midst of a transition from depending solely on competition enforcement to also adopting sectoral regulation, we are missing out on the "hybrid approach" which could also be adopted, keeping in mind the institutional framework and history of competition law in India. But it is impossible to adopt such an approach before comparing it with the pre-existing exclusivity model and concurrency model. Therefore, this section of the article, tries to advocate the expansion of the competition enforcement by adopting a participatory "Rule Making" approach,[86] correspondingly at the same time putting forward some legal and economical arguments in derogation of the pre-existing models, namely, the Exclusivity model & Concurrency model of the interface between competition and sectoral regulations leading to the age-old issue of jurisdictional overlaps.

1. *The Fallbacks of Exclusivity Model*

The exclusivity model is a model in which competition enforcement authorities are the sole authorities to handle competition enforcement in all sectors in an exclusive manner. Indian Competitional regime has somewhat adopted this approach and has explicitly failed in order to evolve a system of harmonious cooperation between competition law and sectoral regulation. Moreover, it has raised a cornucopia of issues like lack of organic growth of the market,[87] ultimate burden on consumers,[88] and reduction in the

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[86] Chopra, R. '*Competition and Consumer Protection in the 21st Century*' (Washington, D.C. 20580, 2018).

[87] Ian S Forrester, *'Sector-Specific Price Regulation or Antitrust Regulation—A Plague on Both Your Houses?' in Claus-Dieter Ehlermann and Mel Marquis (eds*); '*European Competition Law Annual 2007: A Reformed Approach to Article 82 EC*' (Hart Publishing 2008).

[88] Richard A. Posner, "Theories of Economic Regulation", (2004) Working Paper, No. 41, Centre for Economic Analysis of Human Behaviour and Social Institutions. <https://www.nber.org/system/files/working_papers/w0041/w0041.pdf> accessed 22 October 2021.

effectiveness of the policies.[89] As these above-mentioned issues are primarily dealt in the previous section of the article, this section would mostly include limitations of the exclusivity model on the basis of economy-wide approach and its international application.

Australia was one of the few countries to adopt this approach for creating a smooth interface between sectoral regulations and competition enforcement by establishing a body named the Australian Competition and Consumer Commission (**"ACCC"**).[90] However, this scheme led to an extreme complex structure of bureaucracy, devouring the competition body to attain the goals for which it was established.[91] The possible disadvantages of this model include: -

- Lack of technical expertise in the industry-specific sector on the part of the competition authority.
- Lengthy and typical competition enforcement procedures which will lead towards creating a burden on the judiciary.
- Adoption of 'rule of reason'[92] approach shall result into lack of specialization of the body.[93]

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[89] Larouche, P., 'Competition Law And Regulation In European Telecommunications' (2001), 20(1), Yearb. Eur. Law <Https://Academic.Oup.Com/Yel/Article-Abstract/20/1/585/1725967> Accessed 21 November 2021.
[90] Int'l Competition Network, *Antitrust Enforcement in Regulated Sectors Working Group, Subgroup 3: Interrelations between Antitrust and Regulatory Authorities, Report to the Third ICN Annual Conference, Seoul*, April 2004.
[91] Ibid 5.
[92] Hon. Richard D. Cudahy & Alan Devlin, 'Anticompetitive Effect', (2010) 95 MINN. L. REV < HTTPS://SCHOLARSHIP.LAW.UMN.EDU/MLR/430/> accessed 15 November 2021, See also Maurice E. Stucke, 'Does the Rule of Reason Violate the Rule of Law?' (2009) 42 U.C. DAVIS L. REV. 1375 < https://lawreview.law.ucdavis.edu/issues/42/5/articles/42-5_stucke.pdf > accessed 15 November 2021.
[93] Leegin Creative Leather Products, Inc. v PSKS, Inc. [2007] 551 U.S. 877, 917

- This approach involves a high cost of litigation and enforcement.[94]

The isolative approach of competition law fails to protect the public interest and other important social objectives because it is empowered with regulations concerned with protecting competition and not facilitating competition.[95] This model of operation, in turn, creates a risk of instrumentalization, politicisation and bureaucratization of competition law.[96]

2. *The Fallbacks of Concurrency Model*

Building an institutional framework by combining the goals and objectives of two bodies is a very complex task to carry out. Internationally, there are wide variety of concurrency models available for assistance, but the existence of 'dilemma' in choosing, which regulatory body to be favoured in the concurrency model still persists. The doubt regarding favouring competition enforcement or regulatory bodies widens the scope of implications of the limitations of both bodies. As a result, the attraction towards adopting for concurrency model should always be looked in light of the difficulties which it may give rise to, like it did in Mexico and Germany in matters pertaining to the Telecommunications industry.[97] For instance, in Mexico, the Telecommunication Laws 1995 relies on per se approach for matters pertaining to the prohibition of cross-subsidising and discrimination,[98]

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[94] American Bar Association, "*Section on Antitrust Law, Controlling Costs of Antitrust Enforcement and Litigation*" (2012), <https://www.americanbar.org/content/dam/aba/administrative/antitrust_law/2013_agenda_cost_efficiency_kolasky.authcheckdam.pdf.> accessed 23 November 2021.

[95] Trade Practices Act 1974, Part III A.

[96] Spencer Weber Waller., Prosecution by Regulation: The Changing Nature of Antitrust Enforcement, (1998) 77 OR. L. REV. < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=144149> accessed 23 November 2021.

[97] Mullenix, Linda S., 'Gaming the System: Protecting Consumers from Unconscionable Contractual Forum Selection and Arbitration Clauses' (2015). 66 Hasting L.J. 719 <https://ssrn.com/abstract=2485848> accessed on 4 November 2021.

[98] The Federal Telecommunications & Broadcasting Laws 1995, Article 120.

whereas, the Mexican Competition law does not treat cross-subsidising and discrimination as per se offences but rather adopts rule of reason approach to assess the matter which in turn leads to difficulties.[99] The Concurrency model includes the following limitations: (a) Jurisdictional overlap and duplication of work;[100] (b) Dominance of non-competitive consideration in the sectoral regulations; (c) Differences in goals and objectives of both the regulations; and (d) lack of regulation on organized cooperation. In the practical application of the model of concurrency, the regulator may struggle in terms of prioritizing or even reconciling between the contrasting duties and objectives laid down in their governing statutes. The simple and obvious fact that sectoral regulations are not competition authorities should also be acknowledged. The efficiency and legitimacy of the body under this model is also under scrutiny because this model of cooperation violates the legal doctrine of "separation of powers".

Thus, the model of concurrency though successful in the UK, may not work in a developing country like India where hierarchical institutional framework restricts the govt bodies and regulators to cooperate with each other. Since the functional/financial independence and accountability of sectoral regulators in India is not possible because of political interests of the policymakers it is very difficult to adopt the model of concurrency.[101]

3. *The Way Forward: Expanding the competition Enforcement by "Rule Making"*

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[99] The Federal Law of Economic Competition 1993, Article 56.

[100] Patents Act.

[101] CUTS International, 'Harmonising Regulatory Conflicts: Evolving a Cooperative Regime to Address Conflicts Arising from Jurisdictional Overlaps between Competition and Sector Regulatory Authorities' (Indian Institute of Corporate Affairs 2012) 7 <http://oldwebsite.iica.in/images/Harmonising%20Regulatory%20Conflicts.pdf> accessed 19 November 2021.

Taking into consideration, prior efforts made in this area for determining the "balance of power" between Competition law and Sectoral Regulations, we might take a step back, and try to devise an alternative mechanism through which pro-competitive laws can operate in a better way.[102] This approach of expanding the competition enforcement draws our attention towards an idea of "mutual influence" between regulation and competition enforcement. The idea of mutual influence refers to evolving an expert rule-making authority agency for major sectors of the economy, for example (Telecommunications, Energy, Transport, Information Technology, etc.) to guide Competition Commission of India to deal with issues needing sophisticated understanding and dynamics. This would promote rapid use of new ideas and developments in every sector to advance more clarity and certainty, like what happened in the "post-Chicago case"[103]. And would exhaust the debate of jurisdictional overlays between competition authorities and sectoral regulators because only the Competition Commission of India under this mechanism will be entrusted to have jurisdiction governed by Industry-specific competition rules provided by Rule Making (Expert Agency) for every sector. These expert agencies consisting of economists, scholars of particular sectors and policymakers would assist the competition authority by formulating industry-specific competition rules. The practical application of this approach can be attributed to the Congress in the US, where they also sought to create a structure that was both rigorous and vigorous,[104]

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[102] AZB & Partners, "Role of CCI in Regulated Sectors: Overlapping Jurisdictions", (*AZB Partners & Solicitors)* <https://www.azbpartners.com/bank/role-of-cci-in-regulated-sectors-overlapping-jurisdictions/.> accessed 25 November 2021.

[103] Yoo, Christopher S., "The Post-Chicago Antitrust Revolution: A Retrospective" (2020) PENN LAW. 2237. <https://scholarship.law.upenn.edu/faculty_scholarship/2237> accessed 26 November 2021.

[104] C. Scott Hemphill, 'An Aggregate Approach to Antitrust: Using New Data and Rulemaking to Preserve Drug Competition' (2009) 109(4) COLUM. L. REV. < https://www.jstor.org/stable/40380388> accessed 26 November 2021.

where the law would develop not just through judicial courts but also through an expert agency.

Several commentators have also advocated the expansion of competition enforcement through rulemaking. For example, Tim Wu advocates the need of instituting more regulation in the competition system,[105] for example as "using industry-specific statutes, rulemakings, or other tools of the regulatory state to achieve the traditional competition goals associated with the antitrust laws.[106] Similarly, the OECD[107] also proposed certain recommendations for evolving coordination between different regulators, which suggested the agency to adoption of more informed decisions on competition and regulatory issues.

This approach can be modalized through bringing in two strategic actions designed to stimulate the competition enforcements: (1) Making certain industry-specific competition amendments in the governing sectorial statutes to bring more industry-specific competitional clarity and certainty. This would reduce the burden on judicial bodies which is attributed solely to the generalised character of the competition act. (2) Establishing a Rule Making (Expert-agency) in each sector.

This approach would maximize the advantages enjoyed by competition authorities and sectoral regulators as it addresses the limitations

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[105] Tim Wu, Antitrust via Rulemaking: Competition Catalysts' (2017) 16 COLORADO TECHNOLOGY LAW JOURNAL < https://ctlj.colorado.edu/wp-content/uploads/2018/03/3-Wu-1.22.18-FINAL.pdf> accessed 26 November 2021.

[106] U.S. DEP'T OF JUSTICE, 'Division Update, Spring, (2019), <https://www.justice.gov/atr/division-operations/division-update-spring-2019/cartels-beware> accessed 26 November 2021.

[107] Directorate for Financial and Enterprise Affairs COMPETITION COMMITTEE, 'Annual Report on Competition Policy Developments in Spain' (2017) < https://one.oecd.org/document/DAF/COMP/AR(2019)15/en/pdf.> accessed 26 November 2021.

of both. It would lead towards, evolving a risk-based and principle-based regulations and most importantly, as the rules proposed for adjudicating sector-specific competition matter will be readily available in comparison to legislation. It would reduce the litigation and enforcement cost; Reduce ambiguity around what the law is,[108] enhancing the predictability; Reduce opacity and certain undemocratic features of the current approach, enhancing transpiration and participation.[109]

IV. CONCLUSION

The aim of this Article was to analyse the paradox between sectoral regulations and the competition authority in India in contemplation to evolve a model of operation to resolve the regulation/competition dichotomy. The seemingly disruptive interface between the competition authority and sectoral regulation is attributed to the contrasting legislative mandates the two exert to achieve somewhat, complementary goals and objectives.

The article investigated the socialist structure of the Indian economy responsible for the proliferation of sectoral regulators in the economy post 1990's (evolution into unregulated economies). It further scrutinized the interface between sector specific regulators and competition authority in pursuance to analyse, how do sector-specific regulations circumscribe the scope of competition law in the Indian context. Descriptively, the article chooses "rule making" approach as the best model to expand the enforcement of competition law in comparison to the exclusivity and concurrency model, as it stands out as a very practical and pragmatic approach to managing the

[108] *FCC v Fox Television* [2012] 567 U.S. 239, 253.
[109] Harry First & Spencer Weber Waller, 'Antitrust' s Demographic Deficit' (2013) 81 FORDHAM L. REV. 2543 < https://ir.lawnet.fordham.edu/flr/vol81/iss5> accessed 26 November 2021.
[109] *FCC v Fox Television* [2012] 567 U.S. 239, 253.

interface between competition enforcement sectoral regulation. The article also explained, no model is the best model in todays' dynamic economic environment. Therefore, the choice of model of operation needs to be sensitive to experience, practical application, institutional culture, choices made by politicians and policymakers.

Normatively, the article brought forward that the "rule making" approach and establishment of "Rule Making Expert Agency" for competition matters for every sector is the best model to expand the competition law enforcement and to reduce the overlapping of jurisdiction between CCI & industry-specific regulators. It also suggested that by making amendments to the sections of industry-specific statutes dealing with fair competition and market regulation can seek more clarity and reduce the chances of conflicts. For instance, the USA has suggested every industry specific regulator to define the "relevant market" narrowly enough so that competitive conditions within each area are reasonably similar, yet broadly enough to be administratively workable.[110] Similarly, we can also bring such changes to resolve our issues. Moreover, the article also suggested that for any model of operation to work, competition authorities and sector-specific regulators must conduct themselves in a prospective and constructive manner showing flexibility when working together, and perhaps have an accommodative approach towards one another, because the way they conduct each other will have a decisive impact over ensuring the existence of public good, economic efficiency and consumer welfare.

[110] FCC *Pricing Flexibility Order* (1999), 14 FCC Red 14221, paragraph 71.

IV. SHINING A LIGHT ON SHADOW TRADING: UNDERSTANDING ITS IMPLICATIONS WITHIN INDIA'S INSIDER TRADING REGULATIONS

- Aniket Panchal and Khushi Parekh[*]

ABSTRACT

Shadow trading encapsulates a theory of insider trading. It finds its roots in the misappropriation theory propounded by the United States. Based on the idea that secret information from one company may also be relevant for other economically linked companies, shadow trading aims to convict those insiders who may profit from trading in the scrip of such economically linked companies. Regulatory scrutiny has been avoided for these kinds of market transactions up until August 2021 when the Securities Exchange Commission of the United States targeted one Mathew Panuwat based on a complaint of shadow trading. This paper aims to analyze this case and then explore the viability of this theory in the context of Indian law. Further, this paper attempts to examine under what pigeonhole will this theory fit in the existent insider trading laws of the country. Lastly, the authors will recommend policy changes to ensure that the integrity of the securities market in India is balanced against its development and increased participation.

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I. SHADOW TRADING – SETTING THE TONE

Insider trading is when an insider, having access to price-sensitive confidential information, illegally trades in securities listed on the organized securities market.[1] While Indian securities regulations employ a robust disclosure regime that necessitates listed companies to disclose certain information to ensure informed trading by investors, it also effectively allows companies to withhold disclosure of premature information to protect corporate interests. As a corollary to this, share prices in markets are only decided using publicly available information.[2]

For the same reason, insiders are prohibited from trading in securities based on non-public information. If allowed, such trading will be in contravention of two fundamental objectives endorsed by the International Organisation of Securities Commissions ("**IOSCO**")[3] – investor protection and maintenance of fairness, efficiency, and transparency in the securities markets. Adherence to these principles is crucial since the Indian securities market regulator sits on the IOSCO Board, which is responsible for overseeing and setting standards for the organization.[4] In fact, it even goes against the

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[1] CS Bhuwneshwar Mishra, *Law relating to Insider Trading – A comprehensive commentary on SEBI (Prohibition of Insider Trading) Regulations 2015* (Taxmann 2015).
[2] Armaan Patkar, *Insider Trading Law and Practice* (Eastern Book Company 2019).
[3] Objectives and Principles of Securities Regulations, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf> accessed 21 September 2022.
[4] IOSCO Board, <https://www.iosco.org/about/?subsection=display_committee&cmtid=11> accessed 05 April 2022.

foremost objective of the Securities and Exchange Board of India Act, 1992[5] *i.e.,* the protection of investors' interest in the securities market. Not only that, but such acts can also undermine public confidence in the securities market.

On the contrary, some economists argue that Insider Trading ought to be encouraged rather than outlawed it. One such thinker is the famed economist and Nobel Laureate, Milton Friedman, who advocated insider trading in a 2003 interview with CNBC. In his interview, he stated "*here you have got a company like Enron which is doing fraudulent things. People on the inside know about it. One of the best ways to bring it out is to make it profitable. A whistle-blower takes a chance, does not gain anything by it, but a person on the inside who knows things are going wrong, can make money on it and at the same time serve the market purpose of driving down the price of the stock and that alerts other people*".[6]

While the jurisprudence on Insider Trading is prospering exponentially, it is the offence of Shadow Trading that has recently attracted the attention of securities market regulators worldwide. The offence of shadow trading is nothing but an extension of insider trading. In 2021, the phenomenon was dubbed "shadow trading" by Mihir Mehta, David Reeb, and Wanli Zhao in their work titled "Shadow Trading".[7] To contextualize the same, the concept of shadow trading is straightforward: a piece of information held by the insider about a company may also hold some relevance for the economically-linked company and accordingly can be exploited by him to make profits. Put simply,

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[5] Preamble, Securities and Exchange Board of India Act, 1992 (Act 15 of 1992) preamble ("SEBI Act 1992").

[6] Pratap Ravindran, 'Using Insider-Trading as a Weapon' (*The Hindu Business Line*, 17 September 2003) <http://www.thehindubusinessline.com/2003./09/17/stories/2003091701330900.htm> accessed 07 September 2022.

[7] Mihir Mehta, David Reeb and Wanli Zhao, 'Shadow Trading' (2021) Account. Rev. 23, 27.

confidential information emerging from the "source company" may be price-relevant for the "linked company" as well. This paper is divided into seven chapters, with each chapter analyzing different aspects of shadow trading. The paper begins by introducing the concept of shadow trading and discussing its potential impact on market integrity. It then analyzes the case of *SEC v. Mathew Panuwat* and its implications for future shadow trading cases. The paper then delves into Indian jurisprudence and examines how it applies to shadow trading. The extension of the shadow trading doctrine in India and its incorporation into existing laws and regulations are discussed in Chapter 4. The challenges to the shadow trading regime are explored in Chapter 5, and Chapter 6 proposes policy recommendations to strengthen market integrity while promoting its growth and development. The paper concludes by summarizing its key findings and proposing pragmatic solutions to the issue of shadow trading.

II. SEC SHINES A LIGHT ON SHADOW TRADING: *SEC V. PANUWAT*

In January 2022, the United States District Court for the Northern District of California, rejected a motion to dismiss filed by Matthew Panuwat against a compliant brought by the Securities and Exchange Commission ("**SEC**").[8] What is interesting to note here is that the enforcement action was brought under the regime of 'shadow trading', a novel doctrine that seeks to punish the use of insider knowledge for the trading of securities of a peer company.

[8] *Complaint filed by SEC* <https://www.sec.gov/litigation/complaints/2021/comp-pr2021-155.pdf> accessed 28 September 2022.

A. Mathew Panuwat's lucrative windfall in the oncology-focused biopharmaceutical companies

Matthew Panuwat held the designation of Senior Director at a company named 'Medivation', a mid-sized oncology-focused biopharmaceutical company. Incyte was another competitor in the same highly concentrated market of oncology-focused biopharmaceutical companies. Both the companies, being value and mid-cap companies had become a target of acquisition by large-cap biopharma companies. Using his previous knowledge, Panuwat realised that back in 2015, another large-cap company had acquired one of their competitors which resulted in a substantial increase in the stock prices of both the competitors – Medivation and Incyte.

Panuwat, by getting access to asymmetrical information via a confidential e-mail, came to know that Medivation would be acquired by a large-cap pharmaceutical company, Pfizer. As soon as he received this information, Panuwat purchased Incyte's securities even though the prices were way above Incyte's stock price at the time. As soon as the acquisition announcement became public, Medivation and Incyte's stock price rose substantially. His action allegedly resulted in profits of $107,066.[9]

B. Sneak Peek at the substantive contentions in Panuwat's Case

The case involved two key questions (a) whether the knowledge of the acquisition can be 'material' to Incyte in order to constitute a violation of insider trading laws? (b) whether Panuwat owed a duty to Medivation to not use its confidential information to trade in the securities of another company?

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[9] ibid.

The SEC argued that Panuwat had engaged in shadow trading, which falls under the misappropriation theory of insider trading. Specifically, the SEC alleged that Panuwat knowingly misappropriated Incyte's securities, recognizing that the confidential information was material to both Incyte and Medivation due to the highly concentrated market and potential for acquisition. Further, he also breached the duty that he owed to Medivation. On the other hand, Panuwat filed for the motion to dismiss on the grounds that the SEC's shadow trading theory constitutes an unnecessary attempt to improperly expand the umbrella of the existing violations of securities law. Any conviction based upon the theory would be unlawful as there is no explicit policy prohibiting such conduct.

The matter is currently sub-judice.

C. The ripple effects and future implications of Panuwat's case

Usually, any claim under insider trading typically involves a person who uses 'insider information' by virtue of his position in relation to a corporation, to trade in the securities of the same corporation or its associated companies. This is based on the 'classical theory of insider trading.'[10] However, Panuwat did not commit any such violation. In fact, his action was based on the misappropriation theory of insider trading –

"*a corporate outsider trades in breach of duty of trust or confidentiality that they owed to the source of their information*."[11]

Essentially, if Panuwat had traded in the securities of the large-cap

[10] Randall Quinn, 'The Misappropriation Theory of Insider Trading in the Supreme Court: A (brief) response to the (many) critics of United States vs. O' Hagan' (2003) Fordham J. Corp. & Fin. L., 8, 865.
[11] *United States v O' Hagan* [1997] 521 U.S. 642.

biopharma company that was to acquire Medivation, a strong case could have been made out by the SEC against him under the existing jurisprudence. However, because there is no direct financial relationship between Incyte and the source of knowledge, the duty owed cannot be proven.

However, one can argue that the fiduciary duty which was owed to Medivation is not confined only to the corporation itself but also extends to the misappropriation of "material non-public information used to trade in the securities of the employer company, or the acquirer company, but also a similarly situated company, as long as it can be proven that the information was material to the third company as well." [12]

This linking becomes more relevant when the market is highly concentrated, with only a few key players sharing the same kind of characteristics. Usually, there are a limited number of mid-caps, oncology-focused biopharmaceutical companies, and it becomes fairly obvious that the acquisition of one of these corporations would automatically make the other attractive in the market, thus leading to an increase in its stock price. One cannot turn its head away from the fact that the information in question is material to Incyte as it can be used by any reasonable investor to make an informed decision about buying or selling Incyte's stock.

In the current jurisprudence, there appear to be no other cases where an insider has been held liable for insider trading by using material information regarding his own company to make a trade of another company having a

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[12] Mihir Desmukh, 'Shadow Trading – An Indian Perspective' (*IndiaCorpLaw*, 22 January 2022) <https://indiacorplaw.in/2022/01/shadow-trading-an-indian-perspective.html> accessed 07 September 2022.

[12] *Complaint filed by SEC* <https://www.sec.gov/litigation/complaints/2021/comp-pr2021-155.pdf> accessed 17 September 2022.

connection to his own company. However, one cannot undermine its potential implications on future convictions based on shadow trading. In fact, market participants should deliberate on reviewing and determining their future actions following the enforcement of this new area of insider trading.

III. TRACING THE INDIAN JURISPRUDENCE

In India, the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**") governs the violations of insider trading obligations in the market. The PIT Regulations prohibits "an insider i.e., a person who is in possession of or has access to Unpublished Price Sensitive Information ("**UPSI**") from trading in securities on a stock exchange when in possession of UPSI."[13] UPSI has been defined to mean *"any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities*."[14]

The definition of UPSI has a wide ambit that aims to include within itself, all information that is related to the company. This also, interestingly, includes direct and indirect information that has the potential to materially affect the price of the securities. This view has been endorsed by the Securities and Exchange Board of India ("**SEBI**") several times. It has liberally taken the view that because of an existing financial relationship between subsidiaries and/or group companies, any information that is relayed between them can hold the power to be price sensitive. This threshold is subjected to the test of its likelihood of having a material effect on the price of the securities even if

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[13] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, reg 4 ("SEBI Regulations 2015").
[14] SEBI Regulations 2015 reg 2 (1) (n).

it indirectly relates to the company.

This is elucidated in In Re: Insider Trading in the Scrip of 63 Moons Technologies Limited,[15] where SEBI affirmed that UPSI is information that not only pertains to the company in question but also to a group company. The information in question was regarding a regulatory notice to the National Spot Exchange Limited ("**NSEL**"), a subsidiary of Financial Technologies (India) Limited ("**FTIL**").

It was argued that such UPSI was not material enough to sustain a charge of insider trading from a trade in the shares of FTIL. SEBI clarified that any kind of such information shall be subjected to the test of the likelihood of material effect on the price of the securities, even though it is not directly related to the company itself. The reasoning behind the same is that in spite of an indirect relationship, because of them being subsidiary-holding companies, any adverse impact on one will cause a similar impact on the other.

In fact, even in the matter of In Re: Insider Trading in the Scrip of Multi Commodity Exchange of India Limited,[16] SEBI clearly held that UPSI regarding a regulatory notice to NSEL can have an adverse impact on the trade of securities of the Multi Commodity Exchange of India Limited ("**MCX**"), another subsidiary of FTIL. SEBI stated that:

"MCX and NSEL were companies under the same holding company i.e. FTIL. Any adverse impact on the business and operations of NSEL was likely to have a contagion, cascading, and materially adverse impact directly

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[15] *In Re: Insider Trading in the Scrip of 63 Moons Technologies Limited,* WTM/MPB/EFD/129/2018.

[16] *In Re: Insider Trading in the Scrip of Multi Commodity Exchange of India Limited,* WTM/MPB/EFD/116/2018.

on the holding company (FTIL) and indirectly on the associate company (MCX).”[17]

It could further be argued that business decisions by, or events in respect of, a customer, supplier, or competitor of a company indirectly relate to such company and may have an effect on the price of the company's securities given the broad definition of UPSI under the Indian Insider Trading Regulations. Such commercial relationships and their effect on the price of a firm's securities have not yet been tested in the Indian context; instead, the Indian case law that has been developed so far has only dealt with circumstances where the pertinent information concerned a subsidiary or a group company.

In light of this, the Panuwat case serves as a timely reminder that a clear-cut definition of the scope of Indian insider trading regulations is still lacking, particularly with regard to the situations in which trading in securities of one company while in possession of information about another company may be regarded as a violation. According to the authors, the facts of a given instance could support an accusation of insider trading with the help of such information. In the meanwhile, Indian listed companies and other stakeholders and participants in the Indian securities market would be well served in tracking this development and taking it into consideration in documenting their insider trading policies.

A. Scienter (Intention)

In the USA, scienter refers to “a mental state embracing intent to deceive, manipulate, or defraud” which forms the very foundation of insider

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[17] Ibid para 21.

trading conviction.[18] In India, as per the recent interpretation given to the PIT Regulations, an insider's attempt to encash the benefit of the information is indispensable which is not exactly the same as mens rea.[19] Therefore, if a similar situation had arisen in India wherein the case was to be decided by SEBI, it would have been imperative for SEBI to prove Panuwat's profit motive. SEBI would have had to test whether the act of Panuwat was an attempt to take advantage of or encash the benefit of the information in his possession.[20]

In the USA, the prosecution needs to prove that the perpetrator acted with intent to deceive or to cause actual harm.[21] However, when the 'necessary result' of the actor's scheme is to injure others, fraudulent intent may be inferred from the scheme itself.[22] The Court, in the present case, noted uncertainty within the Ninth Circuit as to whether the scienter requires proving that the defendant used the material information to make the trade or if it is enough that the defendant that knowledge of such material information. The Court preferred the latter explanation that the defendant can merely be aware of the information. It was easier to prove nonetheless, since Panuwat traded Incyte's securities within a minute of learning the information, despite not having traded such securities before. These facts are thus sufficient to show *Panuwat's* mental intention—the fact that he acted knowingly or recklessly.

IV. EXTENSION OF INSIDER TRADING REGULATIONS TO SHADOW TRADING

[18] *Ernst & Ernst v Hochfelder* 425 U.S. 185, 194 n. 12 (1976).
[19] *Securities and Exchange Board of India v Abhijit Rajan* 2022 SCC OnLine SC 1241, para 42.
[20] ibid.
[21] *United States v Stavroulakis* 952 F.2d 686, 694 (2d Cir. 1992).
[22] *United States v D'Amato* 39 F.3d 1249, 1257 (2d Cir. 1994).

A. Whether SEBI (PIT) Regulations contemplate for Shadow Trading in India?

The fate of the first shadow trading case is still up in the air since the case is still pending final adjudication. While the matter is still sub judice in the United States, the current situation begs an important question in the Indian context i.e. "What is the applicability of shadow trading doctrine in India?". A corollary to this question would be – "whether SEBI (like SEC in the panuwat's case), under the extant legal framework, may be able to successfully bring similar claims in India?"

To assess the shadow trading doctrine's applicability in India, a complete understanding of the country's insider trading laws *i.e.* SEBI Prohibition of Insider Trading Regulations, 2015 is of vital importance. At the outset, while the PIT regulations define the word "Insider" and "Trading" under Sections (2)(1)(g) and 2(1)(l) respectively, it does not define insider trading.[23] The term "Insider Trading" finds a reference in a report submitted by a high-level committee constituted under the chairmanship of former chief justice N.K. Sodhi.[24]

The report defined insider trading as *"trading in securities with the advantage of having asymmetrical access to UPSI."*[25] Various jurisdictions have adopted different nomenclatures; however, it was noted in the N.K. Sodhi report that there is no difference[26] between the universally used word "material non-public information" and "unpublished price sensitive information"

[23] SEBI regulations 2015, reg 2(1)(g) and reg (2)(1)(l).
[24] Report of the high-level committee to review the SEBI (PIT) Regulations, 1992.
[25] ibid 5.
[26] ibid 24.

adopted by the SEBI Act in India.[27]

B. Examining *SEC v. Panuwat* from the lens of SEBI (PIT) regulations

The best approach to determine the applicability of shadow trading in India is to check if *SEC v. Panuwat* can happen in India. In this regard, at first blush, the definition of "UPSI" under Section 2(1)(n)[28] would reveal two things. First, the information must directly or indirectly "relate" to a company or its securities. Second, upon becoming generally available, the information should be "likely" to materially affect the price of the securities.[29] Now, the first hurdle might be that the information on acquisition did not really concern Incyte, but this could be regarded as an indirect relationship. This is because, according to the facts of Panuwat's case, just a few prospects remained in 2016, notably Medivation and Incyte, for large-cap companies willing to purchase mid-caps. This made it a highly concentrated market and thus each purchase was extremely crucial for the remaining possible targets since it increased their appeal.

Consequently, upon the information becoming publicly known, the price of securities should be likely to change. Each purchase, as previously noted, had a major influence on the other targets and raised their stock values. In fact, this is evidenced by a comparable announcement of the purchase of a different firm made in 2015 which significantly raised the stock prices of both Medivation and Incyte.[30]

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[27] SEBI Regulations 2015, reg 2(1)(n).
[28] SEBI Regulations 2015, reg 2(1)(n).
[29] cf Desmukh (n 12).
[30] *Complaint filed by SEC* <https://www.sec.gov/litigation/complaints/2021/comp-pr2021-155.pdf> accessed 17 September 2022.

C. All-embracing definition of Insider under PIT Regulations

With this backdrop, if it is answered in the affirmative that the information was UPSI for Incyte's scrips, the following question would be – whether Panuwat qualifies as an Insider for Incyte under Indian law?

As per the definition of "Insider" under Regulation 2(1)(g),[31] it is not a sine qua non for an insider to be a connected person. In fact, even mere possession of or access to UPSI will be sufficient to attract the definition of Insider. Therefore, in India, Panuwat can be readily regarded as an insider under rule 2(1)(g)(ii) since he had access to this information. As is obvious from the above paragraph, the definition of Insider is wider in India than in the USA since "mere possession" is sufficient to trigger the threshold. It does not require the intention of the parties to commit the contravention. However, historically, that has not been the case always. In fact, until such a motive was proved, a trade would not amount to a contravention of the 1992 regulations[32] (as originally enacted) and consequently would not trigger liability under the SEBI Act.

This only changed in 2002, when the SEBI amended the 1992 regulations to adopt the "possession" standard. Then onwards, mere possession of UPSI at the time of trading would trigger the contravention of the SEBI Act.[33] Ostensibly, this continued under the 2015 PIT regulations which ex-facie neither requires proof of use nor any motive to commit insider trading.[34] That said, an insider may of course escape the clutches of this contravention by proving his innocence, including by applying the defences

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[31] SEBI Regulations 2015, reg. 2 (1)(g).
[32] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 ("SEBI Regulations 1992").
[33] SEBI Act 1992.
[34] cf Patkar (n 2).

set out in Regulation 4.[35]

Therefore, based on the foregoing analysis, if SEBI chooses to adopt the SEC's practises, it may be successful in bringing comparable claims in India. In light of the foregoing, it can be said that the Indian regime contemplates the offence of shadow trading.

D. Can PFUTP regulations save shadow trading's bacon?

On the other hand, even if one were to argue that the extant framework for insider trading i.e., SEBI (Prohibition of Insider Trading) Regulations 2015[36] does not contemplate the inclusion of shadow trading doctrine, one other legislation might come to the rescue of this doctrine, i.e., the Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market 2003 ("**PFUTP**"). [37]

The aforementioned argument is solidified on a comparison of the offences of Front-running and Insider Trading. Front running is buying or selling securities ahead of a large order to benefit from the subsequent price move.[38] Although fundamentally distinct, front-running is similar to insider trading,[39] with the difference that the broker works for the client's brokerage rather than being an insider. However, despite noted similarities, front-running is prohibited under PFUTP regulations and not PIT Regulations since SEBI

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[35] SEBI Regulations 2015, reg 4.
[36] SEBI Regulations 2015.
[37] SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulation 2003 ("SEBI Regulation 2003").
[38] P Ramanatha Aiayr, *Major Law Lexicon* (4th edn, LexisNexis 2010).
[39] Khyati G, 'What is Front Running – A Q&A Piece in light of the SEBI Order against dealers of Reliance Securities Ltd' (*CAM Corporate Law Blog*, 10 September 2020) <https://corporate.cyrilamarchandblogs.com/2020/09/what-is-front-running-a-qa-piece-in-light-of-the-sebi-order-against-dealers-of-reliance-securities-ltd/> accessed 18 August 2022.

recognises[40] it as an undesirable manipulative practice punishable under regulation 4(2)(q) of PFUTP.[41]

Likewise, even shadow trading could come within the clutches of PFUTP regulations considering that the prohibition against deceptive practices is broad. In fact, the United States' handling of insider trading, which renders a person liable under both the "classical theory" and the "misappropriation theory," lends weight to this viewpoint.[42]

The classical theory of insider trading is where a corporate insider—i.e., an employee, director, or officer—commits securities fraud by trading in securities of their own company on the basis of MNPI. Whereas, the misappropriation theory goes a step further in extending liability to those who are not insiders at the company (outsiders) and forbids them from engaging in trading based on information which was obtained by them in breach of a duty owed to the source of the information.[43]

Therefore, if India decides to subscribe to the misappropriation theory of the USA i.e., consider such offences in violation of anti-fraud provisions, it may still be able to bring claims under PFUTP regulations. Without prejudice to the foregoing analysis, the nitty-gritty of the problem has to be worked out by the judiciary as and when such questions of interpretation surface in India. However, the possibility of shadow trading coming under the pigeonhole of

[40] Securities & Exchange Board of India, *Consultative Paper dated 16 March, 1995* (reference no PR 34/95).
[41] SEBI Regulation 2003, reg 4.
[42] Troy Cichos, 'The Misappropriation Theory of Insider Trading: Its Past, Present, and Future' (1995) 18 Seattle Univ. Law Rev 390.
[43] Era Anagnosti, 'SEC Extends the Misappropriation Theory of Insider Trading Beyond Targets of Acquisitions to Companies "Economically Linked" to Such Targets' (*White & Case*, 02 October 2022) <https://www.whitecase.com/insight-alert/sec-extends-misappropriation-theory-insider-trading-beyond-targets-acquisitions> accessed 09 September 2022.

PFUTP regulations cannot be completely ruled out.

V. CHALLENGES OF A SHADOW TRADING REGIME

A. Is the expansion of the insider trading law desirable in India?

SEBI's orders in the context of insider trading have always followed the classical theory of insider trading. Meaning, the PIT Regulations define insider trading as trading in securities with the advantage of having asymmetrical access to UPSI.[44] This is unlike the USA where there needs to be first, an established fiduciary duty between the insider and the corporation. Thus, in India, it is easier to include a variety of instances under the provisions. The question then arises as to whether SEBI must tread on the sensitive path and follow the SEC which will enable SEBI to successfully bring claims of shadow trading in India. Is such a path desirable?

Insider trading laws exist to restrict trade in the market for people who have an unfair advantage. However, this inside information, because it cannot be used to trade in the securities of that company, forces the people to use it to the next best use, i.e., trade of securities in the peer stocks.[45] However, such an encouragement, in our opinion, still constitutes an unfair advantage. A shadow trader also has an edge over the other market participants by virtue of him being privy to information that is exclusively accessible to him.

Thus, SEBI is to examine the extent to which it can outlaw shadow trading: a complete restriction on shadow trading by virtue of the insider's

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[44] Securities & Exchange Board of India, *Report of the High-Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992* (2013).

[45] Prachi Deuskar, Aditi Khatri and Jayanthi Sunder, 'Insider Trading Restrictions and Informed Trading in Peer Stocks' [2022] <http://dx.doi.org/10.2139/ssrn.4210203> accessed 29 September 2022.

exploitation of UPSI or just to prevent the insider from making a sound investment decision based on his asymmetrical information. Although we agree with SEBI that a charge of insider trading is one of the most serious charges in the realm of securities law,[46] a balance needs to be meted out to ensure that the scope of such a charge is not so wide that becomes a tool for harassment of the market participants. A mere 8% rise in stocks of Incyte has caused Panuwat to lose his entire career.

This concern is especially in light of the context that the securities market in India is extremely undeveloped[47] with only a handful of participants who regularly have access to the market. With the preamble of the SEBI Act[48] ensuring that the market is developed while maintaining its integrity, SEBI needs to introduce policies that do not impede market access to the public. Additionally, bringing the stocks of competitor firms within the ambit of the insider trading policy of firms is a very difficult task.

First, Indian firms will have to "alter their insider trading policies." Stock Substitutes can be identified as: "a firm's competitors, suppliers, customers, or manufacturers of complementary products."[49] However, identifying a particular set of companies that serve as stock substitutes is neither possible nor is it desirable. On this count, shadow trading does seem to obstruct the integrity of the securities market in India, the authors

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[46] *Order against Shri Dilip S. Pendse, In The Matter Of Insider Trading In The Shares Of M/S Tata Finance Ltd*, SEBI (29 December 2006).

[47] GN Bajpai, 'Development of the Securities Market in India' in Jahangir Aziz, Steven Dunaway and Eswar Prasad (eds), *China and India: Learning from Each Other - Reforms and Policies for Sustained Growth* (International Monetary Fund 2006) <https://www.elibrary.imf.org/downloadpdf/book/9781589065192/ch004.pdf> accessed 29 September 2022.

[48] SEBI Act 1992, preamble.

[49] Ian Ayres and Joseph Bankman, *Substitutes for Insider Trading* [2001] <http://dx.doi.org/10.2139/ssrn.265408> accessed 29 September 2022.

are of the opinion it may not be desirable to introduce it in India.

B. Falling under the scope of 'trade analyst'

> Trade analysts are the drivers of market efficiency. It was the SEC itself who noted that: "the value to the entire market of analysts' efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by their initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.[50]

However, implementing the shadow trading theory by SEC will have a direct effect on the professional analysts who advise their clients to trade as well as traders who pose as analysts. Their careers will be at substantial risk. In the Panuwat case, the UPSI that he had access to was not used to trade in the stocks of Medivation or the company that was to acquire Medivation. In fact, he used it to trade in the securities of another peer company in a highly concentrated market. In this context, he acted as an analyst.

As a senior director of the corporation, he based his choices on his personal experience and knowledge. He gained expertise in the "biopharmaceutical industry" as a result of his experience, which he then used to his own advantage. He kept a close eye on the stock prices, pharmaceutical offerings, and product development plans of other biopharmaceutical firms, including Incyte. He was not a Medivation executive; instead, he worked as a trader.

C. Trading in a highly focused market

People who work in a certain industry frequently choose to invest in other businesses in that same industry. They regularly monitor and attempt to

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[50] *Dirks v SEC* [1983]463 U.S. 646, 658.

understand their sector. When investing in a business in a sector where the investor has prior experience, they should bear in mind the "invest in what you know" maxim. However, employees of such public companies may frequently be privy to proprietary information about their own industry. Additionally, when information regarding one firm in an industry becomes public, the stock values of other companies in the same industry are quickly impacted.

Similarly, investment professionals like advisers and analysts concentrate on specific industries. These specialists may learn important information about a certain business in an industry while they conduct their research, which may include speaking with company officials in interviews. A savvy investment professional won't trade a business's shares until the information is made public if such insider information about the company might be regarded as UPSI.

The investment expert, who concentrates on the industry as a whole, will nonetheless be aware of such information when forming overall industry opinions, giving advice to customers and others investing in related companies, and possibly even when making personal trades in related companies. Thus, information about a company will have a direct impact on the trading activities of a similar company, which in itself makes it difficult for regulators to create a boundary that will define what information becomes inside information.

D. Challenges with Compliances

As aforementioned, enforcement of shadow trading actions will result in companies needing to redefine and expand their insider trading policies and training programs. It will be difficult to convey this clearly and ensure that all staff grasps it. And for many businesses, accomplishing this may take years.

Employees who are trading in the interim but are uninformed of the new idea will be in danger.[51] Employee restrictions, whether they involve asymmetrical information or not, become problematic from a legal standpoint because the counsels cannot support them.

VI. POLICY RECOMMENDATIONS

All in all, the jurisprudence on shadow trading in India is almost non-existent, and the following points shall help address the issues raised in the previous sections as and when India decides to incorporate this doctrine in its jurisprudence.

A. Defining stock substitutes or economically linked companies

As mentioned earlier, shadow trading refers to the practice in which insiders use UPSI to facilitate trading in economically-linked entities to avoid insider trading laws.[52] A cursory look at the existing definition (given by academics) of this doctrine would reveal that the wording “economically linked entities” has ambiguity attached to it.

In the sense that it might be challenging to define what counts as an economically related firm stock and what does not. To contextualize, it cannot be said that all other companies will be off limits for investment to those with possible UPSI about the first company.[53] A line has to be drawn somewhere, which makes defining shadow trading all the more difficult task.

The issue that arises on the enforcement of the Panuwat claim is what

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[51] Stephen Crimmins, ‘Shadow Trading Becomes Insider Trading’ (*CLS Blue Sky Blog*, 28 March 2022) <https://clsbluesky.law.columbia.edu/2022/03/28/shadow-trading-becomes-insider-trading/#_ftn18> accessed 29 September 2022.

[52] cf Mehta, Reeb and Zhao (n 7) 27.

[53] cf Crimmins (n 52).

constitutes a 'relevant market' to bring claims for shadow trading. SEBI, in order to pursue claims under this doctrine also needs to define the scope and boundary of what constitutes a relevant market for the purposes of insider trading. Will it be different for large markets with a number of competitors? Or will it encompass the entire market in the case of a highly concentrated industry such as the biopharmaceutical one in the present case. There is no readily available jurisdiction for the present case in India.

Thus, if at all India decides to accord recognition to this doctrine, it will be imperative to have a definition of "economically linked entities" or "stock substitutes". While pinning down a workable solution to this knackering problem, a similar standard adopted by the Competition Act 2002[54] might come in handy. Under the Competition Act, while assessing the "abuse of dominance" offence, the relevant market as defined under Section 2(r)[55] is delineated by the regulator. It is categorized into two limited domains, namely relevant product market and relevant geographic market by the Competition Commission of India ("**CCI**"). To give a definite answer, one needs to look at the factors to be considered to determine what will be a relevant market.

As per section 19(6) of the Competition Act, the factors enlisted for the relevant geographic market for CCI's consideration are many[56] such as regulations that govern trade barriers, national policies, consumer preferences, linguistics, local requirements, etc. Similarly, as per section 19(7) of the Competition Act, the factors enlisted for the relevant product market for CCI's consideration are many such as the physical characteristics of the goods,

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[54] The Competition Act, 2002 (Act 12 of 2003) ("Competition Act 2002").
[55] Competition Act 2002, s 2(r)
[56] *M/s Saint Gobain Glass India Ltd. v M/s Gujrat Gas Company Limited,* CCI No. 20 of 2013.

special producers, classification of these products under law, etc.

The CCI, and consequently SEBI, needs to determine the relevant market in its sphere so as to define the boundary of what constitutes insider trading and whether in India, shadow trading can fall under the same domain. This will introduce a restraint and imposes costs so as to discourage traders with asymmetrical information to promote unfair competition in the market. However, the end result of the competition law us restrain unfair abuse of dominant position in the relevant market and damage the healthy competition in it.

In doing so, the impact on entities falling in the defined relevant market is assessed. If consumers consider two goods to be close substitutes, those two goods are considered to be in the same relevant market. Drawing parallels, a similar standard can be adopted by the securities regulator of India to determine the stock substitutes of a company while assessing the offence of shadow trading. This too can be based on the factors like – prices of stocks, characteristics of the products and services (provided by the company), consumer perception as to the interchangeability, etc.

B. Amendment to Regulation 2 of the PIT Regulations

Till now, the doctrine has been defined only in academic work and addressed in a handful of cases, some of which are still sub judice. However, the offence is yet to find its legislative recognition. This can be remedied by including a definition to this account in Regulation 2. While shadow trading is arguably an extension of insider trading, it might still be advantageous to define it separately in the regulations. Additionally, the authors also suggest that "Insider Trading" shall also be defined in the regulations since the extant

regulations define "insider" and "trading" separately under regulations 2(1)(g)[57] and 2(1)(l)[58] respectively.

VII. CONCLUDING REMARKS

With the advent of shadow trading in *SEC v. Panuwat*,[59] it is demonstrated that the boundaries of Insider trading regulations are not clearly drawn particularly with regard to the situations in which trading in securities of one company while in possession of information about another company may be regarded as a violation.

While this concept's expansion to information about subsidiaries or group companies was manifested by 63 Moons[60] and MCX Case,[61] it is unclear if and under what conditions this principle will also apply to information about any economically-linked companies. However, based on the foregoing analysis, the authors opine that the insider trading regime of India does, in fact, contemplate such an offence.

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[57] SEBI Regulations 2015, reg 2(1)(g).
[58] SEBI Regulations 2015, reg 2(1)(l).
[59] *Securities and Exchange Commission vs. Matthew Panuwat* - <https://www.sec.gov/litigation/litreleases/2021/lr25170.htm> accessed 16 September 2022.
[60] *In Re: Insider Trading in the Scrip of 63 Moons Technologies Limited,* WTM/MPB/EFD/129/2018.
[61] *In Re: Insider Trading in the Scrip of Multi Commodity Exchange of India Limited,* WTM/MPB/EFD/116/2018.

V. COMBATTING INSIDER TRADING IN INDIA: DETERMINING EXISTING LOOPHOLES AND EFFECTIVE DETERRENTS

- Rini Kothari*

ABSTRACT

Despite severe consequences capable of causing reputational damage, and the existence of stringent laws and regulations specifically designed to curb insider trading, the violations and leakage of unpublished price-sensitive information have become more common. The cases being probed by the Securities and Exchange Board of India have rapidly increased from 10 to 20 percent during Financial Year (FY) 2003-18, to over 30 percent during FY 2019-21. Yet, the rate of conviction in these cases remains significantly low. This implies that flaws and gaps persist which impede the effectiveness of the laws prohibiting insider trading. There are several layers involved in regulating the cases of insider trading, *viz*., legislation, investigation, prosecution, and conviction. This paper delves deeper into the concept with the main aim to determine the stage at which the loopholes largely persist structurally within the regulatory regime and the issues which plague that specific layer in India. The paper also attempts to ascertain effective deterrents for combatting insider trading in the context of India. Further, since research indicates that developed countries have a better record of prosecution than emerging markets, this paper seeks to examine the laws and experiences of one of such developed countries, the United States of America, known to have the most robust and vigorous regulations and prosecution of insider trading cases globally, and determine whether the practices followed in the U.S. are suitable for the regulatory/enforcement culture in India. Some of the findings of this paper reveal that SEBI lacks sufficient investigative tools and mechanisms to effectively prosecute an insider trading case. The loophole majorly persists at the investigation and conviction level. Research shows that even the laws in the U.S. face criticism for being ambiguous in nature, particularly regarding the definition of insider trading. However, the main reason behind the effective regulation of insider trading in the U.S. is the fact that the Securities Exchange Commission in the U.S. has powerful investigative tools, and the U.S. leverages technology to effectively investigate the cases, and imposes strict penalties on the convicts of insider trading. Moreover, research suggests that in order to effectively deter insider trading, allocating adequate resources towards this effort is just as essential as enacting and formulating relevant laws and regulations. SEBI requires access to advanced technological tools to enhance its ability to detect instances of insider trading at a nascent stage. Further, to ensure the highest level of protection against insider

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trading, it is imperative to adopt precautionary measures like safeguarding material non-public information and implementing strong corporate controls and compliance policies. Imposing strict penalties on the convicts and longer incarcerations are also some of the measures that have aided the U.S. and the U.K. in reducing the incidences of insider trading cases.

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I. INTRODUCTION

In India, Insider Trading is defined as, “Trading of shares by an ‘insider’ based on unpublished price sensitive information (“**UPSI”).**[1] When the trading is based on such non-public, material information, it is considered illegal. However, trading based on publicly available information is considered legal.[2] Insider trading is a serious issue as it disrupts businesses and contaminates the whole stock market. Thus, it is imperative to have robust laws which eliminate this vice from its roots.[3] Insider trading not only undermines the integrity and fairness of the stock markets but also poses a problem for the international financial markets. Almost every country prohibits insider trading to promote investor confidence, and market efficiency

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[1] Maulik Madhu, ‘All you wanted to know about insider trading’ *The Hindu Business Line* (7 June 2021) <https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about/article34755136.ece> accessed 2 February 2022.

[2] James H. Thompson, ‘A Global Comparison of Insider Trading Regulations’ [2013] IJAFR <https://www.macrothink.org/journal/index.php/ijafr/article/viewFile/3269/2976> accessed 7 May 2022.

[3] Mahendra Tiwari and Deepshikha Sharma, ‘Brewing Insider Trading Provision in India with E-Governance’ [2021] EEO 6795 <http://ilkogretim-online.org/fulltext/218-1620490515.pdf?1643663745> accessed 2 February 2022.

and enhance the integrity of the financial markets.[4] In India, Section 12A(d) of the Securities and Exchange Board of India Act, 1992 prohibits insider trading.[5] While the common perception is that insider trading is inefficient (bad) for some firms, it is also contended by some law and economics scholars that it might be efficient (good) for some firms, thus firms must be free to regulate their insider trading privately through contracts on a case-to-case basis, as opposed to regulating all corporations under a common umbrella of one single statute.[6] Professor Henry Manne initiated the discourse on the efficiency inquiry of insider trading by arguing in his thesis that contrary to the prevailing legal and moral opinion at the time, insider trading is desirable because it is economically efficient.[7] The former claim regarding inefficiency pertaining to insider trading is a more common one as insider trading is generally believed to disrupt businesses, ruining their reputation and eventually leading them to losses. The latter claim regarding the possibility of insider trading resulting in more efficiency for some firms is a rare one. The reason why some law and economics scholars believe this is because they believe that in certain cases, insider trading might be beneficial for both, the company and the investors/shareholders, as insider trading may motivate entrepreneurial innovation and enhance the efficiency within a firm. According to its proponents, the entrepreneurs would be rewarded in direct

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[4] Liu Duan, 'The Ongoing Battle against Insider Trading: A Comparison of Chinese and U.S. Law and Comments on How China Should Improve Its Insider Trading Law Enforcement Regime' [2009] DB LJ 129 <https://heinonline.org/HOL/LandingPage?handle=hein.journals/duqbuslr12&div=10&id=&page=> accessed 2 February 2022.

[5] Securities and Exchange Board of India Act, 1992, Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.

[6] Laura N. Benny, 'Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate' [2007] J. Corp. L. 32 <https://repository.law.umich.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1053&context=articles> accessed 8 May 2022.

[7] ibid.

proportion to their innovations. In simpler terms, efficiency implications propounded by Prof. Manne in his thesis are that an insider, through a piece of non-public information, can profit by buying the Company's shares before the public learns about the innovation, this in turn has the potential to lead to a rise in the Company's value and the insider can make profits by sharing the shares at a higher price after the information is available. If the insider is wealth-constrained and is not capable of buying unlimited shares, they can also make profits out of selling the information itself.[8]

Earlier, insider trading was considered a concern peculiar to the United States.[9] The U.S. was the first country to have ever discussed the insider trading phenomenon in the case of *Strong v. Repide,*[10] In 1909. In this case, the Supreme Court laid down that a company director had the power to influence the value of shares of his company, thus keeping his expected plans and actions a secret from the public, and buying or selling his shares based on material information would be deceitful and fraudulent. This case lead to the foundation for insider trading laws in the U.S., however, the statutory regulations came into place only decades later with the introduction of the Securities Act, 1933. For the longest time, the U.S. had the most robust and vigorous regulations and prosecution of insider trading cases of any country. Even though in the U.S. the opinions on insider trading vary, the members of Congress, and the courts, time and again justified restriction on insider trading, claiming that it defends the notion of fairness, curtails the integrity of capital markets, and breaks the confidence of the public in the system.[11] In this paper,

[8] ibid.
[9] Harvey L. Pitt, 'Games without Frontiers: Trends in the International Response to Insider Trading', [1992] 55 L & Contemporary Problems 199 <https://doi.org/10.2307/1192109> accessed 8 May 2022.
[10] 213, U.S. 419 (1909).
[11] Pitt (n 9).

comparisons and contrasts are being drawn between the insider trading laws in the U.S. and India, inter alia because, (a) U.S. is one of the largest democracies in the world after India, (b) U.S. was the first country to introduce insider trading laws, it has the most comprehensive and effective insider trading laws,[12] and the stiffest penalties in the world,[13] (c) these laws in the U.S. have constantly evolved and developed constantly since their introduction,[14] (d) plethora of scholarly work demonstrates that developed countries have a better record of tackling insider trading cases than developing countries,[15] (e) India and the U.S., are both common law countries and the system of law in both countries largely depends on court precedent in formal adjudications, (f) Insider trading laws in the U.S. are widely considered the strongest 'best practice' and other countries have been significantly influenced by its laws on the subject, (g) the Division of Enforcement 2020 Annual Report revealed that the Securities Exchange Commission (**"SEC"**) in the U.S. has been highly successful in detecting and punishing people involved in Insider Trading.[16]

This paper is divided into three parts. The overarching questions that this paper attempts to answer are:

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[12] Nishith M. Desai and Krishna A. Allavaru, 'Insider Trading: A comparative study' Nishith Desai Associates Opinion paper, Pg. 8 [1997] <http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Associates_Insider_Trading_-_A_Comparative_Study.pdf> accessed 29 June 2022.
[13] U.S. Securities and Exchange Commission, Press Release <https://www.sec.gov/news/pressreleases> accessed 29 June 2022.
[14] Pitt (n 9).
[15] Utpal Bhattacharya and Hazem Daouk, 'The world price of insider trading' [2002] TJF 75 <http://www.jstor.org/stable/2697834> accessed 2 February 2022.
[16] U.S. Securities and Exchange Commission, *Division of Enforcement Annual Report* (2020), Pg. 14 accessed 30 June 2022.

- Whether the present insider trading regulations, i.e., the Securities and Exchange Board of India Act, 1992, and the rules and regulations made thereunder, effectively combatting insider trading in India?
- Since several layers are involved in regulating the cases of insider trading, *viz*., legislation, investigation, prosecution, and conviction, at which stage do loopholes largely persist structurally within the regulatory regime and the issues which plague that specific layer thereby hindering the effective regulation of insider trading in India?
- How can insider trading be combatted in India?

The first part is titled 'Insider Trading in the U.S'. This part sheds light on the history of insider trading in the U.S. and analyzes how the prosecution of insider trading cases has evolved since the introduction of insider trading regulations. This part also discusses the multi-faceted theories of insider trading recognized in the U.S., *viz*, classical theory, the misappropriation theory, and the parity of information theory.The second part titled 'Insider Trading in India: History & Evolution' discusses the contributions made by various committees in the insider trading laws in India.

The third part titled 'Combatting Insider Trading: Effective Deterrents' seeks to determine the existing loopholes in the current insider trading regime and examine the applicability and suitability of incorporating the practices followed in the U.S. in the Indian context, thereby also highlighting the criticisms attached to the laws in the U.S. It is acknowledged that rarely any legal system is perfect, and there may be certain loopholes in the laws in the U.S. as well, however, lessons from the U.S. may still present a better way forward in dealing with the insider trading cases in India. Further, the paper

concludes by providing a general summary and reiterating the findings of the paper.

II. INSIDER TRADING IN THE U.S.

A. Tracing The History

In 1909, the U. S. was the first country to have ever discussed the insider trading phenomenon in the case of *Strong v. Repide*.[17] The Supreme Court of the United States, in the aforementioned case laid down that a company director had the power to influence the value of shares of his company, thus keeping his expected plans and actions a secret from the public, and buying or selling his shares based on the knowledge and awareness regarding material information would be deceitful and fraudulent. The Supreme Court established 'the insider rule' which barred the director of a company from trading if he knew any material non-public information, or mandated them to disclose it to the public before trading upon such information. However, this case did not lay down the definition of who an 'insider' was or what constituted 'insider trading'.[18] Though this case lead to the foundation for the recognition of insider trading cases, the statutory regulations came into place decades later with the introduction of the Securities Act, 1933, and the Securities Exchange Act, 1934.[19] The Securities Act covers issues about securities, while the Securities Exchange Act particularly aims at protecting stocks. Sections 16(b) and 10(b) of the Securities Exchange Act outlaw unlawful trading practices and explain using various rules of the U.S. SEC, the meaning of fraudulent trades, and by whom

[17] 213, U.S. 419 (1909).
[18] Bhattacharya (n 15).
[19] Pitt (n 9).

they can be perpetrated. The 1934 act also denotes when a trade is considered unlawful.[20]

In *SEC v. Texas Gulf Sulphur Company,* the United States Court of Appeals for the Second Circuit held that if any person has non-public information about stocks or securities of a firm, he has a duty to either disclose the same to the firm, its stockholders, and the public so they can benefit from it as well or not trade based on the undisclosed information at all.[21] In *United States v. Newman,* the court for the first time made it illegal for a nonrelated/an outsider party to engage in trades based on non-public information. Although the person, in this case, was not held liable for engaging in insider trading as he did not benefit from the transaction, it was further clarified that engaging in trading based on non-public information even by an outsider is illegal.[22]

B. Theories of Insider Trading in the U.S.

1. The Classical Theory

The U.S. recognizes the 'classical theory' of insider trading which stipulates that "a finding of liability is based in fraud" and thus, an insider is required to follow the "abstain or disclose rule", wherein, an insider who trades without prior disclosure is in breach of fiduciary duty to their companies. This rule was laid down in the case of *Cady, Roberts & Co*.[23] The Supreme Court interpreted Section 10(b) of the Securities Exchange Act of 1934 and stated that if an insider does not disclose the insider information and all material available to him, he must abstain from trading. Thereby, indicating that not only trading upon such information is offensive but also the omission

[20] The Securities Act, 1933; the Securities Exchange Act, 1934.
[21] 2 A.L.R. Fed. 190.
[22] 773 F.3d 438 (2014).
[23] 40 S.E.C. 907 (1961).

of disclosure. The court recognized that since the insiders act on behalf of the corporation and have the information simply by the virtue of their relationship with the company, allowing them to take advantage of such a relationship would be unfair in the case of non-disclosure. Chief Justice Burger, in his dissenting opinion, went a step further to state that the language of Section 10(b) and Rule 10b-5 recognized "any person engaged in any fraudulent scheme" as an insider, thereby extending the ambit of insider trading out of the "corporate insiders" dealing just with "corporate information". Consequently, it also means to impose an absolute duty to disclose or abstain from trading using such misappropriated undisclosed information.[24]

In the case of *Dirks v. SEC*, the Supreme Court clarified that merely because an insider receives material, non-public information, a duty cannot be imposed on him to disclose or abstain. It further clarified that a fiduciary duty is breached when the non-public information has been disclosed by the shareholder to the tippee in breach of his fiduciary duty and the tippee is aware of such breach. Moreover, the 'purpose of disclosure' was also emphasized to be of importance in such cases, as the purpose must be to make a direct or indirect personal gain through such breach.[25]

2. The Misappropriation Theory

This theory treats UPSI as a property, or commodity owned by a corporation.[26] Thus, any unauthorized use of such information is considered to be a theft of intellectual property. In the case of *Carpenter v. United States*, the Supreme Court recognized that the petitioner intended to take the UPSI

[24] Prateek Bhattacharya, 'India's Insider Trading Regime: How Connected Are You?' (2019) 16 NYU JL & Bus1.
[25] 463 U.S. 646 (1983).
[26] Bhattacharya (n 24).

which was recognized to have property rights, to make profits/personal gains.[27] Further, in the case of *United States v. O'Hagan*, the Supreme Court held a lawyer accountable for insider trading when he breached his fiduciary duty by misappropriating information from the law firm he worked at, thereby, deceiving the ones who entrusted him with access to such UPSI.[28] The Court also highlighted that this theory applies in situations wherein information is misappropriated through manipulation and deception.[29]

3. *The Parity of Information Theory*

This theory stipulates trading on UPSI irrespective of how an investor received access to such information, thus, any kind of trading based on UPSI would be illegal under this theory.[30]

III. INSIDER TRADING IN INDIA: HISTORY AND EVOLUTION

A. Contributions of Various Committees in Developing Statutes

1. *P.J. Thomas Committee*

In India, for the first time in 1948, the P.J. Thomas Committee was constituted to restrict insider trading. The committee was required to assess and recommend suitable actions which would help in curbing the cases of insider trading. This committee made suggestions related to disclosure obligations and restrictions that must be imposed upon stock market traders who made "short-swing profits".[31] The recommendations of this committee

[27] 484 U.S. 19, 22 (1987).
[28] 'Insider Trading', *Legal Information Institute*, Cornell Law School <https://www.law.cornell.edu/wex/insider_trading> accessed 30 June 2022.
[29] U.S. 642 (1997).
[30] Bhattacharya (n 24).
[31] ibid.

were incorporated in Sections 307 and 308 of the erstwhile Companies Act, 1956. The recommendations required mandatory disclosures by the managers and directors of the company. However, even though the committee was successful in establishing the need for regulation of insider trading in India, it was not so successful in preventing illegal insider trading.[32]

2. Sachar Committee and Patel Committee

In 1978 and 1986, the Sachar Committee and Patel Committee, respectively, reviewed the shortcomings of the insider trading laws in India and suggested measures to prevent insider trading as well as recommended enacting a statute specifically to regulate insider trading. The Patel Committee laid down the definition of Insider Trading as, "*Trading in the shares of a company by the person who is in the management of the company or is close to them based on undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others*".[33]

Later in 1992, upon the recommendation of the aforesaid committees, the Securities and Exchange Board of India (SEBI) (Prohibition of Insider Trading) Regulations, 1992 were enacted under section 30 of the SEBI Act, 1992. However, loopholes persisted even in this legislation, which was subsequently amended through the 2002 amendments. Ever since, the laws have been amended twice, the latest one being amended in April 2019.[34]

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[32]ibid.
[33] Sonakshi Das, 'The Know-all of Trading - Decades of Corruptive Prevention', (2015) academike <https://www.lawctopus.com/academike/know-insider-trading-decades-corruptive-prevention/> accessed 8 May 2022; *Insider Trading Regulations – A Primer*, *Report by Nishith Desai Associates*, <http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Insider_Trading_Regulations_-_A_Primer.pdf> accessed on 8 May 2022.
[34] Bhattacharya (n 24).

Insider trading is governed by the SEBI Act of 1992 read with the regulations thereunder.

3. N.K. Sodhi Committee

Over the years, since the inception of the SEBI (Prohibition of Insider Trading) Regulations, 1992, the laws have evolved and the onus on companies has now increased to protect price-sensitive information.[35] In 2015, the recommendation of Justice N.K. Sodhi's committee was adopted which proposed that the model code of conduct should be principle-based rather than rule-based, as it would help better prevent leakage of price-sensitive information. The concept of trading plans was also introduced at this time, which mandated the insiders to announce their plans of buying or selling well in advance. In 2017, the T.K. Vishwanathan Panel Report recommended that organizations introduce policies and procedures to enquire whenever material information gets leaked. It also prohibited communication and access to UPSI. However, it permitted communication that was done for any legitimate purpose as a part of due diligence.[36] Following this, certain amendments were incorporated ("**2019 Amendments**"), and the 2015 PIT Regulations were revised and made effective from April 2019.

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[35] Palak Shah, 'Price Rigging Down, Insider Trading Up' *Business Line* (Mumbai, 15 February 2021) <https://www.thehindubusinessline.com/markets/stock-markets/price-rigging-down-insider-trading-up/article33836372.ece> accessed 8 May 2022.

[36] Jayshree P. Upadhyay, 'How India Cracks Down on Insider Trading' *Mint* (Mumbai, 28 January, 2020) <https://www.livemint.com/market/stock-market-news/how-india-cracks-down-on-insider-trading-11580199120367.html> accessed 8 May 2022.

IV. Combatting Insider Trading

A. Determining Existing Loopholes

Despite having proper regulatory frameworks for insider trading, the cases of insider trading have been consistently rising and were highest in the last financial year. An article in the Mint highlighted that in the last three decades of SEBI's existence, there has not been a single conviction in an insider trading case.[37] Even when in the financial year 2018-19 and 2019-20, SEBI detected a total of 119 insider trading cases, a number significantly higher than those detected by SEBI in any of the previous years.[38] This indicates that the detection rate in insider trading cases is still low in India. The lack of proper surveillance tools is one of the major reasons why SEBI has failed in connecting the dots, establishing links, and collecting evidence to unravel a complete case.[39]

As per SEBI's 2019-20 Annual Report, it investigated 85 cases and could complete only 25 by 2021.[40] Upon examining the proceedings, the reason which was traced was that the majority of these cases involved a lack of disclosure and trading on alleged insider information. Neither the link of the communication could be established, nor who benefitted from the information could be traced. Even in the financial years between 2011 to 2017, SEBI had only completed probes in about 10-30 cases each year.[41] Further, the Handbook of Statistics released by SEBI indicated that 57 cases were completed in the year 2019-2020, but there were no convictions in any of the

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[37] ibid.

[38] Securities and Exchange Board of India, *Annual Report: 2020-21*, <https://www.sebi.gov.in/reports-and-statistics/publications/aug-2021/annual-report-2020-21_51610.html> accessed on 28 June 2022.

[39] Upadhyay (n 36).

[40] Securities and Exchange Board of India, Annual Report: 202-21.

[41] ibid.

cases until 2017, and there is no data on the convictions of the following years until 2022.[42]

As per the Mint article, the biggest reason behind the low prosecution rate in insider trading cases in India is the fact that SEBI is not empowered with the basic investigative powers and tools to detect insider trading at an earlier stage.[43] SEBI was only granted the authority to access phone call records in 2014, and to this day, it does not possess such powers. In order to effectively convict those involved in insider trading, SEBI introduced an Informant Mechanism – as per this mechanism, anyone who assisted in leading a case of insider trading towards conviction would be rewarded with a hefty ₹1 crore rupees. This was introduced with the aim to benefit the regulator, company, shareholder as well as informant as they would be making monetary gains.[44] However, there is no data so far on how helpful this incentive has been.

A Business Standard's report revealed that Vaneesa Agrawal, founder of a law firm, and former SEBI official, said, "There is a limitation on the number of investigations that can be undertaken with limited resources". It was also emphasized that when the authorities are also responsible for investigating cases of violations other than insider trading, the probes of insider trading are affected adversely. [45]

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[42] Table 80, Table 81 and Table 82, Handbook of Statistics 2020, Securities and Exchange Board of India <https://www.sebi.gov.in/reports-and-statistics/publications/may-2021/handbook-of-statistics-2020_50238.html> accessed on 30 June 2022.

[43] Upadhyay (n 36).

[44] Jayshree P. Upadhyay, 'How India Cracks Down on Insider Trading' *Mint* (Mumbai, 28 January, 2020) <https://www.livemint.com/market/stock-market-news/how-india-cracks-down-on-insider-trading-11580199120367.html> accessed 8 May 2022.

[45] Sachin P. Mampatta, 'Market Regulator SEBI Turns its Glare on Insider Trading, Shows Data' *Business Standard* (Mumbai, 26 January 2022) <https://www.business-standard.com/article/markets/markets-regulator-sebi-turns-its-glare-on-insider-trading-shows-data-122012600067_1.html> accessed 8 May 2022.

SEBI has limited access to a technology-driven investigative process unlike the SEC, SEBI still cannot wiretap phone calls, which has been instrumental for SEC in prosecuting insider trading cases. This inevitably makes obtaining information more difficult. Furthermore, sharing information that may have personal details or communications via WhatsApp, would also be against the right to privacy envisaged in the constitution of India as a fundamental right, and also raise concerns regarding data privacy.[46]

Historically, SEBI has handled cases with extreme softness. Under Section 15G of the SEBI Act, 1992, it has the power to impose a penalty that can range up to INR 25 crores or three times the profit that is made through insider trading, whichever is higher. However, the maximum penalty SEBI has imposed till date is INR 5.5 crores in the case of Shelter Infra Projects Limited.[47] Moreover, there is also a major human resource crunch in the SEBI. The nature of insider trading investigations is time-intensive and the lack of technological resources makes it an even more cumbersome process to prosecute the cases in a timely and effective manner.[48]

B. Lessons from the U.S.: Determining Effective Deterrents

One of the biggest lessons to learn from the U.S. is that to curb insider trading, resources devoted to enforcement might be just as important as the enactment and formulation of the statutes, regulations, and legal prohibition. The mere enactment of a law does only so much to gain investor confidence in both domestic and international parlance and sometimes the impact is even

[46] Bhattacharya (n 24).

[47] Press Trust of India, 'SEBI imposes Rs. 5.5 Cr. Penalty in Shelter Infra Projects case' *Business Standard* (Mumbai, 7 March 2014) <https://www.business-standard.com/article/companies/sebi-imposes-rs-5-5-cr-penalty-in-shelter-infra-projects-case-114030700877_1.html> accessed 30 June 2022.

[48] Bhattacharya (n 24).

nil. It is only when the cases are prosecuted and convictions are made, that investors gain confidence in the system. As per Gevurtz, the enactment of laws prohibiting an act merely helps in reflecting the disapproval of society towards a particular act, it does not help in actually decreasing the commission of such illegal acts. More resources must be devoted to enforcement rather than enactment as simple enactment of laws might just shift the communication of inside information into more subtle forms.[49]

As stated in the Division of Enforcement 2020 Annual Report, the SEC uses strict mechanisms to detect cases of insider trading at the earlier stages by establishing robust corporate controls and compliance policies, and also by safeguarding the material non-public information.[50] The UK and the U.S. alike, have installed sophisticated computer surveillance software systems which help in tracking insider trading, by flagging when there is an unusual swing in the price or volume of the securities.[51] Such technological advancement has not seen the light of day in India, but SEBI must be equipped with more technology.[52] There are enough resources in India to make it possible once the Supreme Court allows SEBI to get access to more technological tools.

The SEC also brings enforcement actions against professionals who allegedly misappropriate and trade on material non-public information. The successful prosecution of insider trading cases mentioned in the Division of

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[49] Franklin A. Gevurtz, 'The Globalisation of Insider Trading Prohibitions' [2002] 15 Transnat'l Law. 63 <https://scholarlycommons.pacific.edu/cgi/viewcontent.cgi?article=1012&context=facultyarticles> accessed 8 May 2022.

[50] Division of Enforcement Annual Report (2020).

[51] Madhav Misra, 'Insider Trading: Indian Perspective on Prosecution of Insiders' (2011) 18 J Fin Crime 162

[52] Rahul Mehta, 'The Redundant Nature of Prevalent Insider Trading Laws.' (2021) IJCLP <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884828> accessed on 30 June 2022.

Enforcement 2020 Annual Report reflects that the efforts of the SEC in coordinating with its criminal counterparts are effective and appropriate. Moreover, the U.S. goes a step ahead of merely prohibiting insider trading and strives to curb abusive trading altogether – it takes action against manipulative trading practices which artificially boost or depress the prices of the stocks by creating a false appearance of interest for the investors. The actions of the SEC in such cases include filing emergency actions and freezing assets.[53] From charging the former finance manager at Amazon to a former IT administrator at Palo Alto Networks Inc. The SEC not only charged those involved in insider trading but also brought enforcement actions against professionals who allegedly misappropriated and traded on material non-public information. The successful prosecution of insider trading cases in the U.S. reflects that the efforts of the SEC in coordinating with its criminal counterparts are effective and appropriate. The report also highlights that to avoid insider trading cases material non-public information must be safeguarded by establishing robust corporate controls and compliance policies.[54]

Joseph G. Sansone, chief of the SEC's Market Abuse Unit, stated in an interview that with the help of "trading analysis tools", the SEC was successfully able to hold a partner at McKinsey & Company, a management consulting giant, accountable for breaching his fiduciary duties towards the company by misappropriating confidential information for personal financial gains. The convict was arrested and imposed a hefty penalty of USD 450,000.[55]

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[53] Division of Enforcement Annual Report (2020).
[54] Division of Enforcement Annual Report (2020).
[55] Press Trust of India, 'Indian-origin partner at Mckinsey arrested; charged with insider-trading' *Business Standard* (New York, 11 November 2021) <https://www.business-standard.com/article/international/indian-origin-partner-at-mckinsey-arrested-charged-with-insider-trading-121111101021_1.html> accessed on 30 June 2022.

India lacks a proper surveillance system to detect cases of insider trading early at a premature stage.[56] The existing laws lack several aspects concerning the issue, and there is a need for better precautionary measures.[57] Publicizing insider trading cases and imposing high penalties on convicts like in the USA might be helpful. The SEBI, like the SEC in the U.S., must work with other governmental agencies to investigate insider trading cases.[58] Further, the SEBI would need to adopt a gloves-off approach in imposing penalties in insider trading cases to ensure future insiders are deterred.[59] A gloves-off approach would essentially entail that the SEBI acts in an uncompromising way while dealing with insider trading cases. Imposing little amounts would not help in attaining what the SEBI has set out to achieve with the PIT regulations. There is a dearth of human resources in the SEBI, thus SEBI would also have to ensure that separate and enough authorities are assigned to deal with insider trading cases, so the cases can be completed effectively and expeditiously.[60] If wiretapping of phones and access to electronic communications is permitted to the SEBI during investigations, the risk of insider trading is likely to decrease at least in cases where the communication is happening through electronic means and not in person. Although, this power would inadvertently raise privacy concerns as it may have a negative impact on the personal liberty of individuals, however,

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[56] Pranav Saraswat, 'Elements of Effective Insider Trading Regulations: A Comparative Analysis of India and U.S.A.' [2020] NULJ 81 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3870326> accessed on 2 February 2022.

[57] Anil Kumar Manchikatla and Rajesh H. Acharya, 'Insider trading in India – regulatory enforcement' [2017] JFC 48, 54 <https://idr.nitk.ac.in/jspui/bitstream/123456789/8319/1/6.Insider%20trading%20in%20India.pdf> accessed on 2 February 2022.

[58] Rahul Mehta, 'The Redundant Nature of Prevalent Insider Trading Laws' [2021] IJCLP 1, 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884828> accessed on 4 February 2022.

[59] Bhattacharya (n 24).

[60] ibid.

exceptions can be carved in high-stake cases. In the U.S., the court views large-scale insider trading cases as seriously as organized crime, extortion, and similar misconduct wherein wiretapping is more commonly used, similarly, in India, the Supreme Court must consider using wiretaps in high-stake cases so that people privy to the insider information do not make profits at the expense of those kept in the dark.[61] Furthermore, insider trading laws must be dynamic to effectively deal with future exigencies. India, like many other jurisdictions, has rejected the fiduciary model adopted in the U.S. which seems like a good decision given the ambiguous nature of the model.[62] Also, even though the SAT in the case of *Rakesh Agarwal v. SEBI*,[63] stated that laws in the U.S. and UK are not like the SEBI PIT regulations, yet, upon examining the PIT regulations carefully, various theories recognized in the U.S. can be seen incorporated in the regulations. Moreover, a small glance at the laws in the European Union, considered to be the world's first multinational insider trading regime, shows that the EU laws are more expansive than the U.S. model which requires a breach of fiduciary or other similar duty.[64] The EU extends its scope of liability beyond that of the U.S. and many other regimes across the globe. Firstly, its definition of "inside information" is broad and is defined as-

> Information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant

[61] Robert Khuzami, 'Speech by SEC Staff: Remarks at AICPA National Conference on Current SEC and PCAOB Developments' [2009] Speech – U.S. Securities and Exchange Commission <https://www.sec.gov/news/speech/2009/spch120809rsk.htm> accessed on 4 January 2023.

[62] John P. Anderson, 'Regulatory Ritualism and other Lessons from the Global Experience of Insider Trading Law' [2021] U. Penn. J. of Bus. L. 2 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3788993> accessed on 30 June 2022

[63] 1 CompLJ 193 SAT (2004).

[64] Anderson (n 62).

> effect on the prices of those financial instruments or on the price of related derivative financial instruments.[65]

And secondly, it works on a similar model to that of the "parity of information" approach that was rejected by the Supreme Court in the U.*S.* in the case of Chiarella (discussed above in para 1.2.3), and presumes the use of inside information from mere possession of information, thereby meaning that the EU picks even the individuals who simply overhear a conversation of insiders. Thus, the only requirement under the EU model is that the trader was aware while trading that he is in possession of information that is material and non-public. This model offers relative clarity and simplicity to insider trading enforcement, although at the expense of being overbroad in this seemingly streamlined approach.[66]

However, since seldom any legal system is perfect, there are certain loopholes in the laws in the U.S. as well. John P. Anderson, a legal scholar, in his paper titled 'Regulatory Ritualism and other lessons from the Global Experience of Insider Trading Law', highlighted concern with the U.S. insider trading regime. He stated how the people who claim that reform is needed in the laws, do not agree about the nature of the solution to the existing problems. [67] A few of the problems with the insider trading laws in the U.S. as highlighted by the author are that the laws are overbroad, and due to a lack of statutory definition of insider trading, there is vagueness in the law which often makes it unjust and economically inefficient.[68] Studies show that there

[65] ibid.
[66] ibid.
[67] *Id*. at 62.
[68] John P. Anderson, 'The Ethics of Insider Trading Reform' [2018] Mercatus Working Paper, Mercatus Center at George Mason University <https://www.mercatus.org/system/files/anderson-insider-trading-mercatus-working-paper-v1.pdf> accessed on 30 June 2022.

is a need for reform in the U.S. The statutory language in the U.S. needs to be amended so there is some clarity in the laws, and so that the market participants are also certain about the laws. For instance, in a 2018 New York Times op-ed piece, Mr. Jackson, a Securities Exchange Commissioner stated that the laws in the U.S. around insider trading are outdated and unclear, and do not define "insider trading".[69] This leaves investors and defendants confused about what kind of information sharing would be permissible or what kind would be problematic. Mr. Preet Bharara, a former United States attorney, and Mr. Jackson also stated that though the U.S. Government has decided many strong insider trading cases, the laws remain somewhat ambiguous.[70] They further point out the commonly accepted idea of what constitutes insider trading i.e., trading based on material, non-public information associated with a breach of duty, but they emphasize that this can be a difficult standard to apply.[71] Some also believe that insider trading laws in the U.S. need to be liberalized so innocent persons do not get into trouble for no reason merely because of strict laws.[72] Ron Cordova, an Attorney-at-law, also expressed that the vague insider trading laws cause confusion and may at times even open the door for people to fall prey to such charges unknowingly even when they genuinely did not intend to engage in illegal activities but the ambiguous nature of the laws found them facing such charges.[73] One such instance of an unproven claim of wrongful conviction is when the Ex-Goldman Sachs director, Rajat Gupta, who was convicted of

[69] Preet Bharara and Robert J. Jackson Jr., 'Insider Trading Laws Haven't Kept Up With the Crooks' [2018] Speech - U.S. Securities and Exchange Commission <https://www.sec.gov/news/speech/jackson-insider-trading-laws-havent-kept-crooks> accessed on 4 January 2023.

[70] ibid.

[71] ibid.

[72] *Id*. at 62.

[73] Ron Cordova, 'Vague Insider Trading Laws Cause Confusion' [2019] Attorney At Law <https://www.roncordovalaw.com/blog/2019/01/vague-insider-trading-laws-cause-confusion/> accessed on 4 January 2023.

illegally sharing information about Goldman to a hedge fund manager, claimed after seven years of his conviction that he is innocent.[74] In an interview, he stated that he regrets speaking too freely about Goldman's corporate secrets and not testifying in his trials.[75] He also stated that "I was going to testify. And in the very end, they wore me down and convinced me I shouldn't. And to me, it was a personal failure".[76] Gupta was convicted because he had divulged information on a call to Rajaratnam 16 seconds right after Warren Buffet agreed to invest in the Company.[77] This is possibly only one of many such cases where an individual might have been wrongfully convicted without actually engaging in insider trading. However, lessons from the U.S. may still present a better way forward in dealing with insider trading cases in India.

V. CONCLUSION: THE WAY FORWARD

Prosecuting an insider trading case can be particularly difficult as the investigation in such cases requires obtaining information that is shared during personal communications. Investigating such personal communication would inevitably lead to the infringement of the privacy rights of an individual, meaning - too many investigative powers in the hands of authorities pose a major threat to various fundamental rights of humans. Thus, striking a balance between basic human rights and having enough powers to investigate an insider trading case is a difficult task.

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[74] Emma Newburger, 'Ex-Goldman director Rajat Gupta says he's innocent seven years after insider trading conviction' [2019] CNBC U.S. News <https://www.cnbc.com/2019/03/22/ex-goldman-director-rajat-gupta-says-hes-innocent-seven-years-after-insider-trading-conviction.htmlaccessed on 4 January 2023.

[75] ibid.

[76] ibid.

[77] ibid.

SEBI chairman, Ajay Tyagi, in his interview with Business Standard said, *"let me say among all the violations, we treat insider trading as the most serious one. It goes against the very basics of trust in the securities market*."[78] The situation in India currently regarding the prosecution of insider trading might be better handled by devoting more resources to the enforcement of policies and surveillance mechanisms, besides having robust and vigorous laws in place. Studies also show that there is a need for more manpower for the investigation and prosecution of insider trading cases in the SEBI.

Even though the statutes for insider trading in India are sufficient to deal with insider trading cases, the cases of insider trading have only been increasing year by year. This is due to the insufficient investigative tools and mechanisms to effectively prosecute a case. The loophole majorly exists at the investigation level, due to which the investigation in insider trading cases, more often than not is prolonged for an unreasonably long period. Conviction, which is the last layer in dealing with insider trading cases, is also imbued with issues as records show that SEBI imposes meagre fines which do not help in preventing insider trading. Thus, higher penalties need to be imposed to deter insiders from misusing the UPSI and protect the integrity of the market.

Moreover, some people also favor altogether deregulation of insider trading, firstly because those people believe that insider trading pushes the price of the security towards the amount that it would command if the undisclosed information was made public, thereby benefitting both, society as well as the firm through increased profits. Secondly, they believe that insider trading could be a great way to compensate the managers for producing additional value for the firm as well as society. However, deregulation is

[78] *Id*. at 45.

perceived to cause more harm than good by most lawmakers, scholars, etc. who believe that regulation protects the integrity of the market.[79]

To conclude, some of the steps that the SEBI needs to take to effectively combat insider trading in India are: (i) as a precautionary measure - strive to safeguard material non-public information, (ii) establish strict early detection mechanisms which raise alerts when there are signs of irregular trading activities, or when there is an unusual rise in the value of shares, (iii) adopt gloves-off approach and treat insider trading cases as seriously as other organised crimes – like in the case of the EU, (iv) leverage technologies like machine learning, natural language processing tools, and artificial intelligence for the purposes of surveillance, and during investigation and prosecution, i.e., upon suspecting any wrongdoing, analysing data, banking transactions, social media connections, and call records might help in building a stronger case, (v) impose hefty penalties and incarcerate the offenders for a longer period of time, lastly, (vi) publicising the alleged offenders rather than suppressing and sweeping the news under the rugs might hold back insiders in engaging in the nefarious activities of insider trading.

[79] Stephen Mark, 'The Law and Economics of Insider Trading: A Comprehensive Primer' [2001] UCLA <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=261277> accessed 30 June 2022.

VI. THE LEGITIMACY OF ASYMMETRICAL ARBITRATION CLAUSES IN INTERNATIONAL COMMERCIAL ARBITRATION

- Ahan Gadkari*

ABSTRACT

Despite the contrast in the parties' positions, unilateral dispute settlement provisions have garnered widespread recognition from judicial tribunals due to their consensual character. Nevertheless, due to specific flaws inherent in their one-sided character, similar provisions have been rejected in a few cases in the past. Apart from causing substantive imbalance, they foster procedural inequality by allowing one of the parties to choose the venue after the dispute has occurred. Their legitimacy, however, has never been challenged against the standard set out in Article 18 of UNCITRAL Model Law, which demands equal treatment of parties in arbitral proceedings.This paper aims to examine such asymmetrical arbitration clauses provisions under Article 18 of UNCITRAL Model Law, taking inspiration from the judicial handling of similar clauses under Article 6 of the European Convention on Human Rights, which is the basis of Europe's need for equitable treatment. Thus, the article's subsequent sections explore the nature and scope of Article 18 in order to determine if it may be used to challenge unilateral dispute settlement provisions. Finally, the paper suggests an objective three-step test that judicial courts and arbitral tribunals might use to resolve this majorly unresolved issue.

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I. INTRODUCTION

International arbitration has always been based on the basic premise of party autonomy.[1] It enables parties to craft an arbitration agreement that is uniquely tailored to the circumstances of their relationship.[2] On this basis, business parties often engage in one-sided dispute resolution arrangements that favour one party, notably with respect to forum selection.[3]

Generally, such arrangements are made for the purpose of resolving disputes in connection with financing agreements in order to balance the risk that a lending party carries in such transactions. To provide a local illustration, a bank providing a line of credit, to an unsecured or partially secured debtor would include an asymmetrical arbitration clause to account for the additional risk assumed by them. It is feasible, and indeed extremely probable, that the borrower's assets, the guarantor's assets, and the borrower's place of business are situated in separate countries.[4] As a result, if the lending party is not allowed to start actions in any of the relevant jurisdictions, the borrowing party may successfully avoid any obligation.

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[1] Ahan Gadkari, 'Single-Party Arbitrator Nomination as a Ground of Annulment in India' *(American Review of International Arbitration*, 28 Mar. 2022) <http://blogs2.law.columbia.edu/aria/single-party-arbitrator-nomination-as-a-ground-of-annulment-in-india/> accessed 11 April 2022.
[2] Lauren D. Miller, 'Is the Unilateral Jurisdiction Clause No Longer an Option: Examining Courts' Justification for Upholding or Invalidating Asymmetrical or Unilateral Jurisdiction Clauses' (2016) 51 Tex. Int'l L.J 321.
[3] International Chamber of Commerce, 'Unilateral Jurisdiction Clauses in International Financial Contracts' (2015) Doc. No. 470/1248rev 1.
[4] ibid 4.

To address these special needs, parties include unilateral dispute resolution provisions (**"UDC"**) in their contracts. Under such terms, the beneficiary party has the option of beginning legal procedures before any of the forums available, whereas the opposing party is limited to initiating proceedings before a single forum. Such a provision considerably benefits the beneficiary party since it enables such party to examine the facts of a particular dispute and choose the most appropriate venue.

Despite the seeming imbalance, business parties tolerate the inclusion of such one-sided terms in order to get some additional advantages deemed more significant than remedy parity. For example, during contractual discussions, party A insists on the inclusion of a UDC, which party B agrees subject to liability limitations. If A and B accept each other's considerations, their exchange of advantages leads to a mutually advantageous agreement that includes, among other provisions, a one-sided dispute resolution clause.

However, party autonomy must be constrained by legal obligations or public policy reasons. These provisions have been called into doubt in several cases as a result of the imbalances they generate between the parties, notwithstanding the parties' assent during contract completion.[5] Indeed, some academics, like Hans Smit,[6] have argued that such terms are obviously unjust and discriminatory towards the economically weaker party that is often coerced to engage into such agreements. In this respect, the doctrine of unconscionability,[7] the principle of mutuality of remedy,[8] the right of access

[5] Hans Smit, 'The Unilateral Arbitration Clause: A Comparative Analysis' (2009) 20(3) Am. Rev. Int'l Arb 391, 391.
[6] ibid 403.
[7] Alan Scott Rau, *Asymmetrical Arbitration Clauses – The United States, in Jurisdictional Choices in Times of Trouble* (Bachir Georges Affaki and Horacio Alberto Grigera Naón eds., Kluwer Law International 2015) 21, 26
[8] *Baron v. Sunderland Corp.* [1966] 1 All ER 349, 351; *Norris v. Fox* [1891] 45 F. 406, 407.

to court,[9] the potestative character,[10] and the general requirement of equality[11] have all been used to invalidate such provisions.

In the context of arbitration, the demand for equal treatment derives from Article 18 of the UNCITRAL Model Law,[12] which strives to harmonise national practises and has been adopted verbatim by states with a variety of legal, social, and economic systems. This will be discussed in detail in the next section.

This paper is divided into six sections. Section I introduces the subject and sets the scope of the paper. In Section II, the author examines the implementation of Article 18 of the UNCITRAL Model Law in assessing the validity of UDCs. The author begins by discussing some significant reasons for invalidating such provisions. Following that, Sections III and IV have defined the scope of Article 18 which emphasizes both parties being treated equally to illustrate whether it contains a claim for the invalidation of such terms. In Section V, the author suggests a three-step procedure for establishing the validity of UDCs according to Article 18 of the UNCITRAL Model Law. Finally, Section VI summaries the paper's findings and concludes.

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[9] *Golder v. The United Kingdom* [1975] 1 EHRR 524. (Golder)

[10] *Ms. X v. Banque Privee Edmond de Rothschild* [2012] 1e civ. 983. (French Cour. de Cassation) (Rothschild)

[11] *Russkaya Telefonnaya Kompaniya v. Sony Ericsson Mobile Communications* [2012] Case No. VAS – 1831/12 (Rus. LLC Supreme Arbitrazh Court). (Sony Ericson)

[12] United Nations Commission on International Trade Law, *UNCITRAL Model Law on International Commercial Arbitration 1985: With Amendments* (2008) 14, <www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf> (accessed 01 April 2020). (Model Law)

II. VALIDITY OF CLAUSES RELATING TO UNILATERAL DISPUTE RESOLUTION

In general, common-law nations such as the United Kingdom,[13] the United States,[14] Hong Kong,[15] Singapore,[16] and others have accepted UDCs proceeding on the argument that the applicable norm of equality only applies to behaviour or treatment inside the forum or during the proceedings. However, the stance of civil law jurisdictions is not as fixed in this respect, as Bulgaria,[17] China,[18] and Russia[19] demonstrate have declared such provisions null and void due to the unequal nature of their treatment, whereas France,[20] and Germany[21] have maintained UDCs to be of a potestative nature on a case-to-case basis.

UDCs are fundamentally based on the notion of party autonomy. Despite the fact that this concept is the bedrock of contracts and arbitration, it is not without limitations. For example, in a football game, if team A and team B mutually agree to allow the former to score goals not only with their feet but also with their hands, such an agreement would violate the game's basic regulations. Similarly, if a UDC breaches some fundamental values, beyond the permissible thresholds of party autonomy, it cannot be justified. Several concepts for invalidating UDCs have been addressed in this section to expose the flaws in these provisions.

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[13] *Law Debenture Trust Corp. plc v. Elektrim Fin*. [1999] 1 WLR 1591 (EWHC).
[14] *Sablosky v. Edward S. Gordon Co*. [1989] 535 N.E.2d 643 (N.Y.) 646.
[15] *Anzen Ltd. v. Hermes One Ltd*. [2016] 1 UKPC. (Privy Council)
[16] *Wilson Taylor Asia Pacific Pte Ltd v. Dyna-Jet Pte Ltd.* [2017] 1 Lloyd's Rep. 59 (Singapore HC).
[17] [2011] Commercial Case No. 1193/2010 (Bulgarian Supreme Court of Cassation).
[18] Zheng Sophia Tang, 'Effectiveness of Exclusive Jurisdiction Clauses in the Chinese Courts: A Pragmatic Study' (2012) 61(2) Int'l & Comp. L.Q. 469, 469.
[19] *Sony Ericson* (n 10).
[20] *M.J.A. v. Apple Sales* [2015] Cass. civ., 1ère (French Cour. de Cassation) (Apple Sales).
[21] [2003] Case No. III ZB 06/02(German Bundesgerichtshof)

A. Doctrine of Unconscionability

At times, arbitration agreements are one-sided simply because the negotiating abilities of the contractual parties are different. Arbitration agreements between employers and workers, vendors and customers, health maintenance organisations and patients, franchisors and franchisees, and others are impacted by unequal bargaining power.[22] UDCs that come from a discussion between two parties with such disparate interests are often accepted by the weaker party, despite the fact that the weaker party receives no advantages in return. Such provisions, which lack mutuality of remedy[23] have been declared unconscionable by courts, most notably in the United States.[24] Additionally, several basic principles of contract law preclude the enforcement of unconscionable agreements.[25] The Restatement of Contracts[26] and the UNIDROIT Principles[27] include two of the most significant rules in this respect. While the phrase "unconscionable" is used in the former, the latter refers to "gross discrepancy," which has been interpreted to be founded on the same premise.

1. The Principle of "Gross Disparity"

In accordance with Article 3.2.7 of the UNIDROIT Principles,

> A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract

[22]Uniform Arbitration Act 2000 (30 R.U.A.A.) s 6, Comment 7 (2000), <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=cf35cea8-4434-0d6b-408d-756f961489af>.

[23] *Richard Harp Homes, Inc. v. Van Wyck* [2007] 262 S.W.3d 189 (Ark. App) 192-193.

[24] Gary B. Born, *International Commercial Arbitration* (2014) 856 (Born); *Shroyer v. New Cingular Wireless Services Inc.* [2007] 498 F.3d 976 (9th Cir.) 981-82; *Armendariz v. Foundation Health Psychcare Services, Inc* [2000] 6 P.3d 669.

[25] Born (n 24) 856.

[26] Restatement (Second) of Contracts (Am. Law Inst. 1981) s 208.

[27] UNIDROIT Principles of International Commercial Contracts (Rome 2016) art 3.2.7 (UNIDROIT).

> or term unjustifiably gave the other party an excessive advantage.

According to the clause, it allows a party to abandon a contract term if there is a material gap between the parties, resulting in an "unjustifiably excessive advantage" for one side.[28] It is also worth noting here that the disproportionate and unreasonable benefit must exist at the moment the contract is concluded.[29] The clause specifically assigns major weight to the fact that a party took undue advantage of the other party's dependency, urgent requirements, inexperience, or lack of negotiating skill during contractual talks.[30]

It is not essential to study the contract in its entirety under this clause.[31] This is consistent with the provision's language, which also refers to a "term" of the contract. As a result, the author argues that when determining the validity of one-sided clauses, a court or tribunal applying the UNIDROIT Principles may not consider the bargain between the parties and may not permit the avoidance of these clauses if they unjustifiably provide a party with an "excessive advantage." This means that even if the entire transaction between the parties is fair, the unjust character of the arbitration clause may result in its avoidance if the prerequisites are satisfied.

2. Doctrine of Unconscionability in the United States

As previously indicated, the idea of unconscionability has been used multiple times in the United States to invalidate one-sided terms. Mr. Gary

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[28] ibid.
[29] Jacques du Plessis, *Validity in Commentary on the UNIDROIT Principles of International Commercial Contracts* (Stefan Vogenauer ed., 2d ed. 2015) 511 para 12.
[30] UNIDROIT (n 27) art 3.2.7(1)(a).
[31] E.A. Kramer, 'Contractual Validity According to the UNIDROIT Principles' (1999) 1 Eur. J. L. Reform 269, 277.

Born emphasised[32] that such provisions have been declared unconstitutional for restricting the disadvantaged party's access to legal counsel,[33] granting the stronger party certain unreasonable procedural benefits.[34] Such a method leads to conferring a disproportionate ability to appoint arbitrators;[35] conferring substantial advantages in an egregious manner,[36] or where the contract was concluded in an unjustifiable manner.[37]

The Third Circuit Court of Appeals suggested a two-part test for unconscionability in the case of *Leibrand v. National Farmers*. First, the contractual conditions must be "unreasonably favourable to the drafter"; and second, the opposing party cannot have reasonably accepted the provisions.[38] In *Iwen v. US West Direct*, the Montana Supreme Court applied this test to a dispute resolution provision that permitted both parties to arbitrate but only one to commence court action. Because the favoured party was both the more powerful negotiation party and the agreement's drafter in that instance, the first component of the test was found to be fulfilled. Additionally, since the provision was handed to the weaker negotiation party "take it or leave it," the weaker bargaining party had "no real option."

Alternatively, the Court recommended in the Art's Flower Shop case,[39] that a judgement of unconscionability must be determined by the parties' relative positions, the strength of their negotiating position, the substantial alternatives accessible to the plaintiff, and the presence of unfair contract

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[32] Gary B. Born, *International Commercial Arbitration* (2014) 862 – 863.
[33] In *re Am. Exp. Merchants' Litg*. [2012] 667 F.3d 204 (2d Cir.) 214.
[34] *Nino v. Jewelry Exch., Inc*. [2010] 609 F.3d 191 (3d Cir.) 204.
[35] *McMullen v. Meijer, Inc.* [2004] 355 F.3d 485 (6th Cir. 2004) 494.
[36] *Paladino v. Avnet Computer Tech., Inc*. [1998] 134 F.3d 1054 (11th Cir.).
[37] *Chavarria v. Ralphs Grocery Stores* [2013] WL 5779332 (9th Cir.).
[38] *Leibrand v. National Farmers Union Property & Casualty Co*. [1995] 898 P.2d 1220 (Mont.).
[39] *Art's Flower Shop, Inc. v. Chesapeake and Potomac Tel. Co*. [1991] 413 S.E.2d 670 (W. Va.).

conditions.[40] In the case of *Arnold v. United Companies Lending Corporation* **("Arnold")** the West Virginia Supreme Court of Appeals resorted to this criterion. In that case, a major corporate lender and an old, naïve customer had engaged into a UDC, which allowed both parties to arbitrate and the former to sue. The provision was declared unconstitutional by the Court.

In the Arnold case, the nature of the two parties made their negotiating power unequal. This doctrine does not hold water when both parties are commercially competent and cognizant of the repercussions of their actions.[41] For example, in the China Res. Products case,[42] a tiny US corporation agreed to arbitrate against a Chinese state-owned entity before a Chinese state-regulated arbitral tribunal. Despite its apparent injustice, this agreement was upheld because the US corporation understood the implications of consenting to such a condition. As a result, if both parties are intelligent and almost equal in position, it would be difficult to invalidate a one-sided provision on the grounds of unconscionability.

B. Potestative Nature

Courts in France[43] and Bulgaria[44] have nullified UDCs on the ground of their potestative nature. *Mme X v. Banque Privée Edmond de Rothschild* invalidated potestative UDCs by the virtue of French Civil Code.[45] The Code defines potestative as a circumstance in which "determination of unconscionability must focus on the relative positions of the parties, the adequacy of the bargaining position, the meaningful alternatives available to

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[40] ibid syllabus point 4.
[41] Christopher R. Drahozal, 'Non-Mutual Agreements to Arbitrate' (2002) 27 J. Corp. L. 537, 547 (Drahozal).
[42] *Chinese Res. Products v. Fayda International Inc.* [1990] 747 F.Supp. 1101 (D. Del.).
[43] *Rothchild* (n 9).
[44] [2011] Commercial Case No. 1193/2010 (Bulgarian Supreme Court of Cassation).
[45] *Mme X v. Banque Privée Edmond de Rothschild* [2013] I.L.Pr. 12.

the plaintiff, and the existence of unfair terms in the contract."[46] It has been noted that this basis may be effectively raised only if the UDC provides the beneficiary with a limitless choice of forum.[47] This is because, in the absence of an infinite option, the beneficiary cannot impose an unduly high degree of uncertainty on the disadvantaged party.[48] This also indicates that where the forum selection provision is objectively worded and sufficiently explicit to aid the judge in determining whether the court has jurisdiction, the argument of potestative nature fails.[49] Alternatively phrased, vague and thus, arbitrary power to select the forum attracts the principle of potestative nature to invalidate a UDC. A similar pattern has been followed by Indian courts in cases like *Bhartia Cutler Hammer v. AVN Tubes*,[50] *Emmsons International Ltd. v. Metal Distributors*,[51] etc. Delhi High Court in the preceding instances decided against UDC due to the absence of an explicit clause for *ad infinitum* recourses to the beneficiary.

Using this standard, the French Supreme Court nullified a UDC in the Rothschild case,[52] (49) for being potentiative potestative. A Spanish customer based in France entered into an arrangement with a Luxembourg-based bank. The UDC vested Luxembourg's courts with exclusive jurisdiction, subject to the bank's power to pursue cases in any other competent court. As a result, the clause created confusion for the client and was determined to be potent.

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[46] French Civ. Code 2016, art 1170.
[47] Maxi Scherer, 'Chapter 1: A Cross-Channel Divide Over Unilateral Dispute Resolution Clauses' *in Jurisdictional Choices in Times of Trouble* (Bachir Georges Affaki and Horacio Alberto Grigera Naón eds., Kluwer Law International 2015) 10, 12.
[48] Marie-Elodie Ancel, 'Chapter 4: A French Introspection' *in Jurisdictional Choices in Times of Trouble* (Bachir Georges Affaki and Horacio Alberto Grigera Naón eds., Kluwer Law International 2015) 64, 66.
[49] *Coreck Maritime GmbH v. Handelsveem BV and Ors.* [2000] Case C-387/98 (ECJ 2000) [15].
[50] *Bhartia Cutler Hammer v. AVN Tubes* 1995 (33) DRJ 672.
[51] *Emmsons International Ltd. v. Metal Distributors* 2005 (80) DRJ 256.
[52] *Rothschild* (n 9).

However, in a more recent ruling, the Court supported the legitimacy of a UDC in cases where the competent courts could be determined objectively.[53]

C. European Convention on Human Rights (Article 6)

The European Convention on Human Rights **("ECHR")**,[54] Article 6, stresses the need of a fair hearing before an independent and impartial tribunal for all. This rule has been seen as the genesis of the demand of procedural fairness and equitable treatment of the parties in European courts.[55] Additionally, this rule has been cited in several instances, involving UDCs, like the Sony Ericson,[56] Mauritius Commercial Bank,[57] etc.

1. Right to Equitable Access to Court

The right to access justice is recognised as a human right in Article 6 of the ECHR and some other international treaties.[58] It has been proclaimed by domestic legislation as well.[59] This right is jeopardised when UDCs limit a party's ability to litigate, which has been seen as a component of this broad right.[60] For the purposes of this section, unilateral litigation clauses (hereafter

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[53] *Apple Sales* (n 19).
[54] *Golder* (n 8); European Convention on Human Rights (1 June 2010) E. T. S. No. 5 (ECHR) art 6; Janneke Gerards and R. Lizep Glas, 'Access to Justice in the European Convention on Human Rights System' (2017) 25 Neth. Q. Hum. Rights 11, 13; European Agency for Fundamental Rights, *Handbook on European LawRelating to Access to Justice* (2016) 14.
[55] European Court of Human Rights, *Guide on Article 6 of the European Convention on Human Rights: Right to a Fair Trial (Civil Limb)* (2015) 72, <https://www.echr.coe.int/documents/guide_art_6_eng.pdf> (accessed March 22, 2023).
[56] *Sony Ericson* (n 10).
[57] *Mauritius Commercial Bank Limited v. Hestia Holdings Limited and Sujana Universal Industries Ltd.* [2013] EWHC 1328 (Comm.) (HC).
[58] United Nations Development Programme, *Programming for Justice: Access for All: A Practitioner's Guide to Human Rights-Based Approach to Access to Justice* (2005) 5.
[59] American Bar Association, *Human Rights and Access to Justice* (2020), <https://www.americanbar.org/advocacy/rule_of_law/what-we-do/human-rights-access-to-justice/?q&wt=json&start=0>; *Re Keshav Singh* AIR 1965 SC 745 (India).
[60] W. Shill Stephan, *Developing a Framework for the Legitimacy of International Arbitration Legitimacy: Myths, Realities, Challenges* (2015) 825.

referred to as 'ULCs') and unilateral arbitration provisions (hence referred to as 'UACs') have been discussed separately due to their distinct influence on the disadvantaged party's ability to access the courts.

To begin with, it's worth noting that a ULC gives the party at benefit the option of litigation or arbitration, while the disadvantaged party is limited to initiating arbitration procedures.

These provisions imply an infringement of the party's right to sue. Having said that, it's worth noting that all typical arbitration agreements are legal waivers of the right to sue. However, in the case of ULCs, the "unequal" limitation on both parties' ability to sue becomes a source of worry, casting doubt on the legitimacy of such a waiver.

In the Sony Ericson case,[61] the Russian Supreme Court nullified a ULC due to the imbalance it generated between the parties. Among other reasons, the provision was declared unconstitutional because it limited the disadvantaged party's ability to sue. The Court stressed in this case that the ECHR ensures equal protection under procedural safeguards and a party's right to be on an equal footing with the opposing party.[62]

In the case of UACs, only the beneficiary has the right to commence arbitration, while both parties retain the right to file a lawsuit. Unlike the right to litigate, the right to arbitrate is not a party's inherent right. Rather than that, it is the result of the parties' consent. As a result, a party's refusal to submit to arbitration should not be the reason for alarm. However, UACs are typically intended to subordinate the parties' power to commence judicial actions to the

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[61] *Sony Ericson* (n 10).
[62] Ibid; Pavlo Malyuta, 'Compatibility of Unilateral Option Clauses with the European Convention on Human Rights' (2019) 8(1) UCL J. L. & Jurisprudence 1, 15 (Malyuta).

beneficiary's choice to go to arbitration. A provision resolving disputes in this manner would read as follows:

"The courts in India would have exclusive jurisdiction over any dispute arising out of the Sales Agreement, subject to the First Party's right to go to arbitration."

Such provisions would have the effect of excluding the disadvantaged party from continuing court actions launched by the "First Party" if the First Party elects to go to arbitration. As a result, the First Party is entitled to halt the disadvantaged party's proceedings by using its right to arbitrate the issue. In this case, despite of their equal ability to commence court actions, the parties would not have equal access to the courts, since the disadvantaged party would really lack an equal right to sue. Finally, a right is only valuable if it is properly enforced.[63] Thus, one may claim that even UACs are unlawful on the grounds that they violate the disadvantaged party's right to enter the court.

2. *Divergent Viewpoints in the United Kingdom and Russia*

The validity of UDCs under Article 6 of the ECHR has been widely addressed in legal jurisprudence.[64] However, the viewpoint is not constant across countries, with judicial courts in England and Russia, expressing divergent views.

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[63] Susan James, 'Rights as Enforceable Claims' (2003) 103(2) Proceedings of the Aristotelian Society 133, 133-147; Siobhán McInerney Lankford, 'Human Rights and Development: a Comment on Challenges and Opportunities from a Legal Perspective' (2009) 1(1) J. Hum. Rights Practice 51, 51 – 81.

[64] Bas Van Zelst, 'Unilateral Option Arbitration clauses: An unequivocal choice for arbitration under the ECHR?' (2018) 25(1) Maastrcht Journal of European and Comparative Law 77.

The English Commercial Court said in the Mauritius Commercial Bank case that "Article 6 (of the ECHR) is directed to(wards) access to justice within the forum chosen by the parties, not the choice of forum".[65] This means that even if a disadvantaged party is denied a forum selection, its access to justice in the forum selected by the beneficiary is equal. The Court indicated therein a preference for procedural equality for both parties throughout the course of the proceedings, regardless of the venue. In contrast, depending on the same rule, the Russian Supreme Court dismissed a UDC in the previously described Sony Ericson case for not treating the parties equally in terms of forum selection.[66]

This discrepancy in the two courts' view results in a compelling issue that forms the crux of this discussion: can the principle of equal treatment be extended to stage forum selection? This topic would have to be evaluated in the context of arbitration in light of Article 18 of the UNCITRAL Model Law, which serves as the arbitration equivalent to Article 6 of the ECHR and establishes the parties' entitlement to equal treatment in arbitration.

III. ARTICLE 18'S REQUIREMENT FOR EQUAL TREATMENT

To assess whether Article 18 of the Model Law may be used to invalidate UDCs, it is necessary to ascertain if the issue of forum selection is covered by this provision. This may be accomplished by examining the wording of the Model Law, the purpose of its drafters, and the implementation of the provision in case law, among other things.

[65] *Mauritius Commercial Bank Limited v Hestia Holdings Limited and Sujana Universal Industries Ltd.* [2013] EWHC 1328 (Comm.) (HC).
[66] *Sony Ericson* (n 10).

A. Interpreting Article 18

According to Article 18 of the Model Law, "the parties shall be treated with equality and each party shall be given a full opportunity of presenting his case."[67] The language of this article implies that it is the tribunal's obligation to treat the parties equally, and not that the parties are obligated to treat each-other equally. Indeed, the UNCITRAL Digest supports this, stating that the provision's objective is to protect a party from "egregious and injudicious" behaviour on the part of a tribunal.[68] As a result, one may claim that Article 18 does not apply to the step of forum selection, which is unrelated to the tribunal's action.

Additionally, this clause has been included in Chapter V of the Model Law, which has the headline "Conduct of Arbitral Proceedings". This also implies that the tribunal's handling of the parties throughout the pendency of the proceedings is being discussed herein. In general, the date on which the institution receives the notice of arbitration is understood to be the day on which the arbitral proceedings begin.[69] As a result of this interpretation, the step of forum selection falls beyond the scope of Article 18 since it occurs prior to the initiation of proceedings.

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[67] Model Law (n 11) art 18.

[68] UNCITRAL, *2012 Digest of Case Lawon the Model Lawon International Commercial Arbitration* (2012) 98 para 7, <www.uncitral.org/pdf/english/clout/MAL-digest-2012-e.pdf> (accessed 29 March 2020) (Digest).

[69] London Chamber of International Arbitration, LCIA Rules (as revised in 2014), rule 1.4, https://www.lcia.org/Dispute_Resolution_Services/lcia-arbitration-rules-2014.aspx#Article%201 (accessed 30 March 2020); International Chamber of Commerce, ICC Rules of Arbitration (as revised in 2017), rule 4.2, https://iccwbo.org/dispute-resolution-services/arbitration/rules-of- arbitration/#article_4 (accessed 30 March 2020); Hong Kong International Arbitration Centre, HKIAC Administered Arbitration Rules (as revised in 2018), rule 4.2 (accessed 30 March 2020); Singapore International Arbitration Centre, SIAC Rules (as revised in 2016), rule 3.3 (accessed 30 March 2020).

Another noteworthy point to note is that the parties to a UDC become "parties" to an arbitration for the purposes of Art. 18 only when the beneficiary elects for arbitration. As a result of the aforementioned and other indicators obtained from the provision's language, it is concluded that the obligation of equal treatment under Art. 18 of the Model Law cannot be extended to the stage of forum selection. As a result, according to the provision's language, UDCs would be excluded from its scope.

B. The Intention of the Drafters

After examining the limitations of Article 18 as expressed in its phrasing, in this section, the author would explore whether the drafters intended to extend this obligation to: first, stages other than the current arbitration procedures, and second, issues unrelated to the tribunal's behaviour.

With reference to extension of this need of equal treatment beyond the arbitration processes, reliance might be put on the United Nations General Assembly's Analytical Commentary. Therein, it has been declared unequivocally that the need of equal treatment under Article 18 incorporates all procedural situations.[70] As a jurisdictional clause is a procedural agreement,[71] it should be included in the scope of this expanded need.

Prof. Holtzmann and Prof. Neuhaus make an intriguing point in their Guide to the Model Law about issues unrelated to the tribunal's activity. They

[70] UNCITRAL, 'Analytical Commentary of Draft Text of a Model Lawon International Commercial Arbitration' (25 Mar. 1985), Doc No A/CN.9/264, 46, para 7 (Analytical Commentary).

[71] Abdul Hamid El Ahdab, 'The Lebanese Arbitration Act' (1996) 13(3) J. Int'l Arb. 39, 39 - 115; Nadezda Rozehnalova, *Arbitration in International and National Commerce* (2008) 64; *Westacre Investments Inc v. Jugoimport-SDRP Holding Co Ltd*. [1999] EWCA Civ.1401 (Eng. & Wal. Ct. of App.)

emphasised that the drafters' intention, as shown by previous versions, was to use Article 18 exclusively as a "limitation only on the discretion of the arbitral tribunal and not on the parties."[72] However, subsequent versions make it abundantly apparent that the clause is meant to apply to both tribunal proceedings and parties' procedural agreements.[73] One may also rely on this understanding to argue that a jurisdictional phrase is within the scope of the provision.

However, the author asserts that a counterargument to the above argument may be found in the Analytical Commentary itself. It was stated there that Article 18 is a general rule that is further defined by illustrative provisions such as Articles 24(3), 24(4), 26(2), 16(2), 23(2), and 25(3).[74] All of these rules address issues pertaining to phases of an arbitral tribunal's ongoing procedures. This means that Article 18 was meant to apply solely to pending actions, not to the stage of forum selection.

After considering the drafters' intentions, as reflected in the numerous sources cited, it is obvious that the clause may be expanded to include matters unrelated to the tribunal's activity. Nonetheless, owing to different conclusions formed, the topic of extending the scope to stages beyond the proceedings remains unresolved. To address this point, the manner in which this clause has been applied by various courts may be explored.

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[72] Howard M. Holtzmann and Joseph Neuhaus, *A Guide to the UNCITRAL Model Lawon International Commercial Arbitration: Legislative History and Commentary* (Kluwer Law International 1989) 550 (*UNCITRAL Commentary*); *See* Second Draft, Doc No A/CN.9/WG.II/WP.40, art XV, at 555; Fourth Draft, Doc No A/CN.9/WG.II/WP.48, art 19, at 556.

[73] *UNCITRAL Commentary* (n 65); Fifth Working Group Report, Doc No A/CN.9/246, para 62, at 556

[74] Analytical Commentary (n 63) para 8.

C. Judicial Courts' Application of the Provision

While Article 18 has not been extended to the parties' strategic decisions,[75] provisions of arbitration agreements that violate the principle of equal treatment have previously been determined to be in violation of Article 18 and hence illegal. In *Iwona G. v. A. Starosta I Wspolnicy*,[76] the Court nullified the arbitration agreement for breaching the principle of equal treatment by allowing the claimant to name just one of the seven arbitrators.

One may argue that in that instance, the stage was that of nominating arbitrators, which is included in the arbitration process. However, it should be emphasised that the clause has already been expanded to include stages other than the proceedings of an arbitral tribunal. In *Methanex Motunui v. Spellman* ("**Methanex Motunui**"), the New Zealand Court of Appeal highlighted that equal treatment must be extended to the stage of appeal against an arbitral award, which is obviously distinct from the arbitral tribunal's continuing proceedings.[77] In that instance, the Court overturned a clause in the parties' agreement that precluded reconsideration of the tribunal's verdict on certain grounds of natural justice.

It should be noted that the provisions invalidated in both instances referred to issues affecting the parties' procedural equality. This is true even in the Methanex Motunui case when conduct beyond the scope of the arbitration procedures was examined. This is because a review of a tribunal's ruling on natural justice grounds would ultimately involve procedural injustice throughout the procedures. As a result, the author believes that any uneven

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[75] *Re Corporación Transnacional de Inversiones, S.A. de C.V. et al. v. STET International, S.p.A. et al.*, CanLII 14819 (Ont. Sup. Ct. of Justice 1999) (Corporacion).

[76] *Iwona G. v. A. Starosta i Wspólnicy spółka jawna w B*. [2011] A/CN.9/SER.C/ABSTRACTS/157 (Pol. Ct. of App.).

[77] *Methanex Motunui v. Spellman* [2004] 3 NZLR 454 (NZ Ct. of App.).

treatment at a stage subsequent to the proceedings that have an effect on the proceedings' fairness would likewise fall within the meaning of Article 18. This interpretation of Article 18 permits an examination of the legality of UDCs under the provision, since UDCs primarily concern the stage of forum selection before the arbitration procedures.

IV. IS IT POSSIBLE TO RELY ON ARTICLE 18 TO INVALIDATE UDCS?

An examination of the legitimacy of UDCs under the rubric of Article 18 would largely rely on their influence on the fairness of the proceedings. The provision will be in conflict with Article 18 only if the disadvantaged party is denied a fair hearing throughout the proceedings as a result of the inequity caused by a UDC. In this respect, researchers and academicians have claimed that UDCs do not, in and of themselves, result in procedural injustice since the non-beneficiary has no disadvantage once the processes have begun in a fair venue.[78] Contrary to this notion, the author argues that UDCs often have the effect of increasing discrepancy in the positions of the parties throughout the course of the procedure, so becoming incompatible with Article 18. Three fictitious scenarios have been envisioned to bolster this point by demonstrating that UDCs may have an effect on arbitration processes on their own.

In each of these circumstances, the clause is a UAC that allows 'X' to choose between arbitration and litigation, while 'Y' is the non-beneficiary party that may only commence court actions.

Scenario 1: When a legal topic is well decided and a scholar expresses disagreement from the established legal stance. In such a case, X would have

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[78] Drahozal (n 40) 565.

the option of proceeding to arbitration and benefiting from the scholar's views by selecting them as an arbitrator or opting for litigation to guarantee that Y does not profit from the scholar's views by nominating them as an arbitrator. Such a decision by X would result in discord between the parties throughout the proceedings.

Scenario 2: Where the items in issue are believed to have certain faults. If X is the seller of the products in this circumstance, it may choose arbitration to protect the secrecy of its flaws. X, on the other hand, would commence legal procedures if Y is the seller. Such a decision would deprive Y of a fair hearing since it would be unable to present all of its arguments owing to the forum's public character. Here, it may be highlighted that the imbalance is caused by the selection of X, rendering the UDC procedurally unjust.

Scenario 3: Where the provision empowers X to choose between arbitral procedures in Y's country and judicial proceedings in X's country, and X's nation's public policy prohibits UDCs but Y's country permits them. In this circumstance, X may commence arbitration in Y's country. This option ensures that X can enforce the award against Y in the event that Y is unable to enforce the award against X, providing that their respective nations' assets are located only in their respective countries.[79] This puts X in an advantageous position throughout the proceedings, since it may leverage public policy issues to its favour.

Taken together, the three possibilities demonstrate the prospect of UDCs having a practical effect on procedural equality, even when the step of forum selection is not included in the arbitral processes. As a result, the author

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[79] Matti S. Kurkela et. al., 'Certain Procedural Issues in Arbitrating Competition Cases' (2007) 24(2) J. Int.l Arb. 189, 189 – 209.

has established objective rules for establishing the legality of such provisions under Article 18 of the Model Law in the following section.

V. USE OF A THREE STEP TEST FOR TREATING UDCS UNDER ARTICLE 18

The author offers a three-step test in this section after taking into account all of the previously described peculiarities. This objective criterion is intended to aid courts and tribunals in evaluating UDCs according to Model Law Article 18. To begin with, it is necessary to determine if the agreement was a strategic decision made by the non-beneficiary side. It is worth noting here that Article 18 does not apply to a party's strategic decisions.[80] As a result, if a non-beneficiary party accepts a UDC in exchange for getting certain additional advantages, the provision cannot be declared unlawful for violating the equal treatment requirement. In this respect, the Singapore Court of Appeal's comment in the Soh Beng Tee case may be instructive.[81] The Court said that "only when the alleged breach of natural justice has surpassed the boundaries of legitimate expectation and propriety can or should a remedy be made."[82] As a result, a UDC between two commercially savvy parties that is a manifestation of party autonomy may not be covered by the clause, as the parties would be cognizant of the repercussions of their strategic decisions.

Second, if the UDC was not included due to a strategic decision, the clause's influence on the proceedings should be considered. Despite the fact that the UDC relates to a step of forum selection that is not included in the "proceedings" of arbitration, the UDC may breach the need for procedural

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[80] *Corporacion* (n 68).
[81] *Soh Beng Tee & Co. Pte. Ltd. v. Fairmount Development Pte. Ltd.* [2007] 3 SLR (4) 86 (Sing. Ct. of App.).
[82] *Digest* (n 61) 99, para 9.

equality, as established in the preceding segment via various situations. If this is the case, Article 18 may be used to invalidate the provision.

Third, if the court or tribunal finds that the UDC before consideration of the tribunal violates Article 18, the provision may be modified into a bilateral one, granting both parties identical rights with respect to venue selection. In this sense, one may allude to the Sony Ericsson case, which was previously explored. Although the phrase was declared unlawful in that instance, it is the Russian Supreme Court's judgement, as stated in its Digest,[83] that is critical in this issue. The Digest highlighted that the phrase should have been modified to a bilateral arrangement. This has also been the remedy under UNIDROIT Principles Article 3.2.7, which allows for the modification of conditions that unjustifiably provide an excessive benefit to one of the parties.

However, one must bear in mind that the remedy of contract adaptation, which has been favoured over termination, may not always be within an arbitral tribunal's jurisdiction. Contradictory views have been stated in this regard, and it cannot be inferred categorically that the remedy of adaptation of a UDC may be provided in all circumstances.[84] Nonetheless, the author advises that the provision be adapted as the preferable remedy if the tribunal has the authority to do so.

VI. CONCLUDING REMARKS

UDCs are nearly commonly recognised, especially in finance and commercial agreements, where they are based on sound business rationale. Thus, the essence of the legitimacy debate over UDCs is a clash between party

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[83] *Sony Ericson* (n 10).

[84] *Sony Ericson* (n 10); *See Mauritius Commercial Bank Limited v Hestia Holdings Limited and Sujana Universal Industries Ltd.* [2013] EWHC 1328 (Comm.) (HC); *Mme X v Banque Privée Edmond de Rothschild* [2013] I.L.Pr. 12.

autonomy on the one hand and their essentially unbalanced character on the other. As a result, such sentences are often described with several flaws that have been previously disclosed. Additionally, these provisions are intrinsically susceptible to generating procedural disparity between the parties in certain instances.

Hence, the author recommends that, in addition to being assessed on grounds such as unconscionability, potestative nature, and infringement of the right to access the courts, UDCs must also pass the test set out in Article 18 of the Model Law when arbitration proceedings are commenced.

VII. A CRITICAL ANALYSIS OF THE INFORMANT MECHANISM UNDER THE SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015 VIS-À-VIS GLOBAL BEST PRACTICES ON WHISTLEBLOWING

- Sagnik Sarkar*

ABSTRACT

Whistleblowers perform a key social function. They expose wrongs that would otherwise have been difficult, if not possible, for State authorities to detect. This is the advantage of their proximity to the internal affairs of the organization they were, or are, employed with. Whistleblowers thus play a key role in upholding public ethics, by contributing to the detection of, and the enforcement of remediation measures and sanctions against, wrongs. Whistleblowing is particularly useful for securities law enforcement actions. These actions tend to rely heavily on circumstantial evidence, which is often difficult for a regulator to procure without disclosure from a whistleblower. The informant mechanism under the Regulations allows whistleblowers to report information concerning insider trading directly to SEBI. While the mechanism is well-intentioned, it falls short of global best practices on whistleblowing on multiple counts. Firstly, it fails to vest in employees a right to refuse to follow a direction from a superior reasonably believed to be unlawful. Secondly, it imposes an unwarranted burden on the informant to satisfy themselves that the conduct they are disclosing is wrongful. Thirdly, there is inadequate guidance on the extent to which SEBI will keep the informant's identity in confidence. Fourthly, the mechanism omits to protect the family members of informants against retribution. Fifthly, a protected person cannot seek a remedy against retribution as a matter of right. Finally, the burden of proof necessary to prove retaliation appears to be disproportionately high, with the odds of success stacked against the claimant.

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I. INTRODUCTION

There is no global consensus on the precise meaning of 'whistleblowing' and a 'whistleblower'.[1] However, there seems to be some common ground in the understanding of the term in a legal sense.[2] The general, international legal consensus seems to be that 'whistleblowing' refers to the act of: (*i*) a present, or former, an employee of an organization; (*ii*) disclosing information of an alleged wrong; (*iii*) by, or in, that organization; (*iv*) to a government authority.[3] The person who engages in this activity is a 'whistleblower'. Whistleblowers

[1] Organization for Economic Cooperation and Development (OECD), 'Study on Whistleblower Protection Frameworks, Compendium of Best Practices and Guiding Principles for Legislation' (OCED 2012) <https://www.oecd.org/corruption/48972967.pdf> accessed 27 October 2022, 7-8; United Nations Office on Drugs and Crime (UNODC), 'Resource Guide on Good Practices in the Protection of Reporting Persons' (UNODC 2015) <https://www.unodc.org/documents/corruption/Publications/2015/15-04741_Person_Guide_eBook.pdf> accessed 27 October 2022, 8-10.
[2] OCED (n 1); UNODC (n 1).
[3] ibid; The United Nations Convention Against Corruption 2003, art 33; The Council of Europe Civil Law Convention on Corruption 1999, art 9; Council of Europe, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, Council Res OECD/LEGAL/0378 (November 26, 2021), para. XXII; Bryan A. Gardner, *Black's Law Dictionary* 1627 (8th edn, Thomson West 2004).

may sometimes be described in legal instruments using other nomenclature.[4] The whistleblower, because of their past or present position in the organization in question, was or is privy to information about the alleged wrong that is not generally known to the public.[5] By engaging in whistleblowing, they bring this information to the knowledge of a government authority. This puts the government authority at notice of a probable wrong and allows them to initiate enforcement proceedings to remediate the effects of, and/or punish that conduct. Whistleblowers perform a key social function. They expose wrongs which would otherwise have been difficult, if not possible, for government authorities to detect.[6] This is the advantage of their proximity to the internal affairs of the organization they were, or are, employed with. Whistleblowers thus play a key role in upholding public ethics, by significantly increasing the detection of, and the enforcement of remediation measures and sanctions against, wrongs.[7] Several judicial precedents have recognized that the very act of whistleblowing, and therefore the conduct of whistleblowers, is in the public interest.[8] Whistleblowing is protected as a form of speech under the right to freedom of speech and expression and is thus deserving of protection

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[4] OCED (n 1); UNODC (n 1).

[5] ibid.

[6] UNODC (n 1) 3-5; Iheb Chalouat, Carlos Carrión-Crespo and Margherita Licata, 'Law and practice on protecting whistle-blowers in the public and financial services sectors' 2-3 (ILO 2019); International Bar Association (IBA) and Government Accountability Project, 'Are whistleblowing laws working? A global study of whistleblower protection litigation' (IBA 2021) <https://www.ibanet.org/MediaHandler?id=49c9b08d-4328-4797-a2f7-1e0a71d0da55> accessed 27 October 2022, 2.

[7] UNODC (n 1) 3-5; Chalouat (n 6); IBA (n 6) 2; Transparency International, 'International Principles for Whistleblower Legislation' (Transparency International 2013) <https://images.transparencycdn.org/images/2013_WhistleblowerPrinciples_EN.pdf> accessed 27 October 2022.

[8] *Indirect Tax Practitioners Association v R K Jain* (2010) 8 SCC 281 (India); *Lane v Franks* 573 US 228 (2014); *Department of Homeland Security v MacLean* 574 US 383 (2015); *Guja v. Moldova* App No 14277/04 (ECtHR, 12 February 2008); *Marchenko v Ukraine* App No 4063/04 (ECtHR, 19 February 2009); *Kudeshkina v Russia* App No 29492/05 (ECtHR, 26 February 2009); *Heinisch v Germany* App No 28274/08 (ECtHR, 21 July 2011); *Bucur v. Romania* App No 40238/02 (ECtHR, 08 January 2013).

by the State.[9] In cases where the benefits from the disclosure outweigh its harms, and where there is no effective alternative to redress the conduct being disclosed, the whistleblower has a constitutional or human right to be protected against any form of retribution— not just by the State but by any private person too.[10] In such a case, retribution gives the whistleblower a right to seek redress under constitutional law or human rights law.[11] In the context of securities law specifically, whistleblowing is especially useful as an aid to the regulation of the securities market consistent with the free market ethics of ensuring that the market offers every participant a level playing field.[12] Experience shows that enforcement actions for violations of securities law are heavily reliant on circumstantial evidence.[13] Circumstantial evidence, by its nature, is quite difficult to detect and collect, without some aid from an insider in the target of the investigation.[14] This makes securities enforcement actions

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[9] *Indirect Tax Practitioners Association* (n 8); *Lane* (n 8); *MacLean* (n 8); *Guja* (n 8); *Kudeshkina* (n 8); *Heinisch* (n 8); *Marchenko* (n 8); *Bucur* (n 8).

[10] ibid.

[11] ibid.

[12] Chester S. Spatt, 'An Informal Perspective on the Economics and Regulation of Securities Markets' (2010) 2(1) Annual Review of Financial Economics 127; Paul G. Mahoney, 'The Economics of Securities Regulation: A Survey' (2021) 13(1) Foundations and Trends in Finance 1, 8-13; US Securities and Exchange Commission, 'Remarks of Commissioner J. Carter Bessee, Jr., U.S. Securities and Exchange Commission: The Role of Ethics in Protecting the U.S. Capital Markets: AIMR Conference on Ethics, Washington, D.C., November 30, 1993' (SEC 1993) <https://www.sec.gov/news/speech/1993/113093beese.pdf> (accessed 27 October 2022).

[13] US Securities and Exchange Commission, 'Speech by SEC Staff: Insider Trading – A U.S. Perspective: Remarks by Thomas C. Newkirk Associate Director, Division of Enforcement, Melissa A. Robertson, Senior Counsel, Division of Enforcement, U.S. Securities & Exchange Commission: 16th International Symposium on Economic Crime Jesus College, Cambridge, England, September 19, 1998' (SEC 1998) <https://www.sec.gov/news/speech/speecharchive/1998/spch221.htm> accessed 27 October 2022; Shruti Rajan and Vidhi Shah, 'The Use of Circumstantial Evidence in Securities Law Enforcement', *IndiaCorpLaw*, 16 September 2020 <https://indiacorplaw.in/2020/09/the-use-of-circumstantial-evidence-in-securities-law-enforcement.html> accessed 27 October 2022.

[14] Stephen Hall and Jason Grimes, 'SEC's Whistleblower Program: A $5 Billion Success Story With a Bright Future", Better Markets, January 20, 2022' <https://bettermarkets.org/wp-content/uploads/2022/01/BetterMarkets_Report_SECs_Whistleblower_Program_January_2

relatively harder to prosecute, compared to prosecution for traditional crimes and other wrongs which are not as reliant on circumstantial evidence. Thus, the presence of a whistleblower with knowledge of inside information concerning a violation of securities law is especially useful.[15] Therefore, it is not surprising that securities market regulators across the world have established mechanisms for whistleblowers to bring information about alleged violations to their notice. These regulators, especially the US Securities and Exchange Commission, have experienced significant success in prosecuting violations of securities law based on information received under their whistleblowing mechanisms.[16] From a public ethics perspective, whistleblowing is a social good. It is therefore prudent to implement policy measures that can incentivize whistleblowing. These may be established through the constitution of a whistleblower mechanism. There seem to be two primary challenges any whistleblower mechanism must tackle. *Firstly*, the act of whistleblowing itself must be effective.[17] Whistleblowing is socially useful only if it leads to the discovery of actionable information that a government authority may reasonably rely on to commence an enforcement action. It is axiomatic that this requires the information disclosed to meet a minimum

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022.pdf> accessed 27 October 2022; Jason Zuckerman and Matthew Stock, 'Better Markets' Report Documents the Success of the SEC Whistleblower Program', (*The National Law Review*, 21 January 2022) <https://www.natlawreview.com/article/better-markets-report-documents-success-sec-whistleblower-program> accessed 27 October 2022.

[15] Hall (n 14); Zuckerman (n 14).

[16] 'Speech: The SEC as the Whistleblower's Advocate' (SEC, 2015) <https://www.sec.gov/news/speech/chair-white-remarks-garrett-institute> accessed 05 April 2023; SEC Office of the Whistleblower, 'SEC Whistleblower Office Announces Results for FY 2022' (SEC, 2023) <https://www.sec.gov/files/2022_ow_ar.pdf> accessed 05 April 2023; SEC Office of the Inspector-General, 'Evaluation of the SEC's Whistleblower Program' (SEC, 2013) <https://www.sec.gov/about/offices/oig/reports/audits/2013/511.pdf> accessed 05 April 2023.

[17] International Bar Association (IBA) and Government Accountability Project, 'Are whistleblowing laws working? A global study of whistleblower protection litigation' (IBA 2021) <https://www.ibanet.org/MediaHandler?id=49c9b08d-4328-4797-a2f7-1e0a71d0da55> accessed 27 October 2022, 8.

standard of quality. *Secondly*, despite the general ethical soundness of the very act of whistleblowing, whistleblowers themselves face the threat of victimization. A whistleblower, by definition, reports to the government a conduct for which their employer can potentially be held liable. Hence, it is not surprising that, quite often, the employer engages in retribution by exercising their power over the whistleblower by virtue of the subsisting employment relationship between the two. Thus, there is a consensus that whistleblower mechanisms must be designed to protect whistleblowers from victimization for their conduct.[18] Hence, the object of a good whistleblower mechanism should be to maximize the achievement of both these policy objectives. In India, securities law was lacking a whistleblowing mechanism for a significant time. A potent aid to enforcement was thus lacking. A whistleblower mechanism was introduced in 2019 by an amendment[19] to the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.[20] Through this amendment, SEBI inserted Chapter III-A in these Regulations. The Chapter establishes an informant mechanism for reporting alleged instances of insider trading to SEBI. It contains provisions regarding the reporting mechanism, protecting the confidentiality of the

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[18] Transparency International, 'International Principles for Whistleblower Legislation' (Transparency International 2013) <https://images.transparencycdn.org/images/2013_WhistleblowerPrinciples_EN.pdf> accessed 27 October 2022, 2-6; Organization for Economic Cooperation and Development (OECD), 'The Role of Whistleblowers and Whistleblower Protection' (OCED 2016) <https://www.oecd.org/corruption/anti-bribery/OECD-The-Role-of-Whistleblowers-in-the-Detection-of-Foreign-Bribery.pdf> accessed 27 October 2022; Iheb Chalouat, Carlos Carrión-Crespo and Margherita Licata, 'Law and practice on protecting whistle-blowers in the public and financial services sectors' (ILO 2019), 1-5; Council of Europe, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, Council Res OECD/LEGAL/0378 (November 26, 2021), para. XXI, XXII; IBA (n 16) at 8.

[19] The Securities and Exchange Board of India (Prohibition of Insider Trading) (Third Amendment) Regulations 2019.

[20] The Securities and Exchange Board of India (Prevention of Insider Trading) Regulations 2015.

informant's identity, and rewards for the informant. No literature has comprehensively, and critically, analyzed the extent to which the informant mechanism under these Regulations was able to attain the policy objectives of a good whistleblowing mechanism. The available literature seems to be mere piecemeal comments on the informant mechanism, and none of them delineates the yardstick by which the mechanism has been analyzed. [21] This paper intends to fill that gap. The object of this paper is to critically analyse the informant mechanism established under the Regulations. The author hypothesises that the informant mechanism is not consistent with the global best practices on good whistleblower mechanisms. In Part II, the paper describes the best practices for establishing an effective whistleblowing mechanism, gathered from the learned experience of well-functioning whistleblower mechanisms across the world. In Part III, the author studies the features of the informant mechanism under the Regulations and analyzes the extent to which its features conform to the best practices discovered in the last Part. Finally, in Part IV, the author summarizes their findings, tests the hypothesis, and recommends amendments to the informant mechanism to increase its effectiveness.

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[21] Dhruti Lunker and Isiri SD, 'Reward for Revelation: A Critical Analysis on SEBI's Informant Mechanism', (*NUALS Law Journal Blog*, 08 May 2020) <https://nualslawjournal.com/2020/05/08/reward-for-revelation-a-critical-analysis-on-sebis-informant-mechanism/> accessed 27 October 2022; *Tushar Oberoy, 'SEBI's Informant Mechanism: Impact of the Incentives on Internal Compliance Programs', (NLIU CBCL Blog, 01 August 2020)* <https://cbcl.nliu.ac.in/capital-markets-and-securities-law/sebis-informant-mechanism-impact-of-the-incentives-on-internal-compliance-programs/> *accessed 27 October 2022; Preet Choksi, 'Informant mechanism in India and whistleblower in USA: A step towards curbing insider trading', (NLUJ Law Review Blog, 19 March 2021)* <http://www.nlujlawreview.in/informant-mechanism-in-india-and-whistleblower-in-usa-a-step-towards-curbing-insider-trading/> *accessed 27 October 2022.*

II. HOW TO DEVELOP A GOOD WHISTLEBLOWER MECHANISM: LESSONS FROM THE WORLD

There is ample, authoritative literature that has studied whistleblower mechanisms across the world. Each of these works has succinctly distilled the best practices that we can gather from global experience in designing a good whistleblower mechanism. One of the most comprehensive studies on this subject is a joint report by the International Bar Association and the Government Accountability Project.[22] This report has studied whistleblower protection legislation, and related litigation, across the world. There is another study, conducted by the International Labour Organization (ILO),[23] that has studied trends in whistleblower mechanisms specifically in the public sector and the financial services sector across the world. The UN Office on Drugs and Crime (UNODC) has published a resource guide[24] that has identified global best practices for designing a good whistleblower mechanism, based on a global review of whistleblower mechanisms. Similarly, the G20 Anti-Corruption Plan has published a report identifying global best practices in designing whistleblower mechanisms.[25] There is a remarkable similarity in the recommendations contained in each of these works. In this part, the author will

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[22] International Bar Association (IBA) and Government Accountability Project, 'Are whistleblowing laws working? A global study of whistleblower protection litigation' (IBA 2021) <https://www.ibanet.org/MediaHandler?id=49c9b08d-4328-4797-a2f7-1e0a71d0da55> accessed 27 October 2022 ('IBA-GAP Study').

[23] Iheb Chalouat, Carlos Carrión-Crespo and Margherita Licata, 'Law and practice on protecting whistle-blowers in the public and financial services sectors' (ILO 2019) ('ILO Study').

[24] United Nations Office on Drugs and Crime (UNODC), 'Resource Guide on Good Practices in the Protection of Reporting Persons' (2015) <https://www.unodc.org/documents/corruption/Publications/2015/15-04741_Person_Guide_eBook.pdf> accessed 27 October 2022 ('UNODC Guide').

[25] Organization for Economic Cooperation and Development (OECD), 'Study on Whistleblower Protection Frameworks, Compendium of Best Practices and Guiding Principles for Legislation' (OECD 2012) <https://www.oecd.org/corruption/48972967.pdf> accessed 27 October 2022 ('OECD Study').

briefly describe these recommendations. For convenience, the author has divided the recommendations into three distinct stages, depending on which stage in the typical whistleblowing process each recommendation pertains to: (*a*) pre-disclosure; *(b*) during disclosure; and (*c*) post-disclosure.

A. Best Practices in the Pre-Disclosure Stage

The role of a formal whistleblower mechanism begins even before a whistleblower makes a disclosure. The policy measures pertaining to this stage lay the groundwork for effective whistleblowing. The best practices for designing the pre-disclosure stage, in no particular order, are the following.

1. Definition of Protected Disclosures

The first challenge of designing a good mechanism is definitional—what constitutes whistleblowing, and who is a whistleblower? This is a two-stage process. *Firstly*, we identify the types of wrongs regarding which whistleblowing can be allowed. Ideally, this scope should be as broad as possible.[26] *Secondly*, one should define whistleblowing to encompass all situations in which a whistleblower discloses information that provides a reasonable basis to believe that one of those types of wrongdoing has occurred, is occurring, or is about to occur.[27] On the contrary, the worst standard to apply

[26] IBA-GAP Study, 13-16; ILO Study, 14-18; UNODC Guide, 22-26; Transparency International, 'International Principles for Whistleblower Legislation' (Transparency International 2013) <https://images.transparencycdn.org/images/2013_WhistleblowerPrinciples_EN.pdf> accessed 27 October 2022 4-5 ('Transparency International Principles').

[27] IBA-GAP Study, 13-16; ILO Study, 14-18; UNODC Guide, 22-26; Transparency International Principles; Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law ('EU Whistleblower Protection Directive'), art 15(1)(b); The Public Interest Disclosure Act 1998, s 23, 43G (UK); The Public Interest Disclosure Act 2013, s 26, 28 (Australia); 18 USC § 1514(a).

(instead of reasonable basis to believe) is a requirement of good faith.[28] A requirement to demonstrate good faith places a difficult evidentiary burden for the whistleblower to satisfy, in addition to the troubles they are already subject to, by virtue of their identity.[29] This has a chilling effect on whistleblowing. A 'reasonable basis to believe the standard is better because it allows a whistleblower to make "honest mistakes" while incentivizing the disclosure of all information that may be potentially useful to a regulator at the same time.[30]

2. *Broad Definition of 'Employee'*

As explained above, whistleblowing, in a legal sense, is typically defined to restrict the scope of a 'whistleblower' to an 'employee'. In practice, whistleblower mechanisms should define this term broadly, to include not only employees in the traditional sense but also persons in quasi-employment relationships— such as contractors, probationers, interns, etc.[31] The scope should be extended to all persons who, by virtue of their proximity to the internal affairs of the organization in question, are as likely as traditional employees to be privy to inside information of potential wrongs.[32]

3. *Right to Refuse Violation of Law*

The reality of the workplace is that, in many situations, an employee may be directed by a superior to conduct themselves in a manner which is potentially unlawful. In every case where an employee has reasonable basis to

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[28] IBA-GAP Study, 13-16; ILO Study, 14-18; UNODC Guide, 22-26; Transparency International Principles.
[29] ibid.
[30] ibid
[31] IBA-GAP Study, 17-18; OCED Study; ILO Study, p. no. 14-15; Transparency International Principles, 4-5.
[32] ibid; See EU Whistleblower Protection Directive, art 4; See The Public Interest Disclosure Act 2013, s 10(b) (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 2, 4, 8, 10; See The Protected Disclosures Act 2000, s 19A (New Zealand).

believe they are being directed to act unlawfully, they must be: (*i*) vested with the right to refuse to follow that direction and (*ii*) be protected from adverse consequences for this refusal.[33] In some cases, an employee may need to consult a professional – such as a lawyer – for expert advice on the legality of the conduct in question. In such a case, the same protection should also be extended for the entirety of the time necessary to seek such advice.[34]

4. *Ban on 'Gag Orders'*

Any provision of law, or contract, that imposes a restraint on whistleblowing, or prescribes adverse consequences for whistleblowing, should be void.[35] This is relatively easy to ensure. The whistleblower law in question must have an overriding effect, and declare all provisions which act as 'gag orders' void.[36]

B. Best Practices in the Disclosure Stage

The disclosure stage, the stage in which the whistleblower actually 'blows the whistle' by disclosing information, is the most critical of the entire process. It is particularly important to design this stage with care, as the resulting framework can make, or break, a whistleblower mechanism. The best practices for designing the disclosure stage, in no particular order, are the following.

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[33] IBA-GAP Study, 16; Transparency International Principles, 6; See 5 USC § 2302(b)(9)(d).
[34] IBA-GAP Study, 17-18; OCED Study; ILO Study, p. no. 14-15; Transparency International Principles, 4-5; EU Whistleblower Protection Directive, art 4; See The Public Interest Disclosure Act 2013, s 10(b) (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 2, 4, 8, 10; See The Protected Disclosures Act 2000, s 19A (New Zealand).
[35] IBA-GAP Study, 21; UNODC Guide, 26; Transparency International Principles, 6.
[36] ibid; See EU Whistleblower Protection Directive, art. 21-22, 24; See The Public Interest Disclosure Act, 2013 (Act No. 133 of 2013), s. 10(1)(b), 10(2)(b) (Australia); See The Public Interest Information Disclosure (Provide Protection) Act, 2011 (Act No. 7 of 2011), s. 3 (Bangladesh).

1. Identity Protection

As explained above, the primary challenge of whistleblowing seems to be the real risk of retribution that follows. Protecting the identity of the whistleblower from disclosure significantly mitigates the probability of retribution. Absent this crucial information, it is difficult for the employer, and their associates, to identify the whistleblower and target them with adverse consequences. Identity protection for whistleblowers should therefore be a key element of any whistleblower mechanism.[37] In the absence of effective identity protection, there can be a serious chilling effect on whistleblowing. [38] Identity protection may be achieved in any of two ways: (*i*) anonymity, in which case the identity of the whistleblower is unknown to the government authority receiving the information; and (*ii*) confidentiality, in which case their identity is known to the government authority, but is protected from disclosure to the public at large by that authority.[39] Confidentiality must extend to not just the whistleblower's direct identity (such as their name, address, designation, etc.), but also to information which may indirectly identify them.[40] The authority must not disclose the whistleblower's identity without their consent. If the authority instead chooses to adopt a model where it may disclose identity without consent, it should have a clear policy, publicized well in advance, governing such non-consensual disclosures.[41]

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[37] IBA-GAP Study, 21; UNODC Guide, 26; Transparency International Principles, 6.
[38] ibid
[39] ibid; See EU Whistleblower Protection Directive, art 16; See The Public Interest Disclosure Act 2013, s 20-21, 24 (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 5 (Bangladesh); See The Republic of Lithuania Law on Protection of Whistleblowers, art 8-9; See18 USC § 1514A(b)(2).
[40] IBA-GAP Study, 21; UNODC Guide, 26; Transparency International Principles, 6.
[41] ibid.

2. Interim Relief

Interim relief is yet another means by which a whistleblower can be protected from retribution. In practice, a determination on the merits of a whistleblower retaliation claim may consume a significant amount of time. In the meanwhile, absent interim relief, the whistleblower will be left to fend for themselves, including by being subject to retaliation. Thus, the absence of interim relief practically allows the adverse consequences of retaliation to play out, which has a chilling effect on whistleblowing.[42] Hence, every whistleblower mechanism must allow for interim relief.[43] The mechanism should allow for a broad range of common law, and equitable, reliefs.[44] It seems that reinstatement of the employee in question to their original position prior to termination, with the same privileges and benefits they were drawing at the time of termination, is a particularly powerful interim relief because this incentivizes the employer to engage in 'damage control' by inducing them to settle on fair terms.[45]

C. Best Practices in the Post-Disclosure Stage

Finally, the ambit of a good whistleblower mechanism extends even after the whistleblower has made a disclosure. The best practices for designing the post-disclosure stage, in no particular order, are the following.

1. Rewards

Incentives are the most primal language all humans understand. Hence, everything else remaining constant, the promise of a potential monetary

[42] IBA-GAP Study, 28-29.
[43] ibid.
[44] ibid; See EU Whistleblower Protection Directive, art 21; See The Public Interest Disclosure Act 2013, s 15 (Australia); See The Public Interest Disclosure Act 1998, s 9 (UK); See 5 USC § 1214(b)(1), 1221(c).
[45] IBA-GAP Study, 29.

reward will stimulate more whistleblower disclosures. Hence, a whistleblower mechanism may allow for rewards to whistleblowers.[46] The quantum of the reward is typically linked to the monetary penalty recovered by the regulator in question on successful enforcement action. [47]

2. *Broad Protection against Retaliation*

Retaliation has a very significant chilling effect on whistleblowing. Hence, every whistleblower mechanism must protect a whistleblower against retaliation.[48] In defining the scope of retaliation, three key principles apply. *Firstly*, the forms of retaliation possible seem to be "limited only by the imagination".[49] Hence, a whistleblower mechanism needs to define retaliation broadly. Essentially, any form of discrimination or conduct – actual, threatened, or recommended attributable to the act of whistleblowing must be forbidden.[50] The consequences may not always be limited to the workplace and the employment relationship between whistleblower and employee. All forms of retaliation outside of the employment context such as civil actions, criminal actions, harassment of family members, etc. – should be prohibited. *Secondly*, it is important to recognize that retaliation may flow from not just the employer, but also third parties.[51] These third parties may not always be associated with the employer, or even in connivance with the employer. For example, a misplaced sense of loyalty to the organization may induce the whistleblower's co-workers to become hostile, without any inducement to that effect by the employer.[52] *Thirdly*, in the thirst to identify the whistleblower,

[46] ILO Study, 21-22; UNODC Guide, 67-68; OECD Study, 22.
[47] IBA-GAP Study, 29.
[48] IBA-GAP Study, 19-20; ILO Study, 18-19; UNODC Guide, 45-46; OECD Study, 22.
[49] IBA-GAP Study, 29.
[50] ibid; See EU Whistleblower Protection Directive, art 5, 19, 21; See The Public Interest Disclosure Act 2013, s 10, 13, 23, 57, 58 (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 5 (Bangladesh).
[51] IBA-GAP Study, 29.
[52] ibid.

individuals may often identify the wrong person as the whistleblower, and subject that person to retaliation. Thus, all employees who are, or may be perceived as a whistleblower, or as aiding a whistleblower, must be protected from retaliation.[53] *Finally*, retaliation targeted against the family members of protected persons is almost as consequential as retaliation against the protected persons themselves. Hence, the scope of protection against retaliation must be extended to the immediate family members too.[54]

3. *Reverse Burden of Proof for Retaliation Claims*

Experience shows that it is extremely difficult for whistleblowers to prove retaliation when the entire burden of proof is placed on them.[55] The 'reverse' burden of proof, first adopted by the USA in its Whistleblower Protection Act, 1998, has now become the 'gold standard' across the world for whistleblower retaliation claims.[56] This standard makes it relatively easier for whistleblowers to prove retaliation claims.[57] Under this standard, (*i*) at the very outset, the whistleblower must make out a prima facie case of retaliation; and (*ii*) once they discharge this onus of proof, the onus shifts to the employer to prove, by "clear and convincing evidence" (an evidentiary standard higher than 'preponderance of probabilities but lower than 'beyond reasonable doubt'), that the conduct in question is not attributable to the whistleblower's

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[53] IBA-GAP Study, 16-17; EU Whistleblower Protection Directive, art 4; See The Public Interest Disclosure Act 2013, s 13, 57 (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 10(3); See18 USC § 1514A.

[54] IBA-GAP Study, 17-18; EU Whistleblower Protection Directive, art 4; See The Public Interest Disclosure Act 2013, s 10(b) (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 2, 4, 8, 10.

[55] IBA-GAP Study, 25-27; UNODC Guide, 64-65.

[56] IBA-GAP Study, 17-18; EU Whistleblower Protection Directive, art 4; See The Public Interest Disclosure Act 2013, s 10(b) (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 2, 4, 8, 10.

[57] ibid.

disclosure.[58] Under the first limb of this standard, it is enough for the whistleblower to prima facie prove that the employee's whistleblowing was a 'contributing factor' for the conduct in question.[59]

4. True Compensatory Reliefs for Retaliation

Once retaliation is proved, the relief afforded to the whistleblower should be compensatory to the fullest extent possible.[60] The object is to restore the whistleblower to the status quo ante.[61] Hence, relief should extend to past, present, and future, consequences of the retaliation, including intangible consequences, such as emotional distress, loss of reputation, etc.[62] Notably, the whistleblower must be awarded real costs, to allow them to recoup the expenses incurred in the entire process of proving the retaliation claim.[63] Costs incurred in prosecuting a claim can quite often be very significant, and these must be compensated.

5. Capacity for Settlement of Retaliation Claims by ADR

Whistleblowers must be given the option to refer their retaliation claims to methods of alternative dispute resolution (ADR).[64] ADR

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[58] ibid; See EU Whistleblower Protection Directive, art 21; See 5 USC § 1214(b)(2)(4), 1221(e); See The Law on Whistleblower Protection in the Institutions of Bosnia-Herzegovina, art 8(3).
[59] ibid.
[60] IBA-GAP Study, 27-28; UNODC Guide, 47-48; OECD Study, 22; See EU Whistleblower Protection Directive, art 21; See The Public Interest Disclosure Act 2013, s 14, 16 (Australia); See The Protected Disclosures Act 2000, s 17 (New Zealand).
[61] EU Whistleblower Protection Directive, art 21; See 5 USC § 1214(b)(2)(4), 1221(e); See The Law on Whistleblower Protection in the Institutions of Bosnia-Herzegovina, art 8(3).
[62] ibid.
[63] IBA-GAP Study, 30-31; See EU Whistleblower Protection Directive, art 20; See The Public Interest Disclosure Act 2013, s 18 (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 8, 14; See The Protected Disclosures Act 2000, s 17 (New Zealand); See 5 USC § 1221(g).
[64] IBA-GAP Study, 25; See 5 USC § 7121.

mechanisms are often a viable, and less costly, a process by which a fair settlement can be reached in retaliation claims.[65]

6. Personal Accountability for Retaliation

In many cases, the employer that engages in retaliation will be a body corporate. Body corporates are abstract entities. They only act at the direction, and through the agency, of natural persons. The humans who direct the body corporate to retaliate or engage in retaliation on behalf of the body corporate, must be held individually liable.[66] This is necessary to ensure that humans are held responsible for their conduct, and for the deterrent effect of sanctions for retaliation to have its effect on them.[67]

III. THE INFORMANT MECHANISM UNDER THE SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

A. Background

In India, statutory whistleblower mechanisms, that is, those established by a statute or according to a statutory direction are few and far between.

In principle, the need for a general whistleblower statute in India has been long recognized. A general law for the promotion of whistleblowing, and protection of whistleblowers against retaliation, was recommended as early as

[65] IBA-GAP Study, 30-31; See EU Whistleblower Protection Directive, art 20; See The Public Interest Disclosure Act 2013, s 18 (Australia); See The Republic of Lithuania Law on Protection of Whistleblowers, art 8, 14; See The Protected Disclosures Act 2000, s 17 (New Zealand); See 5 USC § 1221(g).
[66] IBA-GAP Study, 31-32; UNODC Guide, 57-58; See EU Whistleblower Protection Directive, 23; See The Public Interest Disclosure Act 2013, s 14, 19 (Australia); See 18 USC § 1514A.
[67] IBA-GAP Study, 31-32.

2001, by the Law Commission in its 117th Report.[68] The Report includes a draft Bill for that purpose.[69] The 4th Report of the Second Administrative Reforms Commission, published in 2007, recognized the public value of whistleblowing and recommended the enactment of legislation to promote whistleblowing and protect whistleblowers from retaliation.[70] It noted that no law to that effect had yet been enacted.[71] Spurred by the controversy surrounding the murder of 'grand corruption' whistleblower Satyendra Dubey, and acting on the recommendations of the Law Commission, the Central Government introduced a whistleblower mechanism under the aegis of the Central Vigilance Commission (CVC). Notably, this was introduced through an executive resolution notified in the Gazette of India[72] and did not have and continues to lack any statutory basis. The scope of this mechanism is limited to disclosures concerning corruption by government servants, and employees of government-owned, or government-controlled, bodies[73] CVC continues to implement this mechanism based on that executive resolution, and in furtherance of additional executive circulars on the same subject.[74] The introduction of the Whistleblower Protection Bill, of 2011 was the first attempt at enacting a general whistleblowing statute.[75] After deliberation in committee

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[68] Law Commission of India, *117th Report on The Public Interest Disclosure and Protection of Informers* (Law Commission of India 2001).
[69] ibid.
[70] Second Administrative Reforms Commission, '*Fourth Report of Second Administrative Reforms Commission: Ethics in Governance'* (Government of India 2007), 77-79.
[71] ibid.
[72] Central Vigilance Commission, 'Notification No. No. 371/12/2002-AVD-111' (Gazette of India, 21 April 2004) <https://cvc.gov.in/sites/default/files/371_4_2013-AVD-III-16062014_0-7-13_1.pdf> accessed 18 March 2022.
[73] ibid.
[74] 'PIDPI Complaints | Guidelines for Lodging PIDPI Complaint', *Central Vigilance Commission* <https://cvc.gov.in/?q=citizens-corner/whistle-blower-complaints> accessed 27 October 2022.
[75] 'The Whistle Blowers Protection Bill, 2011', (*PRS Legislative Research)* <https://prsindia.org/billtrack/the-whistle-blowers-protection-bill-2011> accessed 27 October 2022.

and the Houses of Parliament, the Bill was passed as the Whistle Blowers Protection Act, 2014.[76] However, quite extraordinarily, despite the passage of 8 long years since, the Act has not yet been notified as law by the Central Government.[77] Thus, even today in 2022, India lacks a general statute on whistleblowing. In the meanwhile, parallel developments were unfolding in the limited arena of securities law. In 1999, SEBI appointed the K.M. Birla Committee on Corporate Governance to study the state of corporate governance in India and recommend changes to securities law to improve the governance of listed companies.[78] The committee's report recommended several changes, and thus changed the landscape of corporate governance in India forever. Many of the recommendations of the report such as the appointment of independent directors, raising an Audit Committee of the Board, and enhanced financial reporting standards[79] have since become the mainstay of the governance of listed companies today. SEBI enforced these recommendations through an exchange-driven regulatory mechanism. It directed stock exchanges to incorporate Clause 49 in the Listing Agreement, the agreement in a prescribed form, that every company desirous of listing must execute with the stock exchange[s] to incorporate the report's recommendations as obligations vested in listed companies.[80] In 2004, SEBI revamped the entire Clause 49 and directed the exchanges to enforce the

[76] The Whistle Blowers Protection Act 2014 (India).
[77] Gaurav Vivek Bhatnagar, 'Five Years After Passing Law to Protect Whistleblowers, Govt Yet to Operationalise It', (*The Wire*, 22 February 2019) <https://thewire.in/government/whistle-blowers-protection-act-five-years> accessed 27 October 2022.
[78] Kumar Mangalam Birla Committee on Corporate Governance, 'Report of the Committee Appointed by the SEBI on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla' (SEBI 2000) para. 2.1-2.5
[79] ibid, para. 6.3-6.10, 9.1-9.10, 12.1.
[80] Securities and Exchange Board of India (SEBI), 'Circular No. SMDRP/POLICY/CIR-10/2000' (SEBI, 21 February 2000) <https://www.sebi.gov.in/legal/circulars/feb-2000/corporate-governance_17930.html> accessed 19 March 2022.

revised Clause 49.[81] The revised Clause 49 contained a skeletal prescription regarding an internal whistleblower mechanism in listed companies.[82] It recommended, but did not obligate, listed companies to establish an internal whistleblower mechanism, under the supervision of the Audit Committee of the Board of Directors.[83] The obligations under Clause 49 of the Listing Agreement were later given statutory form in the SEBI (LODR) Regulations, 2015.[84] Under the SEBI (LODR) Regulations, every listed company is now mandated to establish an internal whistleblowing mechanism known as the 'vigil mechanism', once again under the supervision of the Audit Committee of the Board.[85] The Companies Act, 2013 repeats the same requirement.[86] These Regulations too are not very prescriptive regarding the vigil mechanism, and this confers on the Board a significant degree of discretion in designing the mechanism.[87] SEBI's intent of establishing an external whistleblower mechanism by which disclosures can be made directly to SEBI was revealed in concrete form for the first time in 2019. SEBI released a discussion paper on the proposed mechanism and called for public comments on the proposal.[88] By an amendment [89] to the Regulations later that year, SEBI

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[81] Securities and Exchange Board of India (SEBI), 'Circular No. SEBI/CFD/DIL/CG/1/2004/12/10' (SEBI, 29 October 2004) <https://www.sebi.gov.in/legal/circulars/oct-2004/corporate-governance-in-listed-companies-clause-49-of-the-listing-agreement_13153.html> accessed 19 March 2022.
[82] ibid Annexure I, para. D(12); Annexure I C, para. 7(iii); ibid, Annexure I D, para. 7.
[83] ibid.
[84] The Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015.
[85] ibid, reg 4(2)(d)(iv), 22, 46(2)(e).
[86] The Companies Act 2013, s 177(9), 177(10) (India).
[87] ibid.
[88] Securities and Exchange Board of India (SEBI), 'Discussion Paper on amendment to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to provision for an informant mechanism' (SEBI, 2019) <https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism_43237.html> accessed 27 October 2022.
[89] The Securities and Exchange Board of India (Prohibition of Insider Trading) (Third Amendment) Regulations 2019.

inserted a new Chapter III-A. The chapter established an informant mechanism for whistleblowers to report information concerning insider trading to SEBI.[90] It contains a reporting mechanism, provisions concerning the protection of the informant's identity, and rewards for the informant. [91] The scope of this mechanism is limited to disclosures concerning insider trading alone.[92] There is presently no similar mechanism for the disclosure of any other wrongs under securities law to SEBI. In this part, the author has deconstructed the key provisions of the informant mechanism under the Regulations and critically analyzed each of them, using the global best practices for designing a whistleblower mechanism as the yardstick.

B. Gag Orders and Right to Refuse

The Regulations explicitly declare as void any contractual provision that prevents any person other than an advocate from disclosing the informant mechanism.[93] This is entirely consistent with the global best practice of preventing 'gag orders'.[94] Global best practice also requires the law to confer on every employee a right to refuse to act in a manner reasonably believed to be unlawful until a legal determination is obtained.[95] The Regulations, however, are entirely silent on such a right. To that extent, the Regulations are not consistent with global best practices.

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[90] ibid.
[91] ibid.
[92] ibid.
[93] SEBI (PIT) Regulations, reg 7J.
[94] IBA-GAP Study, 21; UNODC Guide, 26; Transparency International Principles, 6; See EU Whistleblower Protection Directive, art 21-22, 24; See The Public Interest Disclosure Act 2013, s 10(1)(b), 10(2)(b) (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 3 (Bangladesh).
[95] IBA-GAP Study, 16; Transparency International Principles, 6; See 5 USC § 2302(b)(9)(d).

C. Definition of 'informant'

Under the Regulations, the whistleblower has been termed as an "informant". Unfortunately, the informant mechanism under the Regulations seems doomed from the very beginning due to the unsound definition of the term "informant". The definition is not consistent with global best practices on defining a whistleblower and the scope of protected disclosures, as it imposes an onerous burden of proof on the informant.

The Regulations define "informant" as an individual who discloses information concerning a violation of insider trading that: (*a*) has occurred; (*b*) is occurring; or (*c*) the informant has a reasonable belief is about to occur. [96] Note that the reasonable belief qualifier applies only to the third limb of the definition, to the exclusion of the first two limbs. Thus, to be considered an informant under the Regulations, a whistleblower disclosing past or present, the conduct must provide information concerning an actual violation of insider trading laws. This places a burden on the informant to satisfy themselves that the information disclosed relates to conduct that is an actual violation of insider trading laws. This burden is unduly onerous because of two reasons. *Firstly*, the informant has to satisfy themselves with a legal question, which they are not qualified to do. They must therefore seek counsel from a professional, and thus incur costs in the process. *Secondly*, and more importantly, a determination by a professional is hardly conclusive. SEBI is the final arbiter of questions of violation. It is very much possible for SEBI, and the professional in question, to arrive at different conclusions, even when both are acting reasonably and in good faith. This introduces a significant element of unpredictability in the informant mechanism. The increased costs, and unpredictability, that result is likely to deter some whistleblowers from

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[96] SEBI (PIT) Regulations, reg 7A(b).

reporting useful information. The burden placed on whistleblowers under this mechanism is inconsistent with the global best practice, which is to require the whistleblower to merely demonstrate a reasonable belief that the information disclosed pertains to a violation.[97]

D. Informant Identity Protection

On the upside, the Regulations adopt a 'layered' framework for protecting the identity of the informant. When the informant discloses the informant mechanism, they have two options: (*i*) file the disclosure individually; or (*ii*) file it through a "legal representative" entitled to practice law in India, that is an advocate.[98] If filed individually, the informant must disclose their identity.[99] Filing the disclosure through an advocate adds a layer of quasi-anonymity, which can be pierced only by SEBI.[100] The advocate must verify the identity of the informant before filing but must not disclose it to SEBI unless specifically directed to by SEBI. [101] This allows the informant to choose a trusted advocate as a 'gatekeeper' for their identity. However, the identity protection framework suffers from two serious limitations: (*i*) there is inadequate guidance in the Regulations on how SEBI will treat identifying information in the disclosure form; and (*ii*) the framework on confidentiality, and non-consensual disclosures, is not sufficiently precise to inspire confidence in, and promote, whistleblowing. To the extent possible, the informant is allowed to expunge identifying information in the disclosure form.[102] To the extent not possible, they are allowed to specifically indicate

[97] IBA-GAP Study, 13-16; ILO Study, 14-18; UNODC Guide, 22-26; Transparency International Principles, 4-5.
[98] SEBI (PIT) Regulations, reg 7B(1).
[99] ibid; Schedule D.
[100] ibid; ibid, reg 7B.
[101] ibid.
[102] ibid, reg. 7B(C).

the particular information in the form that is identifying.[103] This presumably is an indicator for SEBI to treat that part of the disclosure with additional care, although there is technically no obligation on SEBI to do so. Absent a clear indication in the Regulations of the utility of marking identifying information as such, this provision does not seem to be of much guidance to a whistleblower. In every case, as a general rule, disclosures under the informant mechanism are held in confidence.[104] However, there are broad, discretionary exceptions to this obligation, such as when the information is required to be disclosed in a legal proceeding in furtherance of the Board's legal position, or when disclosure is otherwise required or permitted by law.[105] SEBI also has a broad discretionary power to disclose the information to any regulator, self-regulatory organization, stock exchange, clearing houses, law enforcement organizations, or public prosecutors.[106] Global best practice recognizes that: (*a*) ideally, confidentiality must not be pierced without the consent of the informant; and (*b*) if non-consensual disclosure is allowed under the law at all, there must be a clear policy, publicized well in advance, to guide such disclosures.[107] The Regulations fail to provide adequate guidance regarding the policy of SEBI on non-consensual disclosures. Broad discretionary powers, such as those vested in SEBI under the informant mechanism, hardly satisfy that standard. This almost certainly has a very serious chilling effect on whistleblowing, as whistleblowers do not know, with sufficient precision, the extent to which their identity will be protected.

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[103] ibid.
[104] ibid, reg. 7H(3).
[105] ibid, reg. 7H(1).
[106] ibid, reg. 7H(2).
[107] IBA-GAP Study, 21; UNODC Guide, 26; Transparency International Principles, 6.; See EU Whistleblower Protection Directive, art 16; See The Public Interest Disclosure Act 2013, s 20-21, 24 (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 5 (Bangladesh); See The Republic of Lithuania Law on Protection of Whistleblowers, art 8-9; See18 USC § 1514A(b)(2).

E. Protection Against Retaliation

The Regulations contain several provisions to protect whistleblowers from retaliation. However, these provisions fall short of global best practice on four grounds: (*i*) the scope of protected persons does not extend to 'insiders' outside of an employment relationship; (*ii*) the causal link a whistleblower must demonstrate between their whistleblowing and the discrimination by the employer is onerous; (*iii*) most critically, there seems to be no real remedy against retaliation; and (*iv*) finally, the Regulations does not apply the 'reverse' burden of proof that is considered the gold standard in retaliation claims.

The scope of protected persons – that is, persons who are protected from retaliation for disclosing the informant mechanism – is broader than the scope of an informant. Given the unsatisfactorily narrow definition of an insider, the relatively broader definition is a saving grace to a large extent. Nevertheless, the definition is not broad enough. Under the Regulations, a protected person is: (*a*) any employee, (*b*) of a listed company or an intermediary, (*c*) who discloses the informant mechanism. [108] The definition of an employee restricts its scope to: (*a*) directors, partners, regular employees, and contractual employees, and (*b*) a person who is an employment relationship with the listed company, or the intermediary, in question.[109] The global best practice is to extend the protection against retaliation to, every 'insider' who is likely to be privy to inside information concerning a wrong (including persons outside of employment relationships, such as probationers,

[108] SEBI (PIT) Regulations, reg 7I(1); ibid, reg. 9(1).
[109] ibid, reg 71(1), Explanation.

interns, consultants, etc), and their family members. [110] The definition under the Regulations fails to protect 'insiders' outside the employment relationship, and the family members of 'insiders'. To that extent, the definition falls short of global best practice.

Retaliation, under the Regulations, is defined broadly. It extends specifically to all direct, and indirect, "discharge, termination, demotion, suspension, threats, harassment".[111] More importantly, the scope of retaliation is left open-ended, to include any form of "discrimination".[112] To this extent, the definition is consistent with the global best practice of defining retaliation in an open-ended manner, since the forms of retaliation possible are limited only by the imagination. [113] However, the definition seems to fall short in its definition of the causal link required between the disclosures of the informant and the conduct of the employer. Discrimination against an employee is retaliation only if it is "because of": (*a*) making a disclosure under the informant mechanism; (*b*) aiding SEBI in a proceeding; or (*c*) breaching a term of employment that prevents the employee from cooperating with SEBI. [114] The expression "because of" seems to suggest that the three listed events must be the only, or at least the primary cause or the dominant cause, for the discrimination in question. This is not consistent with global best practice, which is to require the whistleblower's conduct to merely be a contributing

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[110] IBA-GAP Study, 19-20; ILO Study, 18-19; UNODC Guide, 45-46; OECD Study, 22; See EU Whistleblower Protection Directive, art 5, 19, 21; See The Public Interest Disclosure Act 2013, s 10, 13, 23, 57, 58 (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 5 (Bangladesh).
[111] SEBI (PIT) Regulations, reg 7I(1).
[112] ibid.
[113] IBA-GAP Study, 19-20; ILO Study, 18-19; UNODC Guide, 45-46; OECD Study, 22; See EU Whistleblower Protection Directive, art 5, 19, 21; See The Public Interest Disclosure Act 2013, s 10, 13, 23, 57, 58 (Australia); See The Public Interest Information Disclosure (Provide Protection) Act 2011, s 5 (Bangladesh).
[114] SEBI (PIT) Regulations, reg 7I(1).

factor (that is, a relevant cause, but not necessarily the primary cause or the dominant cause) for the discrimination.[115] A 'primary/dominant' factor, or a 'sole factor', the test is inappropriate because it is an unduly onerous, and impractical, standard for the whistleblower to satisfy in a retaliation claim. [116]

On paper, there is a remedy under the Regulations for retaliation. A listed company, or intermediary, that engages in retaliation against an employee is liable to enforcement action by SEBI under securities law.[117] However, on closer analysis, this remedy seems entirely farcical for two reasons. *Firstly*, this most critical provision is torpedoed by the fact that these particular provisions seem to be ultra vires the SEBI Act. The Regulations, as subordinate legislation, must be enacted within the quasi-legislative competence of SEBI under the SEBI Act.[118] SEBI is empowered to enact Regulations to "carry out the purposes of [the] Act", but the Regulations so enacted must not be inconsistent with the Act or the rules made under it.[119] The purpose of the Act is limited to: (*a*) protecting the interests of securities investors; and (*b*) regulating, and promoting the development of, the securities market.[120] Whistleblowing per se provides valuable information to SEBI, relying on which it can commence enforcement actions to protect the integrity of the securities market. However, enforcing remedies against retaliation does not have such a direct link to the regulation of the securities market. Hence, the causal link between SEBI providing and enforcing, remedies for retaliation by listed companies, and intermediaries, against informants, appears quite

[115] IBA-GAP Study, 25-27; UNODC Guide, 64-65; See EU Whistleblower Protection Directive, art 21; See 5 USC § 1214(b)(2)(4), 1221(e); See The Law on Whistleblower Protection in the Institutions of Bosnia-Herzegovina, art 8(3).
[116] ibid.
[117] SEBI (PIT) Regulations, reg 7I(3).
[118] *Shri Sitaram Sugar Co Ltd v Union of India* AIR 1990 SC 1277 (India); *Municipal Corporation of Greater Bombay v Nagpal Printing Mills* AIR 1988 SC 1009 (India).
[119] The Securities and Exchange Board of India Act 1992, s 30.
[120] ibid, Preamble.

tenuous. The provision in question thus seems to have no nexus with the purposes of the Act. It, therefore, appears to be ultra vires the parent statute, and thus void. *Secondly*, even otherwise, the employee seems to lack an effective remedy for retaliation. Under the Regulations, the employee has the right to seek relief from retaliation under other laws.[121] At present, there is no other law that provides an equally effective remedy against retaliation. Theoretically, the employee can claim that the right against retaliation is a statutory right arising out of the Regulations, enforceable by a civil suit. As a general rule, bare rights, and obligations, arising out of a statute are civil.[122] However, even in such a case, the SEBI Act would explicitly prevent the employee from bringing a civil suit to enforce that right, as the Act ousts the jurisdiction of civil courts.[123] As the adage goes, a right without a remedy is not worth the paper it is written on.

Finally, the Regulations are completely silent on the burden of proof in a retaliation claim. This is conspicuously inconsistent with the global best practice, which is to apply a 'reverse' burden of proof in such cases.[124]

F. Rewards Mechanism

The Regulations establish a rewards mechanism under the informant mechanism. An informant who supplies original information that leads to a successful enforcement action is eligible for a reward. The Board, at its sole discretion, can declare a reward up to 10% of the disgorgement amount levied by SEBI on the wrongdoer in that enforcement action, subject to a cap of ₹ 10

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[121] SEBI (PIT) Regulations, reg 7I(2), 7I(4).
[122] *SEBI v Cabot International* (2005) 123 Comp Cas 841 (Bom) (India).
[123] The Securities and Exchange Board of India Act 1992, s 15Y.
[124] IBA-GAP Study, 25-27; UNODC Guide, 64-65; See EU Whistleblower Protection Directive, art 21; See 5 USC § 1214(b)(2)(4), 1221(e); See The Law on Whistleblower Protection in the Institutions of Bosnia-Herzegovina, art 8(3).

crores.[125] The rewards mechanism seems to be consistent with the global best practice, which is to allow discretionary rewards to the whistleblower proportionate to the penalties recovered by the government in an enforcement action initiated based on their disclosure.[126]

IV. CONCLUSION

With the informant mechanism, SEBI's heart appears to be in the right place. Its discussion paper issued before the enactment of the informant mechanism broadly reflects a sound understanding of the relevance of an effective whistleblower mechanism to a securities market regulator, and its fundamental features.[127] However, it seems this intent has failed to entirely translate to regulation. Consequently, the resulting informant mechanism suffers from several lacunae which seriously call into question its effectiveness. On these points, the informant mechanism deviates from global best practices in designing effective whistleblowing mechanisms. Thus, my hypothesis that the informant mechanism is not consistent with global best practices seems to be true.

To conclude, I summarize the points on which the informant mechanism deviates from global best practice and present my recommendation for addressing those lacunae by aligning it with global best practice through an amendment to the Regulations:

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[125] SEBI (PIT) Regulations, reg 7D(1), 7E(1).
[126] ILO Study, 21-22; UNODC Guide, 67-68; OECD Study, 22.
[127] Securities and Exchange Board of India (SEBI), 'Discussion Paper on amendment to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to provision for an informant mechanism' (SEBI 2019) <https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism_43237.html> accessed 27 Octobeer 2022, 1-11.

Drawback	Recommendation
There is no right vested in an employee to refuse to follow a direction from a superior they reasonably believe is unlawful until they can obtain a legal determination on its lawfulness.	Vest every employee of listed companies, intermediaries, and other market participants SEBI has the power to regulate, with this right in the workplace.
The scope of a protected disclosure is limited to information concerning the violation of insider trading laws that: (*a*) “has occurred”; (*b*) “is occurring”; or (*c*) the informant has a “reasonable belief… is about to occur”.	Broaden the definition to protect the disclosure of all information that the informant reasonably believes to be concerning a past, continuing, or future, violation of insider trading laws.
There is inadequate guidance in the Regulations on how SEBI will treat information marked as identifying in the disclosure form.	Explicitly clarify, with sufficient precision, how SEBI will treat identifying information differently from non-identifying information.
There are broad, discretionary exceptions to the general obligation of SEBI to keep the informant’s identity in confidence.	It may not be feasible to entirely discard exceptions to the general obligation of confidence or to vest no discretion in SEBI in that regard. Thus, a better approach would be to: (*i*) reduce the number of exceptions to the minimum strictly necessary,

	and (*ii*) provide sufficiently precise guidance in the Regulations to ensure the scope of the exceptions is reasonably clear to an informant.
The scope of persons protected against retaliation does not extend to: (*a*) 'insiders' outside of an employment relationship; and (*b*) the family members of 'insiders'.	Extend the scope of protected persons to: (*a*) every person who is likely to be privy to inside information concerning a wrong— including persons outside of employment relationships, such as probationers, interns, consultants, etc.; and (*ii*) their family members.
To claim relief against retaliation, the employer must prove that their whistleblowing is the primary, or dominant, cause for the employer's discrimination against them.	The employee should be required to prove merely that their whistleblowing was a "contributing factor" (that is, a relevant cause, but not necessarily the primary cause or the dominant cause) for the discrimination by their employer.
There seems to be no real remedy against retaliation, as the provision concerning anti-relation remedies seems to be outside the quasi-legislative competence of SEBI.	Insert a specific provision in the SEBI Act that allows SEBI to prescribe, and enforce, anti-relation remedies for whistleblowers who make disclosures under the informant mechanism.

The burden of proving retaliation lies entirely on the employee, to a preponderance of probabilities.	Apply the 'reverse' burden of proof that is globally recognized as the gold standard in retaliation claims.

VIII. RE-CONSTRUCTING THE LIMITATIONS UNDER SECTION 7 OF IBC: A CRITICAL ANALYSIS OF THE STATUS OF HOMEBUYERS UNDER INDIAN INSOLVENCY REGIME

- Pranay Agarwal*

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 was enacted with the motive of economic development of the country and in its furtherance, for providing the most efficient and justifiable solution to corporate insolvency. But when it comes to the insolvency of real estate companies and builders, the approach of the Code was shy in the initial years, thus relying majorly upon the judicial precedents and interpretations. With the coming of the amendments of 2018 and 2020, the contentious debate on the status of homebuyers was sought to be put to rest by the Parliament. However, the amendment of 2020, being in contravention to the earlier judicial reasoning raised new questions on the status of the homebuyers. The addition of the second proviso to Section 7 though settled the legal position on the procedural aspect, but new challenges in the light of socio-economic advancements highlight the need to critically analyse the status of the homebuyers with respect to both the substantive and procedural aspects of Section 7. In this article, the author has attempted to resolve this dilemma and has tried to fill the lacunas left in the code and its amendments for the purpose of reconstructing the limitations imposed by Section 7 of the code.

Keywords: Section 7, IBC, RERA, Homebuyers, Financial creditors, Real estate sector, Harmonious construction, public interest

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I. INTRODUCTION

The debt recovery laws in India have been multilayered, giving debt relief frameworks for both individuals and companies. While the object of these frameworks has been changing in the past five millennia,[1] the new insolvency and bankruptcy laws are designed with the aim of promoting efficiency in the corporate market and stimulating economic development and private investments in the country.[2] With this broader objective, the Insolvency and Bankruptcy Code, 2016 (**"IBC/Code"**) was enacted by the Parliament to completely overhaul the insolvency regime in India and provide rather smooth and more beneficial legislation to both the Corporate Debtor (**"CD"**) and its creditors. The most peculiar feature of the law, however, remains its introduction of the Corporate Insolvency Resolution Process (**"CIRP"**), which is one of the methods through which the Code seeks to achieve its objectives.[3]

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[1]Jason Kilborn, 'The 5000-Year Circle of Debt Clemency: From Sumer and Babylon to America and Europe,' (2012) Islamic Law & Law of the Muslim World eJournal < https://www.semanticscholar.org/paper/The-5000-Year-Circle-of-Debt-Clemency%3A-From-Sumer-Kilborn/0d66a18d3da7f841c5eaa8407426528a4f4b4831> accessed 02 March 2023.

[2]Bankruptcy Law Reforms Committee, *Report of the Bankruptcy Law Reforms Committee, Volume 1: Rationale and Design* (November 2015) [3.5] (BLRC Report).

[3]BinoyKattyadiyil and Peer Mehboob, 'Corporate Insolvency in India and Other countries – A comparative study,' [2020] 9 [7(9)] Int'l J. Multidisciplinary Educational Research 149, 151-160

While the Code was in itself complete, some lacunas were left with respect to the position of the Operational Creditors in the CIRP proceedings and the status of homebuyers in the insolvency proceedings of a Real Estate company. In this respect, there have been attempts to incorporate homebuyers and real estate investors in the category of financial creditors and thus into the insolvency regime. The amendment which came in 2018, inserted the explanation to Section 5(8)(f) to give the amount of allottees status of financial debts, thus clarifying the position by giving statutory effect to the wide judicial interpretations previously given.[4] However, the intention of the lawmakers again came into question when limitations were imposed under Section 7 on the filing of an application for CIRP before the National Company Law Tribunal (**"NCLT"**) by the amendment of 2020 as per which the initial application of CIRP has to be jointly filed by 100 or 10 percent of the homebuyers whichever is less.[5]

Moreover, the confusion was added by the varied interpretations given by the NCLT in different cases, which have made its application even vaguer. This is evident through the decision of the NCLT Chennai in the recent case of *N. Kumar v. Tata Capital Housing Finance Ltd.*[6] where a narrower interpretation of the provision has led to an ambiguity in the relationship between the insolvency regime and the real estate market in India.

The author through this paper attempts to bring out the legal ambiguity, which has become more prevalent in recent times and needs careful consideration. The author in this respect will also delve into the status of the homebuyers in the insolvency regime of the country and seeks to resolve the

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[4]Insolvency and Bankruptcy Code 2016, s 5(8)(f) (IBC).
[5] Insolvency and Bankruptcy Code (Amendment) Act 2020, s 3 (2020 Amendment).
[6]*Mr. N. Kumar v M/s Tata Capital Housing Finance Ltd*, IA(I.B.C)/1245(CHE)/2020 In CP(IB)/889(CHE)/2019.

ambiguities through the proper determination of the legislative intent of the law and the socio-economic needs of the country, in order to put forth contentions against the limitations imposed by Section 7 of the IBC and the confusion created by the parochial interpretation of the NCLT.

The paper for that purpose has been segregated into five parts. The first part deals with the status of the homebuyers as financial creditors under Sections 5 and 7 of IBC and has analyzed this in the context of the judicial precedents before the 2018 amendment and the incoming of the amendment in the insolvency law. The second part offers a critical analysis of the second proviso to Section 7 and the limitations imposed by it on the filing of the CIRP application. In this context, the problem is seen from a socio-economical perspective and a comparative view of both foreign and domestic laws of a similar kind. The third part deals with the determination of legislative intent behind such amendments in the IBC with respect to the real estate protection laws, thus providing relevant findings in favor of the raised contentions. In the penultimate part, the paper attempts to solve the legal ambiguities created by the NCLT Chennai through its recent order with the help of the contentions and findings of the previous parts of the paper. In the final part, the paper summarises its findings and gives useful insights in relation to the status of homebuyers in the insolvency regime.

II. HOMEBUYERS AS FINANCIAL CREDITORS

A. Position before the 2018 Amendment

The financial creditors are being given utmost priority over any other stakeholders in not only CIRP proceedings but in most of the aspects of the IBC. This is more evident from the treatment given to the operational creditors, who are still deprived of their rights of voting in the Committee of

Creditors (**"CoC"**) on the resolution plans and therefore have a mere virtual presence in the proceedings.[7] While many contentions have been raised since the enactment of the Code on such unjust treatment, the Bankruptcy Law Reforms Committee (**"BLRC"**) tried to provide ample reasoning to justify such move of the Parliament on the presumptions of financial reliability and credibility of the financial creditors.[8] Moreover, the presumption was also reiterated by the Supreme Court in the *Swiss Ribbons case*,[9] thus highlighting the immense significance of the status of financial creditors in the Indian insolvency regime.

However, when it comes to the status of the homebuyers in a defaulting real estate company as financial creditors, the same was interpreted by the NCLTs and NCLAT from a wider perspective. The question first came before the NCLAT in *Nikhil Mehta & Sons (HUF) v. AMR Infrastructure Ltd.,*[10] where the importance of purposive construction of the term "Financial Debt" under Section 5(8)(f) in the light of facts and common practice was recognised. The NCLAT took note of the fact that

> From the 'Annual Return' of the Respondent and Form-16A, the 'Corporate Debtor' treated the appellants as 'investors' and borrowed the amount pursuant to sale purchase agreement for their commercial purpose treating at par with 'loan' in their return. Thereby, the amount invested by appellants come within the meaning of 'Financial Debt', as defined in Section 5(8)(f) of I & B Code, 2016 subject to satisfaction as to whether such disbursement against the consideration is for time value of money.[11]

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[7] IBC, s 21(8).
[8] BLRC Report (n 2) Chap. 4.
[9]*Swiss Ribbons (P) Ltd. v Union of India*, (2019) 4 SCC 17 [50], [51], [119].
[10][2017] SCC OnLine NCLAT 859.
[11]ibid 23.

The position was then reiterated by the NCLAT in its subsequent decision in *Anil Mahindroo v. Earth Iconic Infrastructure (P) Ltd.,*[12] where the buyer was treated as an investor and the purchase amount as the 'financial debt'. However, the test for "time value of money" became pertinent to qualify for a wider interpretation of the term 'financial debt'. The test though was first laid down in the *Nikhil Mehta case*, it was subsequently explained in *Kamal Dutta v. Anubhuti Aggarwal,*[13] where the importance of the test was highlighted. The test as was explained implies that the disbursement of the due amount should be against the consideration of the time value of money, for instance, interests on loans and other charges which may have been gained by the individual if had not invested in the company.[14]

From a historical perspective, the jurisprudence in India has been constantly in favour of the "allottees" in real estate cases, thus including them in the broad category of financial creditors.[15] However, it is pertinent to understand that two essentials have to be satisfied for such a wide interpretation of the term.

1. *Time value of Money*

Though the test of "time value of money" has been subjected to different constructions over the period of time, the consistent position which can be inferred indicates the importance of the intention behind the agreement and the resultant status which has been conferred on the amount paid or invested. While such an attempt was made in *Mahesh Kumar Panwar v.*

[12][2017] SCC OnLine NCLAT 216, (2017) 4 BC 128.
[13][2018] SCC OnLine NCLAT 319.
[14]ibid 6; *Nikhil Mehta* (n 10) 17.
[15]*Innoventive Industries Ltd. v. ICICI Bank*, (2018) 1 SCC 407, AIR 2017 SC 4084 (Nariman J); *Mobilox Innovations Pvt. Ltd. v. Kirusa Software*, (2018) 1 SCC 353 (Nariman J).

Neelam Singh,[16] where the interest component in the terms of agreement convinced NCLAT of the question of the "time value of money", the order cannot be taken as the supreme authority and therefore has to be decided on a case-to-case basis.[17]

2. Application under correct procedure and law

Following the correct and proper procedure as prescribed by the law is a necessary requirement in not only criminal and constitutional cases but also in commercial and industrial cases.[18] In this regard, it is pertinent to note that the status of the homebuyers is often equated with the 'financial creditors', however, the status of the 'operational creditors', being in stark contrast, cannot be applied to the homebuyers and investors in the real estate market.[19] This was also clarified in *Gurucharan Singh Soni and Kuldeep Kaur Soni v. Unitech Ltd.*,[20] where although the claim and contentions of the applicant were valid and legally justified, the same was not accepted under Section 9 of IBC.

While the amendment of 2018 has given a statutory effect to the position, the jurisprudence given by the NCLAT has not been rendered futile and is still relevant for filling the lacunas of the law and understanding the legislative intention behind the same. In this respect, it is important to understand that the investors are also given the same status as was given to homebuyers.[21] This is further clarified by the observations given in *Raman*

[16]2018 SCC OnLine NCLAT 596 [4].
Atul Mittal v. Khushal Infratech (P) Ltd., 2018 SCC OnLine NCLAT 598.
[18]*AK Gopalan v. State of Madras*, AIR 1950 SC 27.
[19]*Pawan Dubey v. JBK Developer (P) Ltd.,* 2017 SCC OnLine NCLAT 865.
[20]2017 SCC OnLine NCLAT 384.
[21] Gunjan Nandu and Bhoomi Dave, 'Legitimizing Balance of Interests – Investors Vis – `A – Vis Homebuyers' (*Mondaq,* 23November 2021), <https://www.mondaq.com/india/real-estate/1133784/legitimizing-balance-of-interests-investors-vis-vis-homebuyers> accessed 28 October 2022.

Puri v. Pallavi Joshi Bakhru,[22] where the investment, was treated as "commercial borrowings". However, at the same time, it can be inferred from such precedents that more value is given to the effect of the agreement, which is to secure high returns on investment, than to the original intention of the allottee and the builder.[23]

B. Amendment of 2018 and its Impact

The amendment of 2018 was very crucial in terms of the various facets it introduced and reformed in the insolvency regime in India. One of the facets that were introduced was the inclusion of the purchase amount of the real estate property and investments within the definition of "financial debts" under Section 5(8)(f) of the IBC.[24] While the jurisprudence given by the NCLAT in the above cases serves as a valid precedent, thereby providing adequate clarity on the issue, it is pertinent to take note of the reasons in order to understand the intention of the legislators behind such reforms.

If seen from the socio-economic perspective, the then-existing real estate sector of the Indian economy has to be understood as a degrading area due to several legal and economical constraints. The delay in the completion of the under-construction apartments had become a norm. This is more evident by the fact that according to the Ministry of Statistics, 215 projects out of 782 were delayed in 2018,[25] which was also confirmed by the ASSOCHAM.[26]

[22]2018 SCC OnLine NCLAT 895.

[23]*Ranjan Goyal v. Sharad Vadhera*, 2019 SCC OnLine NCLAT 1129.

[24]Insolvency and Bankruptcy Code (Second Amendment) Act 2018, s 3, cl (ii) (2018 Amendment).

[25]Khyati Rathod and Niharika Dhall, 'India: Delays in Construction Projects' (*Mondaq,* 24 January 2017), <https://www.mondaq.com/india/construction-planning/562100/delays-in-construction-projects> accessed 27 October 2022.

[26]LavinaMulchandani, 'Why are Housing Projects Delayed? Industry, Buyer Groups Hope to have Answers Soon' (*Hindustan Times,* 6 May 2017) <https://www.hindustantimes.com/real-estate/why-are-housing-projects-delayed-industry-buyer-groups-hope-to-have-answers-soon/story-abMs34y2V7h8G92aVur9SJ.html> accessed 27 October 2022.

While the delay in projects was not a new phenomenon, the discriminatory treatment could be seen in the real estate sector, where the buyers were not able to get the benefit of the insolvency law otherwise applicable to other sectors.

The immediate cause, however, should be considered as the *Jaypee Builders case*,[27] where the homebuyers moved the Supreme Court after the admission of the CIRP application by the NCLT against the builder-debtors. While this was not a new instance where the rights of the homebuyers were in contention, the case established the homebuyers as a separate legal party that should be included in the voting process of the CIRP proceedings. In the subsequent case of *Chitra Sharma v. Union of India*,[28] directions were also passed by the Apex Court, thus interpreting the provisions of the IBC while keeping in mind the interests of the homebuyers. The most important observation, though was to provide for a representative in the CoC to safeguard the interests of the homebuyers only, irrespective of their status as financial creditors, as was established in the *Nikhil Mehta case*.[29]

Nevertheless, several lacunas remained unfilled with respect to the status of the homebuyers in certain peculiar situations which still required clarification in times to come. Moreover, the resolution process which was assured by the Supreme Court was a court-monitored process and therefore had no legal backing in the practical sense. As was also highlighted by the Insolvency Law Committee (**"ILC"**) in 2018, the judgment has rather aggravated the confusion instead of solving it, which was pertinent from the aftermath statements of the IBBI and its reluctance to accept the verdict of the

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[27]*IDBI Bank Ltd. v Jaypee Infratech Ltd.,* 2017 SCC OnLine NCLT 12613.
[28](2018) 18 SCC 611.
[29] ibid 8.1.

court regarding the position of law.[30] The relevant contention which was given in this regard was in reference to the other judgments of the tribunals and the Supreme Court where in the earlier instances, the current position was rejected, thus working against the interests of homebuyers.[31]

In the chaos that ensued, the committee in its report suggested giving legal clarity to the proposition by conferring the status of financial creditors to the homebuyers, while preserving their unique nature by falling them under the residuary entry to cover such debt transactions. The reasoning which was given by ILC was that

> Not all forward sale or purchase are financial transactions, but if they are structured as a tool or means for raising finance, there is no doubt that the amount raised may be classified as financial debt under section 5(8)(f). Drawing an analogy, in the case of home buyers, the amounts raised under the contracts of home buyers are in effect for the purposes of raising finance, and are a means of raising finance. Thus, the Committee deemed it prudent to clarify that, such amounts raised under a real estate project from a home buyer fall within the entry (f) of section 5(8).[32]

However, the reasons which were given by the ILC and the courts in various instances indicated significant reliance upon the principles of natural justice and the larger public interest in favour of the homebuyers and investors, thus giving them a sense of justice. If seen from this perspective, the objective behind the inclusion of homebuyers in the insolvency regime as financial creditors is not solely based on the consolidation and clarification of the legal

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[30]Vallari Dubey, 'Home buyers breathe a sigh of relief' (*Vinod Kothari Consultants,* 18 August 2017) <https://vinodkothari.com/2017/08/home-buyers-breathe-a-sigh-of-relief/> accessed 17 October 2022.

[31] Ibid.

[32] Ministry of Corporate Affairs Government of India, *Report of the Insolvency Law Committee* (March 2018), 15 (ILC Report).

position but also was motivated by the promotion of the welfare of homebuyers and giving lesser scope to judicial discretion to avoid any legal ambiguity in the area.

III. SECTION 7 OF IBC AND LIMITATION ON THE STATUS OF HOMEBUYERS

Section 7 of IBC[33] is known by the practitioners and other stakeholders in the area of insolvency as the most relevant provision to initiate the CIRP proceedings against the corporate debtor, giving the rights to the financial creditors to file the application before the adjudicating authority. While the prior amendment of 2018 in the IBC had already conferred immense powers on the homebuyers and real estate investors to initiate the insolvency proceedings against the builder-debtor, an alteration in the position of law was seen by the enactment of the amendment of 2020.

The amendment is known for the imposition of limitations over the small claimants, such as debenture holders and homebuyers, from knocking on the doors of the adjudicating authority by mandating a minimum threshold requirement of "at least 100 of such creditors in the same class or not less than 10 percent of such total number of members in the class, whichever is less; to invoke the provisions of the IBC."[34] The addition of the proviso therefore can be seen from both positive and negative perspectives.

Arguing for the amendment, it is pertinent to highlight that since the 2018 amendment, various speculations have been made regarding the violation of the true intention of the legislature in construing the term financial

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[33] IBC, s 7(1).
[34] 2020 Amendment, s 3.

creditors.[35] The financial creditors are always put on a higher footing than other stakeholders in the Code, thus implying the original intention of the legislature was to give effect to the same. However, it has been contended that the amendment which instead in an effort to broaden the definition in the name of public interest and justice, stood in complete contrast with the true legislative intention of the IBC due to its idea of giving extensive rights to the small-claimants like homebuyers.[36]

Another interesting point that was raised is regarding the exclusion of the IBC from the welfare functions which should rather be secured through welfare legislation like the Consumer Protection Act, 1986.[37] In this aspect, the IBC is instead a commercial legislation dealing with stakeholders who have invested in the companies with the sole objective of earning profits and not for consumption and welfare purposes.

While such averments hold water when seen from the purposive interpretation of the statute, the precedents which conferred the status of the financial creditors to the homebuyers and the real estate investors should be taken into account. Moreover, it is also important to highlight that it is long established that the construction of the law should not only be influenced by the original intention of the lawmakers but also for the purpose of serving society as a "social engineer".[38] In this aspect, it is pertinent to analyze the validity of the section from not only the legal aspect but also from the social,

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[35] *Bikram Chatterji v. Union if India*, WP (C) No. 940 of 2017; *Ashutosh Kumar v. Amrapali Centurian Park (P) Ltd.,* WP (C) No. 1397 of 2018 [60]; Vijay Singh, 'Opinion | Homebuyers must be cautious when approaching NCLT' (*LiveMint,* 2 July 2019), <https://www.livemint.com/money/personal-finance/opinion-homebuyers-must-be-cautious-when-approaching-nclt-1562083251326.html> accessed 25 October2022.

[36] Akaant Kumar Mittal, *Insolvency and Bankruptcy Code, Law and Practice* (1st edn, EBC 2021), 393.

[37] *Pramod Kumar Arora v. DLF Homes Panchkula (P) Ltd.,* 2015 SCC OnLine NCDRC 3098.

[38] Roscoe Pound, *Social Control through Law* (1st edn, Taylor and Francis 1996), 559-560.

economic, and other comparative aspects for clarifying the correct position of law suitable to both the purpose of law and socio-economical needs.

A. Social and Economic Impact

Real estate as a sector has been a major investment area in India, carrying investments from not only high-income class groups but also middle-income class groups who are seeking it as a prospective investing opportunity. While this may be termed as rather speculation, the surrounding facts should be given due consideration before making any investment decision.

If seen from the investments, construction constitutes the third largest sector in terms of FDI inflow, which stood at 54.17 Billion USD from FY 2000 to 2022.[39] Moreover, the country saw a growth of 52 percent in investments in real estate compared to the previous financial year.[40] The surge in investments gives ample proof of the rising demand in the sector and its future potential as a favourable investment option.

Furthermore, since society and social behaviour are closely connected to the economic sphere in contemporary times, the economic importance of the sector gives an indication of the social significance that it has. If seen from the light of above-mentioned figures, the impact of the 2020 amendment on the sector and its exclusion of the investors to initiate insolvency proceedings

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[39]ET Infra, 'Construction sector third largest in FDI inflow: DPIIT' (*The Economic Times,* 30 December 2021) <https://infra.economictimes.indiatimes.com/news/construction/institutional-investments-in-real-estate-sector-a-boon-for-realty-says-pankaj-bansal/88588133> accessed 25 October 2022.

[40]Harish Kumar Jain, 'What does the real estate sector look like in 2023?' (*Financial Express,* 25 October 2022) <https://www.financialexpress.com/industry/what-does-the-real-estate-sector-look-like-in-2023/2736923/> accessed 26 October 2022.

will be quite adverse on the investing sentiments which are otherwise on a rising level.

From a social perspective, the rising demands in the real estate industry can be construed to be from either homebuyers or speculative investors. While it has been contended in various instances that speculative investors are different from genuine buyers with respect to their ultimate motive, it is pertinent to note that such a line of difference fades away from the sociological perspective. In this respect, the reasons behind the rising demand in the real estate sector and growing urbanization can be held to be similar which are the growth of nuclear families and purchasing power of the people.[41]

This holds true for investment as well, where due to the high transparency and returns, the middle-income families are inclined towards the sector not only as social welfare but also as an attractive opportunity. This is evident by the speculative report of Savills India, as per which real estate demand for data centers is expected to increase by 15-18 million sq. ft. by 2025.[42] Moreover, the real estate sector is given priority by the state as well which rather saw it from the welfare function by giving low-interest home loans and low mortgage rates.[43]

The amendment being adverse to not only investors but also homebuyers will have a negative implication on the otherwise rising demand. In this regard, it is also important to highlight that the demand was not only created by the investing sentiments but also by growing societal needs thanks

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[41]Kundan Kishore, 'Is the Real Estate Sector on the Cusp of High Growth?' (*Outlook,* 4 June 2022) <https://www.outlookindia.com/business/is-the-real-estate-sector-on-the-cusp-of-high-growth--news-200290> accessed 25 October 2022.
[42]Jack Harkness, Simon Smith and Nancy Wong, 'Asia Pacific Data Centres Spotlight June 2022' (*Savills India,* 31 May 2022) <https://www.savills.in/research_articles/165611/207179-0> accessed 27 October 2022.
[43]Kundan Kishore (n 41).

to the rising population and nuclear families. The impact on the social demand, though will be lesser due to the shelter being a basic necessity, the IBC will nevertheless fail to achieve its objective to balance the interest of every stakeholder in the proceedings.[44]

B. A Comparative Analysis of the Law with Foreign Jurisdictions

While Section 7 of the IBC and amendments made to it regarding the status of the homebuyers have been held valid by the Supreme Court,[45] it may also be contended that the foreign laws and judgments may not be relevant in solving contemporary problems, which are unique in themselves. However, the legal justification of the limitation as well as the correct interpretation of contemporary social and economic advancements require a comprehensive understanding of the laws of other countries with similar insolvency procedures. Moreover, it is also noteworthy that the IBC was drafted while considering the insolvency codes of the USA (moratorium), UK (creditor-centric model), and Singapore (scheme of arrangement), thus setting an example of the commercially developed nations whose laws have a decisive influence on the commercial jurisprudence in India.[46]

1. United States of America ("U.S.A.")

The US insolvency and bankruptcy laws are majorly codified in the form of the Bankruptcy Code, 1978. The most striking feature of the US insolvency laws can be said to be the "Debtor in Possession" principle, which

[44]BLRC Report (n 2) 7.

[45]*Manish Kumar v. Union of India*, Writ Petition (C) No.26 of 2020.

[46] Ernst & Young, 'How Does the Corporate Insolvency Code in India Measure with the UK? –Insolvency/Bankruptcy/Re-Structuring – India' (*Mondaq*, 8 December 2016) <https://www.mondaq.com/india/insolvencybankruptcy/551286/how-does-the-corporateinsolvency-code-in-india-measure-with-the-uk> accessed 14 October 2022.

indicates its "debtor-centric" approach.[47] While the American approach seems divergent from the "creditor-in-control" principle as enshrined in the IBC, the principle is incorporated in a modified form as the main purpose of the Code to safeguard the existence of the Corporate Debtor.[48] The American approach can also be differentiated from the Indian laws with respect to the division of the creditors into "secured" and "unsecured", which was followed even by the Indian laws prior to IBC. However, a similarity can be drawn from the essence of the laws as well as the procedure which is being followed to resolve the insolvency.

However, the American insolvency laws do not specifically provide for real estate companies and homebuyers, thereby considering them within the broad ambit of the two categories. In this respect, it is important to note that the unsecured creditor though not defined in the Bankruptcy Code, is given a plain interpretation to mean creditors with no security interests in the assets of the debtor.[49] There has been ambiguity as to the position of the homebuyers with respect to their secured status which was prevalent even in India before the 2018 amendment. Nevertheless, the status of the creditor is not a matter of concern when it comes to the eligibility in filing the application to initiate the insolvency proceedings.

In this regard, it is pertinent to note that the Bankruptcy Code provides for both voluntary (by Corporate Debtor) and involuntary (by creditors) initiation of the insolvency proceedings, thus giving creditors the right to

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[47] Bankruptcy Code 1978, s 1101 (US).

[48] IBC, Preamble.

[49] James Chen, 'Unsecured Creditor' (*Investopedia,* 26 September 2022) <https://www.investopedia.com/terms/u/unsecuredcreditor.asp#:~:text=An%20unsecured%20creditor%20is%20an,borrower%20default%20on%20the%20loan> accessed 14 October 2022.

initiate insolvency proceedings.[50] However, certain conditions have to be fulfilled for availing of such a right, and therefore the right is curbed by two limitations. Firstly, the debt must amount to at least 18,600 USD and the creditor must demonstrate that the debtor is generally not paying debts as they become due.[51] Secondly, and more relevantly, if a debtor has 12 or more creditors, at least three creditors must join an involuntary petition.[52] Thus, it can be deduced that the Code imposes practical limitations on the filing of the application for insolvency proceedings, similar to Section 7 of the IBC. However, as compared to the Indian laws, the limitations imposed by the American laws are more relaxed and justified, where the minimum threshold has been kept at a pragmatic level of three creditors.

2. United Kingdom ("U.K.")

Indian laws are majorly influenced by English laws and the common law jurisprudence, which continue to govern every legal aspect of the country till today.[53] Therefore, it will be wrong to disregard the English position in the commercial sector like insolvency in construing the Indian position. In this regard, it is also pertinent to note that the Companies Act, 2006 does not deal with exclusively giving the rights to homebuyers. However, at the same time, homebuyers are not completely ignored by the insolvency and bankruptcy laws of the UK due to their major role in the English Bank crisis,[54] thus indirectly providing relief through common law jurisprudence.

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[50] Bankruptcy Code, Ch 11 (US).
[51] Bankruptcy Code, s 303 (US).
[52] Bankruptcy Code, s 303 (US).
[53] Andrew Green and Albert Yoon, 'Triaging the Law: Developing the Common Law on the Supreme Court of India' (2017) 14(4) *J Emp. Leg. Stud.* 683, 705-715.
[54] Committee on the Global Financial System, *Structural Changes in Banking after the crisis* (CFGS Paper No. 60, 2018), 5-7.

In this respect, it is important to highlight the significance of the "failure of consideration" principle which was also applied by the Supreme Court in the *Pioneer* case observing that "Failure of the consideration (money) which on the basis of trust law, ought to revert to the depositors, with a default interest rate which by that very fact qualified their debts as financial."[55] The principle in this regard finds its roots in the common law doctrine of equity, which is enshrined in the commercial laws of the UK – the Companies Act, 2006, and the recent Corporate Insolvency and Governance Act, 2020,[56] thus implying the incorporation of the homebuyers in the broader ambit of creditors and giving them equal status with the secured creditors.

Moreover, if seen from the perspective of the application filing threshold, the UK laws are even more flexible, where a single creditor can also file an application to initiate the proceedings under Section 124 of the Insolvency Act, 1986, if the debtor company owes more than £750 and the debt is not disputed (Compulsory Liquidation).[57]

3. Singapore

Singaporean laws are often taken as the epitome of efficient commercial laws in both substantive and procedural senses, due to the nation's high commercial value owing to the successful implementation of the laws.[58] The insolvency proceedings in Singapore are governed by the Insolvency, Restructuring, and Dissolution Act, 2018 (**"IRDA"**) along with the Singapore

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[55] Williams C. Iheme, 'Remedying the Defects in India's Credit and Insolvency Frameworks with Adapted Solutions from the Anglo-American Legal Scholarships' (2020) 11 Union UL Sch Rev 580, 597-98.
[56] William Goodhart and Gareth Jones, 'The Infiltration of Equitable Doctrine into English Commercial Law' (1980) 43(5) Mod L Rev 489, 508.
[57] Insolvency Act 1986, s 124 (UK).
[58] Corinne Montineri, 'The United Nations Commissions on International Trade Law (UNCITRAL) and the Significance of the Singapore Convention on Mediation' (2019) 20 Cardozo J Conflict Resol 1023.

Companies Act. While the concept of the CIRP is not followed in Singapore, a similar concept of the Scheme of Arrangement is prevalent.[59]

In this respect, while the Singaporean laws classify the creditors as secured and unsecured like that of the US laws, nevertheless it is pertinent to note that Part 5 of IRDA provides that the application can be made by any creditor for the initiation of the Scheme of Arrangement.[60] If seen from the perspective of the homebuyers, it is submitted that the law does not provide for the real estate companies specifically. Nevertheless, it would be wrong to deduce that the law ignores this aspect. The IRDA in this aspect follows the interpretation which is prevalent in the American jurisprudence to give a wider construction to the term "creditors" to include homebuyers in the case of real estate companies and builder debtors.

4. *Australia*

While Indian constitutional and administrative jurisprudence is heavily influenced by the Australian legal system,[61] due to its English nature, little can be deduced from the Australian commercial legislation. However, Australian jurisprudence still holds relevance due to its successful transplantation of English and American commercial laws. In this respect, insolvency and corporate restructuring in Australia are governed by the Corporations Act, 2001.

Under the Australian insolvency regime, the company is presumed to be declared insolvent on the occasion of not serving the statutory demand

[59] Junxiang Koh and Prakash Pillai, 'Singapore: Schemes of Arrangement under the Insolvency, Restructuring and Dissolution Act' (*Mondaq,* 12 August 2020) <https://www.mondaq.com/insolvencybankruptcy/975690/schemes-of-arrangement-under-the-insolvency-restructuring-and-dissolution-act> accessed 18 October 2022.
[60] Insolvency, Restructuring and Dissolution Act 2018, Part 5.
[61] H M Seervai, *Constitutional Law of India,* vol 1 (4th edn, Univ Law Publ 1991) 158.

under Section 459E of the Corporations Act instead of filing the application.[62] Though this procedure seems incompatible with what is followed in the Indian insolvency regime, it is pertinent to note that the statutory notice upon a defaulting company can be served by any creditor, irrespective of its class,[63] while only "secured" creditors are allowed to carry on the restructuring process.[64]

Comparing it with the CIRP proceedings in India, the same seems similar with reference to the rights of the operational and financial creditors. However, the homebuyers who are also not covered by the Australian legislation are attempted to be incorporated under the broad category of the "creditors", thereby borrowing from the Anglo-American jurisprudence.

From a broad and detailed perusal of the insolvency laws in various jurisdictions, it can be inferred that the limitations imposed upon the homebuyers and the degrading of their status from financial creditors to small claimants are not only contradictory to the principles followed in the developed nations, which influenced the formation of IBC but is also based on the flawed reasoning and misapprehensions. Moreover, such taking of the rights is in direct violation of the principles of natural justice and the common law norms of equity and justice which serve as the basic foundation of Indian laws over the centuries.

In this regard, while it can be contended that the insolvency regime is majorly depended on the socio-economic conditions of the country, the basic principles remain the same. From this perspective, the status of homebuyers as a 'small' or 'insignificant' financial creditor contradicts the very objective

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[62] Corporations Act 2001, s 459E (Aus).
[63] Corporations Act, Part 5.4, Div 2 and 3 (Aus).
[64] Corporations Act, s 436A (Aus).

of the insolvency laws at large. Furthermore, the object of preventing cases on trivial claims can be reasonably achieved through making the threshold flexible while also introducing the pecuniary threshold as has been demonstrated in other nations.

C. Comparing with the other domestic laws

The objective behind the Section 7 of IBC has been a clear position of law since the *Swiss Ribbons* case. While such a position seems to be applicable to the enactment of the 2020 amendment as well, the broader objective of such limitation has to be understood from similar legislations in the domestic sphere. In this respect, it is pertinent to highlight that the commercial laws in India provide for such restrictions in certain cases. However, a comprehensive understanding of the objective behind such restrictions has to be given before commenting on the legal justification of the limitations imposed by the amendment.

1. Companies Act, 2013

The Companies Act provides for a minimum threshold requirement for the filing of the application in two instances. The first is the case of Oppression and Mismanagement and the second is the case of Sick Companies. The limitation in the first case is quite similar to that imposed on the homebuyers and requires a minimum of 100 shareholders or shareholders holding an aggregate of 10 percent of the stakes to file the application against the company.[65] While the threshold as given under Section 244 can be construed from a positive view, allowing people with the same injury to jointly file the suit, the contention is irrelevant with respect to Section 245 of the Act.[66]

[65] Companies Act 2013, s 244(1) (Companies Act).
[66] Companies Act, s 245.

The reason for such limitation is to prevent the filing of trivial cases by minority shareholders, which may hinder the functioning of the company. In this regard, NCLAT in *Brookefield Technologies Pvt. Ltd. v. Shailaja Iyer* observed that

> To determine whether the petition filed under sections 241 and 242 of the Companies Act, 2013, the Tribunal has to examine only the averments mentioned in the petition. The concept of 'oppression' is larger than the idea of 'legal rights' and indeed, the term 'interests' is wider than rights. As a matter of fact, the law does not define an 'oppressive act'. Whether an act is oppressive or not is fundamentally a question of fact. The law relating to 'oppression' is cemented on the principles of equity and fair play as against the strict compliance of law.[67]

Thus, in order to uphold the principles of justice, the proviso to the section provides for the power of the tribunal to waive the condition in certain circumstances it may deem necessary.[68] Though such circumstances have not been defined anywhere, leaving it to the discretion of the courts, the waiver has been given in the cases where the question was of serious injury to the principles of natural justice,[69]the substantial interest of the company,[70] and dilution in shareholding because of oppression.[71]

From such a wide interpretation of the section and its limitation, it is evident that the principles of natural justice and the doctrine of equity, justice, and fairness have to be given supreme importance, irrespective of the nature of the legislation and thus, the provision serves as a right example of upholding

[67] Company Appeal (AT) No. 110 of 2020 [36].
[68] Companies Act, s 244(1) proviso.
[69]*Sri Krishna Tiles and Potteries v. The Company Law Board & Ors*, 1979 49 CompCas 409 Delhi, ILR 1979 Delhi 105.
[70]*Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd*., (2017) SCC OnLine NCLAT 261.
[71]*Manoj Bathla v. VishwanahBathla*, (2019) SCC OnLine NCLAT 198.

the needs of the social justice and commercial interests instead of sticking to the line.

The limitation was also imposed on the filing of an application for a declaration of a company as "sick" under Section 253, where at least 50 percent of the secured creditors should raise demand for the amount invested in the company's shares.[72] While the section itself is omitted by IBC,[73] it is pertinent to note the status of sick companies for a proper understanding of the object behind the threshold. In this respect, the declaration of a company as 'sick' though is largely similar to that of insolvency, it constituted a major failure of a company.[74] The difference can be understood as a reference to the SICA Act where it is defined as a situation where the accumulated losses equalled or exceeded its net worth.[75]

Nevertheless, the provision allowed the filing of an application by any individual secured creditor. Moreover, declaring a company "sick" is quite different from declaring it "insolvent" under IBC which does not have far-reaching consequences as compared to the former, thereby making the restriction imposed quite irrelevant in the present analysis.

2. *Insolvency and Bankruptcy Code, 2016 ("IBC")*

The other provisions of the IBC also provide for the minimum threshold requirement apart from the contentious Section 7. In this regard, it is pertinent to note that Section 24 of IBC provides for such requirements by imposing limitations on the operational creditors from participating in the proceedings and barring them from the membership and voting procedure of

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[72] Companies Act, s 253.
[73] IBC, s 255 r/w 11th sch.
[74] Companies Act, s 253(1).
[75] Sick Industrial Companies Act 1985 (repealed), s 3(o).

the CoC.[76] Moreover, Section 30 of IBC imposes a sort of limitation by requiring a minimum threshold of 67 percent of the votes to approve a resolution plan.[77]

However, such limitations do not transcend the filing of the application and its procedural requirement. In this respect, it is important to highlight that an individual operational creditor can file an application for CIRP under Section 9 of IBC if he does not receive payment even after ten days of the Section 8 notice of the unpaid debt.[78]

A comparative analysis of the laws in India as well as in other jurisdictions, along with the perusal of the socio-economic significance of the real estate sector and its investors, shows that the limitations imposed by the Section 7 of IBC is not only legally contrary and unjustified but also incompatible to the existing legal, social and economical environment of the country. Moreover, such restrictive construction of Sections 5(8)(f) and 7 of IBC ignores the basic objective of the legislation as well as the common law foundation of the legal system of India.

While the contention against such reform will continue to sustain on the ground of the commercial nature of the law, the welfare motive inherent even in the commercial legislations can be inferred in not only Indian but foreign laws as well, thereby negating such contentions. Therefore, as has been suggested in the later parts of the article, it is suggested that the legal position should be changed by giving more flexibility to the threshold and instead introducing an additional threshold criterion on the basis of the claim. For that purpose, it is important to give a purposive interpretation of the law with

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[76] IBC, s 24(6).
[77] IBC, s 30(4) and 28(3).
[78] IBC, s 9(1).

respect to the laws prevalent in India as well as the insolvency regimes in other nations. However, a comprehensive analysis of the welfare legislation in relation to the IBC is still required for sustaining the contentions made by the author which has been dealt with in the next part of the paper.

IV. SECTION 7 OF IBC AND RERA

A. Relevance of RERA in the Insolvency Regime

The Real Estate (Regulation and Development) Act, 2016 (**"RERA"**) is a legislation that was enacted with the purpose of protecting the interests of real estate buyers and investors.[79] The applicability of the act has been questioned in various instances, and the courts and tribunals have tried to give a limited application to the legislation in light of the existing provisions of the IBC. Therefore, it is pertinent to note that the relevance is rather given to the interests of the homebuyers in order to determine the prevalence and applicability of RERA in the Indian insolvency regime.

An instance can be taken of the recovery certificates issued by the authority under RERA.[80] However, it has been a settled position that the claim based solely on the recovery certificate cannot be sufficient to initiate CIRP proceedings under Section 7 of IBC as such will not fall within the definition of "financial debt" under Section 5(8)(f).[81] One of the major reasons behind such a restrictive position is the basic principle of the insolvency laws to prevent any fraudulent or malicious initiation of the insolvency proceedings for a purpose other than for the resolution of insolvency.[82]

[79]Ajar Rab, *Real Estate (Regulation and Development) Act, 2016* (1st edn, EBC 2019), 5-11; *Belaire Owner's Association v. DLF Ltd.,* (2011) SCC OnLine CCI 189.
[80] Real Estate (Regulation and Development) Act 2016, s 40(1) (RERA).
[81]*Sushil Ansal v. Ashok Tripathi*, (2020) SCC OnLine NCLAT 680.
[82]*G. Easwara Rao v. Stressed Asset Stabilisation Fund,* (2020) SCC OnLine NCLAT 416.

From a different perspective, the relevance of the RERA in the insolvency regime can be implied from Section 30(2)(e) of IBC[83] which is even applicable to the provisions and objectives of RERA which was enacted before the enactment of the Code. This was also highlighted by the ILC, where, while proposing to protect the rights of the homebuyers, the committee observed that

> Section 30(2)(e) of the Code provides that all proposed resolution plans must not contravene any provisions of law in force, and thus, the provisions of Real Estate (Regulation and Development) Act, 2016 ("RERA") will need to be complied with and resolution plans under the Code should be compliant with the said law.[84]

However, it is important to understand that the non-contravention of the existing provisions of RERA does not mean an overriding effect over the provisions of IBC. This was made much clearer by the Supreme Court in the *Pioneer* ruling[85] where while interpreting Section 88 of RERA,[86] the NCLAT denied any overriding effect of RERA over the IBC and its provisions. However, giving effect to the Section 30(2)(e) of IBC as well, it was further held that the RERA laws and rules can be used to safeguard the interests of the homebuyers by establishing default on the part of the real estate companies.[87]

However, while giving a broader meaning to the term "financial creditors" to include homebuyers within its ambit, the ruling has given a restrictive meaning to the term "allottees". As was observed by the court,

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[83] IBC, s 30(2)(e).
[84] ILC Report, (n 32) [1.8].
[85]*Pioneer Urban Land and Infrastructure Ltd. v. Union of India*, (2019) 8 SCC 416.
[86] RERA, s 88.
[87]*Pioneer* (n 85).

> Under Section 65 of the Code, the real estate developer can also point out that the insolvency resolution process under the Code has been invoked fraudulently, with malicious intent, or for any purpose other than the resolution of insolvency. This the real estate developer may do by pointing out, for example, that the allottee who has knocked at the doors of the NCLT is a speculative investor and not a person who is genuinely interested in purchasing a flat/apartment. They can also point out that in a real estate market which is falling, the allottee does not, in fact, want to go ahead with its obligation to take possession of the flat/apartment under RERA, but wants to jump ship and really get back, by way of this coercive measure, monies already paid by it.[88]

If seen from the legal perspective, the position seems right with RERA providing for the actual homebuyers who want to purchase a home or flat for consumption purposes. In this respect, the position is also in line with the Consumer Protection Act, 1986, which rather tenders a restrictive interpretation of the term "allottees".[89] However, it is pertinent to note the difference between the nature of the two laws through a comprehensive understanding of the transactions and cases they deal with. While the Consumer Protection Act is welfare legislation for the protection of the common man, the inherent nature of the IBC is commercial.

The same can also be deduced by the intention behind both the IBC and the amendment of 2018, which was further highlighted by the BLRC while interpreting the term "financial creditors" and taking note of the problems under the existing regime. If seen from this perspective, it is important to note the observation of the committee that

[88]*Pioneer* (n 85) [16].
[89]*Pramod Kumar Arora* (n 37) [4].

> As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say… When creditors know that they have weak rights resulting in a low recovery rate, they are averse to lend. Hence, lending in India is concentrated in a few large companies that have a low probability of failure.[90]

The investors in the real estate market are also creditors whose money has been put to use in the development of the companies in the sector. If going by the reasoning of BLRC and looking at the socio-economic environment of the country, the exclusion of the investors from the wide ambit of "allottee" will rather be against the public policy and justice, thereby violating the basic objective of both RERA and IBC. In this respect, a harmonious construction is required of both the legislations for not only giving proper application to RERA in the Indian insolvency regime but also practically achieving the objectives of both laws.

B. Harmonious Construction of IBC and RERA

The need for the harmonious construction between both legislations was first signified in the *Pioneer case,* where the Apex Court highlighted that

> RERA is to be read harmoniously with the Code, as amended by the Amendment Act. It is only in the event of a conflict that the code will prevail over RERA. Remedies that are given to allottees of flats/apartments are therefore concurrent remedies, such allottees of flats/apartments being in a position to avail of remedies under the Consumer Protection Act, 1986, RERA as well as the triggering of the Code.[91]

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[90] BLRC Report (n 2) Chap. 2.
[91] *Pioneer* (n 85) [86].

The harmonious construction, which is being attempted in this paper to bring out the legislative intention behind both the laws and determine the legal validity of the limitations imposed by the amendment of 2020, a comprehensive analysis of their objectives is a necessity for such construction. In this aspect, the objective of RERA can be inferred as "to protect the interests of consumers in the real estate sector and to establish an adjudicating mechanism for speedy dispute redressal," thus signifying it as welfare legislation.[92] On the other hand, the Code focuses more on the commercial aspect and has the ultimate objective of preventing the closures of businesses on the ground of inability to pay the debts.[93]

By harmonizing the two laws, it can be deduced that the supreme objective of the laws should be to promote and safeguard the interest and welfare of the allottees, as is referred to under Section 2(d) of RERA.[94] However, while securing such interest, the note should also be given to the businesses and the real estate companies to prevent any further loss to them. In this respect, it should be understood that the CIRP is often termed as a 'group solution' which was introduced to ensure the welfare of every stakeholder.[95] The conferring of the status of financial creditors to the allottees, therefore, can fulfil both the welfare and commercial purposes of the respective laws, thus harmonizing them, and is thus in conformance with the purpose and provisions of RERA.

However, when it comes to the limitations imposed by the second proviso of Section 7 of IBC, the same can be said to be legally justified and

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[92] RERA, St. of Objects and Reasons.
[93] IBC, Preamble.
[94] RERA, s 2(d).
[95] I. Kokorin, 'The Rise of 'Group Solution' in Insolvency Law and Bank Resolution' (2021). 22 EurBus Org Law Rev, 781–811 <https://doi.org/10.1007/s40804-021-00220-4> accessed 23 October 2022.

valid under Section 88 of RERA. While such introduction of the limitations on the existing rights can be said to be in violation of the principles of natural justice, the harmonious balance will be maintained as long as the limitation serves the larger purpose of CIRP and IBC and safeguards the interests of other stakeholders.

V. *N. KUMAR V. TATA HOUSING* CASE AND LEGAL AMBIGUITY

The ambiguities around the legal status of the homebuyers, have though been contended several times, with courts trying to find a middle path, and has subsequently been put to rest by the additions made in Section 5 and Section 7 of the IBC. Though the positions cannot be called settled with the Supreme Court[96] and NCLAT[97] are still dealing with the cases pertaining to the welfare of the homebuyers and giving effect to the 2020 amendment, some clarity was there regarding the procedural aspect of the law. However, the ambiguity again arose with the recent order of the NCLT Chennai in *N. Kumar v. Tata Capital Housing Finance Ltd.,*[98] where the provision was constructed in a contradictory and restrictive manner.

In this case, the applicant is actually the resolution professional for M/s Sheltrex Developers Pvt. Ltd. (Debtor) which was undergoing the resolution proceedings. The debtor had two projects on which the insolvency proceedings were initiated by a separate set of homebuyers. In furtherance, the debtor contended that each project should be treated as a separate entity under the principle of reverse CIRP, thus validating its action of classifying creditors on the basis of their investment in the project. In this respect, the author seeks

[96]*Manish Kumar* (n 45).
[97]*Anand Murti v. Soni Infratech Pvt. Ltd.*, Civil Appeal Nos. 7534 of 2021.
[98]*N. Kumar* (n 6).

to clarify that the vagueness of the decision is being propounded on not only the aspect of contradiction with the established principles but also the wrong interpretation of the principle to reach an erroneous outcome.

While construing the procedural requirements enshrined under Section 7, it is important to understand the position prior to the order of the NCLT. In this respect, the NCLAT in *Flat Buyers Association Winter Hills v. M/s Umang Realtech Pvt. Ltd.,*[99] gave the concept of "Reverse CIRP" relevant for only real estate companies. While such an interpretation of Section 29A of IBC[100] means going beyond its scope, the same was made in consideration of the maintenance of balance between the stakeholders (allottees and CDs) while ensuring the successful completion of the running projects.

The NCLAT in this regard resorted to a constructive interpretation of the provision in order to make it not only operational but also in conformance with the objective of the law and needs of the society. As was rightly observed in its judgment,

> In Corporate Insolvency Resolution Process against a real estate, if allottees (Financial Creditors) or Financial Institutions/Banks (Other Financial Creditors) or Operational Creditors of one project initiated Corporate Insolvency Resolution Process against the Corporate Debtor (real estate company), it is confined to the particular project, it cannot affect any other project(s) of the same real estate company (Corporate Debtor) in other places where the separate plan(s) are approved by different authorities,... The asset of the company (Corporate Debtor - real estate) of that particular project is to be maximized for balancing the creditors such as allottees, financial institutions and operational creditors of that particular project. Corporate

[99]CA AT (Insolvency) No. 926 of 2019.
[100]IBC, s 29A.

> Insolvency Resolution Process should be project basis, as per approved plan by the Competent Authority.[101]

From a basic perusal of the judgment, it can be deduced that the NCLAT, though respecting the limitations imposed by the Section 7 of IBC tried to give a purposive interpretation to the provision to secure the welfare of the homebuyers and real estate investors and avoid any discrimination between them and other speculative investors who can instead initiate the CIRP proceedings.

However, a more important observation that was given by the appellate tribunal was its consideration of the procedural aspect of the filing of the application, where it treated the different projects as different businesses with different creditors, requiring the filing of separate applications.[102] The position was also reiterated in the subsequent cases, which settled the legal position on the procedural aspect of the filing of the application by the homebuyers under Section 7.[103] Nevertheless, the disturbance which is created by the latest order in *N. Kumar v. Tata Housing case* needs a critical analysis to remove ambiguities in this area.

In this regard, the order of the NCLT Chennai is considered a legal blunder due to its incorrect construction in two aspects. The first aspect deals with the disregard of Section 60(5) of IBC[104] in which the case was filed in the first instance. The NCLT being an adjudicatory authority in this respect has jurisdiction to entertain such cases where the CIRP or liquidation application was filed against the CD or if there is any question of priorities or

[101] *Winter Hills* (n 99) [21].
[102] *Winter Hills* (n 99).
[103] *Rajesh Goyal v. Babita Gupta*, I.A. No. 2166 of 2020 In Company Appeal (AT) (Insolvency) No. 1056 of 2019; *Bijay Pratap Singh v. Unimax International*, Company Appeal (AT) (Insolvency) No. 1273 of 2019.
[104] IBC, s 60(5).

laws or facts arising out of the insolvency proceedings. However, giving effect to such provision in the order itself but not understanding its essence of not only conferring jurisdiction but also highlighting the need for providing a detailed reason behind the stance taken is in clear violation of the principle of audi alteram partum.

From the second aspect, the NCLT considered the proposition given in the *Pioneer* case, where the principle of a "Clean Slate" was propounded as one of the objectives of the IBC.[105] In this regard, however, it is equally important to note that the approach of IBC is "creditor-centric" rather than the "debtor-centric" approach of US laws. This is also highlighted in the statements of objects and reasons of the Code where maintaining the balance between the stakeholders is one of the three purposes of the legislation,[106] thus clearly erring in interpreting the code itself.

While the order has been in limelight due to its erroneous approach and disregard of the precedents without any justifiable rationale, the chaos and ambiguities in the legal position which has been created are going to have huge repercussions on the relationship between the real estate industry and the insolvency regime. Though the contentious order is given by the NCLT and therefore is subjected to easy rectification by the appellate authorities, the legal position of the homebuyers and investors has to be made certain for the larger public interest and socio-economic benefits to the country.

VI. CONCLUSION AND RECOMMENDATIONS

Homebuyers are considered as on equal footing as the common people who save their lifetime earnings in purchasing houses or properties. Even

[105]IBC, s 32A(1).
[106]IBC, Preamble.

more, the surging demand in the real estate sector can be attributed to the investments made by the general public due to its high returns and transparent conduct of the business. If seen from this perspective, discriminating the homebuyers and investors in the real estate sector from the shareholders or investors in any other sector would be in contravention of not only the principles of equity and fairness but also the objectives of the insolvency laws in India.

Despite the broader objective of the IBC to ensure economic advantage to the nation, as well as secure equitable interests of the stakeholders, the legislators, and the courts seem to have been blinded by the misconception about the nature of investors and the commercial purpose of the Code.[107]While such a limitation is imposed with a benign objective to uphold the true intention of the lawmakers, considering homebuyers as small claimants who may file trivial cases is not based on any material reasoning. Further, curbing the status of the financial creditors as was conferred in the *Nikhil Mehta case* is also in clear disregard to the reasoning as well as the purposive interpretation of the definition of "financial debt" given in the case. Moreover, though it may be argued that the interests of the homebuyers may be secured through other welfare legislation, it is pertinent to note that welfare legislation like the Consumer Protection Act will provide for e damages only if the homebuyer has suffered some financial injury because of the deficiency in the service.[108] Also, the law will provide this relief on an individual basis depending on the

[107]Pareekshit Bishnoi and Parveen Kumar Aggarwal, 'Weighing the effect and need of the 'minimum threshold' on the home-buyers' (*SCC Blog,* 14 November 2020) <https://www.scconline.com/blog/post/2020/11/14/weighing-the-effect-and-need-of-the-minimum-threshold-on-the-home-buyers/> accessed 28 October 2022.

[108]*Pramod Kumar Arora* (n 37) [3]; *Ved Kumari v. OmaxeBuildhome (P) Ltd.,* (2014) SCC OnLine NCDRC 120; and *New Okhla Industrial Development Authority*, MANU/CF/0089/2014, Consumer Complaint No. 143 of 2013.

quantum of injury received, thereby leading to an increase in the litigations and differentiation between the stakeholders.

In this respect, it is therefore contended in this paper that the limitations imposed on the homebuyers should be relaxed to the extent that the same serves the larger public interest and national interest while respecting the supreme status of the financial creditors. For that purpose, the paper summarises the following findings derived from the above analysis of the status of the homebuyers, along with the proposed suggestions for removing the ambiguity in this area. *Firstly,* the status of the homebuyers, as well as investors in the real estate industry as the financial creditors with equal capacity and privileges under Section 7, should be re-established. This is not only necessary in light of the earlier precedents and the contemporary socio-economic conditions but also in conformance with the recommendation of ILC, which also highlighted the significance of the homebuyers in the Indian insolvency regime.[109] For that purpose, it is recommended by the author that additional criteria of monetary threshold can be included as an alternative option through either notification or amendment. This will not only lead to solving the current problem of under-representation but also will keep the objective of preventing initiation of the proceedings on trivial claims intact.

Secondly, the erroneous order of the NCLT Chennai in the *N. Kumar case* should be rectified by the High courts on a suo moto basis. In this regard, it is pertinent to note that such power of taking suo moto cognizance of the matter is constitutionally mandated under Article 227 in the larger public interest.[110] While the order of the NCLT cannot be said to be strictly in

[109]ILC Report (n 32) 17.
[110]Constitution of India 1950, art 227(1); *L. Chandra Kumar v. Union of India,* (1997) 3 SCC 261; *State of Orissa v. Bhagaban Sarang*i, (1995) 1 SCC 399.

violation of "public interest", the ruckus which has been caused due to erroneous interpretation should be rectified for defining the correct position of law and remove procedural hindrances in the filing of the application for the initiation of the insolvency proceedings.[111] Further, the legal position with respect to the "Reverse CIRP" in the insolvency proceedings of real estate companies and its relation to the scope of the IBC also needs to be clarified.

Thirdly, a harmonious construction has to be given to not only IBC but all the commercial laws of the country with respect to welfare legislation in order to bridge the gap between the two and achieve the objectives of both kinds of legislation. As was also reiterated in the *Pioneer case*, the harmonious construction will lead to the serving of the original purpose of the commercial legislation in India to promote national economic interests and commercial interests, which is evident by the close connection between the social and economic spheres of the country.

The findings, along with the relevant suggestions as has been proposed by the author in the paper are believed to be serving both the commercial interest and welfare of society, thus achieving the true objective and efficiency of the insolvency laws. However, though the above proposals are being made while giving due consideration to the social, economic, normative, and legal factors, detailed thinking has to be given to the amendment of 2020, and the reduction of the status of the homebuyers to small claimants have to be reconsidered from both contemporaneous exposition and contemporary needs. In this respect, it is believed that as long as the limitations are justified by the interests of the larger public while balancing the interests of all the stakeholders of the insolvency proceedings, such considerations are irrelevant. Nevertheless, given the economic boom in demand in the real estate sector in

[111] *N. Kumar* (n 6) [9].

recent years with the ambiguities regarding the status of homebuyers still looming over the insolvency regime, clearly, the lawmakers and the judiciary have to reconstruct Section 7 and its limitations to give the justified position of law.

IX. ANALYSING ADDITION TIER 1 BONDS THROUGH THE YES BANK FIASCO

- Manas Agarwal*

ABSTRACT

First, there is a dearth of literature in Indian academic writing on the issues discussed in this paper. No Indian scholar has critically analyzed the SEBI order or the decision of the High Courts. At best, there have been studies of the impact disclosure on consumer finance, which do not have a direct correlation to the AT-1 bonds. Moreover, even in international literature, the focus has only been on empirical analysis, and not on the interpretation of statutes, circulars, and regulations. Second, the SC has not delivered any verdict on the decision of either the Bombay High Court or the Madras High Court. Moreover, SAT has not given a conclusive order on the issue of violation of PFUTP. Third, the fiasco of AT-1 bonds has been discussed in newspaper articles however; these newspaper articles merely state the stance of the different stakeholders without providing a strong critical analysis. Thus, this paper becomes imperative. It provides a critical and holistic analysis on first, the validity of issuing AT-1 bonds generally, irrespective of the issuing bank, and second, on the specific case of AT-1 bonds issued by YBL.

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I. INTRODUCTORY REMARKS – THE BACKGROUND AND THE STRUCTURE

"Riches either serve or govern the possessor" - Horace[1]

In the Yes Bank Limited (**"YBL"**) fiasco, the riches are the Additional Tier 1 Bonds (**"AT-1 bonds"**) worth eight thousand four hundred and fifteen crores.[2] The possessors are the 1346 individual investors, who invested in the AT-1 bonds.[3] AT1 bonds have a perpetual tenor and are unsecured. In other words, there is no maturity date for these bank-issued bonds. The banks may use their call option to repurchase these bonds from investors. Banks often employ these bonds to increase their tier-1 or core capital. Only common equity is senior to AT1 bonds, which are subordinate to all other debt.[4] Before moving further, the author will *first* explain the fiasco, and *second*, the structure of the paper.

A. The Background of the YBL Fiasco

The background can be simply understood in four chronological steps. *First*, is the issuance stage. YBL issued AT-1 bonds in the year 2016 and 2017

[1] *Piyush Bokaria v Reserve Bank of India*, 2020 SCC OnLine Mad 2693 [60] (Sahi J.).
[2] Yes Bank Limited ('YBL'), *Draft Reconstruction Scheme* (6 March 2020).
[3] In the matter of AT1 Bonds of Yes Bank Limited, Order/SM/MG/2021-22/11306-11309 (*SEBI*, 12 April 2021) <https://www.sebi.gov.in/enforcement/orders/apr-2021/adjudication-order-in-the-matter-of-at1-bonds-of-yes-bank-limited_49822.html> accessed 10 January 2022 ('SEBI Order') [37] (Majumdar AO).
[4] 'Additional Tier-1 bonds, and the case against Yes Bank' (*The Indian Express*, 21 January 2023) <https://indianexpress.com/article/explained/explained-economics/yes-bank-at1-bonds-bombay-high-court-8395311/> accessed 22 February 2023.

respectively.[5] The people, who are bearing the brunt, invested in the AT-1 bonds in the year 2018.[6] The *second* is the deterioration stage. The financial situation of YBL started deteriorating over some time. For instance, the net and gross non-performing assets of YBL increased considerably.[7]

The third is the remedial stage. To remedy the situation, the Government of India acting on the recommendation of the Reserve Bank of India (**"RBI"**)[8] issued a moratorium on 5 March 2020.[9] Furthermore, RBI under Section 36 ACA of the Banking Regulations Act 1949 (**"BR Act"**) appointed an Administrator to supersede the Board of Directors of YBL.[10] After this, the draft reconstruction scheme was released on 6 March 2020.[11] This was followed by the final reconstruction scheme.[12] Fourth, is the effect stage. On the one hand, the draft reconstruction scheme stated that the AT-1 bonds are permanently written down.[13] On the other hand, the final reconstruction scheme contained no such clause.[14] Furthermore, the appointed Administrator informed the stock exchanges that AT-1 bonds are permanently written down.[15] The current situation is that AT-1 bonds of YBL have been permanently written down.

Hence, the crux of the matter is (a) whether the AT-1 bondholders should be compensated for the loss faced by the fiasco (serve the possessor)

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[5] *Piyush* (n 1) [10] (Ramamoorthy J.).
[6] ibid.
[7] ibid [11] (Ramamoorthy J.).
[8] The Banking Regulation Act 1949 ('BR Act'), s 45(1). "..., the Reserve Bank may apply to the Central Government for an order of moratorium in respect of a banking company..."
[9] SEBI Order (n 3) [27] (Majumdar AO).
[10] BR Act, s. 36ACA (1).
[11] Draft Reconstruction Scheme (n 2).
[12] YBL, *Final Reconstruction Scheme* (13 March 2020).
[13] Draft Reconstruction Scheme (n 2) cl 6 ¶ 4.
[14] *Piyush* (n 1) [11] (Ramamoorthy J.).
[15] *Communication from the Administrator of YBL to the stock exchanges* (14 March 2020) cl 3.

or (b) should the loss be treated at best as an investment decision gone wrong (govern the possessor). This dichotomy is the backdrop against which this paper is written.

B. The Structure of the Paper

Structurally, the paper is divided into three parts. The paper in Part I addresses the issue of the validity of the AT-1 bonds in general. The author argues that AT-1 bonds neither violate the provisions of the BR Act nor the provisions of the Companies Act 2013 (**"CA Act"**) **[II]**. The paper in Part II critically analyses the issue of fraud, miss-selling, and disclosure. The author argues that YBL has violated the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 (**"PFUTP Regulations"**) and SEBI Act 1992 (**"SEBI Act"**) among others **[III]**. The paper in Part III evaluates the viability of SEBI Circulars and their potential to serve as a way forward **[IV]**.

Through these three parts, the thesis of the paper is, 'While the issuance of the AT-1 is, in general, valid, the issuance of AT-1 bonds by YBL is fraudulent'

II. THE ISSUANCE OF AT-1 BONDS, IN GENERAL, DOES NOT VIOLATE THE PROVISIONS OF ANY STATUTE

One of the major arguments of the investors of AT-1 bonds of YBL is that the issue of AT-1 bonds, irrespective of the issuing bank, should be treated as invalid.[16] There are two prongs to this argument, and hence the author will deal with them accordingly. *First*, the author argues that the issuance of AT-1

[16] *Piyush* (n 1) [14(iii)], [14 (vi)] (Ramamoorthy J.).

bonds does not violate the BR Act, and *second*, AT-1 bonds do not contravene the provisions of the CA Act.

A. The use of Section 35A of the BR Act to lay down the Master Circular for the Issuance of AT-1 Bonds is valid.

1. Section 12 of the BR Act should triumph over Section 35A of the BR Act with regard to AT-1 bonds – The incorrect argument

The argument from the sides of investors is three-fold. *First,* BR Act envisages the issuance of capital under Section 12,[17] *second,* Section 12 does not encompass AT-1 bonds, and *third*, specific powers conferred by a statute on particular provisions should triumph over the general powers conferred by that same statute on some section/s.[18]

Hence, the Master Circular dated 1 July 2015 (**"MC"**) should be declared invalid to the extent that it talks about AT-1 bonds.[19] This is because the MC was issued using the general powers under Section 35A of the BR Act despite the existence of Section 12. However, the author argues that this three-fold argument is erroneous.

2. Section 12 of the BR Act does not envisage AT-1 bonds, and hence the use of Section 35A is valid – The correct argument

Before moving further, let us understand the origin of the MC. The origin of the MC can be understood in three simple steps. *First*, in 2009, the

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[17] BR Act, s. 12(ii).

[18] *Dharani Sugars v Union of India*, (2019) 5 SCC 480 [26], [40-42], [62-63], [72].

[19] Reserve Bank of India, *Master Circular on Basel III Capital Regulations* (July 2015) Annex 4, Annex 16 <https://rbidocs.rbi.org.in/rdocs/content/pdfs/58BS300685FL.pdf> accessed 15 January 2022 (Master Circular).

G20 leaders met in Pittsburgh (**"G20 Summit"**) One of the main agendas of the G20 Summit was "Strengthening the International Financial Regulatory System".[20] *Second*, under the G20 Summit, the Basel Committee on Banking Standards (**"BCBS"**) released Basel III: A global regulatory framework for more resilient banks and banking systems (**"Basel III"**).[21] One of the goals of Basel III is "Strengthening the Global Capital Framework".[22] Furthermore, Section 4 of the Basel Committee Charter (**"Charter"**) states that central banks are members of BCBS.[23] Hence, the Reserve Bank of India (**"RBI"**) is a member of the BCBS. *Third*, to achieve the mandate of the BCBS,[24] the RBI using the powers of Section 35A released the consolidated MC.[25]

Once the background is established, the author has two arguments. *First*, the scope of Section 35A is wide.[26] If the RBI is satisfied that a course of action is in the "public interest" or "in the interest of banking policy", then the RBI can "issue such directions as it deems fit".[27] As abovementioned, the MC was issued to promote the goals of the G20 Summit, and Basel III. These goals are in place to ensure that the banks' capital adequacy ratio is at a stable level and that the general public does not bear the brunt of the financial crisis.[28]

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[20] G20 Research Group, 'G20 Leaders Statement: The Pittsburgh Summit' (*G20 Information Centre*, September 2009) <http://www.g20.utoronto.ca/2009/2009communique0925.html#system> accessed 15 January 2022.

[21] Basel Committee on Banking Standards, *Basel III: A global regulatory framework for more resilient banks and banking systems* (2010) <https://www.bis.org/publ/bcbs189.pdf> accessed15 January 2022.

[22] ibid part A.

[23]Basel Committee on Banking Standards, *Basel Committee Charter* (2013) s. 4, <http://felaban.s3-website-us-west-2.amazonaws.com/boletines_clain/archivo20140723214926PM.pdf> accessed 15 January 2022.

[24] ibid s. 5.

[25] Master Circular (n 19).

[26] *Dharani* (n 18) [39]; *ICICI Bank Ltd. v APS Star Industries Ltd*, (2010) 10 SCC 1 [35].

[27] BR Act, s. 35A (1).

[28] Master Circular (n 19) part A, Introduction.

Hence, the issuance of AT-1 bonds through MC is in the interest of both public, and banking policy.[29] *Second*, AT-1 bonds are not share capital. The sample form of a balance sheet is present in the Third Schedule of the BR Act.[30] Under the Third Schedule, there are five different schedules. Schedule 1 mention 'Capital' and Schedule 4 mentions 'Borrowings'.[31] To qualify as share capital, there should be "issuance, subscription, and paying-up of share capital".[32] If these requirements are met, then the instrument would be categorized as share capital on the balance sheet.[33] However, the MC states that AT-1 bonds are to be construed as "liabilities for accounting purposes".[34] Furthermore, the balance sheet of YBL categorizes AT-1 bonds as borrowings.[35] Hence, the AT-1 bonds form part of 'Borrowings' and not 'Capital'. Thus, if AT-1 bonds do not fall under the category of share capital, Section 12 is inapplicable. Consequently, the 'specific over general' argument is untenable in the present case.

To conclude, the issuance of AT-1 bonds is valid under the BR Act, as they are within the scope of Section 35A, and do not form part of the share capital.

3. The issuance of AT-1 Bonds does not contravene the provisions of the CA Act

- The CA Act does not envisage perpetual instruments such as AT-1 bonds – The incorrect argument

[29] *Piyush* (n 1) [19] (Ramamoorthy J.).
[30] BR Act, sch III.
[31] BR Act, sch III, sub sch I, sub sch IV.
[32] *Piyush* (n 1) [24] (Ramamoorthy J.).
[33] ibid.
[34] Master Circular (n 19) Annex 4, cl 1.10.
[35] *Piyush* (n 1).

There are three arguments from the side of the investors. *First*, as the AT -1 bonds are reflected as borrowings in the balance sheet, they should qualify as debentures.[36] Furthermore, the MC stipulates that AT-1 bonds should be perpetual.[37] This is in direct contravention of the CA Act. CA Act in Section 2(30) defines debentures to include bonds.[38] Furthermore, according to Section 71(8) of the CA Act, a company is mandated to redeem the debentures.[39] If a company fails to redeem the debenture, then legal action can be taken against it as per Sections 71(10) and 71(12) of the CA Act.[40] *Second*, Section 71(4) of the CA Act mandates that there should be a creation of a debenture redemption reserve.[41] *Third*, it may be argued that, as per Section 1(4)c of the CA Act, the provisions of the BR Act take precedence over CA Act for banking companies.[42] However, the provision for AT-1 bonds is not found in the BR Act, but in the MC. Hence, the exception under Section 1(4)(c) cannot be taken. All these arguments may carry some weight, however, all of them are erroneous. The author will now rebut all three arguments.

- The MC prevails over the CA Act with regard to AT-1 bonds – The correct argument

AT -1 bonds do not qualify as debentures because of three reasons. *First*, AT-1 bondholders do not have even the option, let alone the right of demanding repayment of principal.[43] *Second*, coupon payment is the only enforceable debt obligation present in AT-1 bonds, and even this obligation has certain restrictions.[44] *Third*, AT-1 bonds are regulatory capital to meet

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[36] ibid [14(vi)] (Ramamoorthy J.).
[37] Master Circular (n 19) Annex 4, cl 1.4.
[38] The Companies Act 2013, s. 2(30) (CA Act).
[39] CA Act, s. 71(8).
[40] CA Act, ss. 71(10), 71(12).
[41] CA Act, s 71(4).
[42] CA Act, s 1(4) c.
[43] *Piyush* (n 1) [28] (Ramamoorthy J.); Master Circular (n 19) Annex 4, cl 1.6, 1.7.
[44] Master Circular (n 19) Annex 4, cl 1.8.

CRAR.[45] Hence, AT-1 bonds do not fall within the dichotomy of equity and debt, and they are sui generis instruments.[46]

Furthermore, even if AT-1 bonds were within the ambit of debentures, then also they do not violate the CA Act. This is for three reasons. *First*, CA Act does not prohibit perpetual bonds. Secured debentures have a maximum redemption period of 10 years from the date of issue.[47] However, this is not the case for unsecured debentures. Since AT-1 bonds are unsecured debentures, there is no maximum redemption period specified. *Second*, banking companies are exempted from the creation of a debenture redemption reserve.[48] *Third*, the provisions of the BR Act overrule the provisions of the CA Act. Section 1(4)(c) of CA 2013 lays down that for banking companies, if there is any contravention of the provisions of the CA Act, then the provisions of the BR Act apply.[49] The MC was issued by RBI under Section 35A of the BR Act. The Supreme Court of India (**"SC"**) has held that the circulars issued by the RBI under s 35-A of the BR Act have statutory force.[50] Furthermore, SC has held that when RBI exercises the powers conferred upon it to issue directions, then such directions become a part of the Act.[51] Hence, Section 1(4) c applies to the MC.

To conclude, AT-1 bonds do not contravene the provisions of the CA Act as they do not fall within the ambit of debentures. In any case, banking

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[45] *Piyush* (n 1) [24] (Ramamoorthy J.).
[46] *Piyush* (n 1) [29] (Ramamoorthy J.).
[47] Companies (Share Capital and Debentures) Rules 2014, r 18(1)(a).
[48] ibid, r 18(7)(b).
[49] CA Act, s. 1(4) c.
[50] *Central Bank of India v. Ravindra,* (2002) 1 SCC 367 [55].
[51] *Internet & Mobile Association of India v. RBI* (2020) 10 SCC 274 [150], [167]; *ICICI Bank Ltd. v APS Star Industries Ltd*., (2010) 10 SCC 1 [40]; *Peerless General Finance and Investment Co. Ltd. v Reserve Bank of India*, (1992) 2 SCC 343 [30].

companies are exempted from the provisions of the CA Act to the extent of inconsistency.

To summarise Part I, the MC, and consequently, the *general* issue of the AT-1 bonds is valid. Having said that, the *particular* case of YBL is a separate issue, which will be discussed in the next part of the paper.

III. THE SPECIFIC CASE OF ISSUANCE OF AT-1 BONDS BY YBL IS VIOLATIVE OF STATUTES AND REGULATIONS

In this part, the author will focus on two aspects. The *first* is the theoretical aspect. The author will argue that YBL has violated the provisions of the PFUTP Regulations, the SEBI Act, and the MC. The second is the *empirical* aspect. Using, an empirical case study, the author will argue that the mis-selling by YBL amounts to a violation of the SEBI (Issue of Capital and Disclosure Requirement) Regulations 2009 (**"ICDR Regulations"**), and SEBI (Issue and Listing of Non-convertible Redeemable Preference Shares) Regulations2013 (**"ILNRPS Regulations"**).

A. YBL is Guilty of Fraud and Mis-selling

The author will follow a general to specific approach in proving the guilt. Hence, *first*, the author argues that YBL is guilty on the general grounds of fraud, and manipulation, and *second*, YBL is guilty as it violates specific provisions.

1. YBL is guilty on the general grounds of fraud and manipulation

The test for assessing fraud and manipulation is " the totality of the attending facts and circumstances surrounding the allegations/charges made and levelled the test would always be that what inferential process that a

reasonable/prudent man would adopt to arrive at a conclusion"[52] (emphasis supplied).

In the case of YBL, there are at least ten attending facts and circumstances. The *first* is that YBL has admitted that AT-1 bonds were pitched to the customers, instead of the customers enquiring for the same out of their interest.[53] Hence, the contention of YBL, is that AT-1 bonds were not sold by them in the secondary market,[54] stands rebutted. This is because YBL prepared the step-by-step procedure for selling the AT-1 bonds[55] and YBL adopted an aggressive marketing strategy to sell the AT-1 bonds.[56] Thus, it cannot be termed as mere facilitation. *Second*, YBL has admitted that it wanted the subscription of institutional investors to more capital.[57] Hence, YBL down-sold AT-1 bonds to create shelf space for institutional investors. *Third*, the lot size of AT-1 bonds was substantially reduced, so that a wider number of unsophisticated guileless individual investors can buy AT-1 bonds.[58] *Fourth*, the application form was made available after the investor had already been sold AT-1 bonds. That is, first, the investor was influenced into buying the AT-1 bonds, second, the bond deal was blocked, and third, the application form was provided after the decision had already been formed.[59]*Fifth*, more than 97% of individual investors in AT-1 bonds were existing customers of YBL.[60] Hence, the bank had a fiduciary duty to act in the interests of its client and disclose all details.

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[52] *SEBI v Kishore Ajmera*, (2016) 6 SCC 368 [22].
[53] SEBI Order (n 3) [42].
[54] ibid [51].
[55] ibid [52].
[56] ibid [42].
[57] ibid [36], [42].
[58] ibid [17 (27)], [40], [43].
[59] ibid [56].
[60] ibid [36], [57], [93].

The *sixth* is that RBI had originally prohibited the sale of AT-1 bonds to individual investors, and then, later on, had permitted it with restrictions.[61] Hence, AT-1 bonds are inherently risky. *Seventh*, YBL has admitted that there was no risk profiling of individual investors.[62] However, the risk appetite of institutional investors is different from the risk appetite of individual investors. Hence, the latter needs risk profiling. *Eighth*, YBL has itself submitted contradictory statements.[63] At first, YBL states that AT-1 bonds are not inherently risky.[64] However, later on, YBL states that "the fact that the AT-1 bonds offer a higher return than FDs is ex facie evidence of the fact that there has to be some higher risk".[65] *Ninth*, there are discrepancies present between the Verbal Sales Pitch (**"VSP"**) and the Term Sheet.[66] Furthermore, the Term Sheet was not shared with the investors in many cases.[67] *Tenth*, both CARE and India Ratings assign a stable parameter to the AT-1 bonds. However, YBL has claimed that these ratings have assigned them a "high degree of safety and very low credit risk".[68]

Furthermore, these ten factors expressly or impliedly rebut the submissions made by the YBL.[69] Hence, the author submits that a reasonable/prudent man should conclude that YBL is guilty of fraud and manipulation.

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[61] ibid [30], [59].
[62] ibid [63], [67], [69].
[63] SEBI Order (n 3) [75].
[64] ibid [17 (7)].
[65] ibid [17 (7)].
[66] ibid [77].
[67] ibid [44].
[68] ibid [17 (24)], [81].
[69] ibid [17].

2. YBL is guilty of violating specific provisions

- YBL has violated Regulation 3 of the PFUTP Regulations

Regulation 3 starts with the words, "No person shall directly or indirectly"[70] (emphasis supplied). Hence, the aggressive market strategy used by YBL to sell AT-1 bonds in the secondary market fall within the ambit of Regulation 3 vis-à-vis the word 'indirectly'.

In light of this, *first*, YBL has violated Regulation 3(a).[71] *Firstly*, AT-1 bonds fall within the meaning of securities.[72] *Secondly*, inducement falls within the ambit of dealing in securities which includes such acts which may be knowingly designed to influence the decision of investors in securities.[73] *Thirdly*, even without the amendment of PFUTP Regulations,[74] the SC had held that 'inducement' falls within the definition of fraud[75] in PFUTP.[76] Hence, the ten aspects mentioned in [III.A.1] and highlighting only the positive features of AT-1 bonds[77] proves that YBL induced individual

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[70] SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 ('PFUTP Regulations'), reg 3.
[71] PFUTP Regulations (n 70), Reg 3(a).
[72] SEBI, *Issuance, listing, and trading of Perpetual Non-Cumulative Preference Shares (PNCPS) and Innovative Perpetual Debt Instruments (IPDIs)/ Perpetual Debt Instruments (PDIs) (commonly referred to as Additional Tier 1 (AT 1) instruments)* (6 October 2020) cl 2 (a) (ii), <https://www.sebi.gov.in/legal/circulars/oct-2020/issuance-listing-and-trading-of-perpetual-non-cumulative-preference-shares-pncps-and-innovative-perpetual-debt-instruments-ipdis-perpetual-debt-instruments-pdis-commonly-referred-to-as-additi-_47805.html> accessed 25 January 2022; PFUTP Regulations, reg 2(e); Securities Contract (Regulation) Act 1956, s. 2(h).
[73] PFUTP Regulations, Reg 2(1)b (ii).
[74] SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) (Amendment) Regulations 2018.
[75] PFUTP, reg 2(1) b.
[76] *SEBI v Shri Kanaiyalal Baldevbhai Patel & Others,* (2017) 15 SCC 1 [54], [55], [56]; In the matter of Price Waterhouse Co. & Others (*SAT*, 9 September 2019) <http://sat.gov.in/english/pdf/E2019_JO20187_1.PDF> accessed 30 January 2022 [41].
[77] SEBI Order (n 3) [43].

investors to buy AT-1 bonds. *Second*, YBL has violated Regulation 3(c).[78] *Firstly*, AT-1 bonds were 'listed' by the RBI on the Bombay Stock Exchange.[79] *Secondly*, YBL had designed a *scheme* in which it created a step-by-step procedure to sell the AT-1 bonds.[80] *Thirdly*, the ten aspects mentioned in [III.A.1] prove that this scheme was prepared to defraud individual investors in connection with AT-1 bonds. Furthermore, Section 12A (b) of the SEBI ACT is verbatim that of Regulation 3(c).[81] Hence, YBL violated this section as well.

- YBL has violated Regulation 4 of the PFUTP Regulations

The step-by-step procedure was prepared by YBL and they had the intention to dump AT-1 bonds on individual customers to create more shelf space for institutional investors.[82] Hence, YBL knew[83] the contents of the VSP and Term Sheet.

`Moving on to specific regulations, *first*, ICRA has not provided any raying to the AT-1 bonds.[84] Hence, the claim by YBL that ICRA has provided an AA rating[85] to AT-1 bonds is violative of Regulation 4(2)(s)(i).[86] *Second*, Term Sheets, which contained risks associated with AT-1 bonds were not sent

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[78] PFUTP Regulations (n 70), reg 3(c). "…employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange".
[79] SEBI Order (n 3) [45].
[80] ibid [38].
[81] SEBI Act 1992 ('SEBI Act'), s. 12A (b).
[82] SEBI Order (n 3) [104].
[83] 'Knowledge' is a requirement mentioned in PFUTP Regulations, reg 4(2) (s); The standard for establishing knowledge is a preponderance of probabilities, held in *Kanaiyalal* (n 76) [62].
[84] SEBI Order (n 3) [78].
[85] ibid [74].
[86] PFUTP Regulations (n 70), reg 4(2)(s)(i). "…knowingly making a false or misleading statement."

to many customers.[87] Furthermore, the VSP did not contain any risk differentials.[88] Hence, YBL violated Regulation 4(2) (s) (ii).[89]

Third, the VSP only mentions the positive features of the AT-1 bonds and does not disclose the associated risks.[90] Hence, YBL violated Regulation 4(2) (s) (iii).[91] *Fourth*, YBL had no system in place to ensure that the Term sheet was being shared with the individual investors.[92] Furthermore, there was no process to ensure that the customers knew about the risk factors.[93] Hence, YBL violated Regulation 4(2) (s) (iv).[94]

- YBL has violated Annex 4 of the MC

First, in the VSP, it is stated that "In all likelihood, the YES Bank would exercise the call option at the end of the 5 years."[95] In the Term Sheet, no such expectation is created. However, in many cases, the term sheet was not provided,[96] and in many cases, the term sheet was provided after influencing the decision of the individual investor.[97] Hence, YBL has violated clause 1.6(c) of Annex 4 of the MC.[98] *Second*, YBL has violated clause 1.22 of Annex 4 of the MC. *Firstly*, the VSP mentions the high-interest rates of AT-1 bonds and consequently mentions the comparatively lower interest rates of

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[87] SEBI Order (n 3) [55].
[88] ibid [76].
[89] PFUTP Regulations (n 70), reg 4(2)(s)(ii). "…knowingly concealing or omitting material facts."
[90] SEBI Order (n 3) [41].
[91] PFUTP Regulations (n 70), reg 4(2)(s)(iii). "…knowingly concealing the associated risk factors."
[92] SEBI Order (n 3) [47].
[93] ibid [52].
[94] PFUTP Regulations (n 70), reg 4(2)(s)(iv). "…not taking reasonable care to ensure the suitability of scheme the securities or service to the buyer."
[95] SEBI Order (n 3) [77].
[96] ibid [44].
[97] ibid [41].
[98] Master Circular (n 19) Annex 4, cl 1.6(c).

Fixed Deposits.[99] This is a violation of sub-clause (a).[100] *Secondly*, sub-clause (c) places an affirmative obligation on the issuer to state clearly that AT-1 bonds are different from Fixed Deposits.[101] However, the VSP, which falls within 'other communication with the investor' does not discharge the burden of the affirmative obligation.[102] Hence, YBL has violated sub-clause (c).

To conclude, the author argues that *first,* the totality of attendant facts and circumstances prove YBL's guilt, and *second*, YBL has violated the PFUTP Regulations, the SEBI Act, and the MC.

3. YBL did not fulfill the disclosure requirements

First, the author will apply the subjective standard test to the facts of the YBL case [II.B.1]. *Second*, using empirical data, the author will apply the objective standard test to the facts of the YBL case [II.B.2].

- YBL violated the subjective standard test of the materiality of disclosure

The ICDR Regulation states, "The offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision"[103] (emphasis supplied). Hence, failure to disclose material information amounts to a violation of ICDR Regulations.[104]

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[99] SEBI Order (n 3) [74].
[100] Master Circular (n 19) Annex 4, cl 1.22(a).
[101] ibid Annex 4, cl 1.22(c).
[102] SEBI Order (n 3) [74], [76].
[103] SEBI (Issue of Capital and Disclosure Requirement) Regulations 2009 ('ICDR Regulations'), reg 54(1); SEBI (Issue of Capital and Disclosure Requirement) Regulations 2018, reg 24(1).
[104] In the matter of Brooks Laboratories Ltd. & Others (*SAT*, 21 March 2018) <http://sat.gov.in/english/pdf/E2018_JO2015246.PDF> accessed 1 January 2022.

The issue of violating ICDR Regulations hinges on the 'materiality' of disclosure. *Electrosteel Steels Ltd. v. Securities and Exchange Board of India* is the most pertinent case on the issue of materiality.[105] SEBI and SAT gave conflicting decisions on the appropriate standard to assess the materiality of disclosure.[106]

SEBI opined, "The test for materiality is objective in nature and is not affected by the subjective assessment or optimistic hopes or views of the [Book Running Lead Managers] and the issuer company".[107]

SAT opined, "In other words, it would imply that only facts/ events which the issuer is undoubtedly sure of having no relevance to the issuer or to the issue can be excluded from disclosure".[108]

Hence, SEBI's finding is that materiality has no dependency on the subjective views of the issuer whereas SAT's finding is that materiality is entirely dependent on the subjective views of the issuer. SAT propounded an extremely stringent standard of 'undoubtedly sure' for the materiality of disclosure. In the YBL fiasco, YBL itself admitted that AT-1 bonds carry some

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[105] Yash Ashar and Anjaneya Das, 'To Disclose or Not to Disclose? An Analysis of the Order of the Securities Appellate Tribunal in Electrosteel Steels Limited v. Securities and Exchange Board of India' (*India Corporate Law- A CAM Blog*, 2 December 2019) <https://corporate.cyrilamarchandblogs.com/2019/12/order-of-securities-appellate-tribunal-electrosteel-steels-limited-v-securities-and-exchange-board-of-india/> accessed 2 January 2022.

[106] Umakanth Varottil, 'SAT Rules on "Materiality" of Disclosures' (*IndiaCorpLaw*, 19 November 2019) <https://indiacorplaw.in/2019/11/sat-rules-materiality-disclosures.html> accessed 1 January 2022.

[107] In the matter of Initial Public Offer (IPO) of M/s. Electrosteel Steels Ltd. (formerly M/s. Electrosteel Integrated Ltd.), AK/AO-8-12/2016 (*SEBI*, 31 March 2016) <https://www.sebi.gov.in/enforcement/orders/mar-2016/adjudication-order-in-the-matter-of-m-s-electrosteel-steels-limited-and-m-s-electrosteel-castings-limited-_32230.html> accessed 1 January 2022 [62].

[108] In the matter of Electrosteel Steels Ltd. (*SAT*, 14 November 2019) <http://sat.gov.in/english/pdf/E2019_JO2016223.PDF> accessed 1 January 2022 [16].

higher risk.[109] Furthermore, the MC specifies that AT-1 bonds are risky instruments.[110] Hence, YBL could not have been 'undoubtedly sure' that disclosing the risk is not relevant to the investor. Thus, YBL violated ICDR Regulations.

SAT's subjectivity test makes the author's job easier. However, the author in good faith, argues that the correct standard to assess materiality is the objective standard propounded by SEBI. This is because, *first*, a literal reading of Regulation 54(1) makes it clear that any information that is material for the investors to make an informed and sound decision must be disclosed. Hence, the legal validity of the regulation depends on the condition that the investors are able to make an informed decision and not on whether the issuer finds the information relevant to disclose. *Second*, the objective of disclosure requirements is investor protection as opposed to honouring the intent of the issuer.[111]

- YBL violated the objective standard test of the materiality of disclosure

The objective standard test is that the disclosure should not mislead or omit a material fact so that investors can make an informed decision.[112] The author will now explain an experimental design, conducted by Dvara Research, to argue that YBL did not adhere to the disclosure requirements. Let's take a hypothetical bond, which has a high rate of interest. Two forms were circulated with regards to this form, *first* was the accurate form that

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[109] SEBI Order (n 3) [17(17)].
[110] Master Circular (n 19) Annex 4, cl 1.22.
[111] Luca Enriques and Sergio Gilotta, 'Disclosure and Financial Market Regulation' in Niamh Moloney, EilísFerran, and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (OUP 2015); John Armour and others, *Principles of Financial Regulation* (1st edn, OUP 2016) chp 8.
[112] *Electrosteel* (n 107) [62].

contained information on both returns and risks. *Second*, was the inaccurate form that closely resembles the disclosure for AT-1 bonds of YBL.[113]

The result of this experiment was *first* that only 14% of people, who received the accurate form,[114] opted for buying the product as opposed to 50% for the inaccurate form.[115] The figure below-mentioned explains this better.[116]

TABLE 3: Overall purchase decision by disclosure type

Disclosure Type	Decision to Buy		
	Not Buy	Buy	Total
Inaccurate	85	86	171
	49.71	50.29	100.00
Accurate	114	18	132
	86.36	13.64	100.00
Total	199	104	303
	65.68	34.32	100.00

(The first row has frequencies and the second row has row percentages)

[113] Niyati Agarwal and others, 'Impact of Information Disclosure on Consumer Behaviour: Case of AT1 Bonds' (2021) Dvara Research Working Paper Series No. WP-2021-01, 9 <https://www.dvara.com/research/wp-content/uploads/2021/02/Impact-of-Information-Disclosure-on-Consumer-Behaviour-Case-of-AT1-Bonds.pdf> accessed 2 February 2022.
[114] ibid pg 10.
[115] SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.
[116] ibid pgs 10-12.

TABLE 1: Results of the test for difference in proportions across the two forms of disclosures — Inaccurate and Accurate

	Variables	Inaccurate	Accurate	Proportion (Inaccurate)	Proportion (Accurate)	Difference	p-value
	All observations	171	132	0.56	0.44	0.1288**	0.026
Gender	Male	89	72	0.55	0.45	0.11	0.183
	Female	82	60	0.58	0.42	0.155*	0.068
Age	18 - up to 24 years	4	4	0.50	0.50	0.00	1.000
	24 - up to 34 years	42	30	0.58	0.42	0.17	0.163
	34 - up to 44 years	45	40	0.53	0.47	0.06	0.588
	44 - up to 54 years	53	39	0.58	0.42	0.15	0.149
	54 - up to 60 years	18	10	0.64	0.36	0.29	0.146
	60 - up to 70 years	9	8	0.53	0.47	0.06	0.809
	70 and above	0	1	0.00	1.00	-1.00	
Marital Status	Married	134	108	0.55	0.45	0.1074*	0.097
	Unmarried	31	21	0.60	0.40	0.19	0.173
	Divorced	4	0	1.00	0.00	1.00	
	Separated	1	2	0.33	0.67	-0.33	
	Widow/Widower	1	1	0.50	0.50	0.00	
Occupation	Private Sector, salaried	62	54	0.53	0.47	0.07	0.459
	Public Sector, salaried	7	4	0.64	0.36	0.27	0.383
	Self-employed professional	21	18	0.54	0.46	0.08	0.632
	Business	22	18	0.55	0.45	0.10	0.529
	Freelancer/Consultant	5	5	0.50	0.50	0.00	1.000
	Homemaker	40	27	0.60	0.40	0.19	0.119
	Retired	5	2	0.71	0.29	0.43	0.297
	Retired and partly working again	5	0	1.00	0.00	1.00	
	Others	4	4	0.50	0.50	0.00	1.000
Income Tax Bracket	₹0 - ₹2,50,000	17	17	0.50	0.50	0.00	1.000
	₹2,50,001 - ₹5,00,000	17	9	0.65	0.35	0.31	0.134
	₹5,00,001 - ₹7,50,000	14	9	0.61	0.39	0.22	0.308
	₹7,50,001 - ₹10,00,000	28	12	0.70	0.30	0.4**	0.019
	₹10,00,001 - ₹12,50,000	11	8	0.58	0.42	0.16	0.497
	₹12,50,001 - ₹15,00,000	7	10	0.41	0.59	-0.18	0.474
	Above ₹15,00,000	38	36	0.51	0.49	0.03	0.816
	Do not want to mention	39	31	0.56	0.44	0.11	0.343
Risk	Low risk	19	20	0.49	0.51	-0.03	0.873
	Medium Risk	66	59	0.53	0.47	0.06	0.532
	High Risk	86	53	0.62	0.38	0.2374***	0.007

Second, the third most cited rationale, by people who got the inaccurate form, for buying the bond was that of the safety of the bond[117]. The figure below-mentioned explains this better.[118]

Hence, the inaccurate form falsely induced the investors to buy the bond. This whole exercise coupled with the violation of statutes and regulations proves that disclosing risk factors is a material fact for investors to make an informed decision. Hence, YBL violated ICDR Regulations. Furthermore, once it is proven that ICDR Regulations are violated, ipso facto, Regulation 23 of ILNRPS Regulations stands violated.[119]

To conclude, YBL has violated ICDR Regulations through the subjective standards test.To summarize Part II, YBL has contravened the provisions of the PFUTP Regulations, SEBI Act, MC, ICDR Regulations, and ILNRPS Regulations.

IV. THE VIABILITY OF THE SEBI CIRCULARS AND THEIR POTENTIAL TO SERVE AS A WAY FORWARD

[117] Ibid.
[118] ibid 13.
[119] SEBI (Issue and Listing of Non-convertible Redeemable Preference Shares) Regulations 2013, reg 23(1).

The *first* solution is to allow only Qualified Institutional Buyers to "participate in the issuance of AT-1 instruments".[120] The *second* solution deals with AT-1 bonds in general, and the solution is that the AT-1 bonds should have a fixed maturity date. As the first solution is straightforward, this paper focuses only on the second solution.

A. The Solution of AT-1 Bonds Having a Fixed Maturity Date is iable

1. The valuation principle – pro-investor move

SEBI released a circular, which stated that "the maturity of all perpetual bonds shall be treated as 100 years from the date of issuance of the bond for the purpose of valuation".[121] Hence, SEBI changed the nature of AT-1 bonds from perpetual[122] to instruments with a fixed maturity period. Furthermore, SEBI has put a ceiling on the percentage of AT-1 bonds that mutual funds can have in their portfolios.[123] The author argues that all of this combined is a pro-investor move, as this disincentivizes mutual funds from introducing AT-1 bonds to low-risk appetite investors.

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[120] SEBI, *Issuance, listing, and trading of Perpetual Non-Cumulative Preference Shares (PNCPS) and Innovative Perpetual Debt Instruments (IPDIs)/ Perpetual Debt Instruments (PDIs) (commonly referred to as Additional Tier 1 (AT 1) instruments)* (6 October 2020) cl 3, <https://www.sebi.gov.in/legal/circulars/oct-2020/issuance-listing-and-trading-of-perpetual-non-cumulative-preference-shares-pncps-and-innovative-perpetual-debt-instruments-ipdis-perpetual-debt-instruments-pdis-commonly-referred-to-as-additi-_47805.html> accessed 25 January 2022.

[121] SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 8 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.

[122] Master Circular (n 19) Annex 4, cl 1.4.

[123] SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 2 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.

The author's argument is based on the rationale of the valuation principle. Let us understand how bonds are valued by the markets. The pricing (valuation) is a function of the time value of money.[124] It simply means that a rupee tomorrow is less valuable than a rupee today.[125] In terms of the valuation of bonds, the general method is to use a 'cash flow method'.[126] In this method, the future principal pay-out and the future recurring coupon payments are discounted back to the current period to determine the current valuation of the bonds.[127]

Once the basics of the valuation are clear, the author will now apply it to the AT-1 bonds. Assume that a mutual fund is holding an AT-1 bond, which has a face value of 2 lakhs, and a coupon at 10%. Now, before the SEBI Circular, the AT-1 bond would have been redeemed in 2025 (there is an assumption in the market that the call period of AT-1 bonds is 3-5 years).[128] However, after the SEBI circular, the impact will be that repayment of 2 lakhs will be presumed to happen in the year 2122, and not 2025. As the value of 2 lakhs, hundred years later is exponentially less than the value of 2 lakhs in 2025, the value of AT-1 bonds in the portfolios of mutual funds will reduce drastically. This will result in lower dealing in AT-1 bonds, and consequently lower negative impacts for individual investors.

2. *Criticisms of the fixed maturity solution*

However, one might argue there are two problems with the SEBI Circular. The *first* is the policy implication. Mutual funds are an important

[124] Robert S. Pindyck and Daniel L. Rubinfeld, *Microeconomics* (8th edn, Pearson 2017).
[125] ibid.
[126] Ishan Chopra, 'Valuing AT-1 Bonds: SEBI Calling Spade a Spade' (*NLSBLR*, 7 July 2021) <https://www.nlsblr.com/post/valuing-at-1-bonds-sebi-calling-spade-a-spade> accessed 17 January 2022.
[127] ibid.
[128] ibid.

source for maintaining the capital requirements of banks. Hence, such a drastic reduction in valuation would plummet the appetite of mutual funds for AT-1 bonds. Consequently, it will impose a higher burden on the Government to infuse equity into banks to meet the capitalization requirements.[129] The *second* problem is the retrospective nature problem. SEBI circular uses the words, "all perpetual bonds".[130] This will have the draconian effect of heavy losses on the existing retail investors of the AT-1 bonds because of the valuation principle.

3. The response to the criticisms

With regard to the policy problem, the author argues that a balance should be struck between meeting the capitalization requirements and establishing a safeguard against the mis-selling of AT-1 for individual investors. Furthermore, the revised circular by SEBI establishes such a balance. In this revised circular, SEBI has adopted a phased manner approach. By a phased manner approach, the author means that the "deemed residual maturity" of AT-1bonds will gradually increase from 10 years till 31 March 2022 to 100 years from 1 April 2023.[131] The figure below-mentioned explains this better.[132]

[129] Shivani Bazaz, 'Finance ministry asks SEBI to withdraw new rule on AT1 bonds' (*The Economic Times*, 12 March 2021) <https://economictimes.indiatimes.com/mf/mf-news/finance-ministry-asks-sebi-to-withdraw-new-rule-on-at1-bonds/articleshow/81463006.cms?from=mdr> accessed 17 January 2022.
[130] SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 8 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.
[131] SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.
[132] SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.

Hence, this will have the effect of *first*, reducing the immediate burden imposed on the Government to infuse equity. Second, under clause 2 of the original circular and clause 2 of the revised circular, there will be less exposure of guileless individual investors to the high-risk AT-1 bonds.

Time Period	Deemed Residual Maturity of Basel III AT-1 bonds (Years)	Deemed Residual Maturity of Basel III Tier 2 Bonds (Years)
Till March 31, 2022	10	10 years or Contractual Maturity whichever is earlier
April 01, 2022 – September 30, 2022	20	Contractual Maturity
October 01, 2022 – March 31, 2023	30	Contractual Maturity
April 01, 2023 onwards	100 *	Contractual Maturity
*100 years from the date of issuance of the bond.		

With regards to the retrospective problem, the law of the land is that alteration of the substantive proposition of law should have a prospective application unless otherwise explicitly or impliedly stated.[133] Furthermore, the SC has held that enacting legislation having a retrospective effect is out of the ambit of Section 11(1) of the SEBI Act.[134] Moreover, the retrospective nature can cause heavy losses to the existing retail investors of AT-1 bonds.[135] Hence,

[133] *SEBI v Classic Credit Ltd.*, (2018) 13 SCC 1 [10]; *Hitendra Vishnu Thakur v. State of Maharashtra*, (1994) 4 SCC 602 [26]; *Sudhir G. Angur v. M. Sanjeev*, (2006) 1 SCC 141 [11].

[134] *SEBI v Alliance Finstock Ltd*., (2015) 16 SCC 731; SEBI Act, s 11(1). "Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit".

[135] Samie Modak, 'Explained: What are perpetual bonds &why have new Sebi rules irked FinMin?' (*Business Standard*, 17 March 2021) <https://www.business-standard.com/article/markets/explained-what-are-perpetual-bonds-why-have-new-sebi-rules-irked-finmin-121031601260_1.html> accessed 22 January 2022.

the author admits that the SEBI circulars have a fault to the extent of retrospectivity, and this should be cured.

To summarise Part III, the author argues that the move by the SEBI to cap the maturity period of AT-1 bonds is a viable solution. Furthermore, if the circulars are given prospective applications, then they can serve as a way forward.

V. CONCLUDING REMARKS

In the YBL fiasco, the loss faced by AT -1 bonds (the riches) should have been compensated to the individual investors (serve the possessor). The paper aimed to provide a critical analysis of three aspects of AT-1 bonds. *First*, is the general aspect. The author argued that AT-1 bonds in general do not violate the provisions of the BR Act or the CA Act. Hence, in principle, the MC, and consequently the issuance of AT-1 bonds are valid. The *second* is the specific aspect. The author argued that the YBL committed fraud and did not adhere to disclosure requirements. Hence, the issuance of AT-1 bonds by YBL is invalid. *Third*, is the strategic aspect. The author argued that imposing a fixed maturity period on AT-1 bonds is a viable solution to diminish the risk of individual investors investing in them. Hence, SEBI circulars can serve as a way forward if they have a prospective application.

X. PROPOSING AN ALTERNATE LEGAL INTERPRETATION OF AGREEMENTS FOR SALE- A BUYER-FRIENDLY APPROACH

- Tarun Ashok*

ABSTRACT

The questions surrounding the legal ramifications of agreements for sale have occupied the limelight in property sale transactions. A document pivotal to transactions for sale of property, they have been used and abused by sellers to the detriment of unsuspecting purchasers of property. Aggrieved buyers have been forced to resort to remedies under different laws such as the Specific Relief Act, 1963 and the Indian Contract Act, 1872 to enforce their rights under the contract. This article puts forth avenues of recourse to buyers within the four corners of the Transfer of Property Act, 1882- the primary law governing immovable property in India. In furtherance of the same, it first analyses provisions related to a charge on property through a contract for sale. Then it examines existing jurisprudence surrounding agreements for sale in India. It also considers the questions of part performance, obligations annexed to the land and the English Equitable Doctrine. Finally, it advances a mechanism to establish a charge on the property in the interest of the buyer to shield them against deceitful sellers. It primarily focuses on Section 55 (6) (b) of the Transfer of Property Act, to articulate an interpretation that fully realizes the rights of the buyer, in the form of a charge on property. The existing judicial approach generally steers buyers towards recourse such as specific performance or refund of earnest money. This article propounds a novel re-imagination of this interpretation by securing a charge on the property in the hands of the buyer.

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I. INTRODUCTION

The legal validity and enforceability of a contract for the sale of immovable property have been an area of significant contention for courts over the years. Despite a plethora of judicial decisions, there is still no definite consensus regarding the nature of contracts for sale and their consequent implications on the buyer and seller's rights. Various conflicting approaches by the Supreme Court, as well as High Courts, have complicated the issue. The various questions surrounding earnest money, payment and refund of the purchase money, and a charge on property in the context of agreements for sale have been left largely unanswered. This article propounds a novel, buyer-friendly approach to such contracts, by proposing an alternate interpretative framework of certain key sections pertaining to the law on the sale of property in India.

Various sections of the Transfer of Property Act, 1882 ("**TP Act, 1882**"), among other legislations, deal with this concept. This article will engage with these sections in detail to inspect the protections offered to the transferee, as well as the impact of a contract for sale on the transferor. It will engage in a wide-ranging and comprehensive analysis of the sale of property and agreements for sale, connecting various provisions and reading them in conjunction.

In furtherance of this objective, the article is divided into four main sections. The first section will expound on the main concepts associated with the sale and contract for the sale of immovable property (**II.**). The second section deals with the judicial interpretation of key provisions to discern the court's assessment of the legal implications of an agreement for sale (**III**.).

The third part will conduct a study of the alternate remedies available under Indian contract law and Property law (**IV**.). It will delve into the Indian Contract Act, 1870 as well as the Specific Relief Act, 1963, and analyze case laws on the same. Finally, it will build the argument for establishing a buyer's charge in a contract for sale by propounding an alternative interpretation. It aims to achieve this by identifying the need for a charge on property, resolving the earnest money-purchase price conundrum, and examining case laws that have laid the foundation for a buyer-friendly interpretation (**IV**.)

II. SALE AND CONTRACT FOR SALE- A BRIEF ANALYSIS OF KEY CONCEPTS

Section 54 ("**s. 54**") of the TP Act, 1882 defines a sale and contract for sale.[1] It essentially postulates that an agreement to sell an immovable property on agreed-upon terms constitutes a contract for sale. Further, it asserts that the mere existence of such a contract does not inherently create an interest in the property. A sale is defined as the transfer of ownership with a reciprocal consideration of a price paid or promised. There is a wholesale transfer of rights along with the title from the seller to the purchaser.[2]

The main principles associated with a sale and the creation of a sale deed are as follows

- *First*, the sale of immovable property with a value over Rs 100 must be registered.
- *Second*, there must be a written sale deed, which is properly attested.
- *Lastly*, the transferor must be validly authorized to dispose of it.[3]

[1] Transfer of Property Act 1882 (Act 4 of 1882), s 54 ("TP Act").
[2] Poonam Pradhan Saxena, *Property Law* (3rd edn, Lexis Nexis 2017) 302.
[3] ibid 304.

A contract for sale is in the nature of an executory contract and is an antecedent to a sale deed.[4] Price is an integral component of a contract for sale without which there exists no enforceable contract.[5] The text of s. 54 reads as follows:

"Contract for sale. - A contract for the sale of immovable property is a contract that a sale of such property shall take place on terms settled between the parties. It does not, of itself, create any interest in or charge on such property."

Although no charge is created on the property in favor of the purchaser in s. 54, section 40 ("**s. 40**") of the TP Act, 1882 clearly states that certain obligations are attached to the land.[6] Various cases have solidified this position and held that these obligations might be specifically enforced.[7]

Section 53A ("**s. 53A**"), introduced through a 1929 amendment, deals with part performance. In essence, it confers certain protections to the transferee.[8] It enables him to defend his possession of the property against any actions of the transferor seeking to enforce his rights in the property.[9] For the purposes of this section, the agreement to transfer property necessarily needs to be registered.[10] The next part of the article will delve into three crucial issues that have arisen in relation to contracts for sale.

[4] Sir Dinshaw Fardunji Mulla, *Mulla on the Transfer of Property Act* (13th edn, Lexis Nexis 2018) 473.
[5] ibid 455.
[6] TP Act, s 40.
[7] *Bai Dosabai v. Mathurdas Govinddas and Ors* (1980) 3 SCC 545.
[8] AK Srivastava and Bal Kishna, 'Nature of Right Under Section 53A of the Transfer of Property Act 1882' (1973) 15(4) Journal of Indian Law Institute 608.
[9] *Achayya v. Venkata Subba Rao* AIR 1957 AP 854.
[10] cf Mulla (n 4) 431.

III. JUDICIAL INTERPRETATION OF CONTRACTS FOR SALE

A. Whether a Contract for Sale Would Prevail Over a Claim for Attachment of Immovable Property?

The answer to this pertinent question resolves itself with the assistance of a hypothetical situation. Consider a situation where a seller draws up a contract for sale with a purchaser for a certain price. Later, the property is attached by a creditor in the clearance of dues. This creditor then proceeds to sell this property as though it was the absolute and unqualified property of the debtor. In this scenario, what recourse is available to the initial purchaser? s. 40 protects the purchaser against this sale to enforce his rights.

The Calcutta High Court, in the case of *Purna Chandra Basak v. Daulat Ali Mollah,* had to adjudge whether an agreement for sale before the attachment of the property would prevail over the attachment.[11] It held that the agreement for sale created a "personal obligation of a fiduciary character", which could be enforced against the seller as well as a subsequent purchaser who had notice of the subsisting contract for sale.[12]

Similarly, the Supreme Court put forth that the equitable ownership doctrine of English law finds incorporation in s. 40 of the TP Act.[13] This doctrine will be expounded on in the latter part of this article. A contrary stance was taken by the High Court of Punjab & Haryana in *Mohinder Singh and Anr v. Nanak Singh* where the claim of the attaching creditor was given precedence.[14] The Supreme Court, however, has settled these conflicting

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[11] AIR 1973 Cal 432.
[12] ibid [8].
[13] *Bai Dosabai* (n 7).
[14] *Mohinder Singh v. Nanak Singh* AIR 1971 P&H 381.

interpretations.[15] It held that despite an attachment, a contract for sale entered into prior attachment, although the conveyance is completed after, vests a valid title in the hands of the purchaser.[16]

B. Whether Part Payment Gives the Transferee Certain Protections Against the Transferor?

Section 55(6)(b) (**"s. 55(6)(b)"**) of the TP Act, 1882 provides the transferee additional rights and protections against unscrupulous sellers. The relevant portion of this section is reproduced as follows:

"The buyer is entitled- unless he has improperly declined to accept delivery of the property, to a charge on the property, as against the seller and all persons claiming under him to the extent of the seller's interest in the property, for the amount of any purchase-money properly paid by the buyer in anticipation of the delivery and for interest on such amount; and, when he properly declines to accept the delivery, also for the earnest (if any) and for the costs (if any) awarded to him of a suit to compel specific performance of the contract or to obtain a decree for its rescission."

Rabindra Nath Banerjee v. Harendra Kumar Chakravarty and Ors evince that an agreement for sale is generally accompanied by partial payment of the price.[17] In this situation, a charge proportional to the amount of purchase money paid is created on ownership of the property in favour of the transferee. Since s. 54 emphasizes that a contract for sale "of itself" does not create a

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[15] S A Kader, 'Contract for Sale of Immovable Property — Its Effect on Subsequent Attachment of the Said Property' (2007) 2 Law Weekly 25.

[16] *Vannarakkal Kallalathil v. Chandramaath Balakrishnan* 1990 SCC (3) 291.

[17] AIR 1956 Cal 462.

charge, the part payment attracts s. 55(6)(b) of the TP Act, 1882, and the buyer is invested with an interest in the property he can specifically enforce.[18]

The Supreme Court in *Videocon Properties Ltd v. Dr. Bhalchandra Laboratories & Ors* explained that the principle underlying this section is that of justice, equity, and good conscience.[19] Unless the purchaser improperly refuses delivery or has contractually agreed to waive off its right to have a charge on the property, the buyer's charge would exist until the conveyance is properly completed. Further, s. 55(6)(b) of the TP Act, 1882 also contemplates payment of interest on the part payment advanced unless it has been forgone through the contract i.e., through the agreement to sell executed between the parties in relation to the property under sale.

Karsandas Purshottamdas v. Gopaldas Trikamji enunciated that deposit money created a charge on the property under s. 55(6)(b) of the TP Act, 1882.[20] Therefore, notwithstanding s. 54 of the TP Act, 1882 clearly emphasising that an agreement for sale conveys no charge on the property, s. 55(6)(b) confers certain rights upon the purchaser which are subject to the terms of the contract. The final part of this article will expound further on this idea of part payment, purchase money, and a charge on property, to make the argument for a charge on the property by reading s. 54 and s. 55(6)(b) in conjunction.

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[18] ibid [16].
[19] (2004) 3 SCC 711.
[20] (1923) 25 BOMLR 1144.

C. Whether the English Equitable Doctrine Finds Application in India?

If the transferor has unilaterally breached the contract to sell the property and decided to sell the property to a different purchaser at a higher price, the buyer has no interest in the property except a right to litigate. There is an imbalance of power relations in this case, with the vendor retaining the upper hand.

The doctrine enunciates that when a contract for the sale of immovable property is concluded, the purchase money paid in advance is included in the transferor's estate, and the land becomes a part of the transferee's estate.[21] It was first put forth in *Seaton v Slade* by the Court of Chancery.[22] In *Chhatra Kumari Devi v. Mohan Bikram Shah*, the Patna High Court stated that Indian Property Law does not recognize the concept of legal and equitable estates.[23]

However, it has been postulated by the Supreme Court that there has been a modified import of the equitable doctrine in s. 53A of the TP Act, 1882.[24] It creates an estoppel in favour of the buyer against the seller of the property. Estoppel is a legal principle that prevents a party from taking a position or making a claim contrary to their previous position. *Shrimant Shamrao Suryavanshi & Anr. v. Pralhad Bahiroba Suryavanshi* laid down the requirements to be satisfied by the transferee to avail of this equitable remedy under s. 53A.[25] Encapsulating it briefly, there must be a written contract with specific terms of transfer, and the transferee must take possession of the property. Additionally, the transferee must have taken steps to fulfill the

[21] R T Miller, 'Equitable Conversion by Contract' (1937) 26(1) Kentucky Law Journal 56.
[22] ibid.
[23] AIR 1931 PC 196.
[24] *Rambhau Namdeo Gajre v. Narayan Bapuji Dhotra (Dead)* AIR 2004 SC 4342.
[25] 2002 (3) SCC 676.

contract.[26] In conclusion, the hypothetical situation above would say that the land has passed to the purchaser in equity. However, the land still vests in the hands of the seller in law.

Finally, on s. 40 and the import of the English equitable doctrine in Indian jurisprudence. Under s. 40 of the TPA, 1882, a purchaser under an agreement of sale of land is entitled to the benefit of an obligation arising out of that contract and it provides that the obligation may be enforced against a transferee with notice. The Calcutta High Court, in *Purna Chandra Basak*,[27] held that an agreement for sale created an obligation annexed to the land. Therefore, an agreement for sale would prevail over subsequent attachment by a creditor. Furthermore, the Supreme Court in *Vannarakkal Kallalathil*,[28] opined that the nature of the right envisioned in s. 40 is an equitable right. Therefore, the equitable doctrine has found recognition within the four corners of Indian jurisprudence and serves as the foundation for the argument advanced by this article. The following section will explore the remedies in law available to the buyer.

IV. ANALYSIS OF ALTERNATE REMEDIES UNDER CONTRACT LAW IN INDIA

A. Remedies Under the Indian Contract Act, 1872

Section 73 of the Indian Contract Act, 1872 ("**ICA, 1872**") applies equally to land and immovable property agreements.[29] The Madras High Court held that Section 73 ("**s. 73**") of the ICA, 1872 must be construed widely to

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[26] ibid.
[27] AIR 1973 Cal 432.
[28] 1990 SCC (3) 291.
[29] Pollock and Mulla, *The Indian Contract and Specific Relief Acts* (16th edn., Lexis Nexis 2019) 1599.

cover contracts of immovable property and provide relief to the party suffering damages.[30]

The Supreme Court in *Ghaziabad Development Authority v. Union of India* established that a vendor who breaches a contract for the sale of land is liable to pay damages for losses incurred by the purchaser.[31] Damages can be unliquidated damages, as per s. 73 of the ICA, 1872, or liquidated, as per Section 74 of the ICA, 1872 ("**s. 74**").[32] A provision for damages in the contract, however, is more often targeted at the purchaser's breach, that is, forfeiture of earnest money.[33]

Furthermore, it was laid down in *Rancchod Bhawan v. Manmohandas Ramji* that in case of the vendor's inability to deliver the title in a transaction of sale of property, the damages must be assessed in the usual manner.[34] The Bombay High Court in *Nagardas v. Ahmedkhan* held that "The legislature has not prescribed a different measure of damages in the case of contracts dealing with land from that laid down in the case of contracts dealing with commodities."[35]

Finally, on the idea of earnest money in connection with s. 74 of the ICA, 1872. The general judicial consensus is that the forfeiture of the deposit amount under an agreement for the sale of the property would not fall within the realm of s. 74.[36] However, if the forfeiture is in the nature of a penalty stipulated in the contract, then it could fall within s. 74.[37] The following

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[30] *Adikesavan Naidu and Ors. v. M.V. Gurunatha Chetti,* (1917) 32 MLJ 180.
[31] (2000) 6 SCC 113.
[32] Indian Contract Act 1872.
[33] Samuel Williston, 'The Risk of Loss after an Executory Contract of Sale in the Common Law' (1895) 9(2) Harvard Law Review 106.
[34] (1907) 9 BOMLR 1087.
[35] (1895) I.L.R. 21 Bom. 175.
[36] *Maula Bax v. Union of India* (1969) 2 SCC 554.
[37] *Shri Hanuman Cotton Mills v. Tata Air Craft Ltd* 1969 3 SCC 522.

section will analyze remedies under the Specific Relief Act, to articulate the reliefs available as well as critique its application as an alternate remedy, by highlighting the issues buyers face while resorting to it.

B. Remedies Under the Specific Relief Act

S. 10 of the Specific Relief Act, 1963 ("**SRA, 1963**") post the 2018 amendment, posits that specific performance is generally ordered except in certain circumstances.[38] It reduces the discretionary power of the court to award specific performance.[39] It no longer necessitates the plaintiff to aver or state "readiness" or "willingness" to perform the contract, which was earlier the mandate as per section 16 (c) of the SRA, 1963 ("**s. 16 (c)"**).[40]

The construction of "readiness and willingness" is dependent on the facts and circumstances of the case.[41] Further, the party praying for a specific performance must approach the court with "clean hands".[42] Additionally, a formalist approach would defeat the purpose of this equitable remedy. Concurrently, it is crucial to note that specific performance is not granted simply because it is legal.[43] The court in *Syed Dastagir v. T.R. Gopalakrishna Setty*[44] held that the compliance of "readiness and willingness" has to be in spirit and not in form while making averments in the plaint.

The recent amendment, however, has substituted s. 20 of the SRA, 1963. Previously, it enunciated that the court must use its discretion while

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[38] Specific Relief Act, 1963 (Act 47 of 1963) ("SRA").
[39] Karl Shroff, 'Specific Performance — Principles Revisited' (*SCC Blog*, 18 June 2020) <https://www.scconline.com/blog/post/2020/06/18/specific-performance-principles-revisited/> accessed 27 July 2022.
[40] ibid.
[41] *R.C Chandiok v. Chuni Lal Sabharwal* (1970) 3 SCC 140.
[42] *Lourdu Mari David v. Louis Chinnaya Arogiaswamy* (1996) 5 SCC 589.
[43] *Nirmala Anand v. Advent Corporation Ltd and Ors* (2002) 8 SCC 146.
[44] (1999) 6 SCC 337.

being guided by certain principles such as non-arbitrariness evident from the proviso prior to the 2018 amendment. A line of cases including, *Parakunnan Veetill Joseph's Son Mathew v. Nedumbara Kuruvila's Son,*[45] among others, had previously held that specific performance was an equitable remedy and must not be used as an "instrument of oppression in the hands of the plaintiff."

Section 22 of the SRA, 1963 confers the power to award various other remedies, including a refund of earnest money paid by the transferee, grant of possession, and the like.[46] Section 21 states that the plaintiff may claim compensation apart from specific performance.[47] Notwithstanding the amendment, the Supreme Court has continued to mandate that the plaintiff must demonstrate that he has already fulfilled or has been ready and willing to undertake the material requirements of the contract required of him under s. 16(c) of the SRA, 1963.[48]

In *Man Kaur (Dead) By Lrs v. Hartar Singh Sangha*, the agreement for sale provided for damages in the instance of breach by either party.[49] The court, however, opined that it was not necessary for a contract for sale to contain a clause providing for specific performance in the event of a breach. This was consistent with s. 23 of the SRA, 1963.[50] However, suppose the contract for sale envisioned a scenario where the defaulting vendor will be liable only to pay liquidated damages and return the deposit money, in that case, the court may not grant specific performance.[51]

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[45] 1987 Supp SCC 340 [14]; *Gobind Ram v. Gian Chand* (2000) 7 SCC 548.
[46] SRA, s 22.
[47] SRA, s 21.
[48] cf Shroff (n 39).
[49] (2010) 10 SCC 512.
[50] SRA, s 23.
[51] (2010) 10 SCC 512 [18].

It is vital to note that the amendments to the SRA, 1963 are prospective in nature as postulated in *Smt. Katta Sujatha Reddy v. Siddamsetty Infra Projects Ltd.*[52] Therefore, all cases arising prior to 2018 will need to be adjudicated on the pre-amended provisions of the SRA, 1963, this is another barrier to enforcement of specific performance in cases relating to agreements for sale arising prior to the amendment as the courts can still retain a certain amount of discretion while awarding the relief of specific performance. Furthermore, Article 62 of the Limitation Act grants 12 years for enforcing payment of money secured by a mortgage or otherwise charged upon the immovable property. However, the time period for specific performance is only three years, as per Section 54 of the Limitation Act. This is another limiting factor of the relief of specific performance and an additional reason for adopting the alternate imagination this article proposes in the next part.[53]

Considering that specific performance is the primary remedy in disputes arising regarding contracts for sale, this article will briefly examine a recent judicial decision on this issue. The Supreme Court, in *P. Daivasigamani v. S. Sambandan*,[54] awarded specific performance of an agreement for sale to the plaintiff. It relied on *Syed Dastagir*, noting that the requirements under s. 16(c) of the SRA, 1963 had been made out. It directed the plaintiff to deposit an amount of Rs 1 Crore towards sale consideration, following which the sale agreement would be drawn up in his name.

Therefore, while the relief of specific performance is certainly an alternate remedy, it does not provide a holistic and sure-shot remedy to buyers as it is a discretionary relief. The court would be guided by past jurisprudence

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[52] Civil Appeal No. 5822 of 2022.
[53] *P. Muthusamy v. K. Arumugam* Second Appeal No.426 of 2015.
[54] 2022 SCC OnLine SC 1391.

on the same, which vests immense power in them by allowing them to apply their volition. The factor of limitation is also an important drawback to this remedy. In view of all these reasons outlined above, the following section of this article will lay down the argument for creating a charge on property in the hands of the buyer.

V. S. 54 V S. 55(6)(B) – MAKING THE CASE FOR BUYER'S CHARGE ON THE PROPERTY

A. Buyer's Charge on the Property- The Interpretation and Need

S. 54 and s. 55(6)(b) seemingly offer conflicting conclusions relating to the buyer's interest and charge on the property. While the former articulates the definite non-creation of a charge or interest, the latter holds that a charge is created. This charge is subject to the transferee's payment of part purchase money and persists unless and otherwise, the parties agreed to extinguish such right through the contract i.e., the agreement to sell the property. The key part of s. 54 regarding a contract for sale to be noted is as follows: *"It does not, of itself, create any interest in or charge on such property"*. Therefore, in the case of a standalone contract, there is no charge created on the property in question. However, the accompanying purchase money paid along with the contract would give rise to the possibility of an interpretation that confers a charge on the property in the hands of the buyer. This is also in line with the underlying concept of the English equitable doctrine, analyzed previously in this article.

It is vital at this juncture to understand the need to create an interest or charge in favour of the buyer in the seller's property during the tenure of the agreement to sell or for such period which has been mutually agreed between the parties. An interest or charge on the property gives the buyer a degree of

control over the property's alienation or transfer. It serves as an encumbrance, and the seller would need to discharge such an encumbrance to affect a property sale (unless the subsequent transferee consents to discharge such an encumbrance). A registered agreement for sale is reflected in the encumbrance certificate of the property and the subsequent purchaser would *firstly*, have notice of such a subsisting charge, and *secondly*, would be less likely to purchase an encumbered property.

Section 100 of the TPA, 1882 elaborates on the meaning of a charge.[55] Essentially a charge provides the holder of such charge rights similar to a holder of a simple mortgage as all the provisions that apply to a mortgage apply to a charge. Additionally, a charge can be enforced in a suit. There have been various cases wherein the seller has unscrupulously sold the property without any consideration for the subsisting contract for sale.[56] Therefore, a charge on the property restores the power imbalance, by providing a buyer with a degree of control over the property.

Lastly, s. 57 of the TP Act, 1882, provides a mechanism for the court to adjudicate on incumbrances on property that has been subject to a sale.[57] The court may direct payment in relation to such incumbrance to persons entitled to such an amount. This is also a vital relief associated with the creation of a charge on the property. Furthermore, s. 55(1)(g) of the TP Act, 1882,[58] makes it compulsory for a seller to discharge all incumbrances on the property prior to sale. Therefore, in cases where agreements for sale create a

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[55] TP Act, s 100.
[56] (2004) 3 SCC 711.
[57] TP Act, s 57.
[58] TP Act, s 55 (1) (g).

charge, thereby manifesting as an incumbrance on the property, the buyer has additional protections under the aforementioned sections of the TP Act, 1882.

B. Earnest Money and Purchase Price- The Conundrum

Moving on to the problem, in case of non-payment of the remaining purchase amount, the seller has the absolute right to forfeit the earnest money. However, suppose the seller fails to correctly deliver the property to a legitimate purchaser, who has paid the price. In that case, it is on the purchaser to sue for the return of earnest money, coupled with interest and costs. In most cases, the only recourse available to buyers is to litigate to enforce their rights under the SRA, 1963, or the ICA, 1872.

This power imbalance is partially resolved under a paradigm where the buyer retains a charge under s. 55(6)(b) of the TPA, 1882 unless such right has been contracted out by the parties. This is only possible when the earnest money also operates as part payment of purchase money.[59] The current jurisprudence on earnest money largely excludes it from purchase money, instead treating it as a security deposit paid to bind the contract. The Supreme Court in *Shree Hanuman Cotton Mills & Ors v. Tata Air-Craft Ltd*, referring to seminal texts like *Halsbury's Laws of England*, articulated the intimate connection between the two. It evolved certain principles relating to the earnest money. In essence, the earnest money is paid to bind the contract and is part of the purchase price when the transaction is carried out. Therefore, this interpretation allows for the reading of earnest money within the scope of 'purchase price'. This reading would allow the purchaser to retain a charge on the property under s. 55(6)(b) of the TP Act, 1882.

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[59] *Ran Singh v. Capex Projects Pvt. Ltd* 2019 SCC OnLine P&H 7440.

The apex court in *Videocon Properties case* advanced that "In other words, if the payment is made only towards part payment of consideration and not intended as earnest money then the forfeiture clause will not apply."[60] This would necessarily mean that sellers would be unable to forfeit this amount properly paid by the purchaser as it would not constitute earnest money.

To conclude this section on the distinction between earnest and purchase money it is imperative to briefly examine the court's crucial decision in *Satish Batra v. Sudhir Rawal,*[61] wherein it opined the following, regarding earnest money and purchase money-"Earnest money is paid or given at the time when the contract is entered into and, as a pledge for its due performance by the depositor to be forfeited in case of non-performance, by the depositor. There can be a converse situation also that if the seller fails to perform the contract the purchaser can also get double the amount if it is so stipulated. It is also the law that part payment of the purchase price cannot be forfeited unless it is a guarantee for the due performance of the contract. In other words, if the payment is made only towards part payment of consideration and not intended as earnest money then the forfeiture clause will not apply."[62]

Therefore, a determination of whether an amount paid by a buyer falls into the category of earnest will be guided by the aforementioned judicial principles. In case a seller fails to perform the contract, the second limb of s. 55(6)(b) applies and the buyer is entitled to a refund of the earnest money paid. This forms a crucial aspect of the reliefs available to the buyer under the TP Act, 1882. The next section attempts to resolve this conundrum by offering an interpretation of s. 55(6)(b) of the TP Act, 1882.

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[60] (2004) 3 SCC 711.
[61] Civil Appeal No. 7588 of 2012.
[62] ibid [17].

C. Section 55(6)(b)- The Resolution

Maula Bax v. Union of India[63] postulated that money paid with the intention to form a part of the purchase price could not be regarded as earnest money if the buyer is prepared to complete the transaction. In that case, this interpretation falls short, as earnest money is excluded from the purchase price and is outside the scope of the protection of a charge guaranteed in s. 55(6)(b). There needs to be clarification of this interpretation, to do complete justice to the purpose and intent of the provision by affirming the inclusion of earnest money in the purchase price to fully cover the buyer under s. 55(6)(b) of the TP Act, 1882. This article argues that this interpretation falls within the scope of s. 54 and s. 55(6)(b) of the TP Act, 1882, and must be adopted by courts, to realize the true intent of the section to confer a charge on the property.

First, the interpretation in *Maula Bax* would render the inclusion of the word 'charge' in s. 55(6)(b) essentially useless. This creation of an artificial distinction between earnest money and purchase money militates against the spirit of the section both in text and spirit. Therefore, the alternative interpretation fully realizes the text and intent of the section, by creating a charge on property, to the extent of purchase money paid.

Second, the purchase money paid towards the sale as consideration is non-refundable as it is distinguished from earnest money, which can be forfeited. However, if an unscrupulous seller alienates the property prior to the earnest money operating as part purchase money advanced, then it would be excluded from the charge envisioned in s. 55(6)(b). The court in two landmark decisions has dealt with this in detail. In *Maula Bax*,[64] the court held that "Earnest money is part of the purchase price when the transaction goes

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[63] *Maula Bax* (n 33).
[64] ibid [4].

forward." Earnest may therefore serve a dual purpose, in acting as security for the transaction as well as part of the purchase price. It would therefore be included in the first part of s. 55(6)(b) and confer a charge in favour of the buyer.

Therefore, the interpretation advanced, of s. 54 is to read the section purposively, in a manner that would do complete justice, both to its spirit and text of the spirit. A contract for sale *"of itself"* would not create a charge on the property. However, when it is accompanied by part purchase money, or in some cases, earnest money, a charge on the property would be created in favour of the buyer. This ensures that s. 54 of the TP Act, 1882, can be retained in its present form and would render such an alternate interpretation imagined by this article consistent within the four corners of the provision. The English equitable doctrine, as articulated in the second section also forms an underlying premise from which this re-interpretation may proceed. It strengthens the case by grounding itself in English jurisprudence and therefore such an interpretation is not unknown to common law.

D. Case Laws- Laying the Foundations

This section of the article will examine case laws substantially dealing with the question of a statutory charge under s. 55(6)(b) as well as earnest money and purchase price. It aims to lay the foundation for an alternative interpretation by relying on well-decided cases that provide a starting point for a buyer-friendly regime governing contracts for sale.

The court in *Videocon Properties*,[65] dealing with the question of earnest money and purchase consideration paid, articulated the intimate difference between the two. It evinced that a mere description in the agreement

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[65] (2004) 3 SCC 711.

of the advance paid as earnest, would not exclude it from operating as a charge on the property. It may become a part of the purchase money advanced as its true purpose may not be to solely serve as security for the agreement. This proposition of law has been reaffirmed by the Punjab and Haryana High Court in *Ran Singh*, a 2019 judgement.[66]

The court in *Videocon Properties* categorically stated that "The buyer's charge engrafted in clause (b) of sub-section (6) of Section 55 of the Transfer of Property Act would extend and enure to the purchase money or earnest money paid."[67] This article is in complete agreement with this interpretation. Therefore, the earnest money may be covered under the statutory charge envisioned in s. 55(6)(b) of the TPA Act, 1882.

Delhi Development Authority v. Skipper Construction Ltd[68] was a landmark judgement of the Supreme Court. It was held that a charge under s. 55(6)(b) was of the nature of a statutory charge and could be enforced against not only the seller but all persons claiming under him. It, therefore, provides wider protection to the buyer as he may institute a suit not only against the seller but also subsequent transferees. It also observed that s. 73 of the TP Act, 1882 also envisions such a principle. Furthermore, the principle applicable to mortgages also applies to cases of a statutory charge.[69] Lastly, the period of limitation for enforcement of the charge created under s. 55(6)(b) is 12 years and not 3 years, which provides additional relief to the aggrieved buyer.[70]

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[66] 2019 SCC OnLine P&H 7440 [10].
[67] ibid [13].
[68] (2000) 10 SCC 130.
[69] ibid [30].
[70] ibid [33].

The Supreme Court, in *Asgar S Patel v. Union of India*,[71] held that the charge on property envisioned under s. 55(6)(b) is analogous to the seller's charge under section 55(4)(b) of the TPA, 1882. It further opined that purchase money paid as consideration as well as earnest money properly paid would constitute a charge on the property and serve as an encumbrance on sale.[72] The court opined that a charge under s. 55(6)(b) would be created as soon as there is the payment of purchase money.

Therefore, the aforementioned judicial pronouncements, by the country's apex court, clearly evince the possibility of adopting the alternate interpretation propounded by this article. Therefore, this section laid down not only a normative framework but is also accompanied by a doctrinal approach that grounds itself in Indian jurisprudence.

VI. CONCLUSION

This article has attempted to shed some clarity on the different complex and nuanced legal issues related to contracts for sale. Consequently, the article has engaged in an extensive assessment of case law, coupled with textual analysis of multiple related provisions of various legislations. It has also engaged in a brief foreign law analysis of English law to understand the background of the Equitable doctrine as well as examined concepts such as part-performance, attachment, and obligations annexed to the land.

The first part provides the theoretical foundation for the more nuanced issues articulated in the following sections. The second part engages with detailed questions revolving around the judicial interpretation of contracts for sale. It tackles key questions regarding part-performance, the English

[71] (2000) 5 SCC 311.
[72] ibid [10].

equitable doctrine, and the attachment of property. The third section illustrates the various recourse mechanisms available in contract law in the context of agreements for sale.

The fourth and final part of the article substantiates the central argument, where the friction between s. 54 and s. 55(6)(b) is alleviated by a buyer-friendly interpretation, intended to achieve the ends of equity. It advances a novel framework for reimagining a charge on the property with a buyer-friendly approach. To this end, it first analyzed the need for the creation of a charge on property, subject to the terms of the contract for sale. Subsequently, it examined the various roadblocks to this interpretation and mitigated the same by reconciling various conflicting provisions and concepts. Finally, it elaborated upon multiple landmark judgements that laid the foundation for such an alternate legal interpretation of contracts for sale.

The convoluted and inconsistent holdings of the courts with regard to contracts for sale have led to buyers suffering at the hands of unscrupulous sellers. The article advocates for creating a charge as a possible solution within the four corners of the law, that is, the TP Act, 1882, subject to the terms of the agreement for sale. It emphasizes the need for such an interpretation to be adopted by the judiciary to protect buyers. This alternative framework, it is argued, would ensure that agreements for sale are not reduced to mere pieces of paper, with buyers being at the receiving end of injustice at the hands of sellers. It advances various protective mechanisms, including a refund of earnest money as well as the creation of a charge, to herald a new framework that is buyer friendly, in the interests of equity and fairness.

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