

Contemporary Discourses in Business, Law and Public Policy



Foreword by

Prof. Dr. S. Shanthakumar

Director, Gujarat National Law University

Preface by

Mr. Sherbir Panag

Founder & Managing Partner, Law Offices of Panag & Babu

Editor

Mr. Satya Ranjan Mishra

Associate Professor of Commerce, Gujarat National Law University



Gujarat National Law University



GNLU CENTRE FOR BUSINESS
AND PUBLIC POLICY



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Foreword

It is with immense pleasure and great pride that I pen this Foreword for “Contemporary Discourses in Business, Law and Public Policy,” a remarkable collection of scholarly articles emanating from the 4th GNLU International Conference on Business, Law & Public Policy. This volume stands as a testament to the rigorous intellectual engagement and profound commitment to advancing legal scholarship that defines Gujarat National Law University.

To all the distinguished authors, I extend my heartfelt appreciation for your invaluable contributions. Your dedication to research, incisive analysis, and articulate presentation on such a diverse range of complex subjects is truly commendable. The topics covered in this book are not merely academic exercises but represent the cutting edge of contemporary legal and policy debates, holding immense relevance for the legal profession and society at large.

The articles delve into crucial areas such as the effectiveness of India’s GAAR in tackling tax avoidance, the transformative impact of GST reforms on the nation’s burgeoning gaming industry, and the intricate issues plaguing the voluntary delisting process in India, particularly in light of recent amendments. The critical examination of the need for sector-specific insolvency frameworks, drawing lessons from the challenges faced by Go Air and Jet Airways, offers vital insights into a rapidly evolving economic landscape. Furthermore, the discussions on SEBI’s proposed sustainable asset securitisation, the implications of the CCI’s order concerning technology giants like Winzo Games, and the antitrust puzzle surrounding Google Pay and PhonePe, highlight the pressing need for robust regulatory oversight in the digital age. The analysis of the SME IPO market, regulatory approaches to algorithmic and high-frequency trading, and the perennial quandary of promoter prerogatives versus shareholder protection in voluntary delisting, all underscore the contemporariness and practical significance of the research presented. Each piece contributes meaningfully to our understanding of the challenges and opportunities within India’s dynamic legal and economic environment.

I must also commend the tireless efforts and unwavering commitment of the editorial team. Their meticulous work in curating, reviewing, and refining these papers has been

instrumental in shaping this publication into a coherent and insightful resource. Their dedication ensures the high academic standard that GNLU strives for.

Furthermore, we would be remiss not to extend gratitude to our exclusive law firm partner Shardul Amarchand Mangaldas & Co. Their invaluable collaboration, which provided the authors of the distinguished papers a prestigious opportunity to intern with the firm, has been instrumental in bridging the gap between academic scholarship and professional practice. This initiative has not only enriched the experience of our participants but also signifies a commendable commitment to nurturing the next generation of legal talent.

Our sincere gratitude also goes to All India Reporter, our esteemed Knowledge & Publishing Partner, for their unwavering support in transforming this intellectual endeavor into a tangible and accessible publication. Their partnership is invaluable in disseminating this critical knowledge to a wider audience.

This book is more than just a compilation of papers; it is a vibrant intellectual event in itself, providing a platform for scholars, practitioners, and policymakers to engage with the world's best minds specializing in business, law, and public policy. It offers profound insights and stimulates critical thinking on issues that will undoubtedly shape our collective future.

I urge the entire team to continue this excellent work. Your commitment to exploring socially relevant themes and fostering rigorous academic discourse is a source of immense pride for the Gujarat National Law University. Let this publication serve as an inspiration for many more scholars, both within our university and globally, to contribute their expertise and insights, thereby collectively striving to make this an indispensable, world-class publication in the field.

My best wishes for continued success in all your future endeavors.

Prof. Dr. S. Shanthakumar



Preface

Global business is today overwhelming the cross section of law, public policy and socio-political transformation. This calls for new empirical and normative assessments, as the law can no longer connect with business and governance in silos – but rather holistically and also far faster than it has in past decades.

The growth and diversification of businesses have concurrently led to new age ethical, legal and governance challenges which span not only traditional spaces like corruption, fraud, money laundering, securities law violations; but also new age digital mediums. Enforcement has become significantly harder in adversarial systems and the sub optimal pace has resulted in the lowering of public trust, which in turn is not conducive to economic growth. The corporate crime evolution of the past 100 years has shown us the fading value of deterrence by enforcement and also how little compliance programs do to alter actual behaviour. Law enforcement strategies of increasing physical and human resources are not the answer, nor is the isolated use of technology; nor is increasing the compliance burden unilaterally on companies.

Corporate governance, public policy and enforcement are a trifecta in need of meaningful reform which is substantive, qualitative and quantitative. It is thus with great optimism and responsibility that I present this collection of articles, which are provocative, offer a zeal for reform and a roadmap for where law, public policy and governance ought to go, while being conscious of the lessons learned in the past.



*

Editorial

The Constitution of India envisions economic justice in its preamble. Article 19 (1) (g) of the Constitution guarantees its citizens the right to practise any profession, or to carry on any occupation, trade or business. This paves the way for businesses to flourish. Businesses are wealth creators. They not only optimize the use of natural resources but also create mass employment, contribute a mammoth share of taxes and create financial value for millions of banks and capital market investors. Businesses are accelerators of productivity, innovation and development. Their products and services satisfy critical needs of the humankind. The instance of success of the private pharma industry delivering COVID-19 vaccine at a critical juncture, saving lives of billions stand testimony to this. Their social conscious and CSR contributions also leads to social development.

However, the non-obstante clause- 6 to article 19(1)(g) reasonably restricts the irrational exuberance of businesses when business policies stand in conflict with public policy. The clause states, *“Nothing in sub-clause (g) of the said clause shall affect the operation of any existing law in so far as it imposes, or prevent the State from making any law imposing, in the interests of the general public, reasonable restrictions on the exercise of the right conferred by the said sub-clause”*. This provides greater flexibility to the state in regulating the businesses to protect public interest. For instance, promulgation of the Promotion and Regulation of Online Gaming Act, 2025. The Press Information Bureau outlines the objects of this law as, *“protecting middle class and youth; promoting e-sports and online social games. The legislation is designed to curb addiction, financial ruin and social distress caused by predatory gaming platforms that thrive on misleading promises of quick wealth”*. This may cause substantial loss to the exchequer in terms of tax revenue and loss of employment. But public interest must take precedence. At the same time, the legislation promotes online social gaming but prohibits predatory gaming platforms. Thus, laws aim at striking a fine balance between public interest and business flexibility and opportunity.

India is a mixed economy comprising values of socialism and capitalism. There are enough opportunities for innovators for thriving and building big business fortunes. At the same time, through taxation, effective redistribution of such business profits take place.

Corporate governance mechanisms ensure shareholder democracy and protection of minority investors. It also ensures free flow and symmetry of information. Insider trading regulations aim at restricting profiteering from unpublished price sensitive information as an insider. Competition law on the other hand, ensures free and fair competition and avoidance of creation of monopoly and abuse of dominant position. The CSR provision in the Companies Act, 2013 inculcates a sense of giving back to the society through meaningful social expenditures. The law declared by the courts in cases concerning corporations aim to do complete justice.

Higher order business legal thinking is therefore quintessential to achieve economic justice for businesses and its stakeholders. This book aims to serve this pious object through critical analysis of contemporary business legal discourses to prescribe pragmatic solutions to modern business problems.

This book is a compilation of select research papers presented during the 4th International Conference on Business, Law and Public Policy at Gujarat National Law University. Chapters in this book are broadly divided in to four business legal themes- Taxation, Securities, Insolvency and Competition.

The piece titled, *“Is India’s GAAR (Reddy) To Tackle Tax Avoidance? Reassessing The Consequences of The Telangana High Court Ruling in Ayodhya Rami Reddy”*, addresses the question of law whether General Anti Avoidance Rules (GAAR) would prevail over Specific Anti Avoidance Rules (SAAR) in a situation of specific avoidance of taxation. It highlights the precedence of SAAR in tackling issues of specific avoidance over GAAR. It argues that the Telangana High Court’s ruling in the case of Ayodhya Rami Reddy which held precedence of GAAR is legally unsound. If GAAR becomes the default regime, then SAAR’s existence would be rendered inconsequential in tackling cases of avoidance of taxes. It examines the overlap through a critical analysis of the Shome committee’s report and lessons drawn from jurisdictions such as UK and South Africa.

Goods and Services Tax (GST) rate amendment applying a 28% (highest rate) on the total contest entry value for both skill based and chance based online games may have wide legal, economic and industry implications. The paper, *“Redefining the Game: GST Reforms and Their Implications for India’s Gaming Industry”*, critically examines the new regime, juxtaposing it against judicial precedents such as *Dr. K.R. Lakshmanan v. State of Tamil Nadu* and *Dream11 Fantasy Sports* that uphold the distinction between skill-based games and gambling. However, with the passage of the Promotion and Regulation of Online Gaming Act, 2025, the debate seems to have taken a dramatic turn. While, the legislature may have made a smart move to increase tax revenue, the much-anticipated judicial journey of related cases ahead could pose significant questions about the vanishing of distinction between game of skill and game of chance. Painting every online money game with the same brush could potentially be anti-innovation and anti-freedom of trade. The paper through Laffer Curve analysis, provides an alternative approach of Gross Gaming Revenue model which could balance government revenue and industry sustainability.

The second part of this book contains chapters on contemporary legal issues facing the securities market. The research paper, *“SEBI’s Proposed Sustainable Asset Securitisation: Bond Villain Greenwashing and Blockchain Solution”*, addresses the

challenge of greenwashing in guise of climate financing. It highlights the downside of greenwashing (camouflaging) within India's green bond regime potential to accelerate climate financing. It broadly refers to making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation. It discusses about absence of a universal definition of green securitisation. It advocates for a novel blockchain method to address issues for a robust governance of such bonds. The second paper of the securities law theme deals with the speculative bubble formation in Small and Medium Enterprises (SME) Initial Public Offers (IPO). This surge is backed by retail investors, which is driven by expectations of high returns, especially massive listing-day gains. This trend seems to have gone overboard, with the applicant-to-allotted investor ratio increasing from 4 times in FY 2022 to 46 times in FY 2023, skyrocketing to 245 times in FY 2024. The research paper titled, "*SME IPO Froth: Analysing SEBI's Method of Dealing with the Recent Frenzy*" offers a novel tier-based hybrid model which progressively scales on disclosure compliances and regulatory requirements based on SME's market capital and an escrow account mechanism. The paper goes on to analyse the SEBI consultation paper to address this issue and finds the regulatory stance of SEBI to be restrictive and conservative.

The next sub part in the book deals with the recent amendments on voluntary delisting. There are two scholarly pieces on this issue. "*No way out! Addressing the underlying issues that plague the Voluntary Delisting Process in India in light of recent amendments*", offers insights about delisting strategy. Delisting allows firms to adapt to evolving market and regulatory environments, reduce financial strain, and focus on long-term objectives without the constraints of public market pressures. However, the consequences of a failed delisting could be severe. The failure of delisting of Vedanta Ltd. stand testimony to this. With the Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024, two significant changes were brought: the introduction of the Fixed Price Offer (FPO) as an alternative to the Reverse Book Building (RBB) process and the reduction of thresholds for making counter-offers. The paper criticises these amendments on account of risk of under participation of shareholders at an unattractive fixed price, overvaluation pressure on the issuer and redundancy of the counter offer amendment. The second paper titled, "*Voluntary Delisting in India: A Quandary of Promotor Prerogatives and Shareholder Protection*", also deals with the issue of impact of amendments on the public shareholders and promoters in the new delisting regulation. It has made a comparative study involving US and UK to advocate a lower threshold than 90%. In the paper, "*Regulating Algorithmic and High-Frequency Trading (HFT): Balancing Innovation and Risk*" the authors have highlighted the debate whether the objective of technological innovation and investor protection are mutually exclusive or inclusive. There is absence of regulation for the algo and HFT sector in India. Sophisticated algorithms and exceptional speed of trading creates large volumes for the market at large. However, it creates a technology driven divide in the market. This paper makes a comparative study of various jurisdictions such as US, UK, China and Singapore and suggests model regulations which could be brought in to regulate the HFT sector in India.

There are two research pieces on the theme of competition law. The paper, "*Reining in on A Technology Giant - An Analysis of the Implications of the CCI's Order - In Re: Winzo Games*" analyses the Competition Commission of India (CCI)'s order in Winzo Games vs. Google LLC. The allegations of discriminatory and exclusionary practices were made by Winzo Games on Google LLC when Google decided to include two players only- DFS

and Rummy in its Real Money Games (RMG) pilot program. CCI did not find any definitive wrongdoing. However, it has made its intention to crackdown on excesses by tech giants. This paper has dealt with critical issues concerning the case in five sub parts. It analyses the impact of the CCI's order on the gaming industry, withdrawal of proposal for creating self-regulatory bodies and designating Ministry of Electronics and Information Technology's (MeitY) as the regulator of the gaming industry, abuse of dominance by Google and denial of market access to Winzo Games in the pilot program, Director General's investigating powers and study of impact on stakeholders using game theory.

In the research paper titled, "Double Trouble: Unmasking the Antitrust Puzzle of Google Pay and PhonePe" the authors have highlighted concerns of duopoly in the UPI market. Both the major players enjoy a large combined market share of more than 85%. It argues that despite losses the players have engaged in market share buying. The authors argue that UPI infrastructure currently has an unsustainable revenue model. There's no transaction fee levied by payment applications and on the other hand a huge cost is incurred for processing of transactions and acquiring merchants and customers. Due to this phenomenon, smaller players have not succeeded in competing and slowly scaled down their operations. However, the two large players have continued to offer cashbacks and other rewards to enhance market share. The authors argue that this could lead to anti-trust concerns. They further suggest to apply two tests to see whether the pricing scheme is designed to drive the competitors away and whether recoupment of losses is probable in the future. The paper suggests an implementing an interchange fee similar to the model used for payments made via prepaid payment instrument (PPI) wallets. This could be a marginal fee which helps the smaller players to earn some revenue and thereby making their businesses sustainable. In the longer run, it will ensure competition ad benefit the customers.

The last paper in this book titled, "The need for sector specific insolvency framework for Aviation Sector: Building upon the lessons learnt from the insolvency of Go Air and Jet Airways" deals with the straight jacket approach of IBC 2016 in addressing the issues of insolvency in the aviation sector. The IBC 2016 is insufficient in addressing the aviation industry's specific challenges, which are marked by distinct economic demands, regulatory needs, operational complexities and external shocks such as economic downturns and worldwide pandemics. It can very well be observed from the liquidation of both the airlines as it was almost impossible to keep those as a going concern. Therefore, the authors precisely make recommendations to treat financial lessors as secured financial creditors, enactment of cross border insolvency framework in lines with the model law established by UNCITRAL, debtor in possession approach to strengthen the corporate debtor and strengthening finances during the revival process by establishing a sector specialized fund similar to the Special Window for Mid-Income Housing ("SWAMIH") fund.

These research papers have focussed on precise business legal challenges of the day and offered pragmatic insights to deal with those challenges. The authors have dived deeper and have not only critiqued about the concerns but have provided precise and actionable suggestions for which this book becomes a must read for business law researchers, practitioners and policy makers.



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Is India's GAAR (Reddy) to Tackle Tax Avoidance?
Reassessing the Consequences of the Telangana High Court
Ruling in Ayodhya Rami Reddy

Abstract

The article addresses a critical question in Indian tax law: when both General Anti-Avoidance Rules (GAAR) and Specific Anti-Avoidance Rules (SAAR) could apply to a tax avoidance case, which should take precedence? This question was recently examined by the Telangana High Court, which held, through vague and problematic reasoning, that GAAR would prevail over SAAR. The case comment argues that this ruling is legally unsound and does not resolve the GAAR-SAAR overlap. It is argued that the Court's reasoning would render GAAR the default tax-avoidance provision, which could have the important ramifications of reducing taxpayer certainty and in-

** Anirud Raghav S.U and Prem Vinod Parwani are 3rd year students at the National Law School of India University. They are grateful to Adv. Mihir Nandiwadekar for his valuable inputs on earlier drafts of the paper. The errors are attributable to the authors. Views expressed in this article are solely those of the authors.*

creasing the Revenue's evidentiary burden, thereby frustrating the very purpose of GAAR—to more effectively detect tax avoidance. Instead, it is argued that GAAR was intended to serve a 'gap-plugging' function—it was meant to catch tax avoidance arrangements that escape SAAR's specific provisions. It does so by analysing GAAR's legislative history and undertaking a comparative study of UK and South Africa—jurisdictions which maintain a similar GAAR and SAAR. More broadly, the article contributes to the nascent jurisprudence on anti-avoidance in India by offering a coherent interpretation which bears fidelity to the legislative intent of these anti-avoidance provisions, which could influence future judicial treatment of tax avoidance cases.

Introduction

In its recent judgment in *Ayodhya Rami Reddy*, the Telangana High Court considered a critical question: considering that the Income Tax Act, 1961 ('Act') contains provisions on both General Anti Avoidance Rules ("GAAR")⁽¹⁾ and Specific Anti Avoidance Rules ("SAAR"),⁽²⁾ which of the two should apply in case of an overlap? Can they co-exist? Prior to *Ayodhya Rami Reddy*, no concrete answers were found in Indian law.

While Government committee reports and notifications offered some direction, this question was by no means settled.⁽³⁾ The Court in *Rami Reddy* had seemingly resolved the question of overlap by "upholding the invocation of GAAR over SAAR."⁽⁴⁾

In this paper, the authors argue that the line of reasoning adopted in the judgment is untenable and offers little guidance on the overlap between GAAR and SAAR. Rather, if taken to its logical conclusion, it would render the entire chapter on SAAR redundant. Instead, it is proposed that GAAR must be viewed as serving only a gap-plugging function, while SAAR

1. Income Tax Act, 1961 (Act 43 of 1961) Chapter X-A..

2. *ibid* Chapter X.

3. Central Board of Direct Taxes, 'Clarifications on implementation of GAAR provisions under the Income Tax Act, 1961' (27 January 2017); Expert Committee under the Chairmanship of Dr. Parthasarathi Shome, Final Report on General Anti Avoidance Rules in Income Tax Act, 1961 (2012).

4. Mukesh Butani & Kruthika Prakash, 'India's Telangana High Court on the Writ Challenge Against GAAR Invocation' (Kluwer International Tax Blog, 20 September 2024) <https://kluwertaxblog.com/2024/09/20/indias-telangana-high-court-on-the-writ-challenge-against-gaar-invocation> accessed 25 October 2024.

continues to be the primary framework for tax-avoidance. This view is more consistent with the legislative intent of GAAR as well as international best practices on the subject.

The argument is made in three stages. *Part II* argues that the reasoning in Rami Reddy is untenable. Specifically, it critiques three aspects of the *muddled* legal reasoning used to invoke GAAR over SAAR. These critiques will show that the High Court's understanding of their overlap contradicts the legislative intent of GAAR. *Part III* conducts a comparative study of GAAR provisions in the UK and South Africa to demonstrate that the GAAR serves a 'gap-plugging' function in anti-avoidance rules. This means that GAAR was introduced to plug gaps in SAAR; only if SAAR is not attracted, then must the analysis proceed to GAAR. *Part IV* demonstrates this gap-plugging function in India by situating the GAAR within its legislative framework. *Part V* concludes.

Recent developments following the judgment are noteworthy. On appeal by the Revenue, the Supreme Court has stayed the Telangana High Court's ruling. This underscores the continued relevance of this article in light of the ongoing hearings. At last, one hopes that the long-debated question of the overlap between GAAR and SAAR will find a definitive resolution—for much turns on it.

The Judgment and Its Flaws

In Rami Reddy, the assessee held shares in a company named Ramky Estate. Ramky Estate issued bonus shares to its shareholders in the ratio of 5:1. This reduced the value of each share.⁽⁵⁾ Shortly after, the assessee sold a portion of these shares to another firm. This resulted in a business loss of Rs. 462 crores, which the assessee set-off against his long-term capital gains.⁽⁶⁾ The Court dug into the circumstances of the sale and noted that the transaction lacked any 'business purposes' and had the 'sole motive of evading tax'.⁽⁷⁾

However, it faced the question of which anti-avoidance rule to apply; SAAR (Chapter X of the Act) or GAAR (Chapter X-A of the Act). The assessee argued that the facts of the cases were covered by SAAR, since special provisions ordinarily override the general provisions such as GAAR.⁽⁸⁾ However, the Court rejects this contention and invokes GAAR over SAAR. This was supported primarily by three reasons. For clarity, each of them will be dealt with separately. Using precedents, principles of statutory interpretation and the drafting history of GAAR, it is argued that these reasons are legally unsound.

5. Ayodhya Rami Reddy v. CIT, AIROnline 2024 Tel 283.

6. *ibid.*

7. *ibid.*

8. *ibid.*

Flaw 1: The GAAR Was Enacted After SAAR

The first reason given by the Court for GAAR's precedence over SAAR is the chronology in their enactment. It noted that the special provisions (SAAR) had already existed in the Act while GAAR was enacted by virtue of Finance Act, 2013, w.e.f. 1.04.2016.⁽⁹⁾ In this light, the court rejects the assessee's argument of *lex specialis* – that the specific provisions must prevail over the general provisions. However, it proceeds to turn *lex specialis* on its head. It held that the doctrine would not apply because, on the facts of the case, the general provision had been enacted after the special provision.⁽¹⁰⁾ In other words, the chronology of their enactment negated the doctrine of *lex specialis*. While the Court does not articulate a rationale for this interpretation, it seems to be premised on the rationale that the subsequent law abrogates the earlier one. While this principle finds some support in precedent,⁽¹¹⁾ it cannot be applied without regard to other considerations. Maxwell in *Construction of Statutes* specifically criticizes this method of interpretation, arguing that legislative intent must be derived from a holistic reading of the statute, and not just its chronology.⁽¹²⁾ Particularly, the principle of *generalia specialibus non derogant* must be applied - that the general law cannot derogate from the specific law.⁽¹³⁾

In several decisions, the Supreme Court has repeatedly held that the mere enactment of a subsequent general provision would not impliedly repeal or oust the application of the prior specific provision.⁽¹⁴⁾ In fact, it has been held that a subsequent general law is excluded to the extent that a field is occupied by the special law. For instance, in *Raghunath*, the Supreme Court adjudicated a claim for promotion in public office based on the Karnataka General Service Rules.⁽¹⁵⁾ There were two sets of rules governing this promotion, each with different criterion. One was the set of special rules, while the other was general.⁽¹⁶⁾ The General Service rules were promulgated after the special rules, based on which it was contended that the general rules prevailed.⁽¹⁷⁾ However, the court rejected this contention

9. *ibid.*

10. *ibid.*

11. *Ajoy Kumar Banerjee v. Union of India*, AIR 1984 SC 1130.

12. P. St. J. Langan, *Maxwell on the Interpretation of Statutes* (Sweet & Maxwell, London, 12th edn, 1969) 196.

13. *ibid.*

14. *Maharaja Pratap Singh Bahadur v. Thakur Manmohan Dey and Ors.*, AIR 1966 SC 1931; *Maya Mathew v. State of Kerala*, 2010 AIR 2010 SC 1932; Pramod Kumar, 'JAAR, GAAR and SAAR: Coexistence Without Overlapping?' <<https://www.taxsutra.com/dt/experts-corner/jaar-gaar-and-saar-coexistence-without-overlapping>> accessed 20 October 2024).

15. *R.S. Raghunath v. State of Karnataka*, AIR 1992 SC 81.

16. *ibid.*

17. *ibid.*

and held that the special rule would prevail over the general rule to the extent of the overlap. In support of this holding, it relied on the principles of statutory interpretation in Maxwell.⁽¹⁸⁾ It also relied on the legislative context for the introduction of the general rule. Since the general rule was designed primarily to fill gaps in the special rule, it could not be inferred that the legislature intended for the criterion in the general rule to override the special rule.⁽¹⁹⁾ It further noted that the general rule could override the specific rule only if they indicated a clear intention to override the special rule.⁽²⁰⁾

Thus, two principles emerge to deal with a conflict between general and special rules. First, that the general will not ordinarily override the special rule. Second, the special rule is overridden where only where legislative intent expressly provides for it. In both these principles, the ultimate determining principle is legislative intent.⁽²¹⁾ To unearth this intent, the guiding factors for courts are the object, context, and purpose of the legislation.⁽²²⁾

Applying these principles to the case at hand, it cannot be inferred that the provisions of the GAAR Chapter prevail in their entirety. The provisions of SAAR would prevail over GAAR to the extent of overlap. Even the purpose and legislative context for GAAR would suggest that the GAAR was not meant to 'override' the SAAR, since it primarily serves to plug gaps in the SAAR.⁽²³⁾ However, it may be argued that the presence of the non-obstante provision in the GAAR Chapter (i.e., that it will apply "notwithstanding anything contained in the Act") would show that the legislature's intent was for GAAR to prevail over SAAR. This was the Court's second leg of reasoning, and it is respectfully submitted that this is also untenable.

Flaw 2: The Non-Obstante Clause in GAAR Overrides SAAR

Section 95(1) of the GAAR Chapter provides that "notwithstanding anything contained in the Act", any impermissible avoidance arrangement ("IAA") must be decided as per the provisions of the GAAR chapter. The court uses this to hold that Chapter X-A "gets an overriding effect over and above other existing provisions of law."⁽²⁴⁾ To bolster this 'overriding effect', the Court refers to S.100 of the Act, which says that GAAR Chapter

18. *ibid.*

19. *ibid.*

20. *ibid.*

21. Commissioner of Income-Tax, Patiala v. Shahzada Nand and Sons, AIR 1966 SC 1342 [18]; Maxwell (N 13) 267.

22. AIR 1992 SC 81 ; Reserve Bank of India v Peerless General Finance and Investment Co. Ltd. (AIR 1987 SC 1023).

23. See Part II(c) below.

24. AIROnline 2024 Tel 283.

applies “in addition to, or in lieu of... any other basis for the determination of tax liability.”⁽²⁵⁾ It uses this provision to hold that the legislature intended to “substitute” GAAR with another method of determination, and GAAR provisions thus act as an “all-encompassing safety net.”⁽²⁶⁾ It is respectfully submitted that this interpretation of the non-obstante clause is not tenable in light of the legislative scheme of Chapters X and X-A.

If the Court’s reasoning is taken to its logical conclusion, it would mean that the provisions of the GAAR would always override the provisions of the SAAR, regardless of the facts. This can be the only consequence of interpreting S.95(1) and S.100 as “all-encompassing.” However, the Court confoundingly proceeds to hold that whether GAAR would apply over SAAR “depends on the facts of the case.”⁽²⁷⁾ Not only does this contradict the reasoning of S.95 and S.100, but it also fails to offer any guiding factors for this ‘case by case’ determination.

It is submitted that this interpretation of S.95(1) and S.100 is untenable since it would lead to the effective repeal of SAAR. This could not have been the legislature’s intention while introducing GAAR.⁽²⁸⁾ In every case, the Revenue could resort to the “all-encompassing” reading of Rami Reddy to circumvent the applicability of SAAR. The question remains; how do we make sense of the non-obstante clause read with S.100?

Ordinarily, non-obstante clauses have the effect of giving one provision an overriding effect over another in case of a conflict.⁽²⁹⁾ However, non-obstante clauses do not necessarily have the effect of cutting down the clear terms of the enactment.⁽³⁰⁾ In certain circumstances, the context and setting of the legislation indicates that the non-obstante clause did not intend to override all provisions in the statute.⁽³¹⁾ In such cases, they must be read as clarificatory, i.e., they were inserted *ex abundanti cautela*⁽³²⁾ (by way of abundant caution).⁽³³⁾ In *Raghunath*, the Court held that the non-obstante clause in the general rules did not limit or override the ambit and scope of the special rule.⁽³⁴⁾ In *Jindal Steel*, the Court found that the context and drafting history of the non-obstante clause could only lead to the

25. Income Tax Act, 1962 (Act 43 of 1962), S.100.

26. AIROnline 2024 Tel 283.

27. *ibid.*

28. See Direct Taxes Code Bill 2009, available at <https://prsindia.org/files/bills_acts/bills_parliament/1970/Direct_Taxes_Code_Bill_2009.pdf> (accessed 29 October, 2024) See S.121- S.122 for SAAR, and S.123 for GAAR, where both were promulgated simultaneously.

29. *Chandravarkar Sita Ratna Rao v. Ashalata Guram* (AIR 1987 SC 117).

30. AIR 1992 SC 81.

31. *State of W.B. v. Union of India* (AIR 1963 SC 1241).

32. *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*, 2012 AIR SCW 5950.

33. AIR 1992 SC 81.

34. *ibid.*

inference that that it was “used as a manner of abundant caution and possible reassurance.”⁽³⁵⁾ Thus, it emerges from this that the function of the non-obstante clause is not always overriding; it would depend on the legislative scheme in question.

In this light, we submit that there are three tenable interpretations of S.95(1) and S.100. First, the non-obstante clause in the Act is clarificatory in nature. It was inserted by the legislature out of abundant caution to emphasize the applicability of GAAR over other provisions of the Act, and not to override SAAR in every case. Second, that the non-obstante clause applies to other provisions in the Act which determine tax liability, and not SAAR. For instance, provisions allowing the deduction of expenditure from capital gains may be used to avoid tax.⁽³⁶⁾ The non-obstante clause would prevail over such substantive provisions in the Act. Third, the provision specifies “Notwithstanding any in the Act, any arrangement may be declared to be an impermissible avoidance arrangement.” The words “may be” indicate that the non-obstante clause is not couched in mandatory terms, and that it does not necessarily preclude the application of other anti-avoidance rules (such as the SAAR). Fourth, the Court in Rami Reddy fixates on the words “in lieu of” in S.100, while ignoring the words “or in addition to”, suggesting that the GAAR Chapter may apply in addition to, and not as a substitute for SAAR’s anti-avoidance rules. Thus, the logic of these provisions cannot be used to hold that GAAR would prevail.

Flaw 3: The Shome Committee Report Does Not Address the Question of Overlap

The third reason that the Court upholds the invocation of the GAAR can be traced to its drafting history. Before the GAAR was introduced by the Finance Act 2013, it was referred to an Expert Committee under the chairmanship of Dr. Parthasarthi Shome (‘Shome Report’ or ‘Report’).⁽³⁷⁾ Interestingly, the Report commented on the relationship between GAAR and SAAR.⁽³⁸⁾ Thus, it serves as a useful source to understand legislative intent.

In Rami Reddy, the assessee relied on the Shome Report to argue that SAAR would prevail over GAAR to the extent of overlap.⁽³⁹⁾ However, the Court rejected this contention on

35. Jindal Stainless Ltd. v. State of Haryana, AIR 2016 SC 5617; Tarun Jain, ‘Circumscribing Non Obstante Clauses: Tracing the New Jurisprudence’ (SCC Times, 16 June 2023) <<https://www.scconline.com/blog/post/2023/06/16/circumscribing-non-obstante-clauses-tracing-the-new-jurisprudence/>> accessed 1 November 2024).

36. See Income Tax Act, 1962 (Act 43 of 1962), S.36.

37. Arvind P. Datar, Kanga & Palkhivala’s the Law and Practice of Income Tax (LexisNexis, 11th edn., 2020) 2106.

38. Shome Report (N 4) 48.

39. AIROnline 2024 Tel 283.

the grounds that the comments in the report pertained “mainly to international agreements”.⁽⁴⁰⁾ It is respectfully submitted that this is not the case.

The portion of the Shome Report that deals with the question of overlap is titled “GAAR v. SAAR; and GAAR v. LOB”.⁽⁴¹⁾ From the context of the Shome Report, it is clear that it was intended to apply to SAAR in the Act, and not just international treaties. The language of the Report strongly suggests this:

“It is a settled principle that, where a specific rule is available, a general rule will not apply. In view of the above, the Committee recommends that that where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/element.”⁽⁴²⁾

Perhaps the Court’s confusion arose from the fact that the same portion of the Report also referred to the parallel issue of the overlap of GAAR, SAAR and Limitation of Benefit clauses in international treaties.⁽⁴³⁾ This is because the above final recommendations were given immediately after an illustrative case of an overlap of GAAR and SAAR in international treaties. In fact, in a later commentary Dr. Shome himself notes that the Government did not accept the committee’s suggestion to “apply GAAR provisions...where anti-avoidance rules are provided in a[n] [international] tax treaty in the form of limitation of benefit.”⁽⁴⁴⁾ Thus, it is clear that the Shome Committee Report was not referring to the application of SAAR in the context of international treaties, but in the Act itself.

This reading of the Report is also supported by the Statement of the Finance Minister which accompanied the 2013 Act. It states that Guidelines would be issued to determine the question of overlap between GAAR and SAAR.⁽⁴⁵⁾ Subsequently, these guidelines were issued by the Department of Economic Affairs after deliberation by the Central Board of Direct Taxes.⁽⁴⁶⁾ They explicitly state that “under normal circumstances, where specific SAAR is applicable, GAAR will not be invoked.”⁽⁴⁷⁾ Notably, this is in the context of the

40. *ibid.*

41. Shome Report (N 4) 48.

42. *ibid.*

43. *ibid.*

44. Parthasarathi Shome, *Taxation History, Theory, Law and Administration* (Springer International Publishing 2021) 359.

45. Shome Report (N 4) 48.

46. AIROnline 2024 Tel 283; Ministry of Finance (Department of Economic Affairs), ‘Statement of the Finance Minister’ (2013) 3.

47. Ministry of Finance (Department of Economic Affairs), ‘Draft guidelines regarding implementation of General Anti Avoidance Rules (GAAR) in terms of section 101 of the Income Tax Act, 1961’ (2013) 7.

Act and not international treaties. Thus, the drafting history reveals that GAAR serves a gap-plugging function; i.e.; that in case an arrangement is not covered by the provisions of SAAR, the GAAR may be resorted to. This function of the GAAR as a last resort, gap-plugger is also affirmed by comparative literature, which the next following Part will examine.

Comparative Insights: What is the Relationship Between GAAR and SAAR?

i) Lessons from the UK

The UK's approach towards adjudicating anti-avoidance merits detailed scrutiny because it maintains a parallel GAAR and SAAR regime like India.(48) Until the last decade, anti-avoidance in the UK was exclusively regulated through a complex array of nearly three hundred TAARs.(49) The inefficacy of such this model was recognized,(50) leading to the creation of a GAAR. The UK GAAR was introduced via Finance Act, 2013(51) based on a study by the Aaronson Report—the foundational document for the UK GAAR.(52)

While no noteworthy cases examining the interplay between GAAR and TAAR have emerged, the official Guidance Note on the implementation of GAAR is instructive.(53) The guidance note suggests that in principle, GAAR can operate independently of TAAR.(54) Principally, GAAR was intended to preclude taxpayers from exploiting the loopholes in other anti-avoidance rules, whether TAAR or otherwise.(55)

Moreover, as per the Aaronson Report, GAAR is envisaged not as a rule of construction, but as an “overriding legal rule” to which other tax legislations are subject.(56) Crucially, this does not mean that other legal rules, including SAAR, do not apply at all. Rather, the

48. HMRC's GAAR Guidance available at <<https://assets.publishing.service.gov.uk/media/5a7e0954ed915d74e6223b11/gaar-part-abc.pdf>> (accessed 3 November, 2024).

49. Graham Aaronson QC, GAAR Study: A Study to consider whether a general anti-avoidance rule should be introduced into the UK tax system 18, available at < https://webarchive.nationalarchives.gov.uk/ukgwa/20130321041222/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf> (accessed November 2, 2024).

50. Elizabeth Keeling, 'Wide of the mark? Are Targeted Anti-Avoidance Rules in the UK Tax Legislation Doing Their Job?' 43(2) Statute Law Review (2022).

51. The Finance Act, 2013 (United Kingdom).

52. Aaronson Report (N 54) 53.

53. HMRC Guidance Note (N 50) 48.

54. *ibid.*

55. *ibid.*; Aaronson Report (N 54) 20.

56. Judith Freedman, 'General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World?' (2016) SSRN <https://ssrn.com/abstract=2769554> 19; Aaronson Report (N 54) 28.

proper inference is that SAAR will apply, but will apply subject to GAAR in that if the preconditions of GAAR are met, the latter will hold the field. This is because GAAR, being framed as an “overriding” rule, is not meant to be the provision applicable in the first instance; rather, it is only when an abusive arrangement has escaped SAAR that GAAR will be engaged to rein in the abusive arrangement.

Even the latest guidance note issued by the UK Revenue Authority supports this interplay between GAAR and SAAR; it notes that it is “usually necessary” to determine whether non-GAAR tax rules (TAAR, among others) would first be effective in achieving the purpose of preventing tax avoidance.”⁽⁵⁷⁾ Elaborating on this, it argues that:

“Non-GAAR tax rules will be effective in defeating abusive tax arrangements, and so in such cases the [UK Revenue Authority] will not need to rely on the GAAR. However, there may be cases where abusive schemes would succeed in the absence of the GAAR, which is the reason why the GAAR has been introduced.”⁽⁵⁸⁾

The GAAR and SAAR in South Africa share a similar relationship, whose drafting history also references the UK scheme.⁽⁵⁹⁾

ii) Lessons from South Africa

The South-African interplay between SAAR and GAAR is particularly relevant since India’s GAAR borrows heavily from it.⁽⁶⁰⁾ Section 103 of the South African Income-tax Act contains anti-avoidance provisions.⁽⁶¹⁾ While it initially incorporated only specific anti-avoidance rules (such as the prevention of tax avoidance via round trip financing), it was amended to add the language of a GAAR.⁽⁶²⁾ The South African Revenue Service, in its discussion paper, attributes the need for a GAAR to the flexibility and complexity of derivatives and other financial instruments, which resist a specific SAAR framework. An effective GAAR was thought to “take some pressure off the system”.

57. HMRC Guidance Note (N 50) 7.

58. *ibid.*

59. South African Revenue Service, Discussion Paper on Tax Avoidance (2005, South African Revenue Service) 36.

60. PricewaterhouseCoopers, *Removing the Fences: Looking Through GAAR* (February 2012, PricewaterhouseCoopers) 46; Shome Report (N 4) 124.

61. Income Tax Act, No. 58 of 1962 (South Africa).

62. South African Revenue Service, Discussion Paper on Tax Avoidance (2005, South African Revenue Service) 47-48.

It also discusses the unwieldy and complex nature of SAARs, which can often be circumvented through clever tax avoidance arrangements. From this, it is clear that the GAAR was meant to supplement the SAAR; in other words, to plug the gaps that the SAAR was unable to plug. The Revenue Service recognized that the primary issue with SAARs is that they could be 'gamed' through ingenious tax planning. Hence, a need was felt for a well-drafted GAAR to prevent this form of tax avoidance.(63)

Given that India's legislation borrows heavily (if not entirely) from the South-African legislation, this gap-plugging function of GAAR would be relevant to interpret the Indian scheme. In the next section, we will examine the legislative framework of India's anti-avoidance provisions to better appreciate this interpretation.

Why GAAR is Only a Gap-Plugging to SAAR

India's legislative framework will show that the GAAR was intended to operate in a manner like that in the UK; as a 'gap-plugging' in the SAAR.

i) All SAARs Violations Will Necessarily be GAAR Violations

If we look closely at the SAARs in the Act, we will observe that the transactions specified fall within the ambit of GAAR as well.(64) For instance, S.94 of the Act, which falls under the SAAR Chapter, addresses the avoidance of tax by "certain transactions in securities." It applies, for instance, in cases where one tries to avoid tax on income earned by a security by selling it, and then re-purchasing it after its value appreciates. Such a transaction is facially designed to allow another to temporarily hold the security while its value appreciates, thus, leading to the inference that it is solely for the purposes of tax avoidance. In another instance, we may consider S.93(1), another SAAR, which governs situations where one may acquire the rights of income earned by a non-resident, effectively evading the payment of tax in India. S.93(1) proscribes such an arrangement, and deems the income to be that of the acquirer, and thus subject to tax.(65)

63. South African Revenue Service, Discussion Paper on Tax Avoidance (2005, South African Revenue Service) 55.

64. Besides Chapter X of the Act, a few other provisions are loosely categorized as 'SAARs' since they exist effectively to prevent tax-avoidance. See Shome Report (N 4) 126. Examples are: Section 40A(2)- Expenses or payments are not deductible in certain circumstances involving related parties, Section 80-IA(8)- Market value concept to be followed in relation to transactions with tax exempt entities, 40(a)(i) and (ia)- Disallowance of expenses for non-deduction of tax at source.

65. *ibid* S.93(1).

The common thread running through all SAARs is that they specify certain types of activities which by their very nature lead to a strong presumption that they are meant solely for the purpose of tax avoidance.⁽⁶⁶⁾ Now, let us examine what constitutes a GAAR violation: a transaction is an ‘impermissible avoidance arrangement’ (attracting a GAAR violation) if its ‘main purpose’ is to obtain a tax benefit through a transaction which lacks commercial substance,⁽⁶⁷⁾ or which is done by a transaction which is not bona fide.⁽⁶⁸⁾ If we slot the activities specified in SAAR into the framework of GAAR, we will observe they will invariably meet the definition of ‘impermissible avoidance arrangement’, and thereby constitute GAARs.

This is no coincidence – the GAAR is after all a legislative extension of the SAAR. In other words, it acts as a catch-net for those transactions which escaped the specific provisions in the SAAR. In this light, it makes little sense to apply SAARs/GAAR “depending on the facts of the case”, as the Court says in Rami Reddy.⁽⁶⁹⁾ In every case of tax avoidance, transactions falling under a SAAR will inevitably fall within the GAAR as well. Conducting a GAAR review in select circumstances and not the SAAR in some other does not help us make sense of the legislative scheme. Thus, the GAAR must be seen as ‘plugging a gap’ in the SAARs.

ii) Why Else would the Legislature Want the GAAR and SAAR to Co-exist?

Another indication of this ‘gap-plugging’ function can be located in the co-existence of the two tax avoidance schemes. India is one of the few countries (besides the UK and South Africa) having both SAAR and GAAR.⁽⁷⁰⁾ As we will see, this co-existence is part of the legislative scheme on these anti-avoidance provisions. Clarifying the relationship between them, a CBDT circular responded to the question ‘will GAAR be invoked if SAAR applies’ and said:

“It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legis-

66. Despite categorising the said activities as tax-avoidance, each SAAR allows the assessee to demonstrate to the Assessing Officer that the transaction which falls under the SAAR is not meant for tax avoidance, effectively makes the SAARs function as presumptions that the specified activities are for the purpose of tax avoidance. For instance, see Income Tax Act, Ss.93(3) and S.94(3).

67. Income Tax Act, S. 96(1)(c); for the definition of commercial substance, see S.97 of the Act.

68. *ibid* S.96(d).

69. AIROnline 2024 Tel 283.

70. *ibid*.

lation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case”.

(emphasis added).(71)

From this response, the following observations may be made. First, GAAR is envisaged as a residuary gap-plugger where an IAA manages to circumvent SAAR. This is clear from the first sentence. Second, both GAAR and SAAR can co-exist, but only statutorily, in that one need not supplant the other (by way of a non-obstante clause, for instance), but only one of them apply in any given situation. If both GAAR and SAAR would simultaneously apply, then it would be redundant to state that they may be “applicable as necessary in facts and circumstances of each case.” From this, the most plausible relationship between GAAR and SAAR is that GAAR is serves a gap-plugging function and is not meant to replace SAAR altogether. They can both co-exist in the statute, without the S.95 non-obstante clause resulting in GAAR trumping SAAR all the time.

There is another way of confirming this legislative intent. When the legislature introduced GAAR by way of amendment, the international mechanism on tax-avoidance predominantly endorsed a GAAR-only approach. For instance, New Zealand,(72) Canada,(73) and Australia (74) have only a GAAR provision to regulate tax avoidance, without any corresponding specific rules. The Shome Report even discusses these anti-avoidance regimes at length while making recommendations for India's GAAR.(75) Hence, if the legislature wished to make SAAR entirely redundant, they might very well have repealed SAAR altogether, instead of making them tacitly redundant through S.95. Thus, we see that GAAR performs a gap-plugging function, designed to regulate instances of abusive arrangements that successfully circumvent GAAR.

71. Also see S.119 of the Income Tax Act and CWT v. Sanwarmal Shivkumar (1988) 171 ITR 377 (Raj); Kerala High Court in K.V. Produce. v. CIT (1992) 196 ITR 293 (Ker) and the Supreme Court judgment in CCE v. Ratan Melting & Melting Wire Industries, 231 ELT 22, which hold that circulars issued by the Board carry the force of law, so long as they do not contradict any High Court or Supreme Court decisions.

72. Income Tax Act, 2007 (New Zealand) Ss. BG1, GA1 and YA1.

73. Income Tax Act, 1985 (Canada) S.245.

74. Income Tax Assessment Act, 1936 (Australia) Part IV.

75. Shome Report (N 4) 120-123.

iii) The Ignorance of SAAR Places an Additional Burden on the Revenue

A critical consequence of allowing GAAR to invariably supplant SAAR—an approach that the Rami Reddy judgment tacitly endorses—results in SAAR being rendered redundant, and GAAR becoming the default tax-avoidance framework. The issue with this is the high standard the Revenue must meet to prove a GAAR violation.

Now, let us examine why a higher burden would result. As per S.96, proving a GAAR violation entails establishing two elements. One, that the main purpose of the arrangement is to obtain a tax benefit. Two, that it involves a “tainted element” which refers to either of the four criteria mentioned under S.96(1)(a)-(d). The high burden primarily derives from the first element, referred to in other jurisdictions as the “principal purpose test”. Yet, the UK also recognizes the tainted element requirement as setting a high burden as well.⁽⁷⁶⁾ The following analysis will focus more on the main purpose (or “principal purpose”) test, since some tainted element provisions are so vaguely phrased as to ease the Revenue’s burden.⁽⁷⁷⁾

In analysing the scope of the principal purpose test, the Madras HC noted in the case of Redington India⁽⁷⁸⁾ that tax benefits can be withdrawn if the investment is merely done to circumvent domestic tax laws. Following this decision, a 2J ITAT Delhi Bench in The Infrastructure Pvt. Ltd, Gurgaon vs DCIT⁽⁷⁹⁾ held that “the intent or the principal purpose behind such structures need to be analyzed before it can be seen if the purpose was to avoid double taxation or treaty abuse.”

Moreover, the drafting history of the “main purpose test” suggests that the original draft proposed that the threshold condition for GAAR was that “one of the main/dominant purposes” of the arrangement was to obtain a tax benefit.⁽⁸⁰⁾ However, it was soon recognized that this would create significant uncertainty because there could at once be multiple purposes for an arrangement, and tax benefit could simply be one such purpose; even in

76. HMRC Guidance Note (N 50) 17.

77. See Income Tax Act, 1961, S.96(1)(b) and S.96(1)(d).

78. AIROnline 2020 Mad 1964.

79. ITA No.1915/Del/2022.

80. Final Report on General Anti Avoidance Rules (N 4) 24. This is similar to the UK GAAR. See HMRC Guidance Note (N 50) 17.

these cases, GAAR would be attracted.⁽⁸¹⁾ Thus, the threshold condition was narrowed down from “one of the main purposes” to “the main purpose”, which made its way into the final GAAR chapter that holds the field today. Evidently, this was intended to diminish taxpayer uncertainty and narrowly tailor the applicability of GAAR. This was done by imposing a higher burden on the Revenue. Commonwealth jurisprudence supports the higher-burden approach. Both New Zealand ⁽⁸²⁾ as well as the UK ⁽⁸³⁾ appear to have converged on a “but-for” interpretive standard—but for the tax benefit, the arrangement would not have been entered into. A restrictive interpretation of GAAR, favouring a higher burden on the Revenue, also finds approval in international practice.⁽⁸⁴⁾

Admittedly, this is intended to be a higher burden, meant to act as a safeguard against legitimate transactions being barred as GAAR violations.⁽⁸⁵⁾ The consequence of ignoring SAAR altogether is that the high GAAR standard becomes the default burden. If GAAR were not treated as a mere gap-plugger, and becomes the default burden, this would impose a high default burden on the revenue, where a lower SAAR burden could have been satisfied. This would potentially make it far more challenging for the Revenue to successfully prove tax avoidance, thereby undercutting the very objective of GAAR—and tax avoidance systems—at large. This reinforces need for ‘GAAR as a gap-plugger’ approach.

Conclusion

In this paper, we examined the judgment of the Telangana HC in Rami Reddy. We relied on precedent, principles of statutory interpretation and the drafting history of the anti-avoidance provisions in the Income Tax Act to critique its reasons. Combining this with comparative literature from the UK, we have seen that the GAAR primarily serves a gap-plugging function. It is meant to apply only where the SAAR fails to cover certain artifices of avoidance. Thus, Rami Reddy's ⁽⁸⁶⁾ holding that ‘GAAR prevails over SAAR’ or that it ‘de-

81. Final Report on General Anti Avoidance Rules (N 4) 24.

82. Commissioner of Inland Revenue v. Challenge Corporation Ltd [1987] A.C. 155 (Privy Council).

83. HMRC Guidance Note (N 50) 17.

84. ‘Tackling tax avoidance: a comparative study of general anti-abuse rules across Europe’ (Clifford Chance, June 2013) last accessed December 21 2024 <<https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2013/06/tackling-tax-avoidance-a-comparative-study-of-general-antiabuse-rules-across-europe.pdf>>.

85. See HMRC Guidance Note (N 50) 5; Shome Report (N 4) 19.

86. AIROnline 2024 Tel 283.

depends on the facts of the case' is untenable. Rather, viewing GAAR as a gap-plugger to SAAR, the primary tax-avoidance framework, would comport better with the legislative intent of GAAR.

While the jurisprudence on tax-avoidance in India remains underdeveloped, reconsidering *Rami Reddy* allows us to pave a path to prevent unscrupulous assesses from taking advantage of loopholes in the Act. Both the GAAR and SAAR have been carefully crafted towards this end, and respecting the relationship between them is crucial to prevent avoidance, while maintaining the safeguards inherent in the rules.

Recent developments further emphasize the urgency of resolving this laboured question. With the Supreme Court staying the Telangana High Court's ruling, the present legal position remains unsettled. This case presents an opportunity to finally clarify the interplay between GAAR and SAAR, which will have far-reaching consequences for coherence and certainty in India's anti-avoidance framework.



Redefining the Game: GST Reforms and Their Implications for India's Gaming Industry*

Abstract

*The exponential growth of India's online gaming industry, driven by affordable internet access, technological advancements, and increased smartphone penetration, has necessitated significant regulatory scrutiny, particularly in the realm of taxation. The recent amendments to the Goods and Services Tax (GST) framework, which impose a uniform 28% tax on the total contest entry value for both skill-based and chance-based games, mark a paradigm shift with profound legal, economic, and industry implications. This paper critically examines the new regime, juxtaposing it against judicial precedents such as *Dr. K.R. Lakshmanan v. State of Tamil Nadu (I)* and *Dream11 Fantasy Sports* that uphold the distinction between skill-based games and gambling. The paper also evaluates the economic ramifications of the amendments, including the increased compliance burdens, operational challenges for small and medium enterprises, and the chilling effect*

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1. AIR 1996 SC 1153.

on employment and investment within the sector. Drawing from comparative taxation models in jurisdictions such as the United Kingdom and Malta, the paper argues that a Gross Gaming Revenue (GGR)-based taxation model offers a balanced approach that can reconcile Government revenue generation objectives with industry sustainability. Furthermore, the paper proposes a theoretical Laffer Curve for casino taxation, identifying the optimal tax rate that maximizes Government revenue while minimizing market distortions and incentivizing compliance. In doing so, it underscores the need for a cohesive policy framework that aligns fiscal goals with constitutional principles, fosters innovation, and promotes a globally competitive regulatory ecosystem. By advocating for stakeholder collaboration and nuanced taxation policies, this paper aims to contribute to the ongoing discourse on creating a sustainable and equitable legal framework for India's online gaming sector.

Keywords

Online Gaming Taxation; Gross Gaming Revenue; Skill v. Chance-Based Gaming; Indian Gaming Regulatory Framework

Introduction

“The art of taxation consists in so plucking the goose as to obtain the most feathers with the least hissing.”

– Jean-Baptiste Colbert

The online gaming industry in India has experienced exponential growth in recent years, driven by technological advancements, affordable internet access, and widespread smartphone usage. With this growth, the regulatory framework governing the industry, particularly taxation, has come under scrutiny. The Goods and Services Tax (GST), a landmark reform in India's indirect taxation system, has played a pivotal role in shaping the online gaming sector. However, recent amendments to GST laws have significantly impacted the industry, leading to legal debates, policy deliberations, and industry challenges.

Prior to the recent amendment, the GST treatment of online gaming was relatively straightforward yet varied based on the nature of the game. Games of skill, which rely on a player's knowledge, strategy, and proficiency, were taxed at 18% on the platform's service fee or Gross Gaming Revenue (GGR). In contrast, games of chance, characterized by randomness and luck, attracted a higher tax rate of 28%. The distinction between games of skill and games of chance was crucial, as it reflected the varying nature of these activities and their legal treatment. Games of skill, such as fantasy sports and rummy, were largely viewed as legitimate business activities protected under constitutional provisions, while games of chance, including gambling and betting, were subject to stricter regulations and higher tax rates.

The recent amendment to the GST law has disrupted this distinction by imposing a uniform 28% tax rate on the entire contest entry amount or pot value, irrespective of whether the game is one of skill or chance. This change was introduced following extensive deliberations by the GST Council and the Group of Ministers (GoM) constituted to address the complexities of taxation in casinos, racecourses, and online gaming. The GoM's recommendations, which emphasized uniformity in tax rates and valuation mechanisms, culminated in the amendment aimed at augmenting revenue collection. However, this shift has blurred the lines between skill-based and chance-based gaming, raising concerns about the amendment's impact on the industry's viability and legal standing.

The key changes introduced by the amendment include taxing the full value of the contest entry amount rather than just the platform's service fee. This approach aligns with the GoM's recommendation to simplify valuation mechanisms and treat online gaming on par with other actionable claims like betting and gambling. However, it disregards the nuanced differences between these activities, which have been upheld in multiple judicial pronouncements. For instance, the Supreme Court and various High Courts have consistently held that games of skill, even when played for stakes, do not amount to betting or gambling. The Karnataka High Court's recent ruling in favor of Gameskraft Technology, a major player in the industry, further reinforced this distinction by quashing a GST demand on skill-based games. The court's decision highlighted the need for a clear and differentiated tax regime that recognizes the unique characteristics of skill-based gaming.

The amendment's implications extend beyond taxation to the broader legal and regulatory framework governing the industry. The CGST Act, 2017⁽²⁾, which defines actionable claims and provides the basis for GST applicability, now faces interpretational challenges due to the uniform tax treatment of online gaming. Additionally, the Information Rules⁽³⁾, which introduced self-regulation mechanisms for online gaming intermediaries, may require alignment

2. Central Goods and Service Tax Act, 2017.

3. Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Amendment Rules, 2023.

with the revised GST provisions. The intersection of these laws underscores the need for a cohesive regulatory approach that balances revenue objectives with industry growth and legal clarity(4).

The amendment to the GST law represents a significant shift in the taxation of online gaming in India. While aimed at enhancing revenue collection and simplifying valuation mechanisms, the uniform tax rate on contest entry amounts has raised critical questions about the industry's legal and economic landscape(5). The challenges arising from this amendment, including increased costs, compliance burdens, and potential legal disputes, underscore the importance of a balanced approach that recognizes the unique characteristics of skill-based gaming. As the industry navigates these changes, collaboration between stakeholders, policymakers, and the judiciary will be essential to fostering a conducive environment for innovation, investment, and growth in India's burgeoning online gaming sector. The Indian Government's decision to impose a 28% Goods and Services Tax (GST) on the total deposit value for online gaming, encompassing both skill-based and chance-based games, has significantly impacted the online gaming industry. This move, effective from October 2023, has led to substantial financial and operational challenges for gaming companies operating within India.

Challenges to be Covered

The challenges posed by the amended GST regime are manifold. Firstly, the higher tax burden on the contest entry amount is likely to increase the cost of participation for players, potentially driving them towards unregulated platforms or gray markets. Secondly, the uniform tax rate disregards the distinction between skill and chance, which could undermine the legal status and growth prospects of skill-based gaming companies. Thirdly, compliance with the revised valuation and reporting requirements may strain the operational capacities of smaller gaming firms, limiting their competitiveness in the market.

Difference Between Game of Skill and Chance

The distinction between games of skill and games of chance lies at the heart of the legal and tax treatment of gaming activities in India, particularly after the Supreme Court's seminal ruling in *Dr. K.R. Lakshmanan v. State of Tamil Nadu*(6). This case provides a robust framework for understanding the nature of games and their classification under law, which is particularly relevant to the ongoing controversies surrounding GST amendments for online gaming.

4. "The Transformative Role of Online Gaming in Digital India", E-Gaming Federation (<https://www.egf.org.in/thetransformative-role-of-online-gaming-in-digital-india>).

5. Impact of Covid on online gaming industry of India https://www.researchgate.net/publication/376185213_Impact_of_Covid_on_online_gaming_Industry_of_India.

6. *K.R. Lakshmanan v. State of Tamil Nadu*, AIR 1996 SC 1153.

The Court relied on the “predominance test” to determine whether a game is one of skill or chance. It emphasized that a game of skill is one where success predominantly depends on superior knowledge, training, attention, experience, and adroitness, despite the possible presence of an element of chance. Conversely, games of chance are dictated by randomness or luck, leaving participants with limited control over the outcome. In the judgment, horse racing was identified as a game of skill, as the outcome depends significantly on factors such as the training and fitness of the horse, the expertise of the jockey, and environmental conditions, rather than pure chance. This analysis provides a foundational legal principle for distinguishing legitimate gaming activities from gambling, where randomness dominates.

In the realm of online gaming, applying this precedent becomes crucial. Games like online rummy or fantasy sports, which require strategic planning, memory, and consistent application of skill, are likely to be classified as games of skill. In contrast, pure lottery or roulette games fall into the chance category due to their reliance on random factors like draws or spins. The Public Gambling Act, 1867(7), and similar state-specific legislation, exempt games of skill from their ambit. Courts have consistently upheld this distinction. For instance, in *State of Andhra Pradesh v. K. Satyanarayana*(8), the Supreme Court ruled that rummy is a game of skill since success depends on memorizing cards and making strategic decisions based on probability and skill. Similarly, in *Dream11 Fantasy Sports (Rajasthan HC)*, fantasy sports were classified as skill-based activities, emphasizing their strategic aspects, such as selecting players and predicting performance(9) .

However, the recent amendments to GST regulations have blurred these boundaries. The GST Council decided to levy a 28% tax on the full value of bets in online gaming, regardless of whether the game involves skill or chance. This one-size-fits-all approach disrupts the legal framework established by precedents like *Lakshmanan*, which differentiate between legitimate skill-based businesses and gambling activities. This approach creates significant challenges. First, it undermines the legal recognition of skill-based games as legitimate economic activities protected under Article 19(1)(g) of the Constitution. Second, it penalizes players and operators of skill-based games with excessive taxation, equating them to gambling activities. Third, it creates regulatory uncertainty for an industry that thrives on innovation and user engagement(10).

7. Public Gambling Act, 1867.

8. AIR 1968 SC 825.

9. Dey, Kushal, “An Analysis of Gaming Industry in India”, *International Journal of Science and Research (IJSR)* “<https://www.ijmr.com/papers/2024/1/13817.pdf>”.

10. Kumar Divya, “Monetization Models in The Gaming Industry: A Comparative Analysis of In-Game Purchases, Subscriptions, And Free-To-Play Strategies”, *International Journal for Multidisciplinary Research (IJFMR)* (<https://www.ijfmr.com/papers/2024/1/13817.pdf>).

Moreover, this tax treatment could contravene the precedent set by *Chamarbaugwala v. Union of India*, where the Court explicitly excluded competitions involving substantial skill from the purview of gambling. The GST amendment ignores this distinction and imposes a tax burden that could stifle the growth of India's burgeoning online gaming sector, which is already grappling with regulatory complexities.

Understanding The Factual Matrix of The Case And Events Leading To The Litigation

The case revolves around the Karnataka High Court's landmark decision in *Gameskraft Technologies Private Limited v. Directorate General of Goods and Services Tax Intelligence*(**11**). This case provided crucial relief to the online gaming industry by ruling that games of skill are not included under the purview of "betting and gambling" as defined in Entry 6 of Schedule III(**12**) of the Central Goods and Services Tax Act (CGST Act).

Background and Events Leading to Litigation

Gameskraft Technologies Pvt. Ltd. operates an online platform facilitating skill-based games such as rummy. The platform serves millions of users, enabling them to compete with each other for stakes based on their skill levels. The company's revenue model involves charging a "platform fee" or service fee for providing this platform, while the stakes placed by users are held in a separate designated account without Gameskraft claiming ownership.

The matter before the Karnataka High Court revolved around a series of writ petitions filed by Gameskraft Technologies Private Limited (GTPL), a company engaged in hosting skill-based online games, primarily Rummy. Established in June 2017, GTPL facilitated online platforms allowing users to play games requiring significant skill rather than chance. The company's operations were compliant with legal standards, regularly filing Goods and Services Tax (GST) returns and contributing over Rs. 1,600 crores in taxes by mid-2022. However, the Directorate General of Goods and Services Tax Intelligence (DGGI) conducted search and seizure operations at GTPL's premises between November 11 and November 13, 2021. This action led to the seizure of documents and devices, followed by provisional attachment orders for GTPL's bank accounts under Section 83 of the Central Goods and Services Tax Act, 2017 (CGST Act). The Directorate General of Goods and Services Tax Intelligence (DGGSTI) alleged that Gameskraft misclassified its services to evade taxes. They argued that the entire buy-in amount (stake deposited by users) constituted consideration for the supply of actionable claims categorized as "betting and gambling," subject to

11. *Gameskraft Technologies Private Limited v. Directorate General of Goods and Services Tax Intelligence*, [2025] 170 taxmann.

12. ¶6 of Schedule III to the CGST Act, 2017.

GST at 28%. Based on this interpretation, the authorities demanded a tax liability of over Rs. 2,100 crore from Gameskraft.

Subsequently, on August 8, 2022, the respondents issued an Intimation Notice under Section 74(5) of the CGST Act, demanding a deposit of approximately Rs. 2,09,890 crores in alleged tax liabilities, interest, and penalties. GTPL and its officials, including founders and executives, were summoned for further investigations. This notice and subsequent Show Cause Notices (SCNs) alleged that GTPL's activities constituted "betting and gambling," taxable as actionable claims under GST law. The petitions filed by GTPL sought to quash the attachment orders and challenge the classification of its operations as gambling or betting. The key issue before the court was whether online Rummy, a game predominantly requiring skill, qualified as gambling or betting under GST laws.

The petitioners contended that their business model focused solely on providing a platform for players, collecting a platform fee for their services. They vehemently denied involvement in gambling or betting activities and argued that their operations were misclassified by the respondents. The DGGI, on the other hand, argued that GTPL's activities fell squarely within the ambit of betting and gambling, thereby attracting GST at the highest rate. The resultant legal dispute brought forth significant questions about the interpretation of tax law concerning skill-based games versus games of chance.

Gameskraft challenged this demand through a writ petition in the Karnataka High Court, asserting that skill-based games do not fall within the scope of "betting and gambling" and are therefore exempt from GST. Industry stakeholders, such as the All India Gaming Federation and E-Gaming Federation, supported Gameskraft as intervenors, emphasizing the distinction between games of skill and games of chance.

Issues Arising Due to Amendments and Their Implications

The central issue in this case stemmed from the classification of activities related to skill-based games under the GST framework. Schedule III of the CGST Act excludes "actionable claims" except for those related to lottery, betting, and gambling from the purview of GST. The respondents alleged that GTPL's activities involved betting and gambling, thus constituting taxable actionable claims. This exclusion implies that skill-based games, not classified as "betting and gambling," are not taxable.

The legal question was whether skill-based games, such as rummy, fall under "betting and gambling." Key issues include:

- 1. Classification of Skill-Based Games:** The broader issue also touched upon the legislative competence of the GST framework to tax skill-based games, which were traditionally

protected under various judgments of the Supreme Court and High Courts. Games like Rummy, where success depends predominantly on skill, have been judicially distinguished from games of pure chance. By equating skill-based games played for stakes with gambling, the respondents challenged the long-standing jurisprudential distinction between skill and chance.

2. Implications of GST Amendments: The GST Council's proposal to tax the face value of bets rather than the service fee challenged established principles. This amendment treats platforms like Gameskraft on par with lotteries and casinos, despite judicial precedents distinguishing them.

3. Judicial Precedents and Legislative Ambiguity: The absence of a GST-specific definition of "betting and gambling" necessitates reliance on prior judicial interpretations. Contradictions between the judiciary and the GST Council's stance have led to confusion and potential litigation.

Legal Arguments Presented by Both Sides

Petitioners' Arguments – The petitioners argued that over 96% of the games hosted on their platform were Rummy, a game of skill as consistently recognized by the Supreme Court in cases like *State of Andhra Pradesh v. K. Satyanarayana*(**13**) and *Dr. K.R. Lakshmanan v. State of Tamil Nadu*(**14**). The petitioners emphasized that the character of Rummy as a skill-based game remains unchanged whether played offline or online. Additionally, the petitioners maintained that their revenue stemmed from a platform fee charged for facilitating gameplay. The amounts staked by players were held in trust and did not constitute the company's income. They contended that the DGGI erroneously considered the total staked amounts as the petitioner's revenue to portray an inflated tax liability. The petitioners highlighted that their terms and conditions explicitly stated that the staked amounts belonged to the players and were held in trust until disbursed to winners. This arrangement negated the respondents' allegations that the entire staked amount was part of the company's taxable income. The petitioners also alleged that the respondents acted with malice and arbitrariness by shifting their stance during the investigation. Initially, the investigation focused on alleged misclassification of discounts, which later transformed into accusations of gambling. The petitioners relied on various judgments to argue that skill-based games were distinct from gambling and constitutionally protected as legitimate business activities under Article 19(1)(g). They cited *All India Gaming Federation v. State of Karnataka*(**15**) and *Head Digital Works Pvt. Ltd. v. State of Kerala*(**16**) as relevant precedents.

13. AIR 1968 SC 825.

14. AIR 1996 SC 1153.

15. AIROnline 2022 Kar 120.

16. AIROnline 2021 Ker 1424.

Respondents' Arguments — The respondents contended that the platform facilitated betting by allowing players to stake money on the outcomes of games. They argued that the monetary stakes and the petitioner's commission constituted betting and gambling as defined in GST laws. According to the respondents, the predominance test for determining skill versus chance was not met in the case of online Rummy. They argued that the platform did not track or disclose players' skill levels, making the gameplay dependent more on chance than skill. The respondents argued that the petitioner's commission, derived as a percentage of the stakes, directly tied the company's revenue to the gambling nature of the activity. They rejected the classification of this income as a platform fee for facilitation. The respondents justified their actions by asserting their legislative competence to tax actionable claims involving betting or gambling under the GST framework. They alleged tax evasion and claimed the petitioner's practices misrepresented the nature of their business. The respondents relied on the Supreme Court's judgment in *K. Satyanarayana* to argue that even skill-based games could amount to gambling if played for stakes. They also dismissed judgments favoring the petitioner as factually distinguishable or inapplicable.

Final Judgment and Its Significance

The Karnataka High Court ruled in favor of the petitioners, quashing the impugned Show Cause Notices and holding that online Rummy, being a game of skill, could not be classified as betting or gambling under GST laws. The court reaffirmed the principle that games of skill enjoy constitutional protection and are distinct from games of chance. It held that the respondents had failed to establish any evidence to prove that GTPL's operations involved gambling or betting. The court also criticized the respondents for acting arbitrarily and for misinterpreting established legal principles.

Significance of the Judgment

The judgment reinforced the long-standing distinction between skill-based and chance-based games, aligning with precedents set by the Supreme Court and High Courts. By holding that skill-based games do not fall within the ambit of actionable claims under GST, the court provided much-needed clarity to the burgeoning online gaming industry, preventing potential misuse of tax laws. Court's decision upheld the constitutional right to practice trade and business under Article 19(1)(g)(17), emphasizing the importance of distinguishing legitimate business activities from gambling. The judgment set a precedent for other gaming platforms facing similar allegations. It safeguarded the industry's growth by ensuring that skill-based games were not unfairly taxed or categorized as gambling. The judgment highlighted the

17. Art. 19, India an Constitution.

judiciary's role in scrutinizing arbitrary executive actions, ensuring fairness and adherence to legal principles in tax administration.

Analyzing the Constitutionality of the Gst Amendment On Online Gaming

Indian courts have long upheld the distinction between games of skill and games of chance, which plays a pivotal role in the taxation and regulation of gaming activities.

State of Andhra Pradesh v. K. Satyanarayana(18)

In this case, the Supreme Court addressed whether rummy constitutes gambling. The Court observed that rummy is a game where success depends on the player's ability to memorize cards, anticipate the moves of opponents, and strategize accordingly. Despite a minor element of chance, skill dominates the outcome, distinguishing rummy from gambling. This decision reinforced the view that games involving significant skill cannot be equated with games of chance for regulatory purposes.

(Dream11 Fantasy Sports Case) *Avinash Mehrotra v. State of Rajasthan*(19)

The Rajasthan High Court examined whether fantasy sports platforms like Dream11 qualify as games of skill. The Court highlighted the strategic elements of fantasy sports, such as selecting players based on performance data, balancing team budgets, and predicting outcomes. It concluded that success relies on the participant's knowledge and skill, making fantasy sports a legitimate business activity protected under Article 19(1)(g) of the Constitution. This case further cemented the distinction between games of skill and games of chance in the context of online platforms.

RMD Chamarbaugwalla v. Union of India(20)

This case remains a cornerstone of Indian gaming jurisprudence. The Supreme Court ruled that gambling activities, which are based entirely on chance, are *res extra commercium* and do not enjoy constitutional protection. However, the Court clarified that competitions involving substantial skill are legitimate economic activities. This distinction is critical for understanding the constitutional protection afforded to skill-based gaming.

18. AIR 1968 SC 825.

19. AIROnline 2021 SC 1417.

20. AIR 1957 SC 628.

Judicial Precedents Against Uniform Taxation

Several judicial decisions underscore the unconstitutionality of taxing skill-based and chance-based games at the same rate:

Skill Lotto Solutions Pvt. Ltd. v. Union of India(21)

The Supreme Court upheld the distinct treatment of lotteries, betting, and gambling under the GST framework, emphasizing that these activities are *res extra commercium*. The Court's reasoning reinforces the need for differentiated taxation based on the nature of the activity.

K.T. Moopil Nair v. State of Kerala(22)

In this case, the Supreme Court struck down a uniform tax on land, holding that such taxation fails to account for inherent differences among entities and violates Article 14. This principle applies equally to the GST amendment, which disregards the fundamental distinctions between skill-based and chance-based games.

Murthy Match Works v. CCE(23)

The Court recognized that while legislatures have wide latitude in taxation matters, classifications must not be arbitrary or unreasonable. Treating skill-based games as equivalent to gambling activities contravenes this principle.

State of Rajasthan v. Rajasthan Chemists Association(24)

In this case, the Supreme Court examined whether differential taxation could violate constitutional principles. The Court held that taxation statutes must balance legislative intent and constitutional protections. A law that results in undue discrimination or arbitrarily affects one group more than others fails to meet constitutional scrutiny. This decision is particularly relevant to the GST amendment, as taxing skill-based games at the same rate as gambling ignores their fundamental differences, creating undue burdens on legitimate businesses.

Union of India v. Intercontinental Consultants & Technocrats Pvt. Ltd.(25)

This case clarified the scope of taxation under the Finance Act, emphasizing that taxes must

21. AIR 2021 SC 366.

22. AIR 1961 SC 552.

23. AIR 1974 SC 497.

24. AIR 1996 SC 1219.

25. AIR 2018 SC 3754.

be levied only on the actual value of services provided. The Supreme Court struck down attempts to tax components not directly attributable to the service rendered. Similarly, the GST amendment's approach of taxing the entire contest entry amount, including prize pools held in fiduciary capacity, contravenes this principle and exceeds the permissible scope of taxation.

Sunrise Associates v. Government of NCT of Delhi(26)

The Supreme Court in this case categorized lottery tickets as actionable claims, which are excluded from the definition of goods and services under most tax regimes. The judgment highlighted the unique legal status of actionable claims and the need for tailored regulatory frameworks. By equating skill-based online gaming with lotteries and gambling, the GST amendment ignores these distinctions, violating established legal principles.

The Impact of the GST Amendment

The GST amendment effectively erases the distinction between games of skill and games of chance by imposing a 28% tax on the full contest entry amount for all online gaming activities. This uniform approach disregards judicially recognized differences, creating several constitutional and legal challenges.

Violation of Article 14(27) : Lack of Intelligible Classification — The equal treatment of skill-based and chance-based games under the amended GST framework violates the principle of equality enshrined in Article 14 of the Constitution. The Supreme Court has held that taxation statutes must adhere to the doctrine of intelligible classification, ensuring that entities within a class share common characteristics. In *RMD Chamarbaugwalla v. Union of India*(28), the Court explicitly differentiated gambling from competitions involving substantial skill, reinforcing the need for separate legal treatment.

Conflict with Article 19(1)(g): Right to Conduct Trade and Business(29) — The Constitution guarantees the right to practice any trade or profession under Article 19(1)(g), subject to reasonable restrictions. Courts have consistently held that skill-based gaming constitutes a legitimate business activity. In *Chamarbaugwalla*(30), the Supreme Court ruled that competitions involving skill are protected under Article 19(1)(g) and cannot be equated

26. AIR 2006 SC 1908.

27. Art. 14, Indian Constitution.

28. AIR 1957 SC 628.

29. Art. 19, Indian Constitution.

30. AIR 1957 SC 628.

with gambling, which is considered *res extra commercium* (outside the scope of commerce). The imposition of a uniform 28% GST on skill-based games undermines their economic viability, disproportionately burdening operators and players. This overreach restricts the industry's growth, effectively curtailing a constitutionally protected trade.

Global Taxation Policies For Online Gaming

United Kingdom

The United Kingdom is a global leader in regulating online gaming. The UK Gambling Commission oversees licensing, compliance, and taxation. Online gaming operators in the UK are taxed on Gross Gaming Revenue (GGR) at a flat rate of 21%. This taxation model ensures that only the revenue retained by the gaming platforms is taxed, preventing an undue financial burden on operators and players. This system has successfully contributed to the UK's tax revenue while maintaining a competitive gaming environment. In 2022, the UK's gaming industry generated over GBP 2.8 billion in tax revenue, highlighting the effectiveness of the GGR-based model⁽³¹⁾.

Malta

Malta, a hub for online gaming, employs a similar GGR-based taxation framework. Licensed operators are subject to a tax rate ranging from 0.5% to 5% of their GGR, depending on the type of game and revenue generated. Malta's lenient taxation policy attracts global gaming operators, contributing significantly to its GDP. In 2022, Malta's gaming industry accounted for approximately 13% of the national GDP, showcasing the success of its regulatory model. The emphasis on GGR rather than total deposits minimizes operational disruptions for companies and encourages compliance. Additionally, Malta's regulatory framework prioritizes player protection and responsible gaming, setting a benchmark for global practices.

Comparative Analysis: India v. Similar Tax Models

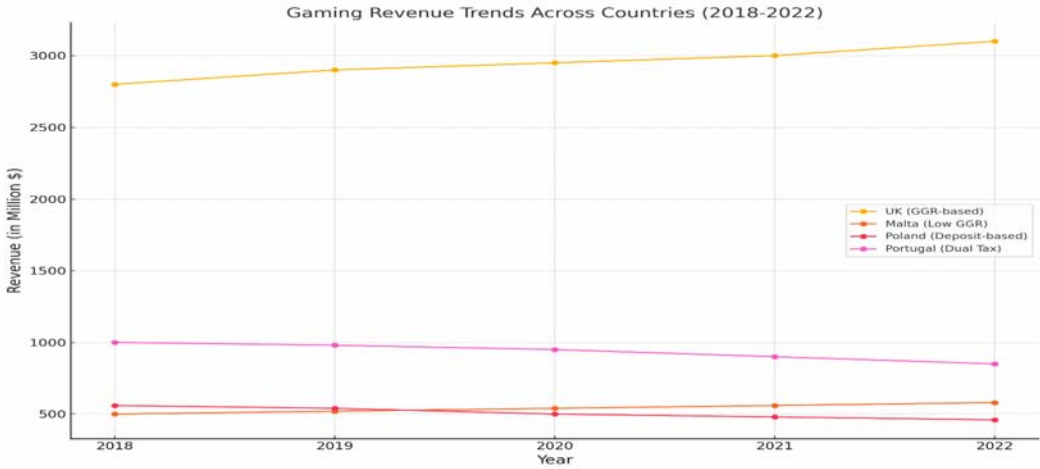
Case Study 1: Poland

Poland's taxation framework for online gaming imposes a tax of 12% on total deposits rather than GGR. This model, akin to India's amended GST, has faced significant criticism. Smaller operators in Poland struggled to sustain their businesses due to the high tax burden, leading

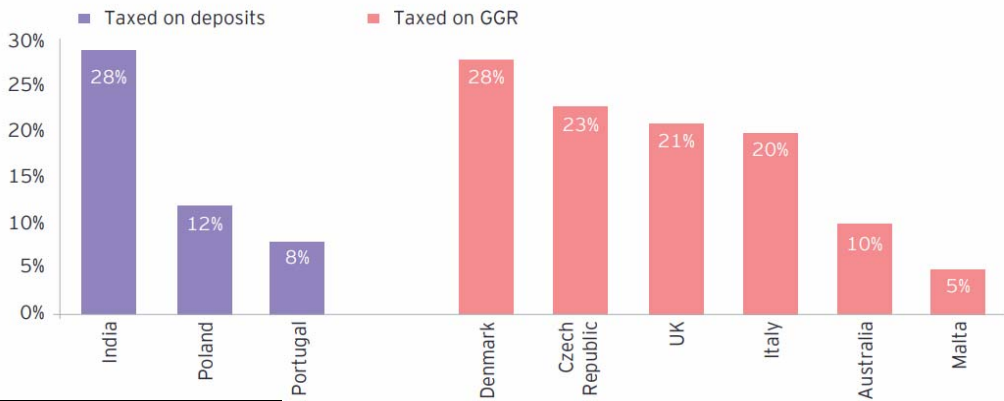
31. Licensing system for online gambling, The Association of Online Gambling Operators <https://copenhageneconomics.com/wp-content/uploads/2021/12/copenhagen-economics-2016-licensing-system-for-online-gambling.pdf>.

to market consolidation dominated by a few large players. Additionally, the high taxation drove many players toward unregulated platforms, causing a decline in the Government’s actual tax revenue(32) .

Case Study 2: Portugal



Portugal’s gaming taxation policy includes a 15-30% tax on GGR but introduces a supplementary tax on total deposits for certain games(33). This dual approach caused confusion among operators and players, deterring investments in the sector. The result was stagnation in Portugal’s gaming market, with operators advocating for a simplified GGR-only taxation model.



32. “European Gaming & Betting Association (EGBA)”, Poland: EGBA supports changes to the tax base for online sports betting - EGBA

33. The Internet Organised Crime Threat Assessment (iOCTA) 2014, Europol (<https://www.europol.europa.eu/ioccta/2014/>).

COMPARATIVE ANALYSIS: PRE AND POST GST AMENDMENT

Following the revision of Goods and Services Tax (GST) regulations in October 2023, skill-based online gaming companies have taken steps to mitigate the impact on players. By absorbing the increased tax burden, these companies have maintained stable growth rates, albeit with reduced profit margins. The new GST framework has notably affected games with smaller player bases, where participants have experienced significant financial impacts. In certain scenarios, winners have faced net losses, while losers have incurred an additional 35.7% in losses. This is primarily due to the shift in the tax base from Gross Gaming Revenue (GGR) or platform fees to the total deposit value

“Case 1: GST@18% on Platform Fees (GGR) (Erstwhile GST regime)”

“In case of a given game wherein two Players X and Y play 5 games each against each other. Each player contributes INR100 in each game inclusive of gaming Platform Fee @ 11% and GST@18% on the GGR/Platform Fee. Hence, the total prize pool for each round is approx. INR 174.04*. Assuming, X wins (3 games) and Y wins (2 games), the

Characteristics	Contribution (Player X) (In INR)	Contribution (Player Y) (In INR)	Platform Fee @ 11%	GST @ 18% on Platform Fee	Prize Pool (In INR)	Winner
Round 1	100	100	22	3.96	174.04	X
Round 2	100 (from the winning pool)	100	22	3.96	174.04*	Y
Round 3	74.04 (from winning pool) +25.96 additional contribution	100 (from the winning pool)	22	3.96	174.04	X
Round 4	100 (from the winning pool)	74.04 (from winning pool) +25.96 additional contribution	22	3.96	174.04	Y
Round 5	74.04 (from winning pool) +25.96 additional contribution	100 (from the winning pool)	22	3.96	174.04	X

net cash flow position for each player at the end of round 5 will be as follows:”

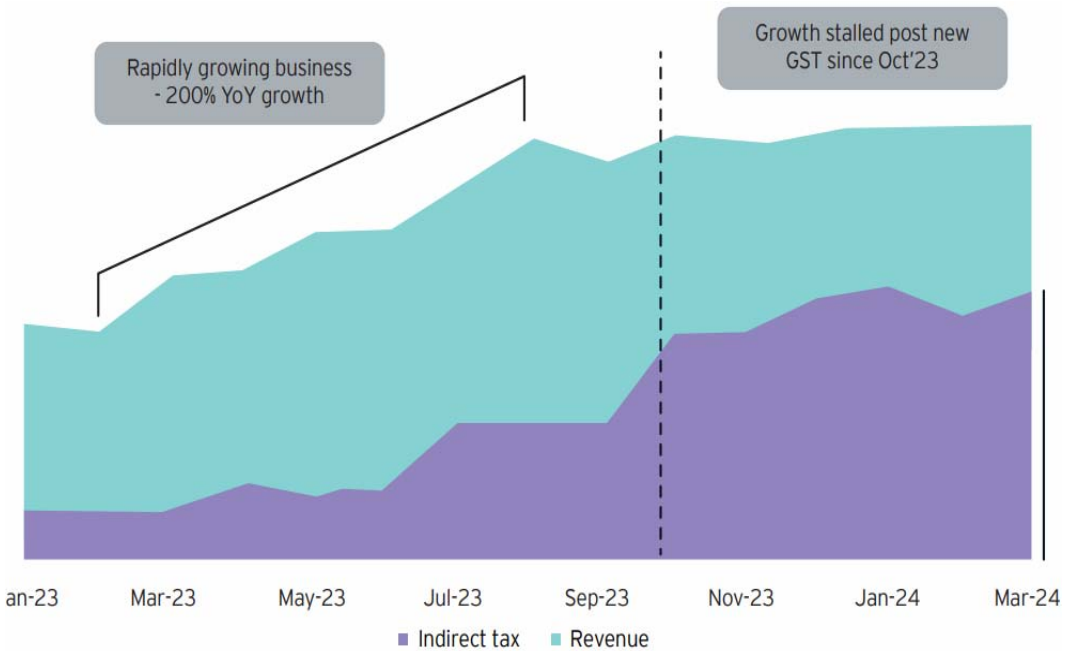
Player	Net Contribution (A)	Net Amount Won (B)	Differential (B-A)
Player X - wins 3 rounds	151.92	174.04	22.12
Player Y - wins 2 rounds	225.96	74.04	-151.92

“Case 2: GST @ 28% on total deposit value (Present GST regime)”

“The below illustration shows the impact of GST @28% on total deposit value in a given small player format game with a similar winning scenario of players X and Y (as shown in case 1). In this case, the prize pool amounts to only INR178 and the net cash flow position for each player at the end of round 5 will be as follows:”

Rounds	Contribution (Player X) (In INR) Inclusive of GST)	Contribution (Player Y) (In INR) Inclusive of GST)	Platform Fee @ 11%	GST @ 18% on Platform Fee	Prize Pool (In INR)	Winner
Round 1	128	128	22	56	178	X
Round 2	100 (from winning pool)	128	22	28	178	Y
Round 3	78 (from winning pool) + 28.16 additional contribution (inclusive of GST)	100 (from winning pool)	22	6.16	178	X
Round 4	100 (from winning pool)	78 (from winning pool) + 28.16 additional contribution (inclusive of GST)	22	6.16	178	Y
Round 5	78 (from winning pool) + 28.16 additional contribution (inclusive of GST)	100 (from winning pool)	22	6.16	178	X

Player	Net Contribution (A)	Net Amount Won (B)	Differential (B-A)
Player X - wins 3 rounds	184.32	178	-6.32
Player Y - wins 2 rounds	284.16	78	-206.16



Economic Effect of the Gst Amendment

Impact on the revenue of the companies

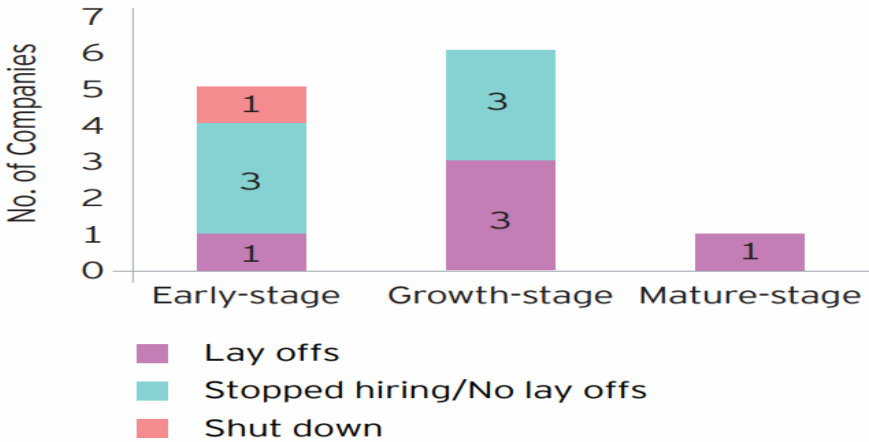
Prior to the GST amendment, the online skill gaming sector experienced exponential revenue growth, with some companies reporting increases between 100-200%. However, in the six months following the amendment, this trend reversed. A survey of 12 companies revealed that only five reported revenue growth post-amendment, while seven experienced either a decline or stagnation. Notably, two companies faced revenue declines of up to 50%, a stark contrast for an industry previously witnessing rapid expansion(34) .

Impact on the employment generation

The downturn in revenue has adversely affected employment within the sector. Out of the 12 companies surveyed, 10 encountered significant challenges in job creation. Four compa-

34. GST on online skill-based gaming, ASSOCHAM and EY report <https://www.assochem.org/uploads/files/Online%20gaming%20Impact%20on%20the%20industry.pdf>.

nies halted hiring without implementing layoffs, while one-third reduced their workforce by up to 50%. Additionally, one company laid off more than half of its employees, and another ceased operation entirely. This decline is alarming for a sector that had previously created approximately 100,000 jobs and was projected to triple that number in the coming years(35).

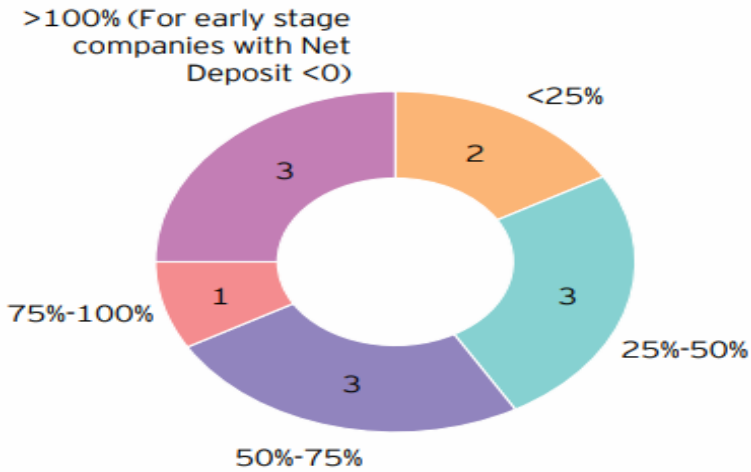


Impact on Margins of the companies

Before the amendment, GST accounted for around 15% of online skill gaming companies' revenue. The increased taxation has had a dual impact, dampening both growth prospects and profit margins within the industry. A substantial portion of platform revenue is now consumed by the increased GST cost, along with other expenses such as marketing, advertising, technology, and banking. Many companies have opted not to pass on the increased tax burden to users, fearing a loss of their customer base due to the market's price sensitivity. Consequently, for some companies, the GST share has escalated to 50-100% of revenue(36). Alarmingly, for early-stage companies with negative net deposits, the GST cost exceeds 100% of their revenue. Passing on the tax cost is also expected to drive players toward offshore betting platforms, resulting in a loss of business for domestic companies and consolidation of smaller businesses.

35. "Analysis of the Recommendation of the Report of the GoM on Imposition of GST on Online Gaming, Deepstrat report (Analysis-of-the-GoM-Report-on-GST-for-Online-Gaming.pdf (deepstrat.in)).

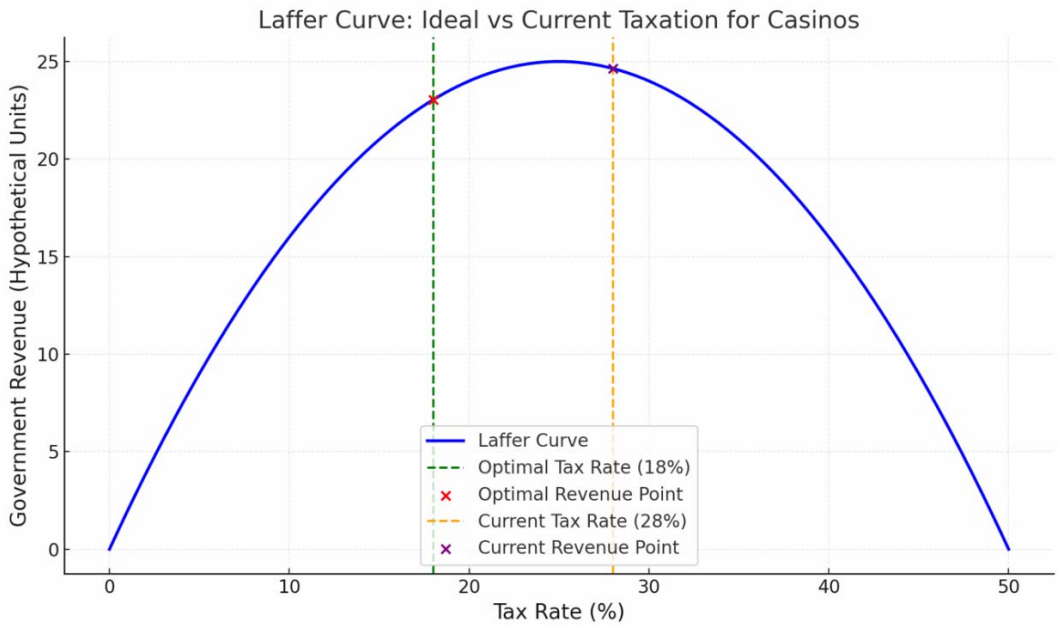
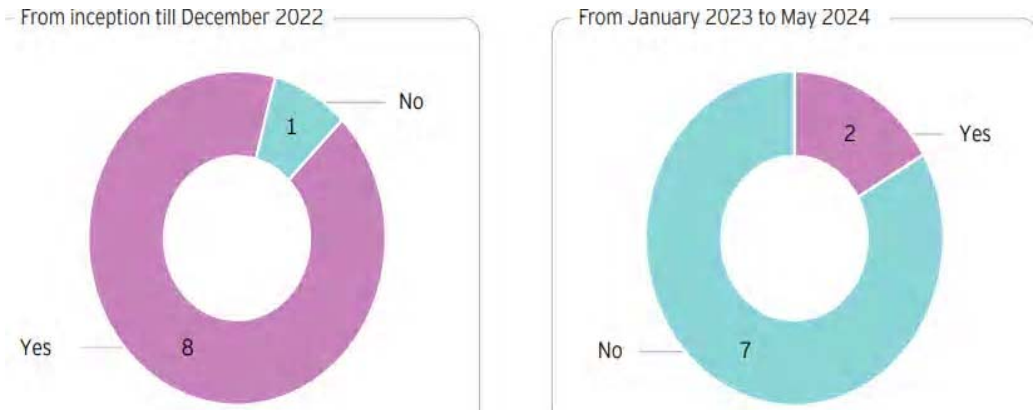
36. "India's media & entertainment sector is innovating in future (https://www.ey.com/en_in/news/2024/03/indianm-e-sector-crossed-inr-2-point-3-trillion-in-2023-expected-to-reach-inr-3-point-1-trillion-by-2026-reveals-the-ficci-ey-report)" .



Funding Winter caused by the new GST Amendment

The high tax rate has significantly impacted investment in the industry. Historically, the sector attracted substantial investor interest, with investments totaling INR 22,931 crore from both domestic and global sources between FY20 and December 2023. However, recent years have seen a slowdown due to macroeconomic headwinds and changes in taxation. Out of the 12 companies surveyed, eight had raised funding until December 2022, ranging from US\$0.5 million to over US\$400 million (37). Since January 2023, only two companies have secured funding, coinciding with discussions about the need to reassess the GST levied on online gaming and the subsequent passing of the GST amendment. The significant increase in GST has rendered Indian skill-based online money gaming business models unviable and drastically hurt investor sentiments. The industry, which previously experienced strong investor support and substantial funding from 2019 to 2022, has seen a significant drop in investor interest since January 2023.

37. “New frontiers – Navigating the evolving landscape for online gaming in India, EY report (https://www.ey.com/en_in/mediaentertainment/new-frontiers-navigating-the-evolving-landscape-for-online-gaming-in-india)”.



Policy Recommendations

The Sweet Spot: Laffer Curve Analysis

The Laffer Curve, a well-established economic concept introduced by Arthur Laffer, offers valuable insights into the relationship between tax rates and Government revenue. It posits that while increasing tax rates initially raises revenue, there comes a point where further increases disincentivize market participation, leading to declining revenue due to reduced compliance and economic activity. In the context of the gaming and casino industry, this principle is highly relevant. Casinos, much like other sectors, respond dynamically to taxation policies. A tax rate that is too high may push players and operators toward unregulated platforms or even offshore markets, thereby undermining both market growth and Government revenue objectives. Conversely, a lower, optimal tax rate incentivizes compliance and sustains economic activity, creating a “sweet spot” where government revenue and market health coexist harmoniously. Below is a graphical representation of the Laffer Curve tailored for casino taxation. The curve highlights the optimal tax rate (18%)—a point where government revenue is maximized without overburdening operators and market players. It also contrasts this ideal rate with the current reality of 28% taxation, underscoring the inefficiencies and revenue losses that arise when taxation exceeds the optimal threshold.

The analysis reveals that India's current tax policy, with a uniform 28% GST on casino operations, likely places the industry on the downward slope of the Laffer Curve. This taxation level imposes significant burdens on market players, reducing their profitability and incentivizing tax avoidance or non-compliance. It also risks encouraging players to migrate to unregulated or offshore markets, further diminishing domestic revenues.

Tiered Taxation Structure

A tiered taxation structure offers a pragmatic solution to address the complexities of the gaming and casino industry by acknowledging the inherent differences between skill-based games and games of chance. The current uniform 28% GST disregards this distinction, treating all forms of gaming, including skill-based games like rummy and fantasy sports, as equivalent to gambling or betting, which are often considered *res extra commercium* (outside the scope of commerce). Such a one-size-fits-all approach not only contradicts established judicial precedents, such as *Dr. K.R. Lakshmanan v. State of Tamil Nadu*⁽³⁸⁾ and *Dream11 Fantasy Sports Case*, but also disproportionately penalizes legitimate economic activities protected under Article 19(1)(g) of the Indian Constitution. By adopting a tiered

38. AIR 1996 SC 1153.

structure, policymakers can align the tax framework with the unique characteristics of different gaming formats.

Under this model, skill-based games could be taxed at a lower rate of 18%-20%, reflecting their legal recognition as legitimate businesses requiring strategic decision-making, memory, and expertise. This lower rate would promote industry growth and encourage compliance, particularly for platforms that provide skill-based gaming. Games of chance, such as lotteries, roulette, or slot machines, could continue to attract a higher tax rate of 28%, acknowledging their greater social and regulatory concerns due to the inherent risk of addiction and speculative behaviour. A middle tier could be introduced for hybrid games, which combine elements of skill and chance, with tax rates ranging between 22%-25%, depending on the predominance of skill. Such differentiation not only creates a fairer taxation system but also provides clarity for operators, reducing disputes and compliance burdens.

This tiered approach is supported by global practices, where countries like the United Kingdom and Malta have effectively implemented differentiated tax rates based on the nature of the gaming activity. By tailoring the tax rate to the specific characteristics of each gaming category, India can encourage innovation in skill-based gaming, protect consumers from over-taxation, and maintain a robust revenue stream for the Government. A tiered taxation structure also fosters a competitive ecosystem, enabling smaller operators to thrive while ensuring that high-risk games contribute proportionately to public revenue and regulatory costs. This nuanced framework would serve as a balanced compromise between revenue generation and fostering a sustainable, equitable gaming industry.

Conclusion

India's amended GST law for online gaming, while aimed at increasing revenue, has sparked significant debate. The uniform taxation on total deposits introduces challenges for operators and players alike, potentially hindering the sector's growth. By examining global practices, it is evident that a GGR-based taxation model, as adopted by countries like Malta, offers a balanced approach to fostering industry growth while ensuring revenue generation.

A re-evaluation of India's taxation framework, incorporating stakeholder feedback and global insights, is imperative to sustain the burgeoning online gaming sector. Policymakers must strike a balance between regulatory objectives and the industry's economic potential to ensure a thriving ecosystem.



No way out!: Addressing the Underlying Issues that Plague the Voluntary Delisting Process in India in light of Recent Amendments

Abstract

One of the most fundamental traits of a healthy stock market is a Company's ability to enter and exit freely. SEBI has consistently emphasized the importance of ensuring that companies are not trapped in the stock exchange if the majority opinion supports their delisting. However, successful delistings in India are still seen few and far between. In September 2024, SEBI, in an attempt to address these failures, introduced amendments to its delisting framework.

While the amendments were introduced with the intent of making the process of delisting easier for the acquirer, further scrutiny reveals the amendments to be mere procedural additions that serve as a fragile band-aid over deeper systemic issues that continue to undermine the effectiveness

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of the Delisting framework.

The watchdog has failed to resolve two primary challenges plaguing the Delisting framework- insufficient shareholder participation and disproportionate power exercised by minority shareholders. This is a result of SEBI overlooking the underlying cause of these challenges, the exorbitant delisting threshold that acts as an exit barrier for the often distressed companies. The authors seek to explore these underlying issues by (a) critically analyzing the current Delisting framework, identifying the key pitfalls and their root causes, and subsequently (b) comparing the Indian regulatory mechanism against the global watchdogs. Further, the authors pragmatically analyze the current framework to explore any redundancy in the provisions to arrive at holistic and feasible suggestions to address the underlying issues.

Introduction

One of the most fundamental traits of a healthy stock market is a company's ability to enter and exit freely. However, successful delistings in India are seen few and far between. Chief amongst the reasons for these failures is low shareholder engagement and the hyper-inflated discovery prices that act as defacto exit barriers for a Company seeking to Delist.

The relevance of these challenges is reflected in the stance of the Securities and Exchange Board of India ("SEBI")(1). SEBI has consistently emphasized the importance of ensuring that Companies are not trapped in the stock exchange if the majority opinion supports their delisting. This principle underscores the need for a framework that facilitates a smooth exit for companies while balancing the interests of all stakeholders.

In pursuit of this objective, SEBI introduced amendments to its delisting framework in September 2024 to overhaul the process and address key obstacles. These changes sought to simplify price discovery mechanisms and encourage greater shareholder participation.

However, deeper analysis casts doubt on whether these amendments truly address the root cause of the aforestated problems or merely serve as a fragile band-aid over deeper systemic issues.

The paper seeks to (a) examine the issues plaguing the current framework and conclusively

1. The SEBI was Constituted as a non-statutory body on April 12, 1988.

determine SEBI's exorbitant threshold for shareholder participation for delisting as being the underlying cause. Then, (b) explore this delisting threshold in greater detail and make a case for diluting the threshold to ensure a better balance between shareholder's interests and ease of exit for the acquirer.

The Importance of Facilitating Successful Delisting

Before delving into an analysis of the merits and shortcomings of India's delisting framework, it is essential to first establish the significance of delisting for companies and the compelling reasons that drive them to pursue this route.

Delisting is a vital strategic tool for companies. It allows firms to adapt to evolving market and regulatory environments, reduce financial strain, and focus on long-term objectives without the constraints of public market pressures.

Furthermore, delisting reduces the significant costs associated with compliance, auditing, and reporting, enabling companies to redirect resources toward growth-oriented activities such as innovation or market expansion.⁽²⁾ It also facilitates greater strategic flexibility, freeing management from the short-term demands of investors and allowing for bolder decisions aligned with the Company's long-term vision.⁽³⁾

Therefore, successful delisting provisions safeguard the company's survival and its ability to thrive in competitive and dynamic economic landscapes.

Consequences of a Failed Delisting

Failed delisting attempts create significant challenges for shareholders, acquirers, and the market. They erode shareholder confidence, heighten market volatility, and deter future delisting efforts. For example, Vedanta Limited's unsuccessful Delisting bid led to a 21% drop in stock price and increased shareholder skepticism.⁽⁴⁾

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2. Isabella Martinez, Stephanie Serve and Constant Djama, 'Reasons for Delisting and Consequences: A Literature Review and Research Agenda' (2005) 31(3) *Journal of Economic Studies* 733.
 3. Douglas Muyeche, 'Voluntary Delisting: The Reasons Behind' 3(1) *GJISS* 16; Securities and Exchange Board of India, 'Discussion Paper on Review of Delisting Regulations' (SEBI, 2014) <https://www.SEBI.gov.in/SEBI_data/attachdocs/1399633833837.pdf> accessed 26 December 2024; Mehran Hamid and Stavros Peristiani, 'Financial Visibility And The Decision To Go Private' Federal Reserve Bank of New York Staff Reports < https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr376.pdf > accessed 13 January 2025.
 4. Press Trust of India, 'Vedanta plunges almost 21% after Delisting 'fails'' *Hindustan Times* (New Delhi, 2020) < <https://www.hindustantimes.com/business-news/vedanta-plummets-nearly-21-after-Delisting-fails/story-pNFY4uTTAjyLIqIlixBYCJ.html> > accessed 2 January, 2025.

Additionally, failed delistings often reduce share liquidity and destabilize market presence, as seen in the Vedanta's case. These outcomes discourage participation in future delisting initiatives, compounding financial and reputational costs for companies.

To address all these aforesaid challenges and to prevent their effects being felt by companies operating in India, a robust delisting framework is critical. A well-structured framework not only mitigates risks but also fosters market stability, encourages participation, and ensures delisting efforts meet their objectives, promoting long-term growth.

Flaws within the Indian Delisting Framework

As mentioned before, delisting in India has been plagued by inefficiencies, with two primary factors—rejection of the discovered price by acquirers and insufficient tendering of shares by shareholders—collectively accounting for nearly 50% of all failures.⁽⁵⁾ In September 2024, SEBI introduced amendments to the delisting framework, aiming to address these challenges. Among these, two significant changes stand out: the introduction of the Fixed Price Offer (FPO) as an alternative to the Reverse Book Building (RBB) process and the reduction of thresholds for making counter-offers.

Fixed Price Offer (FPO) as an Alternative to Reverse Book Building (RBB)

The Reverse Book Building process, which had been the primary mechanism for determining the exit price in delisting, was often criticized for leading to unreasonably high prices due to the disproportionate influence of certain shareholders.⁽⁶⁾ To address this, SEBI introduced the Fixed Price Offer (FPO) as an alternative.⁽⁷⁾

Under the FPO Mechanism:

- The acquirer can set a predetermined price for the delisting offer.
- This price must include a 15% premium over the floor price calculated according to existing valuation norms.
- The FPO option purports to provide a simpler and more predictable method for price determination compared to RBB.

5. Yashasvi Mohanram, Vaishnavi Shankar and Niharika Rozwal, 'Voluntary Delisting Trends in India (2018-2023)' (Touchstone Partners, 9 January 2024) <<https://touchstonepartners.com/wp-content/uploads/2024/01/Voluntary-Delisting-Trends-in-India.pdf>> accessed 14 January, 2025.

6. Securities and Exchange Board of India, 'Discussion Paper on Review of Delisting Regulations' (SEBI, 2014) <https://www.SEBI.gov.in/SEBI_data/attachdocs/1399633833837.pdf> accessed 26 December, 2024.

7. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations 2021, Regulation 20A.

However, upon closer scrutiny the FPO model seems to present practical challenges related to the valuation of shares and participation of shareholders. The rigidity in determining a fixed price, combined with the strategic and financial considerations of the Delisting process, often results in significant misalignment between the expectations of Companies and Shareholders, the consequences of which are expanded upon below:

1. Risk of Under-Participation

The acquirers might set a fixed price that fails to reflect the true market value of the shares, or what seems to be more likely- a price that would meet the extravagant expectations of the shareholders. SEBI has previously noted the tendency of shareholders to overvalue the shares of a company, due to a lack of understanding of the complexities of valuation, often leading to excessively high bids in the RBB process.⁽⁸⁾

Shareholders may therefore perceive the offer price as too low and choose not to tender their shares, leading to insufficient participation.

This may be further exacerbated by the fact that unlike the counter offer mechanism prescribed for the RBB process there is no such means for subsequent negotiation of the discovery price to be made in the FPO process.⁽⁹⁾ Therefore, the possibility of a misalignment in the expectations of the acquirer and the shareholders is very high.

Moreover, as illustrated previously, a significant reason behind companies pursuing delisting is to alleviate the financial burden of remaining listed.⁽¹⁰⁾ These financial constraints increase the probability of offer prices that do not align with shareholder expectations being proposed. As a result, the likelihood of the fixed price being rejected increases significantly.

2. Risk of Deterrence from Overvaluation Pressure

While undervaluation poses one set of challenges, the stringent 90% threshold required for delisting (“Delisting threshold”) creates pressure to set excessively high prices.⁽¹¹⁾

The threshold makes it a mandate that an offer made for delisting of shares shall be deemed to be successful if the post offer shareholding of the acquirer, along with the shares tendered / offered by public shareholders accepted as eligible bids at the discovered price or

8. Securities and Exchange Board of India, ‘Discussion Paper on Review of Delisting Regulations’ (SEBI, 2014) <https://www.SEBI.gov.in/SEBI_data/attachdocs/1399633833837.pdf> accessed 26 December, 2024.

9. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations 2021, Regulation 22(4).

10. Douglas Muyeche, ‘Voluntary Delisting: The Reasons Behind’ (2015) 3(1) GJISS 16.

11. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations 2021, Regulation 21.

the counter offer price, as the case may be, reaches ninety percent of the total issued shares of that class.

In an attempt to ensure sufficient participation, acquirers may feel the pressure to overcompensate by offering prices well above the perceived value. For companies already grappling with liquidity issues, this approach imposes significant financial stress. The cost of meeting inflated price expectations can deter companies from attempting delisting altogether, even when it aligns with their strategic objectives.

The FPO model's challenges are rooted in its rigid pricing mechanism. The limitations in addressing the complexities of the delisting process are evident. Undervaluation risks arise when financially constrained companies set prices too low, while overvaluation risks emerge from the pressure to meet stringent thresholds. Both scenarios discourage participation and deter firms from pursuing delisting.

The Redundancy and Peculiarity of the Counter-Offer Amendment

Previously, the delisting framework allowed acquirers to make a counter-offer only if they achieved a post-offer shareholding of 90% of the total issued shares, including shares tendered by public shareholders.

With the amendment:(12)

- The threshold for making a counter-offer has been reduced.
- Acquirers can now proceed with a counter-offer if the post offer shareholding of the acquirer along with the shares tendered by the public shareholders reaches 75% of the issued share capital, provided that at least 50% of the public shareholding has been tendered.

The decision to lower the counter-offer threshold from 90% to 75% appears to lack the logical coherence necessary to address the challenges inherent in the delisting process. The counter-offer mechanism was introduced to provide acquirers with a means to negotiate when the discovered price from the reverse book-building (RBB) process was deemed unacceptably high or when the post-offer shareholding fell short of the required 90% threshold. (13)

12. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations 2021, Regulation 22(4).

13. Securities and Exchange Board of India, 'Review of Voluntary Delisting Norms Under SEBI (Delisting of Equity Shares) Regulations, 2021' (SEBI, 14 August 2023) <https://www.SEBI.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-review-of-voluntary-Delisting-norms-under-SEBI-Delisting-of-equity-shares-regulations-2021_75335.html> Accessed 7 January, 2025.

The problem lies in the fact that this lower threshold merely allows for the initiation of a counter-offer but does nothing to address the ultimate need to reach the 90% shareholding required for a successful delisting.

If the acquirer rejects the discovery price determined through the RBB process as too high, it is unlikely that a counter-offer—by design, a lower price—would convince shareholders to tender more shares. These shareholders had already set their valuation expectations higher than what the acquirer was willing to pay. On the other hand, if insufficient shares were tendered during the initial process, this reflects a lack of shareholder interest or dissatisfaction with the terms offered. Reducing the threshold to 75% to allow a counter-offer does not change this underlying reality, as the counter-offer would still have to overcome the significant challenge of reaching the 90% threshold for delisting.

While reducing the threshold for initiating a counter-offer to 75% may create the appearance of greater flexibility, it fails to address the central issue. This leaves the counter-offer mechanism as a procedural addition that is unlikely to produce meaningful results, rendering the amendment redundant in practical terms. It creates a superficial sense of progress but offers no substantive resolution to the actual challenges inherent in the Delisting process, that are responsible for the failing delisting offers.

The Underlying Cause of the Inefficient Framework- An Inordinate Delisting Threshold

As reiterated before, the major reasons for the failure of the delisting offer were the rejection of the discovered price by acquirers and the insufficient tendering of shares by shareholders.

A collective analysis of both the reasons for failure of the delisting offer depicts the high Delisting threshold as the common cause of failure of Delisting offers. Firstly, studies show that in the cases of failed Delistings due to insufficient tender in the Reverse Book Building process, the margin of failure was often very narrow, not exceeding more than three or four percent. This shows that despite there being a consensus among the public shareholders to delist, they were unable to do so due to disproportionate power being exerted by a relatively small fraction of the minority shareholders, due to the high delisting threshold.⁽¹⁴⁾

The inflated discovery price can be caused by a multitude of reasons, ranging from a tacit understanding between the bidding parties to an intentionally high bid by investors to take

14. Securities and Exchange Board of India, 'Discussion Paper on Review of Delisting Regulations' (SEBI, 2014) <https://www.SEBI.gov.in/SEBI_data/attachdocs/1399633833837.pdf> accessed 26 December, 2024.

advantage of the delisting process. However, all of these issues are enabled by a single underlying factor: the high delisting threshold. The threshold gives a segment of minority shareholders the confidence to assert influence over the delisting process, feeling empowered to place exceptionally high bids as they anticipate the unlikelihood of the delisting being successful without their participation.(15).

Thus, it can be seen that the failure of the delisting offers is directly related to high delisting threshold. This gives rise to a need for further analysis of the intent of SEBI and the objective need of the threshold, to determine whether there is a need for such a high threshold at all.

SEBI's Rationale behind the 90 percent Delisting Threshold

To understand the origin of the 90 percent threshold, one needs to study the history of Delisting Regulations in India. The first ever Regulations to govern Delisting in India were the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations in 1997 ("1997 Takeover Regulations").(16) This can be seen to be the origin of the 90 percent threshold in voluntary delisting. While not very comprehensive, it prescribed the delisting of a company arising from a fall in public holding to 10 percent or less as a result of a public offer.

Subsequently, the 1998 SEBI circular on the delisting of shares(17) was released, which did not prescribe any such threshold, but relied on compliance of the 1997 Takeover Regulations.

When read in the light of current Regulations, it can be observed that the reason the 90 percent threshold exists is due to the pre-existing guidelines on the listing of shares and other related subjects. This is further proved by the 2002 SEBI report on the Delisting of Shares(18).

The contention of the report was further elaborated in the Concept paper and Draft Regula-

15. Securities and Exchange Board of India, 'Review of Voluntary Delisting Norms Under SEBI (Delisting of Equity Shares) Regulations, 2021' (SEBI, 14 August 2023) <https://www.SEBI.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-review-of-voluntary-Delisting-norms-under-SEBI-Delisting-of-equity-shares-regulations-2021_75335.html> accessed 31st December, 2024.

16. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997.

17. Securities and Exchange Board of India, 'Circular: Amendment to Listing Agreement Delisting Committee' (SEBI, 2002) <https://www.SEBI.gov.in/legal/circulars/apr-1998/to-e-ds-presidents-m-ds-of-all-stock_exchanges_19474.html> accessed 5 January 2025.

18. Securities and Exchange Board of India, 'Report on Delisting of Shares' (SEBI, 2002) <https://www.SEBI.gov.in/web/?file=/SEBI_data/attachdocs/1293169754693.pdf#page=12&zoom=page-width,-22,105> accessed 24 December, 2024.

tions on Delisting of Securities for public comments released by SEBI in 2006⁽¹⁹⁾ highlighted a scenario where the securities would automatically get delisted if the public shareholding is reduced from the levels required to be maintained for the purpose of continuous listing. SEBI opined that this discrepancy could be misused by the companies seeking to delist. This would leave a significant residue of public shareholding behind, since getting compulsorily delisted does away with the mandate upon the acquirer to provide an exit option. Thus, SEBI was of the opinion that there needs to be a harmony between the provisions prescribing threshold for continuous listing, and the provisions laying down a delisting threshold.

Further, the 2006 paper⁽²⁰⁾ claimed that internationally, it is a generally accepted fact that a 10% level of public shareholding is a prudent level for a squeeze-out option to the acquirers whenever companies wanted to delist. This fact was again reiterated in the 2014 SEBI Discussion Paper on ‘Review of Delisting Regulations’⁽²¹⁾, where the authors described the 90 percent threshold as an internationally accepted standard.

Lastly, the conduct of SEBI makes it abundantly clear that SEBI has intentionally opted for an exorbitantly high threshold with an intent to protect minority shareholder’s interests. It can be seen that SEBI, in the past, has pushed the threshold even higher to ensure minority representation in the Delisting process.⁽²²⁾ One such incident was during the Delisting of UP Hotels Ltd, where following a SEBI order, the threshold in this increased from 90% to a little over 95%.⁽²³⁾ UP Hotels Limited had acquired a pre-delisting acquirer shareholding of over 87 percent, but had to meet the updated threshold post-SEBI order, which it failed to obtain.

Thus, it can be seen through an analysis of related legislations, SEBI’s reports and SEBI’s orders that the watchdog practices the 90% threshold for three major reasons:

1) To protect the interests of investors and ensure they have adequate representation in the Delisting process.

19. Securities and Exchange Board of India, ‘Concept paper and Draft Regulations on Delisting of Securities for public comments’ (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January, 2025.

20. Securities and Exchange Board of India, ‘Concept paper and Draft Regulations on Delisting of Securities for public comments’ (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January, 2025.

21. Securities and Exchange Board of India, ‘Discussion Paper on Review of Delisting Regulations’ (SEBI, 2014) <https://www.SEBI.gov.in/SEBI_data/attachdocs/1399633833837.pdf> accessed 26 December, 2024.

22. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations 2021, Regulation 42.

23. Order in the matter of U.P. Hotels Limited SEBI/WTM/GM/CFD/37/2019-20 Securities and Exchange Board of India, ‘Order in the matter of U.P. Hotels Limited’ (SEBI, 30 September 2019) <https://www.SEBI.gov.in/enforcement/orders/sep-2019/order-in-the-matter-of-u-p-hotels-limited_44530.html> accessed 15 December, 2024.

- 2) The reliance on the belief that a 90 percent threshold is the internationally accepted standard.
- 3) The threshold is in harmony with the other legislations on the subject matter. This prevents companies from circumventing the Delisting Regulations.

However, whether these reasons are sufficient to create a hindrance on the free exit of an enterprise is a question that is discussed hereunder.

Is the current delisting threshold, as claimed by SEBI, in line with international norms?

As discussed earlier, SEBI claims that the threshold laid down in the Delisting Regulations(24) is in line with international standards. However, the consultation paper by the watchdog does not elaborate on the same. Moreover, an analysis of some of the most prominent jurisdictions globally reveals a contrasting picture when compared to India.

For the comparative study, the authors in this section analyze two international jurisdictions: the United States of America and Singapore respectively. The United States has the oldest and most robust delisting mechanism, which has evolved with the help of multiple studies over the years.(25) On the other hand, the Singapore Delisting procedure is significant to the study because of its close resemblance to the current Indian model.

The USA model

The United States Delisting provisions are laid down in the Section 12(d) of the Securities Exchange Act, 1934. The law states that any security registered with the National Securities Exchange can be withdrawn from listing and regulation in accordance with the terms that the Securities Exchange Commission deems necessary. The Commission has adopted Rule for removal of listing and Regulation.(26) The rule makes it mandatory that the issuer comply with all the applicable state laws for the delisting process.

24. Securities and Exchange Board of India, 'Concept paper and Draft Regulations on Delisting of Securities for public comments' (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January 2025.

25. Shinhua Liu, John D. Stowe and Ken Hung, 'Why U.S. Firms Delist from the Tokyo Stock Exchange: An Empirical Analysis' (2012) 24 IREF 62-70 <<https://doi.org/10.1016/j.iref.2011.12.001>> accessed 2 January, 2025; Jonathan R. Macey and Maureen O'Hara 'The Economics of Stock Exchange Listing Fees and Listing Requirements' (2002) 11(3) Journal of Financial Intermediation 297.

26. Virginia Bank shares, Inc. v. Sandberg [1991] 501 US 1083.

For the purpose of this paper, the authors have limited the analysis of the laws to the state of Delaware, since two-thirds of the Fortune 500 and half of all publicly traded corporations are incorporated in Delaware.⁽²⁷⁾ The state has since developed a robust securities mechanism that has been adopted by other States as well. A preliminary analysis of the Regulations gives a picture that the State follows a very liberal approach on the Delisting norms, ensuring that free entry and exit opportunities are given primary importance.

The process is preceded by a going private transaction. This process intends to bring down the number of security holders below the thresholds described in the Securities Exchange Act.⁽²⁸⁾

The most common going private transaction is a Freezeout merger⁽²⁹⁾, where the target corporation (the entity going private) merges with a wholly owned subsidiary (the acquirer). As per the Delaware General Corporate Laws, the transaction is initiated by a resolution of each board of the two constituent corporations. The shareholders vote on the board of the target corporation, where the required majority for approval is limited to the majority of all the shares that are not directly or indirectly held by the acquirer (outstanding shares). The merger can be a one-step or a two-step process, but the offer is contingent on reaching the necessary percentage, which, as discussed above, is 50 percent of the outstanding shares.

Other going private transactions include a reverse stock split, where the number of existing shares is consolidated into fewer shares, or a sale of all assets of the target company to the wholly owned subsidiary. What should be noted is that both the processes require only a simple shareholder majority vote.⁽³⁰⁾ Moreover, a specific outside public shareholder approval is not a mandate for the delisting.⁽³¹⁾

Thus, it can be seen that the US Regulations put much effort into optimizing the Delisting process. Following the judgment of the Delaware Supreme Court in *Weinberger v. UOP*⁽³²⁾, the only standards that need to be held in the going private transaction are that of entire fairness. “Fairness” in this context, is defined as a combination of fair dealing and fair price. The minority shareholder’s interests are represented by an independent committee that negotiates the going private transaction. Moreover, there exist tools such as appraisal of

27. William J. Moon, ‘Delaware’s Global Competitiveness’ (2021) 106 ILR 1683, 1693.

28. Securities Exchange Act 1934, Ss. 12(g) and 15(d).

29. Elif Dalkir, Mehmet S. Dalkir and Doron Levit, ‘Freeze-Out Mergers’ [2018] HLSFCG <<https://corpgov.law.harvard.edu/2018/09/25/freeze-out-mergers/>> accessed 2 January 2025.

30. Delaware General Corporation Law, S. 102(4) and S. 27.

31. Jesse M. Fried, ‘Firms Gone Dark’, (2009) 76 U. CHI. L. REV. 142.

32. *Weinberger v. UOP, Inc* [1983] 457 A.2d 701, 715.

offered price⁽³³⁾ or the business judgment rule⁽³⁴⁾ that enable the Delaware Courts to adjudicate the fairness of the price offered to minority shareholders. However, they are not given powers that might allow them to manipulate the offer prices for the purpose of delisting.

It is evident that the ease of exiting the stock market, as guaranteed by US Regulations, has led to a high number of successful delisting offers. However, it would be unfair to compare the US regulations to the Indian Delisting Mechanism, owing to the stark differences between the two. These differences are predicated upon the basic principles that shape the ethos of both the jurisdictions. While the US gives a lot of value to optimizing the delisting process, SEBI has time and again laid emphasis on the need to protect public shareholders' rights.

Thus, it becomes equally important to analyse the Indian Model to a regulator that shares the same principles, such as the Singapore Delisting Regulations, which mirror the Indian approach in terms of the price determination procedure, and a certain degree of reliance on thresholds to ensure shareholder representation.

The Singapore Model

Singapore governs the delisting through regulations laid down in the Companies Act of 1967.⁽³⁵⁾ As per the norms, the Delisting resolution must be approved by at least a 75 percent majority of the total number of shares issued.⁽³⁶⁾ Moreover, a fair and reasonable exit alternative must be offered.⁽³⁷⁾ The listing company appoints an Independent Financial Officer to determine the fairness of the exit offer.⁽³⁸⁾ Furthermore, the consent of Singapore Exchange Limited and the Court is necessary to make the Delisting Resolution.⁽³⁹⁾

Singapore also offers a voluntary offer mechanism where the acquirer may launch a take-over bid, which, if accepted by at least ninety per cent of the shareholders, allows the Listed Company to apply to be delisted.⁽⁴⁰⁾ This alternative allows them to bypass the fair offer requirement, and the offer price is deemed to be the highest in the last three to six months, depending on facts and circumstances.⁽⁴¹⁾ This process also bypasses any requirement for the acquirer to have any additional SGX or Court clearance.⁽⁴²⁾

33. Delaware General Corporation Law, S. 262(b)(2).

34. Kahn v. M&F Worldwide Corp. [2011] 88 A.3d 635.

35. Companies Act, 1967.

36. Companies Act, 1967, S. 210(3).

37. Companies Act, 1967, S. 210.

38. Companies Act, 1967, S. 210(10B).

39. Companies Act, 1967, S. 212.

40. Companies Act, 1967, S. 215(1).

41. Companies Act, 1967, S. 215(1).

42. Companies Act, 1967, S. 215.

While the Singapore Delisting Model does seem to reflect similarities with the current Indian Delisting mechanism since they provide an alternative to choose between what appears to be a “fixed price mechanism” and another voluntary offer mechanism, there exist clear differences in the approach of the two jurisdictions. The Singaporean Delisting Model clearly does not rely on the Delisting Threshold to be the primary safeguard of the interests of the shareholders, while there exist thresholds to ensure that the procedure is not unilateral, they are not so unrealistic that they act as exit barriers, preventing the enterprise from exiting at their own accord.

The difference is quite apparent, and with the Delisting trends of Singapore showing signs of a healthy stock market⁽⁴³⁾, it becomes apparent that the Indian watchdog needs to revamp its procedure to attain global standards.

Whether the Delisting threshold is an adequate safeguard for the shareholder’s interests?

The watchdog claims that the exorbitantly high threshold is to ensure that the shareholders’ rights are not violated during the Delisting process.⁽⁴⁴⁾ The rights in question, based on International Jurisprudence⁽⁴⁵⁾ and SEBI’s consultation papers⁽⁴⁶⁾ can be categorised into fair representation (i.e. shareholders must not unilaterally decide to delist without shareholder approval) and fair price (that the shareholders must be adequately compensated for their shares). The current regulatory mechanism relies heavily on the offer price determination processes (i.e., the fixed price mechanism or the RBB process) to safeguard shareholders’ interests. However, it can be seen that the Delisting Regulations provide shareholders with sufficient safeguards to ensure the preservation of their interests, as discussed hereunder.

Regulations to ensure fair representation of shareholders in the Delisting process

Shareholders’ interest in being represented in the Delisting process has to be protected to ensure that the enterprise does not unilaterally decide to delist without taking into account

43. Yichun Zhao, ‘The Delisting Trends and the Significance of a Healthy Stock Market’ [2023] AEBMR 253 <<https://www.atlantis-press.com/article/125989903.pdf>> accessed 5 January 2025.

44. Securities and Exchange Board of India, ‘Concept paper and Draft Regulations on Delisting of Securities for public comments’ (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January 2025.

45. Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983). Virginia Bankshares, Inc v. Sandberg [1991] 501 US 1083.

46. Securities and Exchange Board of India, ‘Concept paper and Draft Regulations on Delisting of Securities for public comments’ (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January 2025.

the desire of the shareholders. One of the most important safeguards to ensure that shareholders are made a part of a decision to delist is given in the Securities Contracts (Regulation) Rules, 1957 (hereafter referred to as SCRR).(47) The norms mandate that every listed entity will maintain a minimum public shareholding of 25 percent. This makes sure that the acquirer alone does not have sufficient powers to unilaterally enforce Delisting.

Moreover, the participation of a sufficient number of public shareholders is ensured by a mandate to obtain the approval of the shareholder through a special majority(48). Moreover, this special resolution too can be acted upon only if the votes cast by public shareholders in favour of the proposal are at least two times the number of votes cast by the public shareholders against it.(49) Thus ensuring that the Delisting process cannot proceed further without a certain number of public shareholders being on board with the idea of Delisting. Lastly, it is well within the powers of SEBI to increase the Delisting threshold in the interest of shareholders under Regulation 40 of the Delisting Regulations(50). It has already been seen in the case of UP Hotels Delisting(51) , where the watchdog set an additional requirement for the acquirer to acquire approximately 6.9 percent of additional public shares to deem the offer successful.

Lastly, to ensure that the acquirer does not circumvent the requirements, the Regulations mandate appointment of a Peer reviewed Company Secretary(52) , as well as an independent merchant banker as a manager to the office.(53) The independent merchant banker supervises the entire delisting process after the announcement(54). In order to be included in the Delisting threshold, the shareholders have to mandatorily get a certificate from the Company Secretary.(55)

Hence, it can be concluded that sufficient safeguards exist to ensure that adequate representation is granted to the public shareholders.

47. Securities Contracts (Regulation) Rules, 1957, Regulation 19.

48. Securities and Exchange Board of India (Delisting of Equity Shares) Regulation, 2021, Regulation 11(1).

49. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 11(4).

50. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 40.

51. Securities and Exchange Board of India, 'Order in the matter of U.P. Hotels Limited' (SEBI,30 September 2019) <https://www.SEBI.gov.in/enforcement/orders/sep-2019/order-in-the-matter-of-u-p-hotels-limited_44530.html> accessed 15 December 2024.

52. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 10(2).

53. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 9.

54. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 9.

55. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021, Regulation 21.

Regulations to ensure fair compensation to shareholders

Following the 2024 Amendments⁽⁵⁶⁾, adequate safeguards have been introduced to protect the interests of minority shareholders while granting them exit opportunities. Firstly, to prevent an acquirer from timing the Delisting process when the market is down, the floor price cannot be less than the higher of:

(a) volume weighted average price during 52 weeks prior to the reference date or the highest price during 26 weeks prior to the reference date.

(b) adjusted book value based on consolidated financials determined by an Independent Registered Valuer (“Valuer”);

(c) volume weighted average market price of 60 trading days prior to the reference date on the stock exchange with maximum trading volume if the shares are frequently traded; and

d) the price determined by a Valuer based on various valuation parameters if the shares are infrequently traded.⁽⁵⁷⁾

This ensures the fair compensation of the shareholder during the Delisting process. Moreover, for the purpose of determining floor price, the reference date has been associated with the initial announcement made to the public by the Acquirer.⁽⁵⁸⁾ This preparation of the reference date acts as a safeguard against any speculative trading and aligns the floor price more closely with the market conditions.

Lastly, if the acquirer adopts a fixed price mechanism, the amended Regulation 19A⁽⁵⁹⁾ mandates the acquirer to offer a minimum of 15 percent premium over the floor price, ensuring fair compensation to the shareholders.⁽⁶⁰⁾

Thus, it can be seen that there are sufficient safeguards to ensure that adequate compensation is offered to the shareholders as well.

56. Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024.

57. Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024, Regulation 19A.

58. Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024, Regulation 19A.

59. Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024, Regulation 19A.

60. Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2024, Regulation 20A.

From the analysis of the Delisting Regulations in India, it can be seen that the safeguards provided in the Delisting Regulations are adequate. Qualitatively, they are in line with international standards including likes of Singapore Regulations, that have been acclaimed for maintaining a healthy stock market. Therefore, over-reliance on the high Delisting Threshold to protect the shareholders' interests is redundant and in fact, counter-productive. Thus, the threshold can be lowered to a reasonable percentage without hampering shareholder's rights.

Whether the Current Delisting Threshold is Harmonious with the Other Existing Regulations?

SEBI has rightfully opined that there must be harmony in the regulations for continuous listing and for voluntary Delisting.(61) However, closer scrutiny into the current framework reveals that SEBI has been unsuccessful in enforcing the same. Therefore, SEBI's claim that the 90% Delisting Threshold is consistent with current Regulations is misguided.

As per the SCR Rules, 1957,(62) a company must maintain a minimum public shareholding of 25% to remain listed. If public shareholding falls below this threshold, the company may be subject to mandatory Delisting.(63) However, for voluntary Delisting, the Delisting Regulations require acquirers to reduce public shareholding to just 10%.(64)

If 25% is regarded as the minimum level of public shareholding necessary to uphold public participation and liquidity,(65) it is inconsistent and counter-intuitive to mandate a steeper reduction in public shareholding for delisting. This disparity between the thresholds highlights a lack of co-herece between the foundational principles under-pinning public shareholding requirements and the framework governing voluntary Delisting.

Reference to Counter-Offer Mechanisms

In previous sections, we examined the procedural inconsistencies arising from the reduction of the counter-offer threshold to 75%, particularly highlighting its redundancy in the context of the 90% Delisting Threshold. In this section, we shift our focus to analyzing the conceptual inconsistencies introduced by this amendment.

61. Securities and Exchange Board of India, 'Concept paper and Draft Regulations on Delisting of Securities for public comments' (SEBI, 2006) <https://www.SEBI.gov.in/reports/reports/nov-2006/concept-paper-and-draft-regulations-on-Delisting-of-securities-for-public-comments_10830.html> accessed 3 January 2025.

62. Securities Contracts (Regulation) Rules, 1957.

63. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021.

64. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021.

65. Department of Economic Affairs, 'Requirement of Public Holding for Listing' (Department of Economic Affairs) <<https://dea.gov.in/requirement-public-holding-listing>> accessed 15 January 2025.

The pre-amendment 90% threshold for a counter-offer in the Delisting process was designed to signal that there was sufficient shareholder backing for the Delisting to move forward, ensuring the process was close to completion.⁽⁶⁶⁾ It acted as a clear indication that the Delisting had enough support and that the acquirer could proceed with further negotiations or a counter-offer. However, this high threshold often resulted in failed Delisting attempts, even when a majority of public shareholders had already tendered their shares, which in turn led to in-efficiencies and discouraged Delisting efforts.

SEBI's decision to lower the threshold for a counter-offer to 75%, while still requiring that at least 50% of the public shareholding be tendered, is a reflection of a shift in understanding of what constitutes sufficient shareholder support.

This adjustment acknowledges that 75% approval reflects robust shareholder backing, strong enough to justify moving forward with Delisting. By aligning the counter-offer mechanism with this revised threshold, SEBI has effectively recognized the feasibility and fairness of using 75% as a decisive indicator. This serves as a compelling precedent for our proposal to make Delisting successful at the same 75% threshold, promoting consistency and efficiency within the regulatory framework.

Diluting the Delisting Threshold - The Way forward

A preliminary inquiry into the rationale behind this high Delisting Threshold depicts SEBI's misplaced reliance on the Delisting Threshold to act as a safeguard for the public shareholders. This practice is not in line with the most effective regulators globally and runs contrary to the trends of a healthy stock market.

The Delisting Threshold is inconsistent with other domestic regulations that govern the listing of a company, including the Securities Contracts (Regulation) Rules. Moreover, it pragmatically makes the recently amended counter offer threshold obsolete, thus failing to make the process more efficient, which the watchdog had intended.

It must be highlighted that there exist sufficient safeguards to protect the interests of the shareholders. These safeguards are equipped to uphold the right of a company to enter and exit the market freely, while ensuring that the shareholders receive fair representation and compensation in the Delisting process.

66. Securities and Exchange Board of India, 'Review of Voluntary Delisting Norms Under SEBI (Delisting of Equity Shares) Regulations, 2021' (SEBI, 14 August 2023) <https://www.SEBI.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-review-of-voluntary-Delisting-norms-under-SEBI-Delisting-of-equity-shares-regulations-2021_75335.html> accessed 31st December 2024.

In light of the above-mentioned reasons, it appears reasonable to dilute the Delisting Threshold down to 75 percent, a figure which, as stated previously, is far more cohesive with existing regulatory practices. As we have already proven, such a measure will significantly contribute to increasing the success rates of Delisting. Therefore, aligning SEBI's Regulations with its stated objective of fostering an environment where no company is forced to remain listed against its will. Furthermore, minority shareholders are unlikely to be negatively affected by this dilution, given the plethora of aforestated safeguards already in place to protect their interests.

It becomes important to highlight that the authors do not advocate completely doing away with the Delisting Threshold as a safeguard for the public shareholder's interests. The watchdog, as mentioned earlier, is empowered to increase the threshold to ensure public shareholders' welfare should the need arise. However, the authors believe that it is in the overall welfare of the free market if such a power is used as an exception and not the norm.

Without this fundamental alteration in the way SEBI views Delisting in India, success rates are unlikely to improve, and the recent amendments will likely remain ineffective in achieving their intended purpose.



The Need of Sector-Specific Insolvency Framework For Aviation Sector: Building upon the Lessons Learned from the Insolvency of Go Air and Jet Airways



Abstract

The Indian aviation sector, while poised for significant growth, has been plagued by the insolvency of major airlines like Jet Airways and Go First Airline. These instances of insolvency have not only interrupted air travel and impacted various stakeholders, but they also demonstrate major shortcomings in the current insolvency framework. The present framework has proven insufficient in addressing the aviation industry's specific challenges, which are marked by distinct economic demands, regulatory needs, and operational complexities. The complexities of managing airline operations, combined with variable demand and external shocks such as economic downturns and worldwide pandemics, have intensified the challenges that these airlines face. As a result, the existing insolvency regime's incapacity to adequately manage these problems has resulted in severe financial dis-

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tress and, eventually, the failure of important participants in the sector. This study delves into the impact of insolvency of airlines and examines the challenges faced by the airline industry during insolvency proceedings. It also proposes sector specific reforms to the insolvency framework to prevent such outcomes in the future. By implementing these reforms, India can create a more conducive environment for the aviation industry and promote the sector's long-term health.

Keywords

Airlines, Aviation Market, Stakeholders, Liquidation, Sector-specific needs, Sectoral Approach.

Introduction

The aviation sector is one of the key sectors of a country.(1) The aviation sector bolsters tourism and international business through its transportation network.(2) A well-developed aviation market of a country indicates its economic strength, infrastructure development, connectivity, and its integration with global trade and tourism agreements.(3) The market trends in the global aviation market indicate that the demand for air services will increase by an average 4.3% per annum over the next 2 decades.(4)

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1. Air Transport Action Group, 'Aviation Benefits Beyond Borders, 2024' (Aviation Benefits, 5 December 2024) <<https://aviationbenefits.org/downloads/aviation-benefits-beyond-borders-2024/>> accessed 23 January 2025.
 2. Julie Perovic, The Economic Benefits of Aviation and Performance in the Travel & Tourism Competitiveness Index, (The Travel & Tourism Competitiveness Report 2013, World Economic Forum) ch 1.4, 57.
 3. Milan Janic, 'Aviation and Externalities: The Accomplishments and Problems' (1999) 4 Transportation Research Part D: Transport and Environment 159-180 <[https://doi.org/10.1016/S1361-9209\(99\)00003-6](https://doi.org/10.1016/S1361-9209(99)00003-6)> accessed 23 January 2025.
 4. International Civil Aviation Organization, 'The Future of Aviation' <[https://www.icao.int/Meetings/FutureOfAviation/Pages/default.aspx#:~:text=The%20most%20recent%20estimates%20 suggest,GDP%20to%20the%20world%20economy](https://www.icao.int/Meetings/FutureOfAviation/Pages/default.aspx#:~:text=The%20most%20recent%20estimates%20suggest,GDP%20to%20the%20world%20economy)> accessed 23 January 2025.

The Indian airline sector is also poised for an expansion, with airlines placing orders for over 1500 aircraft and predicted demand for 2,200 aircraft by 2042.⁽⁵⁾ Over the past years, the Indian aviation sector has seen substantial growth and is poised to have a progressive future.⁽⁶⁾ However, in recent times, the insolvencies of airlines have plagued the Indian aviation market.⁽⁷⁾

This came as a result of the major airlines i.e. Go Airlines (India) Limited (“Go air”) and Jet Airways India Limited (“Jet Airways”) getting a setback.⁽⁸⁾ Jet Airways encountered a liquidation order in the case of State Bank of India & Ors. v. The Consortium of Murari Jalan and Florian Fritsch & Anr⁽⁹⁾ (“Jet Airways liquidation judgment”), which was subsequently followed by Go Air’s liquidation order issued in January 2025.⁽¹⁰⁾

The tragic end of both airlines has raised many questions with regard to the economic viability of the resolution plan and airline business. The liquidation of both airlines has affected the stakeholders associated with the distressed asset and had a major impact on the aviation sector. The Jet Airways liquidation judgment has highlighted the inefficiency present in the current legal framework and pointed out the need to improve the current resolution landscape.⁽¹¹⁾ The insolvency of Go air has also highlighted the need for a change in the current insolvency framework to balance the interest of the aircraft owners, Corporate Debtor (“CD”), and all other stakeholders associated with the airlines.

In light of the above discussion, Part II of the paper delves into the question of why the insolvency framework needs to adapt to the sector-specific needs related to the aviation sector. Part III examines the various challenges the airline sector faces, which have in-

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5. Department of Economic Affairs, ‘Economic Survey 2023-24’ in Chapter 2: Monetary Management and Financial Intermediation: Stability is the Watchword, Part V: Trends in Indian Capital Markets (2024) 72, para 2.91. (“Economic Survey 2023-24”).
 6. Santosh Kumar, Sarla Meena and Aswathy Nair, ‘India’s Soaring Skies with Inclusive and Booming Aviation’ (Press Information Bureau, 15 September 2024) <<https://pib.gov.in/PressNoteDetails.aspx?NoteId=152143&ModuleId=3®=3&lang=1>> accessed 24 January 2025.
 7. Economic Survey 2023-24 (N 5) para 2.91.
 8. Dhramil Doshi, ‘Tackling India’s Airline Insolvency with Aviation Financing Reforms’ (Observer Research Foundation, 10 February 2024) <<https://www.orfonline.org/expert-speak/tackling-india-s-airline-insolvency-with-aviation-financing-reforms>> accessed 23 January 2025.
 9. SBI v. Consortium of Murari Lal Jalan & Florian Fritsch, AIROnline 2024 SC 864 (“Jet Airways Judgment”).
 10. ‘NCLT Orders Liquidation of Go First Airways’ (Economic times, 21 January 2025) <<https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/nclt-orders-liquidation-of-go-first-airways/articleshow/117387536.cms?from=mdr>> accessed 23 January 2025.
 11. Jet Airways Judgment (N 9) para 166.

creasingly driven entities towards liquidation. Part IV seeks to conceptualize the sector-specific amendments required under the IBC to prevent such outcomes. It evaluates the necessary reforms to the current insolvency framework and proposes an alternative approach tailored to India's need. The research concludes by comprehending the future pathway for the Indian aviation industry.

Why Insolvency Framework Need To Adapt Sector Specific Needs?

The Insolvency and Bankruptcy Code of 2016 (“IBC”)(**12**) was implemented with the objective of resolving the financial distress asset in a time-bound manner.(**13**) To achieve this objective, IBC provided a one-all compassing strategy, i.e., Corporate Insolvency Resolution Process (“CIRP”).(**14**) However, this strategy has failed in the context of the Aviation Industry.(**15**) The experience from the insolvency of Jet Airways and Go Air has shown that there is a need for sector-specific amendments for the following reasons:

i. The distinctive nature of the airline business.

The airline business is one of the most complex and high-risk-taking businesses.(**16**) In the last two decades more than 15 airlines went defunct and insolvent.(**17**) The insolvencies in the aviation sector can be perceived as a reflection of airline company's financial risks and operational challenges. Airlines like the Air Deccan, Kingfisher, Air Saharan, Jet Airways, and Go Air in recent years have either stopped or have been declared insolvent.(**18**) This is due to the distinct features that an airline possesses.

12. Act No. 31 of 2016.

13. Ministry of Finance, ‘The Report of the Bankruptcy Law Reforms Committee’ (2015), para 3.4.1.

14. Rebeca Parry and Neeti Shikha, ‘A Sectoral Approach to Insolvency Law’ in Evolution of Indian Insolvency Ecosystem and way forward, (IBBI and British High Commission, 2024) 160. (“Rebeca Parry and Neeti Shikha”)

15. Reuters, ‘India’s Airline Industry Needs to Clarify Insolvency Laws, Says ACG’ (Business Standard, 01 February 2024) <https://www.business-standard.com/industry/news/india-s-airline-industry-needs-to-clarify-insolvency-laws-says-acg-124020100050_1.html> accessed 23 January 2025.

16. S. Verma and S. Shome, ‘Assessing Airline Bankruptcy in India’ in A. K. Mishra, V. Arunachalam, S. Mohapatra, and D. Olson (eds), *The Financial Landscape of Emerging Economies: Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application* (Springer, Cham 2020) <https://doi.org/10.1007/978-3-030-60008-2_10> accessed 19 January 2025.

17. Business Today, ‘Go First Latest Airlines to Go Bankrupt: Here’s a List of Air Carriers That Went Bust in the Past’ (Business Today 3 May 2023) <<https://businesstoday.in/industry/aviation/story/gofirst-latest-airlines-to-go-bankrupt-heres-a-list-of-air-carriers-that-went-bust-in-the-past-379829-2023-05-03>>accessed 23 January 2025.

18. *ibid.*

Firstly, the airline business is associated with high fixed and operational costs.**(19)** According to the World Air Transport Statistics (“WATS”), a sizeable 28.7% of airline expenses are related to aircraft fuel, underscoring the huge influence of fuel prices on operating costs.**(20)** Meanwhile, amortization and depreciation account for 9.1%, closely followed by flight crew wages and costs (8.6%).**(21)**

In addition to these, for running an airline business, there is a need for high labour, and generally, they have a payroll cost and other costs such as the airport slot cost and ground equipment, etc.**(22)** During insolvency, it’s possible that the CD cashflows have completely dried up or are insufficient to cover these expenses, this makes it difficult for the CD to sustain its operations during insolvency.**(23)**

Secondly, the airline industry is prone to external shocks.**(24)** The market demand and elasticity have a major impact on the airline industry.**(25)** In addition to this external oil prices also have major impact on the airline business. In case of a sudden oil price rise or low demand, the likelihood of the airline encountering a financial crunch would increase, which may also lead to insolvency.**(26)** As in the case of Jet Airways, which encountered insolvency due to oil shock.

In the year 2008, the world suffered from a global oil price rise which effected the financial stability of Jet Airways. Vinod Dubey, CEO of Jet Airways, said, “The rise in the price of

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19. M. A. Camilleri, ‘The Airline Business’ in *Travel Marketing, Tourism Economics and the Airline Product* (Springer Nature 2018) 167-177.
 20. International Air Transport Association, ‘Unveiling the Biggest Airline Costs’ (IATA Knowledge Hub, 4 June 2024) <<https://www.iata.org/en/publications/newsletters/iata-knowledge-hub/unveiling-the-biggest-airline-costs/>> accessed 23 January 2025.
 21. *ibid.*
 22. Agarwal, A, ‘Airline Industry Has Had a Bad Century Since the Wright Brothers: 3 Reasons Why It Is a Tough Business’ (Economic Times, 8 April 2023)<https://m.economictimes.com/markets/stocks/news/airline-industry-has-had-a-bad-century-since-the-wright-brothers-3-reasons-why-it-is-a-tough-business/amp_articleshow/99313287.cms> accessed 23 January 2025.
 23. Stephen A. Ross, Randolph W. Westerfield, and Jeffrey F. Jaffe, *Corporate Finance*, ch. 30, 1038-1042, (McGraw-Hill Education., 10th ed. 2013).
 24. N. Blampied and S. M. R. Mahadeo, ‘Airline Industry Equities Under External Uncertainty Shocks’ *Economics Letters* (2024) 244 111994 <<https://doi.org/10.1016/j.econlet.2024.111994>> accessed 23 January 2025.
 25. J. Cho, J F O’Connell, B. Kim, and H. Shin, ‘The Impact of Political Conflicts on Airline Performance’ *Annals of Tourism Research* (2023) 103 103648 <<https://doi.org/10.1016/j.annals.2023.103648>> accessed 23 January 2025.
 26. A. Liu, Y. R. Kim, and J F O’Connell, ‘COVID-19 and the Aviation Industry: The Interrelationship Between the Spread of the COVID-19 Pandemic and the Frequency of Flights on the EU Market’ *Annals of Tourism Research* (2021) 91 103298 <<https://doi.org/10.1016/j.annals.2021.103298>> accessed 23 January 2025.

Brent fuel, a depreciating rupee, and a resulting mismatch between high fuel prices and low fares have adversely impacted the Indian Aviation Industry, including Jet Airways.”(27)

Additionally, during this period, the market competition increased, and their market share went low. As a result, the debt of Jet Airways rose to a very significant level, which led to a cash deficit in the company.

From the above discussion, it has been clear that the airline business has a high fixed and operational cost and is also prone to external shock. As it is very difficult to run the airline business in the ordinary course of time, thus sustaining it as a going concern during insolvency becomes challenging, as the company is not able to sustain its operation because of the low liquidity.

ii. The resolution process of airlines has concluded with liquidation

One of the objectives of IBC is to resolve the distressed asset and keep liquidation as a last resort. However, this is not the case in the aviation industry. The two major airlines which entered CIRP have concluded with liquidation. In addition to it, the resolution time also crossed 330 days.

In the case of Go Air, the company was admitted to insolvency on May 10, 2023.(28) During the CIRP, the CD was a part of multiple litigation and faced other severe challenges due to which there was a substantial delay in the resolution.(29) This led to erosion of the value of the CD, and ultimately, it ended up with a liquidation order.

Similarly, in the case of Jet Airways, the CIRP was initiated in 2019 and the resolution plan was then approved by the Committee of Creditors (“CoC”) in 2020. Thereafter, issues relating to non-payment by the successful resolution applicant (“SRA”) and the CoC changing its mind led to prolonged litigation, ending with a liquidation order dated 7th November 2024.(30)

27. K. Ghosh, ‘Jet Airways Posts Another Loss in First Quarter, Plans Turnaround’ (Quartz, 28 August 2018) <<https://qz.com/india/1371139/jet-airways-posts-another-loss-in-first-quarter-plans-turnaround>> accessed 23 January 2025.

28. ET Online, ‘NCLT Orders Liquidation of Go First Airways’ (Economic Times, 20 January 2025) <<https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/nclt-orders-liquidation-of-go-first-airways/articleshow/117387536.cms?from=mdr>> accessed 23 January 2025.

29. S.N. Thyagarajan, ‘Go First Case: IRP Argues Delhi HC Can’t Decide on Aircraft Lessor’s Plea’ (Moneycontrol, 30 May 2023) <https://www.moneycontrol.com/news/trends/legal/go-first-case-irp-argues-delhi-hc-cant-decide-on-aircraft-lessors-plea-10701311.html> accessed 23 January 2025.

30. Jet Airways Judgment (N 9).

The liquidation of the major airlines has raised various questions regarding the viability of the resolution plan and resolution process. The liquidation of major airlines has not only affected the various stakeholders associated with the CD but it has had an adverse impact on the Indian aviation market as well.

iii. The impact of insolvencies on the aviation market

Over the past several years, the Indian aviation sector has seen a marked decline in the number of operating carriers.**(31)** This has been driven by multiple factors, including high structural costs, regulatory burdens, and the misapplication of business models designed for Western markets.**(32)** The insolvency of carriers such as Jet Airways and others has resulted in an industry that is now increasingly dominated by just two players that is IndiGo and the newly consolidated Air India group, which, under the financial backing of the Tata conglomerate, has absorbed AirAsia India, Vistara, and Air India Express.**(33)**

*Figure 1: The Depiction of the Airline Market in the FY 2023-24 at Page No. 76.***(34)**

Together, these two companies now control nearly 80%-90% of the domestic air travel market, positioning the Indian skies for a potential duopoly.**(35)** The recent market trends in the Indian aviation sector indicate a duopoly that could be dominated by IndiGo and Air India, with IndiGo holding more than 60% of the market share.**(36)** Air India, following its recent consolidation, carried 2.56 crore passengers during the same period, and together, they accounted for 8.5 crore of the 10 crore total passengers in the Indian aviation market.

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31. Arshad Khan, 'Hits and Misses of Aviation Sector in 10 Years' (The New Indian Express, 26 May 2024) <<https://www.newindianexpress.com/business/2024/May/26/hits-and-misses-of-aviation-sector-in-10-yrs#:~:text=In%20the%20last%205%20years,emergence%20of%20two%20strong%20players>> accessed 18 January 2025.
 32. B. Behera, 'Indian aviation industry: issues and challenges in post-reform era' (2016) 3(2) Splint International Journal of Professionals 58.
 33. Manu Balachandran, 'Between Air India and IndiGo, India's Skies Are Headed for a Duopoly: What's This New Reality?' (Forbes India, 21 September 2023) <<https://www.forbesindia.com/article/take-one-big-story-of-the-day/between-air-india-and-indigo-indias-skies-are-headed-for-a-duopoly-whats-this-new-reality/88431/1>> accessed 18 January 2025. ("Manu Balachandran").
 34. Directorate General of Civil Aviation, Handbook on Civil Aviation Statistics, (2023-24) Ch.1, chart 4, 8.
 35. Vinay Khulbe, 'IndiGo and Tata Group Airlines Corner Nearly 90% Combined Market Share' (NDTV profit, 14 July 2024) <<https://www.ndtvprofit.com/business/indigo-and-tata-group-airlines-corner-nearly-90-combined-market-share#:~:text=market%20neared%2090%25.-,IndiGo's%20market%20share%20rose%20to%2063.2%25%20in%20June%20from%2061.4,basis%20points%20higher%20than%20May>> accessed 18 January 2025.
 36. Manu Balachandran (N 32).

This change is reflective of broader structural issues that have plagued Indian aviation.⁽³⁷⁾ First, it has significantly reduced competition, which could lead to higher fares, reduced consumer choice, and decreased pressure on airlines to innovate and improve service quality. Second, it has concentrated market power in the hands of a few well-funded airlines, allowing them to shape the sector's trajectory by dictating pricing strategies and dominating key routes.⁽³⁸⁾ Due to this, efficacious resolution of airline companies is of paramount importance.⁽³⁹⁾

iv. Low compliance rating vis-à-vis Aircraft Leasing

The insolvencies in the aviation sector have not only impacted the aviation sector but have also impacted India's compliance rating with respect to aircraft leasing, which has gone down from positive to negative.⁽⁴⁰⁾ This came as a result of the recent insolvencies of Go Air and Jet Airways and the treatment of the lessors in the CIRP of these companies.⁽⁴¹⁾

The Aviation Working Group ("AWG") is a global oversight body that monitors aircraft leasing and financing laws. The AWG rates countries on their compliance with international leasing laws. It has reportedly downgraded India's rating due to not providing adequate protection to the lessors.⁽⁴²⁾ The AWG found that India does not fully comply with the Cape Town Convention ("CTC"), an international treaty that provides alternatives for lessors to reclaim aircraft.⁽⁴³⁾

37. Prof. Baisakhi Debnath, Sushan A. Shantharam, Anmisha Reddy Dwarampudi, and Dasari Sri Vidya, 'A Study on the Causes of Financial Crisis in the Indian Aviation Industry with Special Reference to Kingfisher Airlines' (2020) 7 *Journal of Management* 28-41 <<https://ssrn.com/abstract=3735888>> accessed 18 January 2025.

38. Samik Shome and Sushma Verma, 'Financial Distress in Indian Aviation Industry: Investigation Using Bankruptcy Prediction Models' (2020) 13 *Eurasian Journal of Business and Economics* 91-109 <<https://doi.org/10.17015/ejbe.2020.025.06>> accessed 18 January 2025.

39. Neeti Shikha and Rebecca Parry, 'The Case for a Sectoral Approach to Insolvency Resolution in India' (Live Mint, 2 February 2024) <<https://www.livemint.com/opinion/columns/the-case-for-a-sectoral-approach-to-insolvency-resolution-in-india-11675355567427.html>> accessed 24 January 2025. ("Neeti Sikha").

40. Business Today Desk, 'Aviation Working Group Downgrades India Ratings Amid Go First Lessors Fight Over Possession of Aircraft' (Business Today, 7 December 2023) <<https://www.businesstoday.in/industry/aviation/story/aviation-working-group-downgrades-india-ratings-amid-go-first-lessors-fight-over-possession-of-aircraft-408553-2023-12-07#:~:text=In%20September%202023%2C%20the%20aviation,a%20notification%20on%20December%206>> accessed 23 January 2025 .

41. *ibid.*

42. Devesh Kumar, 'Aviation Leasing Watchdog Cuts India's Rating Amid Go First Legal Tussle with Lessors' (Live mint, 25 September 2023) <<https://www.livemint.com/companies/news/aviation-leasing-watchdog-cuts-indias-rating-amid-go-first-legal-tussle-with-lessors-11695662413233.html>> accessed 23 January 2025.

43. Saurabh Sinha, 'GoAir Aircraft Repossession Fiasco: Global Leasing Body Downgrades India to Negative' (Times of India, 7 December 2023)<<https://timesofindia.indiatimes.com/business/india-business/goair-aircraft-repossession-fiasco-global-leasing-body-downgrades-india-to-negative/articleshow/105814467.cms>> accessed 23 January 2025. ("Saurabh Sinha").

As a result of the downgrade in the credit rating the aircraft lease costs would increase by 25% and has put the country on the negative watch list.(44) This financial burden, estimated at an extra \$1.2-1.3 billion, not only impacts the airlines' profitability but also trickles down to consumers in the form of increased airfares.(45)

Challenges faced by the Airline Sector during Insolvency

As discussed in part 2 of the paper airline business is different from any other business. The nature of an airline's business creates unique challenges during the insolvency proceedings.(46) The recent insolvencies in the airline sector, particularly Jet Airways and Go Air, show that the international dynamics, ownership and lease agreements,(47) global regulations(48) hinders the timely resolution of the CD.(49)

i. The Assets of the Airline

The Airline sector of India is predominantly a lessee market. Approximately 80% of the commercial aircraft in India are on lease.(50) The airline majorly depends upon foreign leasing companies for the acquisition of the aircrafts.(51)

Aircraft leasing is a very important aspect of the aviation sector. It becomes very important to provide adequate protection to the lessors.(52) Therefore, the CTC read with Protocol

44. David Pinto 'Changes to India's Bankruptcy Law to Save Airlines Over \$1 Billion' (Tradejini, 18 January 2023) <<https://www.tradejini.com/blogs/b/changes-to-indias-bankruptcy-law-to-save-airlines-over-1-billion>> accessed 23 January 2025.

45. Saurabh Sinha (N 43).

46. Mark Craggs, 'An Insight into Airline Insolvencies' (Norton Rose Fulbright, October 2018) <<https://www.nortonrosefulbright.com/en/knowledge/publications/26fd1c6f/an-insight-into-airline-insolvencies>> accessed 14 January 2025.

47. Andreas Pericleous, 'A Comparison of ACMI Leasing, Operating Leasing and Aircraft Ownership: To Lease or to Own?' (ACC Aviation, 2024) <<https://www.accaviation.com/a-comparison-of-acmi-leasing-operating-leasing-and-aircraft-ownership-to-lease-or-to-own/>> accessed 14 January 2025.

48. Rigas Doganis, 'Flying Off Course: Airline Economics and Marketing' (5th edn, Routledge 2019) 4. ("Rigas Doganis")

49. Manish Pant, 'Mayday: How Go First Insolvency Could Dent India's Aviation Sector' (Business Today, 25 June 2023) <<https://www.businesstoday.in/magazine/deep-dive/story/mayday-how-go-first-insolvency-could-dent-indias-aviation-sector-385181-2023-06-12>> accessed 14 January 2025.

50. PwC, 'Aircraft Leasing in GIFT IFSC' (March 2024) <<https://www.pwc.in/assets/pdfs/aircraft-leasing-in-gift-ifsc.pdf>> accessed 14 January 2025. ("PwC").

51. 'Aircraft Leasing Industry: Has India Nailed the Landing?' (Primus Partners, May 2023) <<https://primuspartners.in/docs/documents/UD9bZaJ2m8WfmlN2ChoR.pdf>> accessed 14 January 2025.

52. Wilbur F. Foster, Jr and Risa M. Rosenberg, 'Aircraft Lessors Entitled to Adequate Protection During the [2025] BLPP / 5

to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (“Protocol”) provided for the protection of the lessor in the case of default.**(53)** The Protocol makes the provision for regaining aircraft in the case of default from the lessee.**(54)**

India is also a signatory of the CTC; however, it has not ratified it fully but has implemented some parts like Irrevocable Deregistration and Export Request Authorisation (“IDERA”) through the Aircraft Rules, 1973 (“Rules”).**(55)** Rules 30(7) and 32A of the rules deal with the defaults of the payment by the lessee.**(56)** Upon the default, the lessor can submit the application to the Directorate General for Civil Aviation (“DGCA”); based upon the application, the DGCA can deregister the aircraft, and within the acceptance of five days of application, facilitation of the aircraft must be done.**(57)** However, this scheme of CTC came into conflict with the scheme of IBC.**(58)**

In the case of Go Air, the airline started defaulting in 2022 and, on 2nd May 2023, applied for voluntary insolvency under section 10 of IBC.**(59)** The insolvency application of the same was accepted on 10th May 2023.**(60)** However, before the moratorium could come in place, the lessors of Go Air lodged the application before the DGCA.**(61)**

§ 1110 60-Day Period’ (American Bankruptcy Institute Journal) <https://www.milbank.com/a/web/1074/022010_abi_fosterrosenberg.pdf> accessed 15 January 2025.

53. Swaraj Baggonkar, ‘Airlines, Aviation: Aircraft Lessors Wait for Cape Town Convention Laws to Take Shape’ (20 January 2024) Financial Express <<https://www.financialexpress.com/business/airlines-aviation-aircraft-lessors-wait-for-cape-town-convention-laws-to-take-shape-3369856/>> accessed 15 January 2025.

54. Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (2001) Art XI, 2307 UNTS 211.

55. Neha Singh, ‘20 Years of Cape Town Convention: Indian Perspective on Aviation’s Lynchpin Framework’ (Mondaq, 7 October 2021) <<https://www.mondaq.com/india/aviation/1119112/20-years-of-cape-town-convention-indian-perspective-on-aviations-lynchpin-framework>> accessed 15 January 2025.

56. The Aircraft Rules, 1937, R. 30(7).

57. *ibid.*

58. Krishan Singhania, Avni Singhania, K. Anjana Devi, Aayush Shah, ‘Insolvency Law and Airline Liquidation in India’ (International Bar Association, 4 June 2024) <<https://www.ibanet.org/insolvency-law-airline-liquidation-india>> accessed 15 January 2025.

59. Rohit Vaid, ‘NCLT Admits Go First Insolvency Resolution Process’ (Indian Express, 11 May 2023) <<https://indianexpress.com/article/business/aviation/nclt-admits-go-first-insolvency-resolution-process-8601394/>> accessed 15 January 2025.

60. *ibid.*

61. ENS Economic Bureau, ‘NCLT Rejects Go First’s Plea for Insolvency Resolution’ (Indian Express, 5 May 2023) <<https://indianexpress.com/article/business/aviation/nclt-go-firsts-plea-insolvency-resolution-8591652/>> accessed 15 January 2025.

The moratorium established under the IBC is designed to safeguard the assets of a corporate debtor, promoting value maximization while preventing any legal actions or proceedings against those assets.⁽⁶²⁾ In the case of Go Air, the DGCA denied the application made by lessors as the moratorium was in place.⁽⁶³⁾ As a result, the writ petition was filed before the Delhi High Court.⁽⁶⁴⁾

The Delhi High Court ruled in favour of the lessors and instructed the DGCA to enable the swift deregistration and export of aircraft leased by Go First.⁽⁶⁵⁾ The Court also relied on the notification issued by the Ministry of Corporate Affairs S.O. 4321(E) dated October 3, 2023 (“Notification”).⁽⁶⁶⁾ The Notification provides an exemption for transactions, arrangements, or agreements related to aircraft engines, aircraft, airframes, and helicopters under the CTC and its Protocol from the provisions of section 14(1) of the IBC.⁽⁶⁷⁾ The Court upheld the retrospective application of the notification, which came as a relief for the lessors.⁽⁶⁸⁾

The Ministry of Civil Aviation is poised to bring the ‘Protection and Enforcement of Interests in Aircraft Objects Bill, 2022’ (“Aviation bill”) to solidify India’s commitment to the CTC and Protocol with an attempt to strengthen the lessor’s rights.⁽⁶⁹⁾ The changes to the IBC introduced by the Notification and the suggested amendments to aviation laws outlined in the Aviation Bill are expected to significantly impact the insolvency resolution process for airline companies in India.⁽⁷⁰⁾

The Notification undoubtedly safeguards the rights and interests of the lessors, but it is likely to negatively impact an aviation company’s chances of being resolved.⁽⁷¹⁾ Due to the

62. Insolvency and Bankruptcy Code, 2016, S. 14. (“IBC”).

63. *Accipiter Investments Aircraft 2 Ltd. v. Union of India*, AIROnline2024 Del 1739. (“Accipiter”).

64. Zarir Bharucha & Dhvani, ‘The Delhi High Court Directs Deregistration of Go Air Aircraft Despite Insolvency Challenges’ (ZBA, 23 May 2024) <<https://zba.co.in/knowhow/the-delhi-high-court-directs-deregistration-of-go-air-aircraft-despite-insolvency-challenges/#>> accessed 15 January 2025.

65. *Accipiter* (N 63).

66. Ministry of Corporate Affairs, Exemption from provisions of section 14(1), S.O. 4321(E) (Notified on 3 January 2023) (“Notification”).

67. *Accipiter* (N 63) para 9.

68. *ibid*.

69. Anand Shah, Rishiraj Baruah & Saptarshi Bhuyan, ‘The Protection and Enforcement of Interests in Aircraft Objects Bill 2022’ (AZB Partners, 26 April 2022) <<https://www.azbpartners.com/bank/the-protection-and-enforcement-of-interests-in-aircraft-objects-bill-2022/>> accessed 15 January 2025.

70. Kumar Saurabh Singh, Ashwaj Ramaiah and Rohitesh Tak, ‘Tweaking IBC to resolve airline insolvency’ (IBBI, 2024) 162. (“Kumar Saurabh Singh”).

71. *ibid* at 166.

notification issued by the Ministry of Civil Aviation, the vital assets of the airline, i.e., aircraft, are being jeopardized, which would substantially lead to the halting of the airline company, substantially forcing it to liquidation as the lessors have unrestricted authority to take away the airline company's most valuable asset.(72)

ii. The Lack of Funds and Financing during the Insolvency Period

The availability of financial resources plays a critical role in ensuring the survival of a CD undergoing insolvency.(73) During the insolvency process, the financing of the company majorly becomes essential for two reasons: Firstly, to keep the distressed entity as a going concern and secondly, for the maximization of value of the CD.(74)

For an airline company, it becomes very important because of its high-cost structure.(75) Aircrafts are the biggest source of income for the airline company.(76) During insolvency, if the aircraft has been grounded, the airlines are not left with any options other than to avail of interim finance. The finance in such a scenario becomes very important to keep the CD as a going concern.(77)

Despite the fact that financing is very important for the restructuring of the CD, the financial institutions abhor it.(78) Studies have shown that a mere 13% of CDs lead to resolution, and only 5% of CDs ordered for liquidation receive finance under the IBC.(79) Studies have also indicated that in almost 85% of instances where interim finance was secured,

72. *ibid.*

73. Mba S., *New Financing for Distressed Businesses in the Context of Business Restructuring*, (Springer., 2019) 1.

74. *Edelweiss Asset Reconstruction Company Limited v. Sai Regency Power Corporation Pvt. Ltd.*, 2019 SCC OnLine NCLAT 921. ("Edelweiss").

75. Umesh S. Mahtani and Chandra Prakash Garg, 'An Analysis of Key Factors of Financial Distress in Airline Companies in India Using Fuzzy AHP Framework' (2018) 117 *Transportation Research Part A: Policy and Practice* 87 <<https://doi.org/10.1016/j.tra.2018.08.016>> accessed 14 October 2024.

76. *Aviation Outlook*, 'Airline Revenue Streams: Different Ways How Airlines Generate Revenue' (*Aviation Outlook*, 11 January 2023) <<https://www.aviationoutlook.com/airline-revenue-streams/>> accessed 15 January 2025.

77. *Edelweiss* (N 74).

78. Malika Tiwari, *Rescue Financing in Light of the Insolvency and Bankruptcy Code, 2016: Success, Challenges and Inspirations* (2022) *GNLU Law Review* 8(1) <https://gnlu.ac.in/Content/the-gnlu-law-review/pdf/volume-8-issue-2/08_malika_tiwari.pdf> accessed 15 January 2025.

79. Ajanta Gupta and Ritesh Kavdia, 'Last mile funding: A way forward' in *Anusandhan: Exploring new perspectives on Insolvency*, (IBBI, 2022), 18.

the amount raised was less than 5 Crore.**(80)** As in the case of Jet Airways, the CoC, after approving the finance, did not release the funds, due to which the company faced severe issues in sustaining its operations.**(81)**

One of the major reasons for this is that the notion of rescue finance may be at odds with the interests of the current creditors of the CD.**(82)** In the majority of the cases, the CoC opposes interim finance, as the creditor's position may be affected in case an insolvent entity goes into liquidation, due to which the CoC votes against super-priority financing.**(83)** Their resistance often stems from their unwillingness to relinquish the coveted 'super-priority' position that rescue financiers enjoy, safeguarding them from being relegated down the hierarchy established by the IBC.**(84)**

From the above discussion, it can be said that the financial institutions are reluctant to provide finance to the CD, and secondly, the amount of finance received to the CD is not sufficient.**(85)** A sector that has such a high-cost structure cannot survive without external financing.**(86)** The insolvency of Go Air and Jet Airways has shown the importance of third-party funding. Jet Airways had to sell 10% of its non-core assets during the insolvency period to meet its financial obligation, maximize company value, and cover CIRP costs.**(87)** In comparison to Jet Airways, Go Air, lacking its own assets and lack of credit, relied on external funds, which were not sufficient to sustain its operations.**(88)**

80. Iyer V. V. et al, 'An analysis of interim finance ecosystem as a supporting tool for the IBC regime' Anusandhan: Exploring New Perspectives on Insolvency, (IBBI, 2022)259 & 276.

81. M. Vyas, 'NCLT Warns Jet Airways COC of Contempt Proceedings' Economic Times (9 January 2020) <https://economictimes.indiatimes.com/industry/transportation/airlines-aviation/nclt-warns-jet-airways-coc-of-contempt-proceedings/articleshow/73159335.cms> accessed 23 January 2025.

82. Sudhaker Shukla and Kokila Jayaram, Promoting Common Good Amidst Anti-Common Behaviour of Stakeholders: Role of Committee of Creditors (2021) in Quinquennial of the Insolvency and Bankruptcy Code, 2016 (Insolvency and Bankruptcy Board of India) ch 18, 207.

83. Uday Kotak.

84. Bob Wessels, Stephan Madaus, Gert-Jan Boon, 'Rescue of Business in Insolvency Law', European Law Institute, 74, 242 (2017).

85. Mark L. Prager, 'Financing the Chapter 11 Debtor: The Lenders' Perspective', (1990) 45 Business Lawyer. 2127, 2131.

86. Aurelio Gurrea-Martinez, 'Debtor-in-Possession Financing in Reorganisation Procedures: Regulatory Models and Proposals for Reform' (2023) 24 European Business Organization Law Review 555, 557.

87. Ashish Chhawchharia Housing Development v. Jet Airways, 2020 SCC OnLine NCLT 8442. (Ind.)

88. Anu Sharma and Aniruh Laskar, 'Go First May Have to Sign New Leases Before Relaunch' (Mint, 20 July 2023) <www.livemint.com/companies/news/gofirstmayhave-to-sign-new-leases-before-relaunch-11689791543073.html> accessed 15 January 2025; See also 'Go First lenders approve Rs. 100 crore of CIRP cost with 98% vote' (Business Standard, 24 August 2023) <www.business-standard.com/companies/news/go-first-lenders-approve-rs-100-crore-of-cirp-cost-with-98-vote-123082400267_1.html> accessed 15 January 2025.

iii. The International and Cross Border Dynamics

One of the core characteristics of the airline sector is the cross-border operation.⁽⁸⁹⁾ For instance, the airline's assets may include aircraft and passengers from different parts of the world, which makes the airline business more complicated.⁽⁹⁰⁾ Also, the airline company lessors usually belong to foreign states, majorly from Ireland and Singapore, due to which there is always a chance of having parallel proceedings.⁽⁹¹⁾

Following the precedent of Jet Airways where, the parallel proceedings were initiated in the District Court of the Netherlands and the NCLT Mumbai.⁽⁹²⁾ There were various creditors involved in the CIRP of Jet Airways. There were more than 30 financial creditors and more than 4000 operational creditors from around the world as the Jet Airways were functioning in more than 20 overseas locations apart from India.⁽⁹³⁾ The claim involved creditors from 28 different countries across the world.

Additionally, simultaneous liquidation proceedings were initiated in the Netherlands and the United Kingdom. As a result, RP needed to implement the cross-border insolvency protocol with the foreign creditor,⁽⁹⁴⁾ due to which the CIRP process got delayed. The HNA group of China also faced the same issue; it was one of the biggest conglomerates in the airline industry of China, and it became insolvent in 2021.⁽⁹⁵⁾ One of the major challenges faced by the HNA group was communicating and gaining support from 60,000 creditors, who were spread across the globe, representing a wide range of assets.⁽⁹⁶⁾

89. Rebeca Parry and Neeti Shikha (N 13) 153.

90. Kumar Saurabh Singh (N 70) 169.

91. PwC (N 50).

92. Satvik Varma, 'Turbulence in the Insolvency Process: Jet Airways' (Bar and Bench, 12 September 2019) <<https://www.barandbench.com/columns/turbulence-insolvency-process-jet-airways>> accessed 15 January 2025.

93. Ashish Chhawchharia, 'Ashish Chhawchharia's Journey with Jet Airways and the Way Forward' (Grant Thornton India, 23 January 2023) <<https://www.grantthornton.in/insights/blogs/ashish-chhawchharias-journey-with-jet-airways-and-the-way-forward/>> accessed 23 January 2025.

94. Jet Airways (India) Ltd. v. State Bank of India, 2019 SCC OnLine NCLAT 121.

95. Richard Summerfield, 'China's HNA Group Put into Bankruptcy Administration' (Financier Worldwide, April 2021) <<https://www.financierworldwide.com/chinas-hna-group-put-into-bankruptcy-administration>> accessed 15 January 2025.

96. 'How an Insolvent Travel Industry Giant Got Back on Track' (EY Parthenon) <https://www.ey.com/en_uk/insights/strategy-transactions/how-an-insolvent-travel-industry-giant-got-back-on-track> accessed 15 January 2025.

From the above discussions, it can be stated that the cross-border and international dynamics play a pivotal role in the CIRP of the CD. One persistent and seemingly unsolvable problem of Transnational Commercial Law is the overlap of insolvency processes in various nations pertaining to a common debtor.⁽⁹⁷⁾ Given the diverse institutional systems and varying degrees of transnational collaboration, a co-ordinated framework is essential to resolve the cross-border insolvency dispute.⁽⁹⁸⁾

Suggestive Changes to be made in the current Insolvency Framework

From the discussions made, it is clear that the aviation business is volatile, and insolvencies in the aviation market have plagued the sector. Due to this, there is a need for IBC to cater to specific changes for better resolution.

i. Treatment of Financial Lessors at par with the Secured Financial Creditor under IBC

From the discussion made in part 3 of the paper, it can be deduced that as soon as an airline files for insolvency, the lessors try to square off their position by taking possession of the aircraft and related assets. This is the result of the inadequate protection provided to lessors under the IBC.

The IBC quantifies the lessors as an Operational Creditor, due to which the lessors are barred from representation, voting, and participation in the CoC.⁽⁹⁹⁾ In addition, the lessors get a lower ranking under the waterfall mechanism during the event of liquidation despite being the owners/lessors of the aircraft. This acts as an incentive for the lessors to recover the possession of the aircraft during the CIRP. The solution to the following situation is treating the lessors at par with the Secured Financial creditors under the IBC.⁽¹⁰⁰⁾

The sustainability of the airline's operations depends upon the lessor, as all the dues with respect to aircraft have to be paid according to the lease agreement. In addition to it, the quantum of dues is also higher which makes the lessors a critical stakeholder associated with CIRP.⁽¹⁰¹⁾ The treatment of the lessors at par with the secured financial creditor

97. Misra, P. and Feibelman, A., 'The Institutional Challenges of a Cross-Border Insolvency Regime' (2021) 2 Corp. & Bus. LJ 329.

98. Mohan, S. Chandra, 'Cross-border Insolvency Problems: Is the UNCITRAL Model Law the Answer?' (2012) 21 International Insolvency Review 199.

99. Wilmington Trust SP Services (Dublin) Ltd. v. SpiceJet Ltd., 2024 SCC OnLine NCLT 619.

100. Kumar Saurabh Singh (N 70).

101. Marintseva K. and Athousaki R., 'Assessment of Aircraft Leasing Efficiency: An Airline Perspective' (2024) 3 Journal of the Air Transport Research Society 100039 < <https://doi.org/10.1016/j.jatrs.2024.100039>> accessed 23 January 2025.

would not only incentivize the lessor to not gain possession during the CIRP, but it also will strengthen the commercial wisdom of the CoC. The lessors are better equipped with aviation business and can better adjudicate upon the resolution plan and viability of the airline operation post-resolution.(102)

In addition, to provide adequate protection to the owners/lessor, section 53 of the IBC should be amended to treat them on par with the workmen and secured creditors. The result of this would be that the lessor would fall second in the priority during the liquidation. Additionally, during the event of resolution, their dues paid under section 30(2)(b) should be calculated under section 53 of the IBC.(103)

The aim of the proposed change is to increase the lessor's sense of security in the event of CD filing for insolvency. These amendments would create a more stable environment for the CD by discouraging lessors from reclaiming their assets during the CIRP. This step is intended to make sure lessors are encouraged to refrain from reclaiming their assets, thereby allowing the distressed asset to sustain its operations.

Furthermore, this amendment would provide adequate protection for the CD, allowing it to continue operations and function as a going concern. The amendment intends to create a framework that promotes the airline's long-term viability by encouraging cooperation during insolvency. Finally, this modification benefits the lessors by offering adequate protection during insolvency while also assisting CD for a better resolution.

ii. Enactment of the Cross-border Insolvency Framework

Part 3 of the paper illustrates that in the insolvency of airlines passengers, creditors, and lessors may originate from a variety of countries. The experience from Jet Airways has shown the difficulty that a distressed corporation faces when various judicial processes are commenced in different jurisdictions. In addition, the company's assets may be located in multiple jurisdictions, and initiating parallel proceedings may result in the seizure of assets in another country. This may cause difficulty in asset tracking and dealing with the claims of the company. The Jet Airways case has also highlighted the difficulty in harmonizing diverse insolvency systems in conjunction with Foreign Courts.

102. *ibid.*

103. Kumar Saurabh Singh (N 70).

To address the complexities raised by the cross-border insolvency, the adoption of a cross-border insolvency resolution framework is required. The Model Law on Cross-Border Insolvency (“Model Law”), established by the United Nations Commission on International Trade Law (UNCITRAL), provides a viable answer to the issues raised in this context. This Model Law targets key aspects such as access, recognition, cooperation, and coordination among jurisdictions.**(104)**

The enactment of the Model Law would result in the streamlining of the process related to cross-border insolvency. The implementation of the Model Law will not only benefit different stakeholders associated with the CD but it will also help in achieving the resolution in the stipulated timeline provided by IBC. It is critical to have a clear framework to balance the complexities of cross-border insolvency. By addressing domestic issues and leveraging global best practices, India can create a strong cross-border insolvency system that will boost confidence and promote global economic ties.

iii. Strengthening the Role of the CD

The current framework under the IBC, particularly when juxtaposed with the implications of adopting Alternative A of the CTC, reveals a creditor-centric orientation that may ultimately prove detrimental to the successful resolution of airline insolvencies. Granting lessors unfettered power to terminate leases and export aircraft upon the expiry of a truncated waiting period could severely disrupt the CIRP, destabilize the airline’s operations, and undermine its ability to function as a going concern.**(105)**

In comparison to the Creditor-In-Control approach, the Debtor-in-Possession (“DIP”) approach can be beneficial for a defunct airline. Under the United States Bankruptcy Code (“US code”), the existing management is allowed to continue operations and can facilitate necessary finance.**(106)** In addition to this, the US code also allows for different mechanisms for the better resolution, such as (a) a global stay that applies to almost all actions taken to recover pre-filing debts, (b) The right to rescind disadvantageous contracts and

104. United Nation Commission of International Trade Law, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, (1997), Part Two, Sub-part I, sub-part B, 19.

105. Kamalnath, A., Corporate Insolvency Resolution Law in India-A Proposal to Overcome the Initiation Problem’. (2019) UMKC L. Rev., 88, p.631.

106. Dahiya, S., John, K., Puri, M. and Ramirez, G., ‘Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence’ (2003) Journal of Financial Economics, 69(1), pp.259-280.

leases (e.g., above market aircraft leases) and to abandon assets, (c) the capacity to obligate dissenting creditors, and (d) access to “DIP” funding to sustain operations and the restructuring process. **(107)**

Strengthening the position of the CD could be the critical paradigm shift needed within the IBC to address the unique challenges of airline insolvency effectively. This framework could offer distinct advantages: (a) it enables the CD to leverage the existing knowledge and expertise of the airline’s management team, ensuring continuity and minimizing disruptions to operations. **(108)** (b) The DIP structure also helps bypass the potential delays, costs, and inefficiencies associated with bringing in external administrators who may lack the necessary industry-specific expertise and the time and cost incurred in understanding the company’s ways. **(109)** (c) By allowing an airline undergoing insolvency to continue operating under its existing management team, the DIP Model can facilitate a smoother and more efficient transition into the CIRP process in India.

iv. Strengthening Finance during the Rescue Procedure

The observations from Jet Airways and Go Air highlight the critical need for financing in corporate rescue efforts. To address this need, a fund could be established by the Central Government, similar to the Special Window for Mid-Income Housing (“SWAMIH”) Fund, which provides financing for stalled real estate projects to facilitate their completion. **(110)** Similarly, there can be a fund designated to support airline operations and ensure their continuity as going concerns.

In addition, Private Equity (PE) Firms, Venture Capital (VC) Firms, and Distressed Lenders (DL), which are classified as Alternative Investment Fund (“AIF”) financiers, may be allowed to fund the CIRP. These AIFs possess a higher risk capacity and can finance distressed assets both pre- and post-insolvency. **(111)** Certain AIFs, such as Special Situation

107. Kelly DiBlasi and Jason George, ‘Aviation Chapter 11 Cases Take Flight’ (Weil Restructuring 19 April 2022) <<https://restructuring.weil.com/pre-filing-considerations/aviation-chapter-11-cases-take-flight/>> accessed 23 January 2025.

108. Berdan, R.J. and Arnold, B.G., ‘Displacing the debtor in possession: the requisites for and advantages of the appointment of a trustee in Chapter 11 proceedings’ (1983) Marq. L. Rev., 67, p.457.

109. Skeel Jr, D.A., ‘The past, present and future of debtor-in-possession financing’ (2003) Cardozo L. Rev., 25, p.1905.

110. Economic Survey 2023-24 (N 5) 53-54.

111. Sai Krishna Bharathan and Ganesh Rao, ‘Alternative Investment Funds in India: Unlocking Sophisticated Investment’ (2019) National Law School Business Law Review <<https://repository.nls.ac.in/cgi/viewcontent.cgi?article=1058&context=nlsblr>> accessed 23 January 2025.

Funds (“SSF”), could be expanded to serve as interim financing options, thereby incentivizing lenders. By incorporating SSFs within the resolution applicant framework, lenders may gain increased assurance.

Furthermore, the enactment of the Insolvency and Bankruptcy Fund (“IBF”) under Section 224 of the IBC should be pursued to enhance the financial support structure for distressed entities. Section 224(3) of the IBC permits those persons who have contributed to the IBF to withdraw an amount equitable to their contribution post approval of the Adjudicating Authority for disbursing payment to workmen, ensuring protection of the assets of such persons, covering the incidental cost during the proceedings or such purposes as may be prescribed.**(112)** The IBC created the IBF, but it did not specify how the Fund will be used. The implementation of the IBF would help the CD to address the need of the funds during the CIRP for its completion.

Developing a structured framework aimed at building a credit market for CDs can significantly impact the financial stability of insolvent airlines. By establishing such a credit market, these airlines will be able to get the necessary money, allowing them to continue operating even during insolvency procedures. This is especially important since it helps airlines negotiate financial difficulties without suspending services, thereby protecting jobs and providing key connectivity for passengers.

Conclusion

It has been discussed in the paper that the insolvency of the airlines has led to the deferential outcome. The discussions made above have suggested that:

1.	The airline sector is distinct and complex from other businesses.
2.	The outcome of the CIRP of airlines has ended up with liquidation as an outcome.
3.	The impact of the insolvency of different airlines is leading to duopoly in the Market.
4.	There has been a substantial delay which takes place in the resolution of Airline companies.
5.	India’s rating has been downgraded vis-à-vis aircraft leasing.

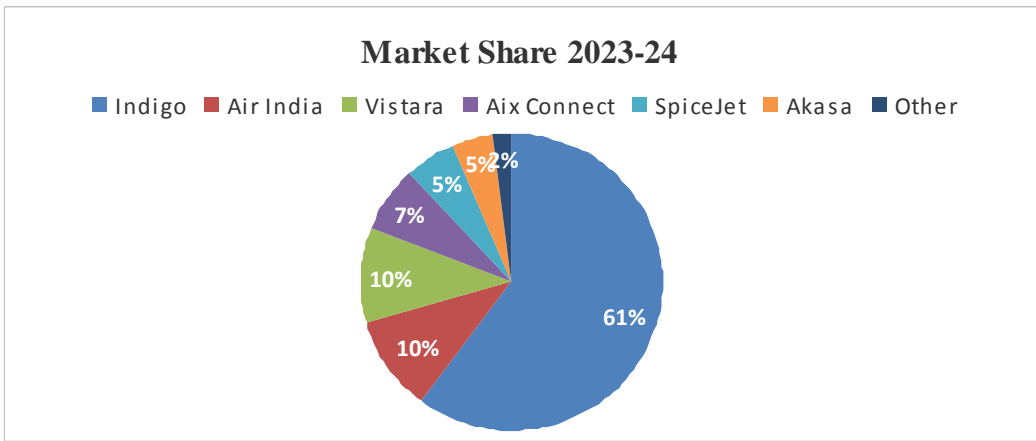
The experiences of Jet Airways and Go Air demonstrate the IBC’s inadequacy in handling the aviation industry’s complex difficulties. While the IBC’s general rules are beneficial in many sectors, they fail to account for the complex reality of aviation, resulting in outcomes that do not benefit stakeholders or the market as a whole.**(113)**

112. IBC (N 62) S. 224.

113. Neeti Sikha (N 39).

In light of these findings, it is critical to review and reformulate the IBC framework, particularly for the aviation industry. Tailored rules that reflect airlines’ particular operational, financial, and regulatory difficulties are critical to supporting more effective resolutions. Such reforms could include faster processes, aviation-specific tribunals, and rules that allow operational viability to be preserved during the resolution process.

By integrating the insolvency framework with the intricacies of the airline business, stakeholders can collaborate on long-term solutions that not only improve recovery chances but also contribute to a more resilient and competitive aviation market. Finally, a modified approach to insolvency in the airline sector is critical for the long-term profitability of the aviation market in India.



Depiction of the Airline Market in the FY 2023-24



SEBI's Proposed Sustainable Asset Securitisation: Bond Villain Greenwashing and Blockchain Solution*

Abstract

This paper examines SEBI's proposed sustainable securitisation framework, assessing its potential to bridge India's climate finance gap while minimising greenwashing risks. It explores the feasibility of leveraging blockchain to enhance transparency in green financial instruments.

The study adopts a tripartite methodology, commencing with an exhaustive analysis of green securitisation, emphasising Green Bonds in India. It then critically deconstructs extant voluntary frameworks, highlighting latent greenwashing risks and limitations. Finally, it propounds a novel blockchain-based framework to overcome these shortcomings and ensure robust governance and efficacy in green securitisation.

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The proposed innovative blockchain-based green securitisation framework addresses gaps in India's sustainable finance landscape. By integrating blockchain's efficacy with green finance nuances, this research offers pragmatic recommendations for regulators and policymakers. This proposed blockchain-based paradigmatic model for emerging markets reconciles sustainability objectives with economic growth. It highlights technological innovation's pivotal role in addressing pressing issues like greenwashing.

Keywords

Green Securitisation, Green Bonds, Greenwashing, Blockchain, SEBI.

Introduction

Financing for climate mitigation remains critically insufficient. To limit global temperature increases to under 2°C, as per the Paris Agreement's goal, (1) annual investments in renewable energy must nearly triple by 2050. (2) The markets have responded towards climate mitigation financing by issuing and developing various green instruments. Green Bonds, a key market response to climate concerns, have exceeded 3 trillion dollars globally since their inception two decades ago. (3) It can also be seen that the investor's confidence, motivated by their ethical motivation - in such instruments is increasing at such a rate that Investors often prioritise environmental goals over financial returns, reflected in an observed "green premium" of 18 basis points (bps) in such investments. (4)

With the rise of green finance with Green Bonds as the front runner, (5) the natural pro-

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1. Paris Agreement, an international treaty on Climate Change was adopted in 2015.
 2. Umair Irfan and ClimateWire, 'Climate Pledges Will Fall Short of Needed 2 Degree C Limit' (SCI. AM., 3 November 2016) <<https://www.scientificamerican.com/article/climate-pledges-will-fall-short-of-needed-2-degree-c-limit/>> accessed 15 January 2025.
 3. Pauline Lam and Jeffrey Wurgler, 'Green Bonds: New Label, Same Projects' (Harvard Law School Forum on Corporate Governance, 3 October 2024) <<https://corpgov.law.harvard.edu/2024/10/03/green-bonds-new-label-same-projects/>> accessed 15 January 2025.
 4. Chaoxi Liang, Xiaoming Ma and Xiawei Liao, 'Unveiling Investor Motivation and Trust in Impact Investing: Evidence from Global Green Bond Issuances' [2024] Journal of Business Ethics <<https://link.springer.com/article/10.1007/s10551-024-05891-w>> accessed 15 January 2025.
 5. S. MacAskill and others, 'Is there a green premium in the green bond market? Systematic literature review revealing premium determinants' [2021] 280(2) Journal of Cleaner Production <<https://www.sciencedirect.com/science/article/pii/S0959652620345352>> accessed 15 January 2025.

gression is the introduction of securitisation specifically for sustainable debts. In the USA, Fannie Mae has issued securitised sustainable debt worth USD 120 billion as of February 2021, with a likely significant growth in further issuance of sustainable securitised debt from Fannie Mae alone.⁽⁶⁾ In 2022, it was predicted that the estimated money value of sustainable securitised debt in the European Union (hereinafter “EU”) alone could reach up to €300 billion annually by 2030.⁽⁷⁾ The Security Exchange Board of India (hereinafter “SEBI”) is considering securitisation to boost sustainable finance in India. This aims to support originators with sustainable credit facilities and provide investors access to securitised debt aligned with green finance frameworks, encouraging eco-conscious investments.⁽⁸⁾ In this regard, SEBI has come up with the “Consultation Paper On Expanding The Scope Of Sustainable Finance Framework In The Indian Securities Market”. In the Consultation Paper, SEBI proposed developing the concept of Sustainable Asset Securitisation⁽⁹⁾ in India, securitising sustainable-green debts that satisfy the international frameworks that SEBI may recommend among the standards listed in paragraph 4.5 of the SEBI Consultation Paper (hereinafter “Listed Frameworks”). The SEBI Consultation Paper presents two pertinent queries regarding the framework for Green Securitisation: a. Whether the proposed framework by SEBI is adequate (hereinafter “First Question”); and b. Whether SEBI should also consider any international standards other than the Listed Frameworks for the purpose of its recommended framework (hereinafter “Second Question”), this paper provides an overview of Green Securitisation and responds to the two questions posed by SEBI.

This paper is structured into three sections. The first section provides a descriptive overview of Green Securitisation and Green Bonds grounded in exploratory research. This foundational section establishes the theoretical basis for our subsequent analysis.

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6. Daniela Di Filippo and others, ‘Green Securitisation: Developments and Challenges’ (Fitch Solutions, 15 April 2021) <https://www.fitchratings.com/research/structured-finance/green-securitisation-developments-challenges-15-04-2021?FR_Web%20Validation%20=%20true&mkt_tok=NzMyLUNLSC03NjcAAAGB5zCg1M1A%20gjiDft%20HCp%20bLwZTps%20rE05AN8fCg96HFE d81JEZA6FLQihm53Yt-Fdh7NLjHEWRh-7LZYr%20KQSWF8rQFiilp XJrNDtHEZ7xllvwfbhdlWF whA> accessed 15 January 2025.
 7. These states are inclusive of the United Kingdom and not just EU members; See AFME and S&P Global Ratings, ‘European Green Securitisation Regulatory State of Play’ (AFME, December 2022) <<https://www.afme.eu/news/press-releases/details/potential-of-green-securitisation-could-exceed-300-billion-annually-by-2030>> accessed 15 January 2025.
 8. SEBI, “Consultation Paper On Expanding The Scope Of Sustainable Finance Framework In The Indian Securities Market” (SEBI, 16 Aug 2024) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2024/consultation-paper-on-expanding-the-scope-of-sustainable-finance-framework-in-the-indian-securities-market_85691.html> accessed 15 January 2025 (“SEBI Consultation Paper”) para 4.4 .
 9. Sustainable Asset Securitisation is generally termed as Green Securitisation. For the purpose of this paper, the phrases ‘Sustainable Securitisation’ and ‘Green Securitisation’ have been used interchangeably.

The second section delves into a critical examination of the Green Securitisation ecosystem, focusing on the issue of greenwashing inherent in voluntary frameworks. Through analytical and inferential research, we respond to the Second Question posed by SEBI, highlighting the limitations of existing frameworks.

The third section proposes a novel framework for Green Securitisation and Green Bonds, leveraging Blockchain technology. This innovative approach addresses the shortcomings of current frameworks and provides a comprehensive response to the First Question.

Green Bonds & Green Securitisation

Securitisation refers to acquiring financial assets, such as debt or receivables, by a special purpose vehicle or asset reconstruction company from an originator to issue securitised instruments or security receipts to investors. These instruments represent undivided interests in the acquired assets and may involve raising funds from qualified buyers or otherwise, based on the structure of the securitisation transaction.⁽¹⁰⁾ In this section, we will look into what constitutes Green Securitisation. As Green Securitisation relies on underlying sustainable debt instruments, it is essential to understand Green Bonds, a critical component of this process.

Green Bonds

Green debt instruments function like traditional debt instruments-, whereas the proceeds are allocated explicitly to projects in renewable energy, energy efficiency, or other sustainable initiatives, adhering to a framework set by the issuer.⁽¹¹⁾ According to a circular issued by the SEBI in 2017, the regulatory framework for Green Debt Securities was formally established. However, this circular was subsequently superseded by and amalgamated into the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (hereinafter “ILNCS Regulations”). Notably, Regulation 2(1)(q) of the ILNCS Regulations delineates the contours of a Green Debt Security, defining it as a debt instrument issued to raise capital, subject to conditions stipulated by SEBI from time to time, for utilisation in financing project(s) and/or asset(s) that fall within prescribed categories.

By February 2023, Indian Green Bond issuances had reached a cumulative value of \$21 billion, with the private sector contributing 84% of this total. Sovereign and Government

10. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ss 2(z) r.w. Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008 reg. 2(r).

11. Abir Lal Dey, Pranay Bhattacharya and Shaivi Shah, ‘Investing in Greener Future: Navigating Green Bonds Regulations’ [2024] 1(2) Journal on Corporate Law and Commercial Regulations 31 <<http://www.sconline.com/DocumentLink/823J6UpI>> accessed 15 January 2025.

agencies accounted for the remaining 14%.**(12)** Further, it is anticipated that the Green Bonds will comprise 8-10% of corporate bond issuance in India in the coming years.**(13)** However, India's green finance sector still has a funding deficit. A Council on Energy, Environment and Water's Centre for Energy Finance analysis reveals a need for \$10.1 trillion in investments by 2070, with an alarming \$3.5 trillion shortfall.**(14)** Addressing this gap through mechanisms like Green Securitisation could unlock untapped potential and drive significant progress toward achieving sustainability goals.**(15)** This allows us to take our discussion to the next part of this section, which discusses Green Securitisation.

Green Securitisation Framework

While "Green Securitisation" lacks a universally accepted definition, it can reasonably be understood as the refinancing of financial assets within the environmentally sustainable or "green" sector through the mechanism of securitisation.**(16)** Evaluating whether a securitisation transaction includes a "green" component generally involves examining three primary factors: the securitisation portfolio, the principal transaction counterparties, and the application of proceeds.**(17)** There may be three broader types of green securitisation: a. Securitisation with Green Collaterals, as the underlying collateral in a debt is a green asset; b. Securitising specifically green debt; and c. Notes of the Proceeds Utilised in Green Projects.**(18)**

12. Naisha Deora, 'Green bonds: Financing the renewable era' (ORF, 8 October 2024) <<https://www.orfonline.org/expert-speak/green-bonds-financing-the-renewable-era>> accessed 15 January 2025.

13. Saurav Anand, 'Green bonds to comprise 8-10% of corporate bond issuances in India: SBI Chairman' Economic Times (10 October 2023) <<https://energy.economictimes.indiatimes.com/news/renewable/green-bonds-to-comprise-8-10-of-corporate-bond-issuances-in-india-sbi-chairman/104312431>> accessed 15 January 2025.

14. Vaibhav Pratap Singh and Gagan Sidhu, 'Investment Sizing India's 2070 Net-Zero Target' (CEEW-CEF, November 2021) <<https://www.ceew.in/cew/publications/investment-sizing-india-s-2070-net-zero-target>> accessed 15 January 2025.

15. ETBFSI Research, 'India needs Rs 162 lakh crore green finance till 2030 amid rising funding costs' Economic Time (9 November 2022) <<https://bfsi.economictimes.indiatimes.com/news/industry/india-needs-rs-162-lakh-crore-green-finance-till-2030-amid-rising-funding-costs/95397962>> accessed 15 January 2025.

16. Vinod Kothari Consultants, 'Green Securitisation in India' (Vinod Kothari Consultants, May 2023) <<https://vinodkothari.com/wp-content/uploads/2023/05/Whitepaper-on-Green-Securitisation-A5.pdf>> accessed 15 January 2025.

17 AFME (N 6).

18. Corrado Fiscale and others, 'Green ABS: a new opportunity' (Hogan Lovells, 21 February 2020) <https://www.hoganlovells.com/~media/hogan-lovells/pdf/2020-pdfs/2020_02_21_italy-insights_dcm_spring_2020.pdf?la=en#:~:text=The%20first%20type%20of%20Green,environmental%20projects%2C%20etc> accessed 15 January 2025.

The SEBI Consultation Paper mentions that the SEBI is currently proposing to build a framework of Green Securitisation by introducing “..“Sustainable Securitised Debt Instruments”, i.e. instruments which have sustainable finance credit facilities as the underlying debt”(19) The paper proposed Sustainable Securitised Debt Instruments (hereinafter “SSDIs”) appear to align with the second framework type discussed earlier, characterised by the securitisation of specifically green debt. Notably, the SEBI Consultation Paper indicates that SSDIs will be backed by sustainable finance credit facilities, conforming to internationally recognised voluntary standards.(20)

Several frameworks have been created to certify a bond’s green credentials, often seen as market-driven solutions to fill any regulatory gap.(21) These standards help issuers demonstrate the green nature of their bonds while providing investors clarity on the environmental benefits derived from the bond’s proceeds.(22) The SEBI Consultation Paper itself points out six such frameworks, i.e., the Listed Frameworks.(23) SEBI is seeking consultation on whether additional frameworks beyond those already listed should be considered.(24) A review of the existing literature reveals that the predominant frameworks are the Green Bond Principles (hereinafter “GBP”) promulgated by the International Capital Market Association and the Climate Bonds Standards developed by the Climate Bonds Initiative.(25)

Even public responses to the SEBI Consultation Paper predominantly endorse the GBP.(26) This preference is consistent with existing market practices, as evidenced by Yes Bank’s

19. SEBI Consultation Paper para 4.4.

20. *ibid* .

21. Cristina M Banahan, ‘The Bond Villains of Green Investment: Why an Unregulated Securities Market Needs Government to Lay Down the Law’ [2019] 3 Vermont Law Review <https://lawreview.vermontlaw.edu/wp-content/uploads/2019/06/vlaw_43n4_Banahan.pdf> accessed 15 January 2025.

22. Pauline Deschryver and Frederic de Mariz, ‘What Future for the Green Bond Market? How Can Policymakers, Companies, and Investors Unlock the Potential of the Green Bond Market?’ [2020] 13(3) Journal of Risk and Financial Management <<https://doi.org/10.3390/jrfm13030061>> accessed 15 January 2025.

23. SEBI Consultation Paper at para 4.5.

24. SEBI Consultation Paper.

25. Lloyd Freeburn and Ian Ramsay, ‘Green bonds: legal and policy issues’ [2020] 15(4) Capital Markets Law Journal <<https://academic.oup.com/cmlj/article/15/4/418/5917371?login=true#218137210>> accessed 15 January 2025.

26. ASIFMA, ‘ASIFMA response to SEBI Consultation Paper on Expanding the Scope of the Sustainable Finance Framework in the Indian Securities Market’ (ASIFMA, 6 September 2024) <<https://www.asifma.org/resource/asifma-response-to-sebi-consultation-paper-on-expanding-the-scope-of-the-sustainable-finance-framework-in-the-indian-securities-market-2024/>> accessed 15 January 2025.

maiden Indian Green Bond issue in 2015, which adhered to the GBP.(27) Similarly, the first rupee-denominated Masala Green Bond issued on the London Stock Exchange also conformed to the GBP.(28) Notably, SEBI's existing framework for Green Bonds under the ILNCS Regulations, as well as the Government of India's issuance of Indian Sovereign Green Bonds, are both aligned with the GBP.(29) So, it may be prudent to infer that the GBP is one of the most influential voluntary standards SEBI may recommend. This GBP, introduced by the International Capital Market Association in 2014, is widely recognised as the leading guideline for evaluating a bond's environmental credentials.(30) GBP has four core components(31) :

- Use of Proceeds: which must finance Green Projects with clear environmental benefits;
- Process for Project Evaluation and Selection: requiring issuers to disclose environmental objectives and criteria for project selection;
- Management of Proceeds: mandating transparent tracking and allocation of funds to eligible projects and
- Reporting: encouraging annual updates on project allocations and impacts, including qualitative and quantitative metrics.

There are aspects like external review and second-party opinions under the GBP framework that ensure transparency.(32) Nevertheless, the most widely endorsed framework has limitations, such as greenwashing, which is discussed in the next section of this paper.

27. Yes Bank, 'YES BANK's maiden 'Green' Infrastructure Bond Issue' (Bombay Stock Exchange, 28 Feb 2018) <<https://www.bseindia.com/downloads/ipo/201522615053yes%20bank%20im.pdf>> accessed 15 January 2025.

28. NTPC, 'NTPC's Green Bond' (NTPC) <<https://ntpc.co.in/foreign-bonds/ntpcs-green-bond>> accessed 15 January 2025.

29. SEBI, 'SEBI Board Meeting' (SEBI Press Release, 20 Dec 2022) <https://www.sebi.gov.in/media/press-releases/dec-2022/sebi-board-meeting_66407.html> accessed 15 January 2025; see also Geeta Shreeprabha, 'Sovereign Green Bonds: Fuelling India's Sustainability Revolution' (Indian School of Public Policy, 14 Feb 2024) <<https://www.ispp.org.in/sovereign-green-bonds-fuelling-indias-sustainability-revolution/>> accessed 15 January 2025.

30. Torsten Ehlers and Frank Packer, 'Green Bond Finance and Certification' [2017] BIS Quarterly Review <<https://ssrn.com/abstract=3042378>> accessed 15 January 2025.

31. International Capital Market Association, 'Green Bond Principles Voluntary Process Guidelines for Issuing Green Bonds' (International Capital Market Association, June 2018) <<https://www.icmagroup.org/assets/documents/regulatory/green-bonds/green-bonds-principles-june-2018-270520.pdf>> accessed 15 January 2025.

32. Richard Kelly and others, 'ESG: Green Bond Principles updated' (Matheson, 18 June 2021) <<https://www.matheson.com/insights/detail/esg-green-bond-principles-updated>> accessed 15 January 2025.

Greenwashing

Green Securitisation's potential is tempered by greenwashing risks arising from voluntary frameworks. This study will primarily focus on the perils of greenwashing prompted by the voluntary frameworks and their implications for Green Securitisation. As SEBI has previously sought to address greenwashing, particularly within the green bond market and independent of voluntary frameworks, it defines greenwashing as “making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation.”⁽³³⁾

a. Giving Meaning to Greenwashing

Environmental activist Jay Westerveld introduced the term ‘greenwashing’ in 1986, critiquing companies that touted environmental responsibility without substantiating their claims.⁽³⁴⁾ Research indicates that greenwashing undermines trust in environmental claims, discourages investments, and fosters scepticism, risk perception, and reduced consumer purchasing intent.⁽³⁵⁾ Beyond these effects, it also damages organisational credibility, influencing perceptions of products, environmental commitments, and user experiences across both physical and digital platforms.⁽³⁶⁾

In the realm of sustainable finance, the phenomenon of greenwashing comprises the deliberate mischaracterisation of investment vehicles as environmentally benign, thereby fostering a misguided impression regarding a company's purported dedication to ecological stewardship and responsible practices.⁽³⁷⁾ However, not all companies engage in greenwashing

33. SEBI, ‘Dos and don'ts relating to green debt securities to avoid occurrences of greenwashing’ (SEBI Circular, 3 February, 2023) <https://www.sebi.gov.in/legal/circulars/feb-2023/dos-and-don-ts-relating-to-green-debt-securities-to-avoid-occurrences-of-greenwashing_67828.html> accessed 15 January 2025.

34. Kristina Marusic, ‘To Prove Your Company Isn't Greenwashing, Endorse Smart Regulation’ (Harvard Business Review, 15 November 2023) <<https://hbr.org/2023/11/to-prove-your-company-isnt-greenwashing-endorse-smart-regulation>> accessed 15 January 2025.

35. Han Chen, Shaniel Bernard and Imran Rahman, ‘Greenwashing in hotels: A structural model of trust and behavioral intentions’ [2019] 206 *Journal of Cleaner Production* <<https://www.sciencedirect.com/science/article/abs/pii/S095965261832897X>> accessed 15 January 2025 ; See also Aysun Kahraman and Ipek Kazançogla, ‘Understanding consumers' purchase intentions toward natural-claimed products: A qualitative research in personal care products’ [2019] 28(3) *Business Strategy and the Environment* <<https://onlinelibrary.wiley.com/doi/10.1002/bse.2312>> accessed 15 January 2025.

36. Lucia Gatti, Marta Pizzetti and Peter Seele, ‘Green lies and their effect on intention to invest’ [2021] 127 *Journal of Business Research* <<https://www.sciencedirect.com/science/article/pii/S0148296321000333>> accessed 15 January 2025.

37. Greg Schneider-Maunoury, ‘Is Greenwashing a Definition or only a Hinderance of Sustainable Finance?’ (SSRN, 20 July 2023) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4507184> accessed 15 January 2025.

in the same way; the strategies employed can vary significantly and influence how stakeholders react to them.⁽³⁸⁾ A particular manifestation of greenwashing in the green finance sphere arises when an issuer engages in duplicitous conduct, deceiving investors regarding the purported utilisation of proceeds for environmentally sustainable objectives while refraining from requisite regulatory oversight and transparency.⁽³⁹⁾

The European Supervisory Authorities' (i.e. European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority) call for evidence regarding greenwashing risks and drivers to present a nuanced framework, dissecting greenwashing into four distinct yet interconnected dimensions. Firstly, it examines the roles assumed by market participants in perpetuating greenwashing, categorising them as initiators, disseminators, and recipients. The second dimension delves into the substantive aspects of sustainability-related claims, encompassing an entity's organisational structure, strategic orientation, and assertions regarding future environmental performance. The third dimension scrutinises the deceptive characteristics of such claims, including intentional concealment, selective presentation of favourable data, and other forms of misrepresentation. Lastly, the fourth dimension investigates the various channels through which these claims are communicated, including ratings, benchmarks, marketing materials, and other disclosure mechanisms.⁽⁴⁰⁾ The risk of greenwashing is disproportionately higher for Securitised Green Debt Instruments compared to green bonds.

b. Greenwashing and Securitisation

As a crucial driver of investment in green finance lies not solely in the financial performance of the asset class but rather in the extent to which the assets exhibit environmentally sustainable characteristics.⁽⁴¹⁾ Consequently, investors will prioritise the 'greenness' of the underlying debt of an SSDI over other factors, such as credit ratings. However, when

38. Menno D. T. de Jong, Gabriel Huluba, and Ardion D. Beldad, 'Different Shades of Greenwashing: Consumers' Reactions to Environmental Lies, Half-Lies, and Organizations Taking Credit for Following Legal Obligations' [2019] 34(1) *Journal of Business and Technical Communication* <<https://journals.sagepub.com/doi/10.1177/1050651919874105>> accessed 15 January 2025.

39. Andreas Karpf and Antoine Mandel, 'Does it Pay to Be Green?' [2017] *Socially Responsible Investment eJournal* <<https://www.semanticscholar.org/paper/Does-it-Pay-to-Be-Green-Karpf-Mandel/071adb7ef2575fde469233be44b13238ddfaa221>> accessed 15 January 2025.

40. 'ESAs Call for Evidence on Better Understanding Greenwashing' (European Banking Authority, 15 November 2022) <<https://www.eba.europa.eu/publications-and-media/press-releases/esas-launch-joint-call-evidence-greenwashing>> accessed 15 January 2025.

41. Chaoxi Liang (n 3).

greenwashing occurs in the underlying debt of an SSDI, market demand for such securities may plummet.

Securitisation has historically been susceptible to moral hazard **(42)** risks,**(43)** most notable example being the Lehman Brothers crisis.**(44)** This risk creates fertile ground for greenwashing to exploit and thrive. For example, the receipt of timely interest payments, as stipulated in the contractual agreement, can substantially complicate a bondholder's ability to flag non-compliance with the environmental terms of the bond **(45)** The existing frameworks can hardly address this issue of Greenwashing.

c. Framework Faultlines

Practitioners highlighted four key faultlines that exist in existing voluntary frameworks: investors may harbour concerns regarding the environmental credibility of projects financed by bond proceeds. Furthermore, the sustainability of the issuer's core operations may be questionable, as illustrated by oil and gas companies' issuance of green bonds. Inadequate tracking and management of green proceeds can also lead to misallocation, while issuers may face difficulties in demonstrating the tangible environmental benefits of their projects, thereby compromising the integrity of their green commitments. **(46)** However, a counterargument to this may be that these may still be overcome by external reviews, which are integral to many of these frameworks. **(47)** Before addressing this contention, it has to be pointed out that multiple frameworks foster regulatory competition among pri-

42. Moral hazard occurs when a party's insulation from potential consequences diminishes its incentive to mitigate financial risks see Mark V. Pauly, 'The Economics of Moral Hazard: Comment' [1968] 58(3) *The American Economic Review* <<https://www.jstor.org/stable/1813785>> accessed 15 January 2025.

43. Liu Zhuang, 'Moral hazard in securitization: Between Truth and Illusion' [2017] 5(2) . *Peking University Law Journal* <<https://www.tandfonline.com/doi/full/10.1080/20517483.2017.1427126>> accessed 15 January 2025.

44. Kevin Dowd, 'Moral Hazard and the Financial Crisis' [2009] 29(1) *Cato Journal* <<https://www.cato.org/sites/cato.org/files/serials/files/cato-journal/2009/1/cj29n1-12.pdf>> accessed 15 January 2025.

45. Michael Doran and James Tanner, 'Critical Challenges Facing the Green Bond Market' (Baker McKenzie, 23 September, 2019, <<https://www.bakermckenzie.com/-/media/files/insight/publications/2019/09/iflr-green-bonds-%28002%29.pdf>> accessed 15 January 2025.

46. Wim Bartels and others, 'Gearing up for green bonds' (KPMG, 2015) <<https://assets.kpmg.com/content/dam/kpmg/pdf/2015/03/gearing-up-for-green-bonds-v1.pdf>> accessed 15 January 2025.

47. Elsa Allman and Brandon Lock, 'External reviews and green bond credibility' [2024] 7 *Journal of Climate Finance* <<https://www.sciencedirect.com/science/article/pii/S2949728024000063>> accessed 15 January 2025.

vate governance regimes and enable market participants to engage in regulatory arbitrage.⁽⁴⁸⁾ This dynamic can result in a 'race to the bottom,'⁽⁴⁹⁾ where standards are progressively diluted, thereby heightening the risk of greenwashing.⁽⁵⁰⁾ A solution to this may be to propose a framework by the market regulator and not any private entities, which SEBI is anyways proposing to do.⁽⁵¹⁾

Already, SEBI has tried to tackle the perils of greenwashing in the case of Green Bonds via a circular dated February 3, 2023.⁽⁵²⁾ According to this circular, companies must furnish precise, corroborated, and transparent disclosures regarding their ecological footprint. Moreover, the circular imposes an additional requirement on companies to publicly disclose their environmental objectives and to ensure that issuers refrain from misrepresenting or falsifying third-party certifications, thereby maintaining the integrity of their sustainability claims.⁽⁵³⁾ Additionally, a subsequent circular issued on February 6, 2023, introduced a further requirement, necessitating the engagement of a reputable, independent third-party entity to conduct a review of the project's viability, eligibility criteria, and the issuance of green debt securities.⁽⁵⁴⁾ This process essentially mirrors the external review mechanisms inherent in voluntary frameworks. But there exists further faultlines while relying upon external reviewers as a safeguard against Greenwashing. There can be another 'race to the bottom' between the external reviewers. Similar to the situation with credit rating agencies prior to

48. Stephen Park, 'Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution' [2018] 54(1) *Stanford Journal of International Law* <https://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/stanit54§ion=5> accessed 15 January 2025.

49. Ryan Chan, 'Ensuring impactful performance in green bonds and sustainability-linked loans' [2021] 42(1) *Adelaide Law Review* <<https://search.informit.org/doi/abs/10.3316/informit.20210914053384>> accessed 15 January 2025.

50. Silvia Ruiz-Blanco, Silvia Romero and Belen Fernandez-Feijoo, 'Green, blue or black, but washing—What company characteristics determine greenwashing?' [2022] 24 *Environment, Development and Sustainability* <<https://link.springer.com/article/10.1007/s10668-021-01602-x>> accessed 15 January 2025.

51. SEBI Consultation Paper para 3.4.

52. SEBI (n 32).

53. Tejaswini Kaushal, 'Revealing the Faultlines: The Perils of Corporate Greenwashing in India's ESG Landscape' (Centre for Corporate Law - National Law University Odisha, 15 January 2024) <<https://ccl.nluo.ac.in/post/revealing-the-faultlines-the-perils-of-corporate-greenwashing-in-india-esg-landscape>> accessed 15 January 2025.

54. SEBI, 'Revised Disclosure Requirements for Issuance and Listing of Green Debt Securities' (SEBI Circular, 6 February, 2023) <https://www.sebi.gov.in/legal/circulars/feb-2023/revised-disclosure-requirements-for-issuance-and-listing-of-green-debt-securities_67837.html> accessed 15 January 2025.

the global financial crisis.(55) Need not to point out that the Indian market has witnessed numerous instances of third-party auditors or reviewers succumbing to moral hazards.(56)

As SEBI is contemplating recommending a framework based on the existing voluntary frameworks and also asked the stakeholders for recommendations of any other voluntary framework for their consideration through the Second Question in the SEBI Consultation Paper, we recommend that instead of reproducing a framework from a mixture of the existing voluntary frameworks, SEBI may consider developing a bespoke framework, independent of voluntary frameworks. We are of the opinion that the framework that will be developed should use various kinds of technological innovations to minimise human intervention in the entire transaction so as to reduce any kind of risk of anyone succumbing to moral hazard. In the next section of this paper, we will further delve into how blockchain technology can enhance transparency and accountability in the Green Bond and Green Securitisation market, providing a robust mechanism to mitigate the risks of greenwashing.

BLOCKCHAIN AND TRANSPARENCY

a. Blockchain and Its Potential

Blockchain has a lot of unrealised potential for combating greenwashing when used in issuing Green Bonds.(57) Blockchain is a decentralised digital ledger that securely and openly records transactions without the need for middlemen or central authority.(58) To create an unchangeable and impenetrable record, every data block is encrypted and connected to the one before it.(59) Transactions are validated through a decentralised network of users, ensuring accuracy and integrity.(60)

55. Noel Murray, Ajay K. Manrai and Lalita Ajay Manrai, 'The financial services industry and society: The role of incentives/punishments, moral hazard, and conflicts of interests in the 2008 financial crisis' [2017] 22(43) *Journal of Economics, Finance and Administrative Science* <<https://www.emerald.com/insight/content/doi/10.1108/jefas-02-2017-0027/full/html>> accessed 15 January 2025.

56. Price Waterhouse, In re [2018] SCC OnLine SEBI 3.

57. Gregor Dorfleitner and Diana Braun, 'Fintech, Digitalization and Blockchain: Possible Applications for Green Finance' in Marco Migliorelli and Philippe Dessertine (ed) *The Rise of Green Finance in Europe: Opportunities and Challenges for Issuers, Investors and Marketplaces* (Palgrave Macmillan, 2019) <https://link.springer.com/chapter/10.1007/978-3-030-22510-0_9> accessed 15 January 2025.

58. Zinon Zinonos and others, 'ParkChain: An IoT Parking Service Based on Blockchain' (15th International Conference on Distributed Computing in Sensor Systems, Santorini, May 2019) <<https://ieeexplore.ieee.org/document/8804765/>> accessed 15 January 2025.

59. *ibid.*

60. *ibid.*

Smart contracts, which are self-executing agreements built into the blockchain, are one of its most prominent features. These smart contracts increase accountability and eliminate the need for middlemen by automatically enforcing obligations if predetermined criteria are satisfied. Numerous industries have adopted blockchain due to its dependability and openness. **(61)** Supply chain management, for instance, monitors the sources and movements of products to guarantee sustainable and ethical sourcing. **(62)** By facilitating the clear tracing of funds, it also plays a vital part in the fight against financial crimes like money laundering. Additionally, blockchain makes it easier to create secure digital identities, increasing the accuracy of credit checks and lowering the danger of identity theft. **(63)**

The potential for blockchain-based security tokens to solve inefficiencies in green investment markets, such as stringent minimum investment requirements and expensive certification and monitoring fees. **(64)** According to existing literature, tokenising assets or financial instruments can improve market transparency, remove liquidity and size barriers, and cut transaction costs. Additionally, as the automated process would greatly limit human participation, the integration of blockchain and smart contracts may significantly minimise the danger of wrongdoing. **(65)**

b. Blockchain in the EU Green Bond Market

Blockchain has a lot of promise to combat greenwashing in the EU Green Bond market, according to existing research, but there is currently a lack of a strong legal framework. **(66)**

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61. Aichih (Jasmine) Chang, Nesreen El-Rayes and Jim Shi, 'Blockchain Technology for Supply Chain Management: A Comprehensive Review' [2022] 1(2) FinTech <<https://doi.org/10.3390/fintech1020015>> accessed 15 January 2025.
62. Shanliang Li and others, 'Can blockchain help curb "greenwashing" in green finance? - Based on tripartite evolutionary game theory' [2024] 435 Journal of Cleaner Production <<https://www.sciencedirect.com/science/article/abs/pii/S095965262304605X>> accessed 15 January 2025.
63. Mohd Javaid and others, 'A Review of Blockchain Technology Applications for Financial Services' [2022] 2(3) Bench Council Transactions on Benchmarks, Standards and Evaluations <<http://dx.doi.org/10.1016/j.bench.2022.100073>> accessed 15 January 2025.
64. Marco Schletz, Darius Nassiry and Myung-Kyoon Lee, 'Blockchain and tokenized securities: The potential for green finance' [2020] ADBI Working Paper Series No. 1079 <<https://www.adb.org/publications/blockchain-tokenized-securities-potential-green-finance>> accessed 15 January 2025.
65. Shanliang Li (n 61).
66. Dennis Heuer, 'New European Green Bond Standard is a game-changer' (White and Chase, 14 December 2023) <<https://www.whitecase.com/insight-our-thinking/new-european-green-bond-standard-game-changer>> accessed 15 January 2025.

Academics have suggested that blockchain technology be adopted as a way to solve issues like greenwashing.⁽⁶⁷⁾ Since the European Union has one of the strongest Green Bond frameworks, most of the blockchain-enabled frameworks are based on the European Green Bond Standards. EUGBS-Chain is one such framework that Christodoulou and their colleagues proposed. This framework presents a blockchain-based system for EU Green Bond (hereinafter “EUGB”) monitoring.⁽⁶⁸⁾

EUGBS-Chain uses a special-purpose framework to create a specialised smart contract that makes use of blockchain technology.⁽⁶⁹⁾ Assuring that EUGBs are invested in green growth projects rather than greenwashing techniques and enabling efficient monitoring of EUGBs to improve accountability and transparency are the two main functions of the smart contract.⁽⁷⁰⁾ To evaluate the smart contract’s performance in real-world scenarios, it is developed in Solidity and evaluated on an Ethereum Virtual Machine (hereinafter “EVM”) using programs such as Remix IDE.⁽⁷¹⁾ Scalability and versatility are guaranteed by the framework’s compatibility with any EVM-supported blockchain, including Ethereum, Polygon, or Avalanche.

Three important parties are involved in the framework. First, the governing body in charge of issuing and transferring green bonds is the EUGBS Admin.⁽⁷²⁾ Second, registered organisations fall into two categories: Type B organisations, which function as green financing companies and are only eligible to receive green bonds, and Type A organisations, which are permitted to own and invest in green bonds. Third, the public and other authorities can examine transaction records to confirm the direction and goal of green bond investments.⁽⁷³⁾

67. Panayiotis Christodoulou and others, ‘A blockchain-based framework for effective monitoring of EU Green Bonds’ [2023] 58(B) *Finance Research Letters* <<https://doi.org/10.1016/j.frl.2023.104397>> accessed 15 January 2025.

68. *ibid.*

69. Bénédicte N Nolens and Massamba Thiøye, ‘Smart Contract-based Carbon Credits attached to Green Bonds’ (BIS Innovation Hub, October 2022) <https://www.bis.org/about/bisih/topics/green_finance/genesis_2.htm> accessed 15 January 2025.

70. Panayiotis Christodoulou (n 66).

71. Shanliang Li (n 61).

72. Yu Gu, Lanxin Jiang and Jun Dai, ‘Using Blockchain and Smart Contracts to Combat Greenwashing in Environmental Disclosures’ (SSRN, 25 November 2024) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4982537> accessed 15 January 2025.

73. EU Platform on Sustainable Finance, ‘A Compendium of Market Practices How the EU’s Taxonomy and sustainable finance framework are helping financial and non-financial actors transition to net zero.’ (EU Platform on Sustainable Finance, January 2024) <https://finance.ec.europa.eu/system/files/2024-01/240129-sf-platform-report-market-practices-compendium-report_en.pdf> accessed 15 January 2025.

The first step in the EUGBS-Chain process is the deployment of smart contracts, which are created in Solidity and put on the blockchain using an Integrated Development Environment such as Remix.⁽⁷⁴⁾ The name of the issuing company and the initial supply of EUGBs are entered during deployment, creating a distinct smart contract address that permits communication with the contract's features.⁽⁷⁵⁾ The EUGBS Admin then registers organisations on the smart contract, providing the EVM-compatible address, name, and status of the organisation. To guarantee that investments are allocated to valid green projects, Type A organisations can transfer green bonds to Type B organisations. In contrast, Type B organisations are only permitted to receive green bonds. Any transfer from a Type A company to an unregistered firm is forbidden because it may be considered greenwashing.⁽⁷⁶⁾

By improving accountability, openness, and credibility, the EUGBS-Chain architecture successfully handles the difficulties of tracking Green Bond investments. Its blockchain-based design ensures that investments comply with environmental regulations by producing a tamper-proof record of transactions. The framework provides a safe and effective solution for stakeholders by lowering monitoring expenses and minimising fraud risks through process automation and middleman removal.

The EUGBS-Chain framework's usefulness is further increased by making it open source. Developers and stakeholders may review and improve the framework thanks to open access to the source code, which promotes transparency and teamwork. Additionally, it speeds up the process of identifying and fixing vulnerabilities, encourages creativity, and helps organisations without the ability to create proprietary solutions adopt the framework.

c. Correlation of the EUGBS-Chain with the "Green Securitization"

The main advantage of the framework is its capacity to create a voluntary standard for Green-Securitized Debt, enabling issuers to designate securities as EUGB if they satisfy particular sustainability requirements. By ensuring consistency throughout the Green Securitisation market, this standardisation boosts investor trust and promotes the expansion of green securitised securities.

74. Shanliang Li (n 61).

75. Shanliang Li (n 61).

76. Shanliang Li (n 61).

The framework enhances market efficiency by facilitating the verification of a bond's environmental credentials through a "Decentralised Distributed Ledger" (hereinafter "DLT"). Standardised criteria, in turn, foster increased investor participation and liquidity in the green ABS market by reducing the costs associated with evaluating green bonds.

The EUGBS-Chain mitigates greenwashing risks by introducing standardised asset classification protocols. This ensures that only environmentally sustainable projects qualify as green securitisation, safeguarding market integrity and fostering investor trust.

The EUGBS's flexibility in use-of-proceeds is crucial, allowing originators to meet green standards at their own level rather than at the special purpose vehicle level.⁽⁷⁷⁾ This incentivises originators to source more taxonomy-aligned assets, broadening the pool of eligible green assets and increasing the supply of Green Securitised Debt.

The system mandates rigorous reporting and disclosure protocols, aligning issuers with EU taxonomy standards. Issuers demonstrate accountability by providing detailed information on the use of proceeds and environmental impact, enabling stakeholders to critically evaluate Green-Securitised Debt sustainability claims.

A primary objective of the EUGBS-Chain is to facilitate funding for sustainable initiatives across various sectors, including infrastructure, renewable energy, and other environmentally critical fields. The framework ensures financial flows are directed towards genuinely sustainable projects by leveraging blockchain technology's immutability and transparency. Its alignment with the EU's climate and sustainability objectives underscores the framework's potential for yielding significant environmental and economic benefits. This context provides a compelling rationale for exploring an analogous framework tailored to the Indian sustainable finance market.

India - Green Securitization - A Proposal

This paper proposes a methodology for integrating a regulatory framework with blockchain technology to facilitate green securitisation in India. Given that the SEBI is tasked with

77. Sukhvir Basran, 'EU Council Adopts New European Green Bond Standard' (The National Law Review, 4 December 2023) <<https://natlawreview.com/article/eu-council-adopts-new-european-green-bond-standard>> accessed 15 January 2025; also see EU Data Ware House, 'The EU Green Bond Standard Regulation at a Glance' (EU Data Ware House) <<https://eurodw.eu/the-eu-green-bond-standard-regulation-at-a-glance/>> accessed 15 January 2025.

developing this framework, this paper suggests a complementary “Framework for Securitising Green Debt”. This framework builds upon the objectives outlined in SEBI’s consultation paper, incorporating blockchain technology to establish robust criteria for green securitisations that align with India’s sustainability and climate objectives.

The proposed architecture establishes a secure environment for issuing and overseeing green debt instruments, leveraging the transparency and immutability of blockchain technology. Utilising an EVM-compatible blockchain, such as Ethereum, Polygon, or Avalanche, the system employs Solidity-written smart contracts to automate key processes. These contracts facilitate automated verification of green assets, regulate issuing and transferring Green Bonds, and ensure compliance with SEBI’s regulatory framework through DLT.

The ecosystem encompasses several key stakeholders, including the SEBI, an SSDI Administrator, and two categories of participants: Type A organisations (originators) and Type B organisations (recipients). SEBI’s purview includes defining eligibility criteria for green assets and ensuring compliance with regulatory requirements. Meanwhile, the SSDI Administrator is responsible for facilitating bond transactions, registering eligible entities, and deploying smart contracts to enforce compliance.

The process commences with deploying a smart contract, which delineates the issuance and distribution of green bonds as blockchain tokens. These tokens are inextricably linked to specific green assets, ensuring accountability and traceability.⁽⁷⁸⁾ Registered Type A organisations can issue and transfer these bonds, while Type B organisations can acquire them to finance certified sustainable projects. The smart contract’s transfer function validates transactions to prevent unauthorised transfers and potential greenwashing. Furthermore, the contract leverages data oracles and IoT connectivity to enable real-time monitoring of financial returns and environmental impact.⁽⁷⁹⁾

The framework mandates regular reporting on project performance and fund allocation to ensure transparency and investor trust. Blockchain-recorded reports provide stakeholders with a comprehensive audit trail, encompassing transaction data, environmental impact, and

78. Tarun Kumar Agrawal and others, ‘Blockchain-based framework for supply chain traceability: A case example of textile and clothing industry’ [2021] 154 *Computers & Industrial Engineering* <<https://doi.org/10.1016/j.cie.2021.107130>> accessed 15 January 2025.

79. Hanane Allioui and Youssef Mourdi, ‘Exploring the Full Potentials of IoT for Better Financial Growth and Stability: A Comprehensive Survey’ [2023] 23(19) *Sensors* <<https://doi.org/10.3390/s23198015>> accessed 15 January 2025.

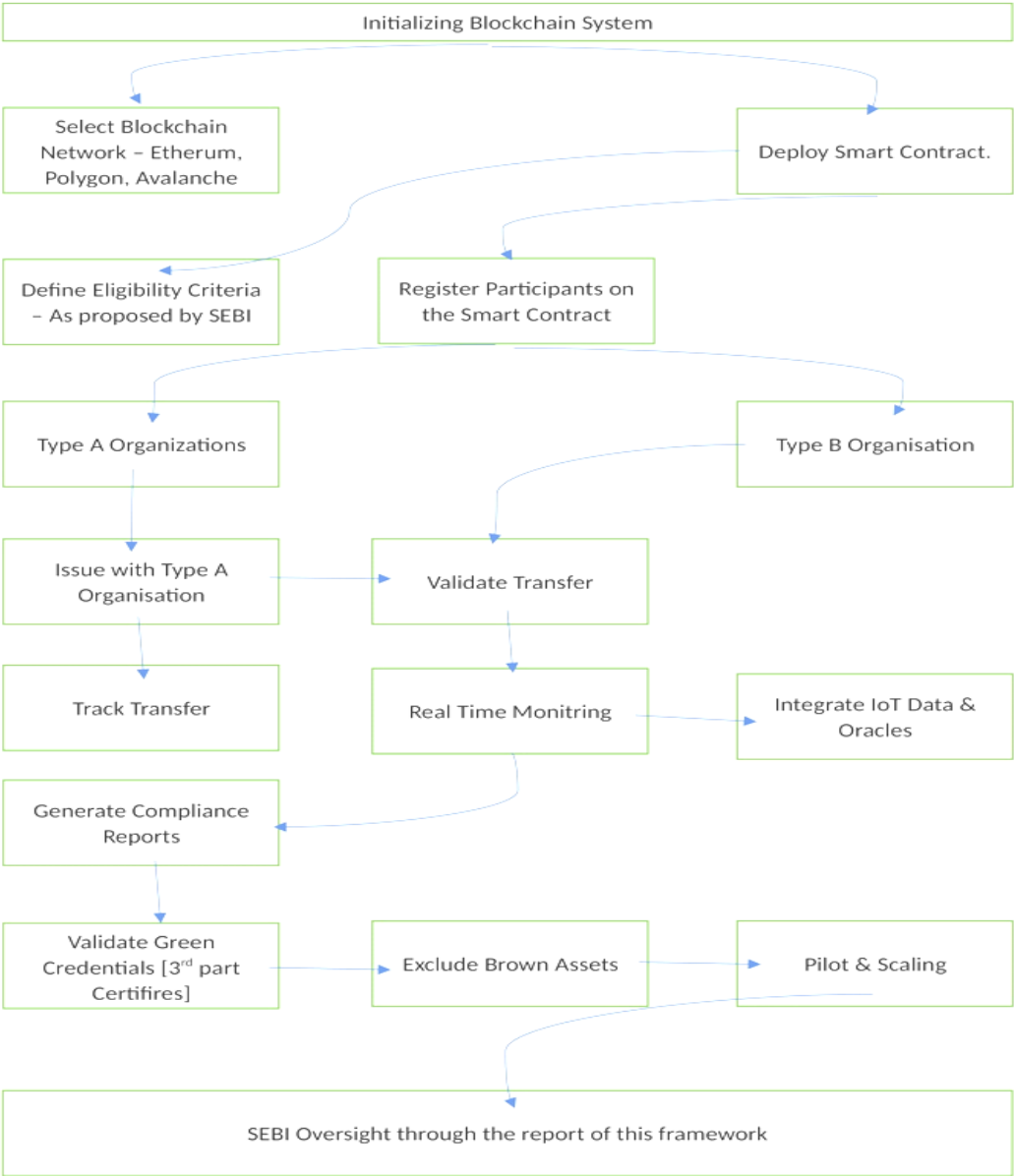
compliance records.**(80)** Additionally, third-party certifications to validate the environmental credentials of projects and assets, enhancing credibility, may also be there, along with the blockchain-based certification. However, that has to be compared with Blockchain-based outputs.

The framework also establishes legislative safeguards to exclude “brown” assets, such as those tied to the fossil fuel industry, from green securitisations. Here, SEBI can collaborate with voluntary frameworks to promote market standardisation, ensuring uniformity in securitisation protocols. Standardised templates for bond issuance, project evaluation, and reporting reduce assessment costs, simplify verification procedures, and foster greater investor participation.**(81)**

By integrating blockchain technology into green securitisation, SEBI can foster a transparent, efficient, and credible market for green debt products. This approach mitigates greenwashing concerns, bolsters investor confidence, enhances market liquidity, and contributes to India’s broader economic and environmental objectives.

80. Derrick Bonyuet, ‘Overview and Impact of Blockchain on Auditing’ [2020] 20 *The International Journal of Digital Accounting Research* <http://dx.doi.org/10.4192/1577-8517-v20_2> accessed 15 January 2025.

81. John C. Coates IV, ‘Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications’ [2015] 124 *Yale Law Journal* <<https://www.yalelawjournal.org/article/cost-benefit-analysis-of-financial-regulation>> accessed 15 January 2025.



The Proposed Framework for Green Securitisation

Conclusion

SEBI's suggested Sustainable Securitisation framework may fill India's significant sustainability finance gap. However, a let-loose securitisation regime can do remarkably more harm than good. This study narrowed the scope down to only the possibility of greenwashing, however, the researchers are of the opinion that the current framework may result in more pitfalls than foreseeable. This constitutes one of the recommendations to future researchers: to study the framework and further clarify the challenges associated with Green or Sustainable Securitisation Frameworks not just in India but at a global level. We believe this study may serve as a strong foundation for such discourse.

As to the pitfall of Greenwashing in Green Securitisation, the situation and its implications have already been pointed out in our piece and need not be reiterated. One of the biggest challenges of financial regulatory laws is that they have to safeguard the market from not always any external or tangible threat but a threat from within human instincts, i.e., moral hazards. One way of tackling moral hazards is over-regulation, which may hamper the ease of business and market flexibility. So, tackling such challenges with novel technological innovations like blockchain is the need of the hour. The suggested blockchain-based system reduces dependency on middlemen while increasing transparency, accountability, and investor trust by integrating features like smart contracts, real-time tracking, and tamper-proof reporting. It is pertinent to acknowledge that the researchers' limited expertise in blockchain technology constrained the development of a holistic framework. Consequently, the proposed blockchain-based framework relied heavily on existing literature and secondary sources, which presented a significant challenge in this study. This allows us to suggest our second recommendation to future researchers: to conduct an interdisciplinary study of law, finance and technology to study the current framework and propose a technology-based framework to ensure fairness and transparency in the market.

SEBI has been one of the earliest Indian regulators to embrace technology proactively.⁽⁸²⁾ One policy recommendation of this study is for SEBI and relevant regulators to be accommodating towards technological innovations that promote transparency. This is particularly crucial given their regulatory purview over systemically important institutions deemed 'too big to fail'.



82. Pavan Burugula, 'Sebi embraces tech, seeks more powers' Mint (20 April 2023) <<https://www.livemint.com/news/india/sebi-seeks-greater-autonomy-to-foster-tech-innovation-in-securities-market-in-talks-with-finance-ministry-to-revamp-sebi-act-sources-11682014695087.html>> accessed 15 January 2025.

Reining in on a Technology Giant - An Analysis of the Implications of the CCI's Order - in Re: Winzo Games

Abstract

Much discussion surrounding the legality of Real-Money Games (RMGs) has taken place over the years, including various judgments of the Supreme Court and the High Courts. Recently, Google was accused of having abused its dominance in the gaming industry through alleged preferencing, the display of warning messages when using Google's payment system for RMGs, and restrictions on advertising of RMGs other than those selected for Google's pilot program. Through this article, the authors analyse the intricacies of, and the implications of the recent order issued by the Competition Commission of India (CCI) in the case involving WinZO Games and Google LLC in five substantial parts, keeping in mind consumer welfare. Part I analyses the order's broader impact on India's burgeoning gaming

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industry, while Part II evaluates the issue considering the Ministry of Electronics and Information Technology's (MeitY) declaration as the regulator of the gaming industry, withdrawing the proposal to designate self-regulatory bodies (SRBs) for the same. Part III answers the imperative question of whether the choice of the two games for the pilot program amounts to an act of exercise of commercial freedom or denial of market access. Part IV studies the scope of the Director General's investigative powers concerning potential collusion between Google and a beneficiary of its pilot. Finally, Part V comprises of a game theoretical analysis of the implications of the order on the concerned stakeholders.

Introduction

"A fair and competitive market is a cornerstone of prosperity. Without it, innovation stalls, inequality grows, and the benefits of progress are unequally shared."

- Joseph Stiglitz(1)

Enterprises enter the business realm with the fundamental understanding that they would be protected against unfair practices. Competition law(2), in general, prohibits abuse of dominance,(3) gatekeeping,(4) anti-competitive agreements,(5) and predatory pricing.(6) The Competition Commission of India ("CCI") protects the interests of market players and prevents unfair practices that lead to a distortion of competition.(7) Recently, the CCI passed an order in Case No. 42 of 2022, involving a dispute between WinZO Games Private Limited ("WinZO") and Google LLC ("Google"), marking a pivotal moment in the ongoing battle for competitive fairness in India's digital ecosystem. The dispute revolves around Section 4 of the Act, which addresses abuse of dominance.(8)

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1. Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (W.W. Norton & Company, 2013).
 2. The Competition Act 2002 (12 of 2003).
 3. The Competition Act 2002, S. 4.
 4. *ibid* S. 4(2)(c).
 5. *ibid* S. 3.
 6. *ibid* S. 4(a)(ii).
 7. *ibid* S. 7.
 8. In re: WinZO Games and Google LLC, Case No. 42 of 2022. `

The informant - WinZO alleged that Google engaged in discriminatory practices, involving its exclusionary policy of including only Daily Fantasy Sports (“DFS”) and Rummy in its Real Money Games (“RMGs”) pilot program and preferential treatment in app listing and advertising on its Play Store platform.⁽⁹⁾ Play Store, being a pre-installed application on all android devices, makes it mandatory for game developers to comply with Google’s requirements. However, the issue stemmed from the fact that Google’s selective choice of RMGs for its pilot program (without objective justification) led to the detriment of the informant at the gain of its competitor. Dream11, a fantasy sports platform, benefitted massively from Google’s pilot program.⁽¹⁰⁾

In findings of abuse of dominance, a crucial pre-requisite is a delineation of the relevant market. In this case, the relevant markets were identified as the market for licensable Operating System (“OS”) for smart mobile devices in India, and the market for application stores available on devices with licensable OS in India. Google, with its Android operating system and Play Store, holds a dominant position in both markets. A dominant position gives the firm a level of control over its operations and its environment that allows it to operate independently of market forces, its competitors, and consumers. This case presents pertinent questions as to whether Google is abusing its dominant position to harm competition. These practices have sparked deliberations on imposition of restrictions on the provision of services, denial of market access, and imposition of unfair conditions. The CCI’s findings underscore the critical role of competition law in safeguarding the flourishing Indian gaming sector and ensuring a level playing field.

Analysis of the Order

The CCI’s order brings to light potential violations of Sections 4(2)(a)(i), 4(2)(b)(i), and 4(2)(c).⁽¹¹⁾ WinZO contended that these provisions, dealing with the abuse of dominant position, were violated by Google. The order marks a pivotal step underscoring the CCI’s effort to ensure fair competition in India’s burgeoning digital markets, particularly in the gaming sector.

The order centers around two integral aspects of digital platform regulation. Firstly, the exclusive nature of Google’s RMG pilot program, and, secondly, the discriminative practices in listing, advertising, and side loading warnings.⁽¹²⁾ . Google’s exclusionary practices, as captured in the order, appear to violate Sections 4(2)(a)(i), 4(2)(b)(i), and 4(2)(c).

9. *ibid.*

10. WinZO (N. 7).

11. *ibid.*

12. *ibid.*

Dominant platforms such as Google possess immense gatekeeping powers, which is perceived differently in different cases. For instance, as propounded in the CCI's order of *In re: Matrimony.com Limited v. Google LLC & Ors.*, Google's practices such as the "search bias" and overall, its unfair dominance over the search ecosystem was described as gatekeeping.⁽¹³⁾ Thus, it was inferred as the unfair ability of a dominant enterprise to control visibility and access for other actors in a market. Additionally, in *Google LLC & Anr. v. Competition Commission of India & Ors.*, Google's practices in the Android ecosystem were examined. The CCI observed that Google's practices, such as pre-installation requirements and exclusionary conditions, amounted to gatekeeping because Google's "must-have" status made the Play Store an unavoidable gateway for app developers seeking market access.⁽¹⁴⁾ Therefore, gatekeeping was deemed to be the practice of restricting access to one's competitors. Through this order, the CCI, once again, highlighted Google's gatekeeping power concerning critical access to inter alia, advertising and app distribution. By implementing selective restrictions and creating unequal market conditions, such practices are prima facie violative of Sections 4(2)(a)(i), 4(2)(b)(i), and 4(2)(c).⁽¹⁵⁾ This has underlined the imperativeness of developing more stringent regulatory measures to check the unhinged dominance of a single enterprise, safeguard the interests of enterprises dependent on dominant enterprises, and ensure fair growth of India's digital economy.

Thirdly, S. 4 of the Act emphasises on the special responsibility of dominant enterprises. Google's discriminatory behaviour, as highlighted by the CCI, underscores noteworthy concerns regarding responsibility interlinked with consumer choice and innovation and thus, are potentially violative of the said section.⁽¹⁶⁾ Such discriminatory practices have the potential to distort market competition. Moreover, these restrictive practices limit opportunities for enterprises dependent on dominant enterprises. This was highlighted by the Supreme Court of India ("SC") in *Excel Crop Care Ltd. v. Competition Commission of India*, where Excel Crop Care Ltd.'s anti-competitive conduct of refusing to supply products to a competing firm hindered market dynamics.⁽¹⁷⁾ Google's action of favouring specific categories of RMGs for its pilot program without objective justification has harmful implications for the flourishing Indian market for RMGs.

This is not the first time that the technology giant has attracted the ire of the law for antitrust violations. In *Epic v. Google*, a California jury found Google guilty of operating an illegal

13. *Matrimony.com Limited v. Google LLC & Ors.* [2018] CCI 07 of 2012.

14. *Google LLC & Anr. v. Competition Commission of India & Ors.* [2023] NCLT Competition Appeal (AT) No.01 of 2023.

15. The Competition Act 2002, S. 4.

16. *ibid.*

17. AIROnline 2017 SC 931.

monopoly.⁽¹⁸⁾ Epic's case partly revolved around a Google initiative known as "Project Hug," where the company paid large sums to key game and app developers to discourage them from launching competing services. In one instance, Google offered Activision-Blizzard, the parent company of Call of Duty, a substantial \$360 million in incentives to ensure its products were released on the Play Store. Google denied any wrongdoing, claiming it faces intense competition from Apple and that the payments were legitimate compensation for developers.

i) Implications under S. 4(2)(a)(i) of the Act

WinZO alleged that Google's policies contribute to the distortion of the market by allowing only certain types of RMGs, particularly DFS and Rummy Games in its pilot program – without objective justification.⁽¹⁹⁾ This preferential conduct is in potential violation of Section 4(2)(a)(i) of the Act – which prohibits dominant enterprises from imposing unfair or discriminatory conditions in the sale of goods or services.⁽²⁰⁾ Such a practice not only deteriorates competition in the market but also has a profound implication on consumer behaviour as it misleads consumers regarding the legitimacy of various gaming applications. Google's reasoning that DFS and Rummy Games are "games of skill" is legally correct as suggested through the cases of Avinash Malhotra v. State of Rajasthan⁽²¹⁾ and State of Andhra Pradesh v. K. Satyanarayana & Ors. respectively.⁽²²⁾ However, this reasoning does not adequately justify the exclusion of other categories of RMGs declared to be games of skill - such as poker⁽²³⁾. Thus, the exclusion of other RMGs in Google's pilot program lacks proper justification and undermines fairness.

The CCI has explained as to how this selective treatment contributes to a two-tiered market structure.⁽²⁴⁾ Privileged participants forming the first tier enjoy the fruits of preferential access, whereas the second tier of the general retail participants lack such access. This discriminatory classification presents a pressing need for a just and equitable marketplace.

ii) Implications under S. 4(2)(b)(i) of the Act

Section 4(2)(b)(i) of the Act explains that a dominant enterprise is deemed to have abused

18. Jury Verdict, In re Google Play Store Antitrust Litigation, No. 20-cv-05671 (N.D. Cal. Dec. 11, 2023), ECF No. 606.

19. WinZO (N 7).

20. The Competition Act 2002, S. 4(2)(a)(i).

21. AIROnline 2021 SC 1417.

22. AIR 1968 SC 825.

23. Indian Poker Association (IPA) v. The State of Karnataka, [2013], 39167 TO 39169 OF 2013, [6].

24. WinZO (N 7).

its dominant position if it “limits or restricts the production of goods or provision of services or market”.**(25)** It is noteworthy that when users attempted to transact with RMG developers through the use of Google Pay; Google imposed arbitrary payment warnings – amounting to the practice of limiting the offering of services, thereby abusing its dominance. Google, through its advertising policies and sideloading warnings, hindered consumer engagement and discouraged engagement with the offerings of other RMG services. Although Google argued that these sideloading warnings were justified**(26)** by compliance with the IT Rules**(27)**, their application to only certain categories of RMGs underlines its discriminatory enforcement. This aspect requires the CCI to study it closely with the view to coming up with measures that may prevent such practices from having adverse effects on consumers (through limiting consumer choice) as well as competition and innovation.

Moreover, through discriminatory practices of Play Store access, advertising, and visibility, Google apparently stifled development in the gaming sector. India’s gaming sector has grown by 23% in FY24 to USD 3.8 billion in revenue**(28)** and in 2023, India was the biggest gaming market globally. An unprecedented 568 million gamers and 9.5 billion gaming app downloads was recorded.**(29)** India cannot afford to run into roadblocks to further development in its gaming sector.

Initially, Google implemented the pilot program for one year but had extended it indefinitely.**(30)** This further deepened the chasm between the two tiers of participants and entrenched the market dominance of the privileged upper tier as the preferred RMG service offerors took advantage of wider consumer outreach and perceived legitimacy for a sustained period.

iii) Implications under S. 4(2)(c) of the Act

It is an entrenched principle of competition law that a dominant enterprise cannot deny market access to other enterprises.**(31)** The same has been enshrined under various stat-

25. The Competition Act 2002, S. 4(2)(b)(i).

26. WinZO (N 7).

27. The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021.

28. India Brand Equity Foundation, ‘India’s online gaming market grew by 23% in FY24’ (2024) <<https://www.ibef.org/news/india-s-online-gaming-market-grew-by-23-in-fy24-report>> accessed 14 January 2025.

29. India Brand Equity Foundation, ‘India’s Thriving Gaming Market’ (13 Aug 2024), <<https://www.ibef.org/blogs/india-s-thriving-gaming-market>> accessed 14 January 2025.

30. WinZO (N 7).

31. Competition Commission of India v. Fastway Transmission (P.) Ltd., AIR Online 2018 SC 875; Shamsher Kataria v. Honda Siel Cars India Ltd. [2015] 59 taxmann.com 419 (CCI).

utes such as Article 102 of the European Union's ("EU") Treaty on the Functioning of the European Union ("TFEU"), which prohibits the abuse of dominant position through the imposition of unfair trading conditions.**(32)** Further, under the Sherman Act of the United States, denial of market access is a prohibited behaviour.**(33)**

In the Indian context, Section 4(2)(c) of the Act prohibits the denial of market access.**(34)** In this case, the Play Store, being a pre-installed application, serves as the sole integral distribution channel in the Android ecosystem. Google's conduct of excluding non-DFS and non-rummy RMGs effectively denied market access to offerors of these RMGs. In addition, they were left with no alternatives, adding salt to their injuries.

The CCI's approach to Section 4(2)(c) in its order in WinZO games**(35)** demonstrates its appreciation of contemporary digital markets. The order indicates that the CCI is aware that in platform-mediated markets, access restrictions can manifest in subtle yet powerful ways. The recognition by the CCI that Google's extended pilot program, which offered a service without geographic or download restrictions, may confer insurmountable benefits on selected participants while prejudicing others, shows its understanding of how market power can be wielded in digital environments.

Of special interest, the CCI analyses Google's market position in relation to network effects.**(36)** Network effects are found when consumer behaviour is driven by the level of usage and engagement decisions of other consumers.**(37)** Availability of RMGs on the Play store not only allows much greater visibility to consumers and easier downloading but also increases the perceived value of such games through a rapidly expanding user base. Positive cross-group external effects**(38)** are observed since offerors of Rummy and DFS are better off the more users are present and vice versa. The CCI wisely understands that Google Play Store as a pre-installed application on all Android devices and being the largest app store, gives it the "must have" position. Google's selective inclusion of Rummy and DFS

32. Consolidated Version of the Treaty on the Functioning of the European Union, 2012 O.J. (C 326) 47 ('TFEU'), Art. 102(a).

33. The Sherman Act 1890 15 U.S.C. §§ 1-38., S 2.

34. The Competition Act 2002, S. 4(2)(c).

35. WinZO (N 7).

36. WinZO (N 7).

37. Paul Belleflamme, Martin Peitz, 'Platforms and network effects' (2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2894906> accessed 14 January 2025.

38. *ibid.*

amplified the positive network effects for the offerors of these games whilst perpetuating negative network effects for offerors of other types of RMGs. For instance, Dream11 gained 55 million users only within a year – ably driven by its inclusion in the pilot program.⁽³⁹⁾ This market reality highlights the anti-competitive impact of Google’s selective policies as being locked out of the Play Store means that offerors of other RMGs are precluded from access to an overwhelmingly large user base.

The order’s treatment of Google’s justifications for its selective policies is particularly instructive. Although Google has cited regulatory risks and risk management as reasons for its strategy, the CCI noted that there were contradictions in these reasons, including the inconsistency between Google’s policy on hosting of RMG apps and its acceptance of advertising revenues from specific RMG categories since 2019. This analysis shows the pressing need to examine commercial justifications in the context of a broader market setting.

The CCI’s approach to remedial measures, involving investigation as opposed to immediate intervention, is intentionally cautious given the intricate nature of the markets in question. This position recognises that there is a need to assess the interplay between competition law enforcement and new regulatory approaches considering threats and opportunities presented by the Ministry of Electronics and Information Technology (“MeitY”)⁽⁴⁰⁾’s role as regulator for the online gaming sector.

The MeitY’s volte-face - Withdrawal of the Proposal to Designate Self-Regulatory Bodies

In early 2024, the MeitY announced that it had dropped the task of designating Self-Regulatory Bodies (“SRBs”) and that it would, instead, act as the regulator of the gaming industry.⁽⁴⁰⁾ This implies that Google could no longer have relied on the Government’s designation of SRBs to determine which RMGs could be offered without attracting the ire of the regulator. Therefore, the tests to determine the character of a game as that of skill laid down in various case law are to be applied on a case-by-case basis to determine the nature of a RMG

39. WinZO (N 7).

40. Jatin Grover, ‘MeitY to prepare guidelines soon: Proposals for industry body rejected, Centre to regulate e-gaming’, (IndianExpress, 13 Feb 2024) < <https://indianexpress.com/article/india/meity-to-prepare-guidelines-soon-proposals-for-industry-body-rejected-centre-to-regulate-e-gaming-9156525/> > accessed 14 January 2025.

The MeitY's rationale for withdrawing from its previous position is based on its belief that deciding on the approval of games as games of skill should not be left to gaming companies lest they use such power unethically to hijack the market.⁽⁴¹⁾ Since the MeitY shall now decide as to the character of a game when it is specifically challenged, this is a mechanism that ensures that the balance of power does not unilaterally tip towards online gaming companies.

Case Law on the Legality of Online Fantasy Games and Rummy as Games of Skill

In *State of A.P. v. K. Satyanarayana*⁽⁴²⁾ the Supreme Court ("SC") explained that games that do involve an element of chance cannot be characterized as games of chance based on that single criterion alone – holding that Rummy was mainly a game of skill. However, the court did explain the caveat that if there was evidence of gambling or the owner of the game making a profit for stakes, that it would fall out of classification as a game of skill.

The SC, in *K.R. Lakshmanan (Dr) v. State of T.N.*⁽⁴³⁾ explained that golf, chess, and even rummy was a game of skill. The court also explained that based on prior jurisprudence of the courts, that the distinction between games of skill and games of chance was the degree of predomination of the element of skill over that of chance.

Concerning online fantasy sports, various judgments of the High Courts upheld the legal validity of such games as online games of skill.⁽⁴⁴⁾ In *Avinash Mehrotra v. The State of Rajasthan & Ors* ⁽⁴⁵⁾, the SC put an end to any potential ambiguity on the same by dismissing a special leave petition that sought relief from the court in the form of the declaration of online fantasy sports as gambling activities.⁽⁴⁶⁾

41. Shouvik Das, 'Online gaming self-regulation hits roadblock, Meity weighs direct control' (Livemint, 1 Jan 2024) <<https://www.livemint.com/industry/online-gaming-self-regulation-hits-roadblock-meity-weighs-direct-control-11704104343456.html#:~:text=NEW%20DELHI%20%3A%20The%20process%20of,games%20and%20companies%20hosting%20them.>> accessed 15 January 2025.

42. AIR 1968 SC 825.

43. AIR 1996 SC 1153.

44. *Varun Gumber v. UT, Chandigarh*, 2017 Cri LJ 3827 (P&H); *Gurdeep Singh Sachar v. U. O. I.*, 2019 (3) ABR (Cri) 467; *Ravindra Singh Chaudhary v. U. O. I.*, AIR Online 2020 Raj 785.

45. AIR Online 2021 SC 1417.

46. ETPrime, 'Supreme Court upholds Dream11 fantasy sports format as game of skill' (Economic Times, 4 Aug 2021) <<https://economictimes.indiatimes.com/technology/startups/supreme-court-upholds-dream11-fantasy-sports-format-as-game-of-skill/articleshow/85040855.cms?from=mdr>> accessed 15 January 2025.

Whether the choice of the two games for the pilot program is merely an act of exercise of commercial freedom or an act of denial of market access

Google explains that its choice of the two games for the pilot program was based on the “fragmented regulatory and legal landscape for RMG apps in India and risks that RMG apps carry”.⁽⁴⁷⁾ This argument that Google relies on is rather shaky for the three following reasons:

i. There is a lack of justification for the selection of only two types of RMGs to the exclusion of others that have been explicitly declared to be games of skill by Indian Courts

Apart from Rummy and DFS, other RMGs have also been held to be legal games of skill by Indian courts. In *Junglee Games India Private Limited v. State of T.N.*⁽⁴⁸⁾ and *All India Gaming Federation v. State of T.N.*⁽⁴⁹⁾, the Madras High Court (“HC”) held that both poker and rummy were games of skill. In August 2024, the Allahabad HC explained in its order that both rummy and poker are “absolutely a game of skill and not gambling”.⁽⁵⁰⁾ Google’s justification for its exclusive choice of DFS and Rummy since these RMGs were declared as games of skill⁽⁵¹⁾ when, say, Poker was also declared to be a game of skill is rather untenable and devoid of logical coherence.

ii. Relying on the Courts or the MeitY to declare an exhaustive list of online games of skill is impractical

As a logical extension of the previous argument, Google’s argument that it awaited further legal clarity on designation of RMGs as games of skill to decide upon the incorporation of further games in its pilot program is untenable. The SC has adopted the ‘dominant factor’ test⁽⁵²⁾ in *State of A.P. v. K. Satyanarayana*⁽⁵³⁾ and *K.R. Lakshmanan (Dr) v. State of*

47. WinZO (N 7).

48. AIR 2021 Mad 252.

49. AIROnline 2023 Mad 2226.

50. DM Gaming (P) Ltd. v. State of U.P., AIROnline 2024 All 1546.

51. WinZO (N 7).

52. Gowree Gokhale, Rishabh Sharma, ‘The ‘Skill Element’ in Fantasy Sports Games’, <https://www.nishithdesai.com/Content/document/pdf/Articles/180406_A_Legality_of_Fantasy_Sports_India.pdf> accessed 14 Jan 2025.

53. AIR 1968 SC 825.

T.N.(54) by explaining that where the element of skill in the game predominates that of chance, that the game be categorised as a game of skill. As such, the courts or the MeitY cannot be expected to determine an exhaustive list of RMGs of skill. This is because it would add an inordinate burden on them, with RMG providers facing significant challenges in seeking permission to carry out their business, leading to delays and unnecessary expenditure. Additionally, it is hard to imagine how the MeitY could declare an exhaustive list when new games are constantly being developed. It is for RMG providers to apply the dominant factor test before offering a game. Should there be any opposition to the offering of a game as a game of skill, the courts or the MeitY may then intervene to prevent a developer from unfairly offering a game of chance as a game of skill.

iii. Territorial limitations on application downloading and advertising is not applicable in states in which all RMGs are forbidden

As stated in the order, the states of Kerala, Andhra Pradesh, and Telangana forbid all kinds of RMGs.(55) Google did not impose any territorial restrictions on advertising and downloading of Rummy and DFS on the play store in these states. Google should have, instead, allowed downloading and advertising of all RMGs or disallowed all in toto. By choosing DFS and Rummy as the only RMGs in its Pilot, Google has potentially contributed towards a distortion of the market for RMGs and allegedly denied market access to gaming companies offering RMGs other than DFS and Rummy.

Implications on the Question of whether relief under S. 33 of the Competition Act can be granted to the Informant

Google's action of initially choosing the two types of RMGs for its pilot program for a period of one year from 28.09.22 to 28.09.23, the declaration of the grace period from September 2023 to 15.01.24, its further extension of the grace period until 21.06.24, and an indefinite extension beyond 30.06.24 led to economic losses to the informant with substantial growth in the earnings of its competitor - Dream11. The lack of objective justification for Google's choice of the two RMGs and the pilot program's indefinite extension led to the CCI's prima facie view that such conduct is violative of S. 4(2)(c)(56) . In CCI v. SAIL,(57) the SC

54. AIR 1996 SC 1153.

55. WinZO (N 7).

56. The Competition Act 2002, S. 4(2)(c).

57. CCI v. SAIL, 2010 AIR SCW 6238.

explained that S. 33 may be used by the CCI when it has formed a prima facie opinion and has directed investigation under S. 26(1). The CCI is required to apply its mind and arrive at a definite satisfaction that the requirements of S. 33 are fulfilled.⁽⁵⁸⁾ The authors are of the belief that it is wise to pass an order under S.33⁽⁵⁹⁾ to temporarily restrain Google from continuing its pilot program. This temporary restraint order would provide a much-needed reprieve to enterprises such as the informant who would continue to be harmed economically should the pilot program be allowed to continue until a finality to the issue is arrived at.

An Analysis of Potential Collusion between Google and Dream11

The selective treatment by Google concerning DFS and Rummy is the common thread that binds all the concerns raised. It is a worthwhile exercise to find out whether Dream11, a DFS gaming company that has benefitted from the pilot program, could potentially be investigated for collusive behaviour. As mentioned earlier, Dream11 gained a whopping 55 million user base within a short span of one year, greatly benefitting from Google's pilot program. In this part, the authors seek to analyse the scope of the DG's investigative powers.

A. The Scope of the DG's investigation – Could Dream11 be investigated for antitrust infringement?

Para 62 of the order mentions that the DG's investigation shall be limited to the issues identified by the CCI in the order. One of the issues identified by the CCI concerns S. 4(2)(a)(i) i.e., Google's potential discriminatory behaviour in allowing advertisements for non-DFS and non-rummy games by WinZO's competitors. While there are no aspersions cast by the CCI on Dream11 (a beneficiary of the pilot program), the question arises whether Dream11 can be investigated for potential antitrust violations if the DG finds reason to do so. Essentially, the question may be rephrased as:

Does the phrase 'limited to the issues identified in the order' imply a restriction of scope of the parties under investigation?

Of particular importance in answering the question is the recent lawsuit filed by a former seller on Amazon – Appario against the CCI for its investigation of the seller for potential

58. *ibid.*

59. *ibid* S. 33.

antitrust violations.⁽⁶⁰⁾ The original matter of investigation was alleged discriminatory behaviour on the part of Amazon in favouring certain types of sellers on its platform. Appario contended that the CCI had exceeded its authority by investigating it along with Amazon. In the initial CCI order of *In Re: Delhi Vyapar Mahasangh*⁽⁶¹⁾, Appario Retail was not named as an opposite party. However, as a beneficiary of preferencing by Amazon, the DG was ordered to investigate these practices. In *Excel Crop Care Ltd. v. CCI*⁽⁶²⁾, the SC explained that the DG's scope of investigation under S. 26(1) would be dependent on the language of the order passed by the CCI. Furthermore, the court explained that the DG was required to explore all facts and that if while investigating, further facts are found, it was undoubted that the DG had the power to investigate these facts. The court explained the purpose of an investigation under S. 26 by stating that it was to "cover all necessary facts and evidence in order to see as to whether there are any anti-competitive practices adopted by the persons complained against." In *Cadila Healthcare Ltd. v. CCI*,⁽⁶³⁾ the Delhi HC explained that the DG's investigation of the complainant (not initially named in the prima facie order for investigation) was legally valid. In *Mahindra Electric Mobility Limited v. Competition Commission of India* ⁽⁶⁴⁾, the Delhi HC emphasised on the expanded scope of investigation of the DG by explaining that the DG can investigate persons or enterprises not named in the order for investigation (without a specific order from the CCI) where there is reason to believe that they have participated in practices amounting to antitrust violations. In *CCI v. Grasim Industries Ltd.*⁽⁶⁵⁾, the Delhi HC referred to *CCI v. SAIL*⁽⁶⁶⁾ and explained that the CCI's order to investigate under S. 26(1) was only meant to initiate investigation and that this would not restrict the opinion formed by the DG in carrying out the investigation. These judgments provide for the conclusion that the DG's powers to investigate are rather expansive in nature.

While in *WinZO games*, the CCI appears to have delineated the boundaries of investigation by explaining that the investigation shall be 'limited to the issues identified in the order', it

60. TOI Technology Desk, 'Former Biggest Seller on Amazon, Appario Retail, sues CCI: What this means and makes it important' (Times of India, 26 Sep 2024) <<https://timesofindia.indiatimes.com/technologynology/technology-news/former-biggest-seller-on-amazon-appario-retail-sues-cci-what-this-means-and-makes-it-important/articleshow/113713574.cms>> accessed 15 January 2025.

61. Case No: 40 of 2019.

62. AIR 2017 SC 2734.

63. AIROnline 2018 Del 1514.

64. 2019 (5) ADR 504.

65. 2020 (1) ADR 307.

66. *CCI v. SAIL*, 2010 AIR SCW 6238.

does not impose any restriction on the parties that can be investigated. Since alleged preferencing by Google is an issue under investigation, the authors are of the belief that this allows for room to investigate the enterprise that benefits from such preferencing i.e., Dream11.

Implications for the Gaming Industry – A Game Theoretical Analysis

A dominant strategy in game theory is explained as a strategy picked by a player that leads to the best outcome (payoff) than any other alternative strategy the player might have.(67) The Nash equilibrium describes a situation when no participant can improve their outcome by changing their strategy, assuming the other participants’ strategies remain the same.(68) Let us assume that the CCI finds Google guilty of violating S.4. In this instance, the best strategy Google has is to discontinue its preferential practices. This would open the market for RMGs and allow market forces to steer its growth. Google would not risk legal sanction since this choice still allows a complainant to seek intervention from the MeitY or the courts where it believes that games of chance are being offered for real money. The same is true in the alternative situation where the CCI might find Google not guilty of abuse under S. 4. The table below explains how the choice to discontinue preferential treatment to Rummy and DFS developers is both the dominant strategy and the Nash equilibrium for Google.

Enterprise/Entity	Dominant Strategy (irrespective of whether the CCI orders against Google or not)	Nash Equilibrium (irrespective of whether the CCI orders against Google or not)
Google	Discontinuing preferential treatment of Rummy and DFS developers	Discontinuing preferential treatment of Rummy and DFS developers

In game theory, Sophie’s choice refers to a challenging situation where a person or entity is required to choose between two unbearable options – with each one seemingly amounting to a ‘no-win’ situation.(69) Although this typically involves a moral dilemma, the case of WinZO games differs in this regard. The table below explains the courses of action available to developers of other RMGs.

67. ScienceDirect, ‘Dominant Strategy’ (ScienceDirect) < <https://www.sciencedirect.com/topics/computer-science/dominant-strategy>> accessed 11 January 2025.

68. CorporateFinanceInstitute, ‘Nash Equilibrium’ (CorporateFinanceInstitute) <<https://corporate-financeinstitute.com/resources/economics/nash-equilibrium-game-theory/>> accessed 11 January 2025.

69. Suzanne Dovi, ‘Sophie’s Choice: Letting Chance Decide’ (2006) 30(1) PAL <https://www.researchgate.net/publication/236773527_Sophie's_Choice_Letting_Chance_Decide> accessed 12 January 2025.

Enterprise/Entity	Sophie's Choice (assuming the CCI does not order in the informant's favour)
Developers of other RMGs	Either suffer further losses and exit the market or switch over their offerings to Rummy and DFS (at the risk of incurring heavy costs, suffering potential implementational bottlenecks, and losing time)

The CCI's decision in this matter has profound public policy implications – particularly for the gaming industry and public interest. If the CCI finds Google guilty of an abuse under S.4, it would open the market for RMGs. Developers would be allowed greater commercial freedom and users would be allowed a wider choice of RMGs. Additionally, this would serve as a precedent reminding dominant technology companies of their special responsibility not to distort market competition. In the alternative, if no abuse under S. 4 is found, it would perpetuate negative market effects for other RMGs and count as a dangerous precedent – empowering dominant online technology giants to act in a rather arbitrary fashion such that it amounts to a distortion of market competition.

Conclusion

While the order of the CCI in WinZO games is not determinative of definite wrongdoing, it highlights the regulator's intent to crackdown on excesses by technology giants. Google is alleged to have violated S. 4(2)(a)(i), 4(2)(b)(i), and 4(2)(c) through the imposition of unfair conditions of trade and preferencing without objective justification. By withdrawing from its decision to designate SRBs to determine permissible RMGs, the MeitY has acted with wisdom. This ensures that RMG developers are allowed the freedom to trade whilst ensuring the existence of a mechanism for redressal with the MeitY acting as the regulator of the gaming industry.

This essay analyses the key issues highlighted in the order and explains why Google's actions in firstly, selectively picking two types of RMGs for its pilot program and, secondly, indefinitely continuing the program is not objectively justified. Considering Google's special responsibility as a dominant enterprise, the authors explain that this likely amounts to an abuse of dominance. Additionally, they advocate for the grant of interim relief to the informant under S. 33. Furthermore, the authors analyse the scope of the DG's powers to investigate Dream11 for potential antitrust violations as a beneficiary of the activities of Google.

In the end, the authors propose a game theoretical and public policy-based analysis of the implications of the CCI's order in this matter – presenting favourable outcomes for various stakeholders in the market for RMGs in India. The authors believe that this case is a golden

opportunity for the regulator to rein in on arbitrary and potentially exclusionary behaviour on the part of dominant technology giants, thereby, empowering participants in the burgeoning market for online RMGs in India.



SME IPO Froth : Analysing SEBI's Method of Dealing with The Recent Frenzy

Abstract

The Indian securities market has seen an unprecedented surge in Small and Medium Enterprises [“SME”] Initial Public Offerings [“IPO”] which is due to excessive participation by retail investors and speculative froth. This article critically examines the SEBI's regulatory approach to address this dilemma in the securities market. It challenges the regulatory body's predominantly conservative and restrictive approach towards this issue. The research analyses SEBI's recent amendments and consultation paper, through the lens of the 'principle of proportionality' and argues that SEBI's substantive regulations may hinder growth and innovation in the SME segment. In response to this, the author provides a case for disclosure based compliance approach, emphasizing transparency and investor awareness. On the basis of this approach, the author proposes a novel tier-based hy-

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brid model (“ANNEXURE A”), which progressively scales on disclosure compliances and regulatory requirements based on SME’s market capital. Complementing this model, the authors further suggest implementing escrow account mechanisms to ensure accountability and proper utilization of funds issued through IPO.

Introduction

The Indian Stock Market, known for its dynamism and diversity, has seen remarkable growth in the last three decades. However, the rapid expansion in the Indian Stock Market, especially after the COVID-19 outbreak, has also given rise to a lot of speculative activities and valuation bubbles. The speculative activities ranged from a very overpriced pharmaceutical sector to a huge number of retail traders participating in Futures and Options [“F&O”](1). The Securities and Exchanges Board of India [“SEBI”](2), being the apex regulatory body, has been at the forefront of addressing these challenges. SEBI was first established in 1992 after the infamous Harshad Mehta scam, and since its inception, it has been instrumental in shaping the regulatory landscape of the Indian Securities Market.

In 2010, the SEBI issued a circular proposing to create a platform for SMEs to launch and trade their IPOs, which was based on the idea proposed by the then Prime Minister’s task force. In response to this circular, NSE and BSE, the two major stock exchanges in India, introduced their SME platforms. The most recent challenge that SEBI is facing is with respect to the enormous surge in retail investors applying for SME IPOs, who expect huge returns without actually understanding the risks associated with investing in such small companies. According to the consultation paper released by SEBI, a total of 355 SME IPOs mobilizing more than 11,700 crores of rupees were issued from 1 April 2023 till 15 October 2024, in comparison to a mere 157 SME IPOs from 1 April 2019 to 31 March 2023(3).

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1. The Economic Times, ‘SEBI Announces 6-Step Framework to Get Indians Rid of F&O Addiction’ <<https://economictimes.indiatimes.com/markets/stocks/news/sebi-announces-6-step-framework-to-get-indiansrid-of-fo-addiction/articleshow/113854643.cms?from=mdr>> accessed 10 January 2025.
 2. The Securities and exchange Board of India was Constituted as a non-Statutory body on April 12, 1988.
 3. Securities and Exchange Board of India (SEBI), ‘Consultation Paper on Review of SME Segment Framework under SEBI ICDR Regulations, 2018 and Applicability of Corporate Governance Provisions under SEBI LODR Regulations, 2015 on SME Companies’.

In response to this SME IPO froth [“froth”], SEBI initially released its consultation paper on 19 November 2024(4) , followed by some amendments in the Board Meeting dated 18 December 2024(5). It was a sine qua non to introduce new laws to deal with such a froth; however, the authors do not fully agree with the approach that SEBI has taken. This article critically examines the implemented amendments alongside the proposed changes, highlighting SEBI's conservative regulatory and restrictive approach in addressing this market froth. Going a step further, the authors suggest an alternative approach which SEBI can take up, presenting a tentative hybrid policy model on how such a froth could be dealt with more efficiently.

Analysing SEBI's Approach To Deal With The Sme Ipo Froth

A. Understanding the Emergence of Market Froth in the SME Sector.

SMEs refer to ‘Small and Medium Enterprises’ (6) , which are businesses that have revenues, assets, or employees below a certain limit. Every country has their own definition of an SME. In India, the definition of SME includes Small Manufacturing and Services rendering Enterprises, which are enterprises with an investment of up to Rs 10 crores in plant and machinery or equipment and turnover of not more than Rs 50 crores, and Medium Manufacturing and Services rendering Enterprises, which are enterprises with an investment of up to Rs 20 crores in plant and machinery or equipment and turnover of not more than Rs 100 crores.

These enterprises have recently witnessed an unprecedented trend of massive oversubscriptions in their IPOs. This surge is backed by retail investors, which is driven by the potential for high returns, especially massive listing-day gains. This trend, however, seems to have gone overboard, with the applicant-to-allotted investor ratio increasing from 4 times in FY 2022 to 46 times in FY 2023, skyrocketing to 245 times in FY 2024. This exponential growth pattern mirrors what market analysts term ‘froth’.(7) “Froth” refers to market conditions preceding an actual market bubble. A frothy market is characterized by investor overconfidence who ignores the fundamentals of the market and increases the asset value or stock value beyond its intrinsic value.(8)

4. Ibid.

5. Securities and Exchange Board of India (SEBI), ‘SEBI 208th Board Meeting’ (December 2024).

6. Department of Scientific and Industrial Research (DSIR), ‘Small and Medium Enterprises (SMEs) in India’ <<https://www.dsir.gov.in/small-and-medium-enterprises-smes-india>> accessed 10 January 2025.

7. Investopedia, ‘Froth’ <<https://www.investopedia.com/terms/f/froth.asp>> accessed 10 January 2025.

8. Ibid.

SEBI's Conservative and Restrictive Regulatory Approach – Necessary or Futile?

To deal with this SME IPO froth, SEBI released its consultation paper for public comments, proposing a number of reforms after getting recommendations from stock exchanges across the country. On the same grounds along with some tweaks, SEBI, in its 208th Board Meeting dated 18 December 2024 **(9)**, discussed 9 major amendments to the SME framework under SEBI (ICDR) Regulations, 2018 **(10)** and the applicability of corporate governance under SEBI (LODR) Regulations, 2015 **(11)** on SME companies. While regulatory intervention in the SME segment was undoubtedly necessary, the approach undertaken by SEBI seems to be highly substantive and restrictive. This stringent stance can also be observed from a number of proposals put forward by SEBI in its consultation paper, which, if implemented in future, would further restrict a number of SME companies from accessing the public markets through IPOs.

Among the implemented amendments, the introduction of an Operating Profit requirement stands out as an example of a particularly restrictive measure **(12)**. This requires the company issuing the IPO to demonstrate an operating profit or EBDT of Rs 1 crore from operations for any two out of three previous financial years, which sets a high bar for SMEs seeking to go public. This criterion, while it ensures that only financially stable companies can enter the market and hence disables the small retail investors from taking higher risks, at the same time, it could exclude innovative startups and growth-stage companies that may not yet be profitable but possess significant potential. Such a substantive threshold overlooks the nature of SMEs, many of which are in their early development phases and prioritize reinvestments over immediate profitability. This measure may inadvertently stifle innovation and discourage reinvestment among SME companies who seek to launch their IPO.

The restrictive stance of the regulatory body is further reflected in the proposed amendments set out in the consultation paper. One of the most restrictive proposals was to increase the size of the minimum application or the minimum lot of SME IPOs from the current Rs 1 lakh to either Rs 2 lakh or Rs 4 lakh.**(13)** For the sake of comparison, the

9. Securities and Exchange Board of India (SEBI), 'SEBI 208th Board Meeting' (December 2024).

10. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ('SEBI (ICDR) Regulations').

11. The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2018 ('SEBI (LODR) Regulations').

12. Securities and Exchange Board of India (SEBI), 'SEBI 208th Board Meeting' (December 2024).

13. Securities and Exchange Board of India (SEBI), 'Consultation Paper on Review of SME Segment Framework under SEBI ICDR Regulations, 2018 and Applicability of Corporate Governance Provisions under SEBI LODR Regulations, 2015 on SME Companies'.

minimum lot for mainboard IPOs is a mere Rs 15,000. While the rationale behind this change is to safeguard small investors from the inherent risks of SME investments, it would significantly narrow the investor base. This increase could effectively exclude retail investors altogether who are willing to invest smaller amounts, thereby limiting market participation and further reducing liquidity in SME stocks. This change would basically mean only HNIs and Other Institutions could invest in the SME market.

On the other hand, amendments such as limits on Offer for Sale [“OFS”], General Corporate Purposes [“GCP”] allocations, and modified lock-in periods, though reflect the restrictive stance taken up by SEBI, seem to be very logical in nature. For instance, limiting GCP allocations ensures that IPO funds are predominantly allocated to specified, predetermined objectives. Therefore, despite its substantive nature, it enhances transparency in the SME segment and makes investors aware of the main objective of the IPO. Similarly, though the loan repayment restriction introduced by SEBI may seem to be highly restrictive in nature, this restriction prevents misuse of funds to repay insider loans, ensuring that IPO proceeds are used for business growth instead of the personal gains to the promoters.

While some of the measures introduced by SEBI serve legitimate regulatory purposes, the overall severity and breadth of these restrictions raise serious concerns about regulatory proportionality. This brings us to a fundamental principle of administrative law that guides such regulatory interventions – ‘principle of proportionality’.

C. SEBI's Approach Travels Beyond the ‘Principle of Proportionality’.

The ‘principle of proportionality’ is based on the idea that the severity of a rule or regulation should be proportional to the gravity of the situation it seeks to address.⁽¹⁴⁾ Basically, it means that administrative decisions and orders should only be as restrictive as necessary for public purposes. This concept was further explained by Lord Diplock in *Council of Civil Service Unions v. Minister for the Civil Services*.⁽¹⁵⁾ He stated that “The principle of proportionality envisages that a public authority ought to maintain a sense of proportion between his particular goals and the means he employs to achieve those goals so that his action impinges on the individual rights to the minimum extent to preserve public interest”.

The main role of a regulator in securities law is to ensure financial stability, market integrity and protect investors. The concept of proportionality in securities law aims to prevent the

14. Nimita Aksa Pradeep, ‘Doctrine of Proportionality in Indian Administrative Law: An Analysis’ (no date) *Indian Journal of Law, Polity and Administration*.

15. [1985] AC 374 (HL).

introduction of policies that could distort the financial markets.⁽¹⁶⁾ This includes avoiding measures that would unduly restrain market development, stifle competition or limit the diversity of market participants. The core principles of ‘proportional regulations’ in securities law involve three conditions: first, introduce simplified rules that should not undermine the stability of financial markets; second, regulators should maintain sufficient knowledge and control over institutions that benefit from such simplified rules; and third, and the most important, the regulations should not seek to overprotect the stakeholders of the market.

The proposed changes, as well as the implemented amendments, collectively indicate a highly conservative regulatory approach by SEBI and raise concerns on whether the approach undertaken by SEBI is in consonance with the ‘principle of proportionality’. While SEBI’s intent is to curb malpractices and protect investors, the extent of some of these restrictions may inadvertently hinder the SMEs’ growth prospects. By raising entry barriers and increasing compliance costs, these proposals and amendments could dissuade SMEs from leveraging public markets for growth capital. The main objective of introducing an SME platform was to provide smaller enterprises with an accessible platform to raise funds. These changes to the platform contradict the original intent of SME exchanges itself.

A more proportionate approach would involve strengthening oversight, increasing transparency in the market and increasing investor awareness without disproportionately burdening the SMEs. For instance, a tiered compliance framework (“ANNEXURE A”) based on issue size, even within the SME segment, could be implemented to monitor fund utilization, ensuring that smaller companies are not overburdened by compliance costs meant for larger SMEs. Similarly, SEBI could focus more on enhancing investor education and introducing disclosure norms to empower retail investors to make informed decisions. This makes the case for a balanced approach of substantive measures with special emphasis on a disclosure-based compliance approach.

The Case for Disclosure-Based Compliance Approach

i. Disclosure-Based Regulations – Foundation, Operational Framework and Mechanisms

Lawmakers have often turned to information and used it as a regulatory tool as it is politically more acceptable and causes minimal interference with individual choices and the operations of free markets. This system, often referred to as a “disclosure-based regulatory

16. Fernando Restoy, ‘Proportionality in Financial Regulation: Where Do We Go from Here?’ (Speech at the BIS/IMF Policy Implementation Meeting on Proportionality in Financial Regulation and Supervision, Basel, Switzerland, 8 May 2019) Bank for International Settlements. 18 Ibid.

system”, is, to an extent, adopted into securities law. Its success stems from its operations being in a ratified environment, meaning a developed, efficient market with the enormous support of both information and market intermediary.

The core purpose of disclosure-based regulations is to bridge the informational void that exists between the investors and the promoters. It acts as a remedy to solving informational implemented disclosure policy, reduces such asymmetries and allows for markets to act in a natural way, in line with the principles of a truly free market.⁽¹⁷⁾ This is especially crucial in today’s market environment, where investors actively seek professional guidance to make wellinformed investment decisions.

The disclosure mechanism operates in this “unrestricted environment”, which provides a way for information to flow freely within the market space. This free flow of information affects investor decisions, and drives desired results by impacting the market price of a security. This flowing information-based mechanism is complex and affects the behaviour of the potential security holder. The effectiveness of this mechanism depends on ensuring that the information that flows must not be corrupted and should be delivered to the appropriate decision-maker at the right time.

From Theory to Practice: Mandatory Disclosures and Risk Assessment

“Mandatory Disclosures”⁽¹⁸⁾ have emerged as a lite version of the traditional hard-hitting and substantively restrictive regulation. Even those who generally stand tall against regulations have come to accept mandatory disclosure requirements. These mandatory disclosure requirements act as a great example of a hybrid co-existing model of substantive and disclosure-based securities regulations. They allow for information to be standardized so as to make information released and disclosed by these organisations more comparable and transparent.

A notable example is the 2006 SEC Rules⁽¹⁹⁾ proposed by the Securities and Exchanges Commission in the United States of America. Christopher Cox, the Chairman of SEC at that time, put great emphasis on the disclosure of executive compensation in organisations, stating that the “market is capable of disciplining excessive compensation, provided that the

17. Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. U. L. REV. 1089 (2007).

18. *Ibid.*

19. Whiteford, Taylor & Preston LLP, ‘SEC Amends Executive Compensation Disclosure Rules for Stock-Based Awards’ (Whiteford, Taylor & Preston LLP, January 2007).

market has adequate information” and that it is “important that investors and consumers have all the information they need in order to obtain the best possible services from the executives and managers at the lowest possible price”.

Among the critical information that mandatory disclosures help reveal is the ‘risk’ profile of securities. One of the most essential factors to correctly price the markets anywhere in the world is “Risk”.⁽²⁰⁾ Risk is always priced in. In finance, standard deviation is a common metric associated with risk. Standard deviation provides a measure of the volatility of a value in comparison to its historical average. A high standard deviation indicates a lot of value volatility and, therefore, a high degree of risk. This higher degree of risk is what makes up for the difference between the pricing of a higher-risk and a lower-risk security.⁽²¹⁾ To understand this, one can look at the pricing and risks of a government bond and that of a risky security listing like Suzlon. When investors buy more of Suzlon⁽²²⁾, they understand they seek higher returns, therefore taking more risk and making the price of the security move up. Thus, “Pricing in the Risk”.

However, when substantive regulators impose opaque restrictions, that hinder the pricing of risk undertaken by players, it disrupts the essential features of a freely structured securities market. The substantive measures proposed by the Securities and Exchange Board of India in its consultation paper act as such “opaque blockades”.

iii) Market Freedom v. Regulatory Intervention: Case Studies and Implications

To illustrate the issue with substantive regulations, we may analyse the very recent circular issued by SEBI regarding the discontinuation of weekly derivative contracts⁽²³⁾ starting in November 2024. This move was aimed at reducing market volatility and promoting investor protection. But all that glitters isn’t gold.

Let us put this in perspective. ‘A’ is a speculative intraday trader, trading in FINNIFTY Weekly Derivative, his strategy being to capture huge liquidity gaps during its expiry each week. Due to SEBI introducing this substantively restrictive regulation, his entire strategy, although risky, goes down the drain. It is on his onus whether he wants to use this rather

20. Chakole, Y. (2022). A critical analysis of risk and return with respect to various investments. *International Research Journal of Modernization in Engineering, Technology and Science*, 4(2).

21. *Ibid.*

22. NSE India, ‘Suzlon Energy Limited Share Price Today, Live NSE Stock Price, News’ <<https://www.nseindia.com/get-quotes/equity?symbol=SUZLON>> accessed 16 January 2025.

23. ICICI Direct, ‘NSE to Discontinue Weekly Derivative Contracts of Three Indices’ <<https://www.icicidirect.com/research/equity/finance/nse-to-discontinue-weekly-derivative-contracts-of-threeindices>> accessed 16 January 2025.

'risky' strategy or not. It is not upon SEBI to stop risky speculation but only to reduce ignorance in the market.

Further, to understand the Disclosure-based compliance approach in action, we may consider SEBI's approach to "Financial Influencers". In its amended regulations(24) released during this wave of financial stock market "gurus", it highlighted the fact that influencers were hiding their commission-based relationships with websites and brokers. Instead of using substantive measures like completely removing such influencers through hard statutory amendments, SEBI made a disclosure-based regulatory amendment requiring these influencers to inform their viewers about their sponsored relationships and commission structures.

To draw another analogy, restricting entry into a farmers' trade fair by not allowing farmers who lack experience and money would restrict liquidity amongst buyers and sellers. Reducing the players will, on paper, not harm the turnover as much but will harm the overall liquidity over a longer period, thus affecting the "freeness" of the markets. This is because it directly attacks the autonomy of the buyer. He wants to take the risk by trying out a new and inexperienced farmer trying out a new fertiliser for his crop. This should be his right and lies upon his onus if he loses his money. The regulators will thus be affecting this autonomy and freeness in the market.

iv) Empowering Informed Decision-Making – SEBI's Role in Regulatory Balance.

The foundation of securities law rests on a robust system of disclosures, which serves three main purposes(25). First, they help investors make smarter decisions by giving them better information. Second, they help the market set fair prices. And third, they can influence the corporate behaviour of the companies. The disclosure-based compliance system works particularly well within the sophisticated ecosystem of financial markets. Investors, while investing in the financial markets, tend to approach financial decisions with greater deliberation than everyday choices. While these decisions are not perfect, investors are generally motivated to make rational choices because their money is on the line. Disclosures, as mentioned above, help investors by giving them the information necessary for making their investment decisions.

Although it is essential for the regulator to protect investors, it should only be to an extent, where the person is still allowed to use their own mental ability and risk endurance capabili-

24. The Economic Times, 'SEBI Amends Rules to Regulate Finfluencers' (18 January 2025).<<https://economictimes.indiatimes.com/markets/stocks/news/sebi-amends-rules-to-regulatefinfluencers/articleshow/112921759.cms?from=mdr>> accessed 19 January 2025.

25. Paula J. Dalley, The Use and Misuse of Disclosure as a Regulatory System, 34 FLA. ST. U. L. REV. 1089 (2007).

ties to make a true financial decision; a ‘true decision’ according to the investor, and not according to the regulator, in this case, SEBI. A regulator’s main task is to make the investor aware and not to restrict their entry into the playground. As Sandeep Parekh, founder of FinSec Law Advisors, aptly summarizes: “SEBI sees this role as somebody who removes ignorance from the market and not stupidity. This distinction is important because beyond a point, if somebody wants to throw their money into the ocean, Sebi is not going to stop them”. This statement truly encapsulates the essence of disclosure-based regulation - providing information while preserving individual choice.(26)

Building on this foundation, the next step would be to explore a hybrid regulatory model (“ANNEXURE A”), along with other suggestions, one which blends the strengths of extensive disclosure-based regulations along with targeted and minimal substantive measures, ensuring a balanced and inclusive framework for SMEs and retail investors alike.

Suggestions and Proposals

i) Why make a Tier-Based Model at all?

Section 277 of the Issue of Capital and Disclosure Regulations(27) states, “An issuer, whose specified securities are listed on an SME Exchange and whose post-issue face value capital is more than ten crore rupees and up to twenty-five crore rupees, may migrate its specified securities to the main board of the stock exchanges if its shareholders approve such a migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the Main Board”. The migration process of SME to a Main Board listing is a rather long and draining process. The SMEs need to meet specific criteria set by the stock exchange, including minimum public shareholding, profitability, and paid-up capital, before they can transition from the SME platform to the main board, making the process not straightforward or automatic. The purpose of the proposal of such a tier-based (“ANNEXURE A”) model, is to slowly and steadily, allow the company to mature into being capable of handling the compliances that a Main Board listing requires.

To bear comparison between our lives and that of a Small and Medium Enterprise, visualise a child, being put through different grades or ‘tiers’ in various stages of our education

26. CNBC TV18, ‘SEBI SME IPO Listing Norms: Challenges for Companies – Sandeep Parekh and Moin Ladha Discuss’ <<https://www.cnbcv18.com/market/sebi-sme-ipo-listing-norms-challenges-for-companies-sandeeparekh-and-moin-ladha-discuss-19526631.htm>> accessed 19 January 2025.

27. Section 277, The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (‘SEBI (ICDR) Regulations’).

system. The child, as he matures, learns to adapt with various realities and compliances that the society mandates and once a student inculcates all the values needed to move forward in the ladder, he is faced with various entrance exams and interviews. This is exactly what he has been training for his entire life through various grades in school. When he faces these hardships, in this case, they fail to strike him as bluntly as they would in case there was no gradual adaptation of the process.

This analogy falls perfectly into the mould of our discussion on SMEs. These budding organisations should be given an environment where they slowly and steadily climb up tiers and adapt to new compliances. They must be allowed to experience rising compliances as their market capitalisation and turnover moves up, so that when that 'exam' of transitioning onto being a main board listing comes, they have already adapted to the regulations and requirements.

ii) Escrow Accounts – A Way out of the Dilemma?

A RERA escrow account⁽²⁸⁾ is a special bank account under the Real Estate (Regulation and Development) Act, 2016 ("RERA"). It protects homebuyers by ensuring their money is spent only on the project they invested in. These payments are deposited into the RERA escrow account. The developer can only withdraw funds from the escrow account for the purpose of construction of the project, and only after obtaining the necessary approvals from the authorities. Under RERA, developers are required to deposit 70% of the funds collected from buyers into a RERA escrow account. These funds can only be used for the construction of the project for which they were collected. Herein, we seek to draw inspiration.

We find ourselves at crossroads here. At one end of the road, we propose a disclosure-based agreement wherein the primary onus is on the company to ensure that the investors are made aware of all the data necessary and as mandated by the Issue of Capital Disclosure Regulations (ICDR). On the other end, how do we ensure that the company is necessarily providing accurate data and not trying to manipulate the investors into using the capital accumulated for purposes other than those listed in the Red Herring Prospectus ("RHP")⁽²⁹⁾ ?

28. Razorpay, 'What is a RERA Escrow Account?' <<https://razorpay.com/learn/business-banking/rera-escrowaccount/>> accessed 22 January 2025.

29. National Institute of Securities Markets (NISM), 'Understanding DRHP, RHP, and Prospectus' (9 January 2024) <<https://www.nism.ac.in/2024/01/understanding-drhp-rhp-and-prospectus/>> accessed 22 January 2025.

What the authors of this article propose to be an effective way out of this dilemma is to form an escrow account with various banks in order to specifically ensure that the money collected is only used by the Promoters for the purposes listed in the RHP. 70% of the funds collected must be used exactly for the purposes listed by the company, whereas the other 30% are to be used as working capital expense funds.

iii) Are Escrow Accounts Already in Use in The Securities Market Eco Space?

Whenever a company decides to go public, the issuing company and syndicate members together open an escrow account with collection banks. Any applicants who wish to apply in the IPO submit applications to the syndicate members with payment of application money in favour of the escrow collection banks. The banks will keep the money till the designated date and afterward, all the funds will be transferred to the bankers to the issue. While the current IPO escrow system functions effectively, it requires refinement to precisely mirror every nuanced detail specified in the Red Herring Prospectus, ensuring absolute regulatory alignment and investor protection.

This is what is being proposed through this article. The funds which are raised are placed in separate escrow accounts with bankers, which only release the funds, whenever the obligations listed out in the RHP are carried out and are verified. This ensures that the funds collected via the SMEs are not misused. This acts as a double-check on the organisation and in addition allows retail and institutional investors to trust these new entrants in the securities markets.

The new substantive regulations implemented by SEBI after the release of the consultation paper, seek to achieve exactly this - Accountability and protection of the funds of investors, mostly those of the retail investors who can't hedge or back-up their funds and lack information. This idea is proposed to be applied to the SME IPO market and could be a revolution in terms of the co-existence of substantive and disclosure regulations by SEBI.

Conclusion

The market of SME IPOs presented a complex regulatory challenge for SEBI that demanded a nuanced, balanced approach. SEBI's proposed regulations, along with the recent amendments, while well-intentioned, may act as an obstacle to the very innovation and growth potential that the SME platform was originally introduced to nurture. The authors of this article argue for a more balanced regulatory approach that focuses more on disclosures than substantive laws that would ultimately lead to a balance in investor protection with market dynamism.

The tentative tier-based hybrid model proposed by the authors can be implemented to deal with this regulatory dilemma. By implementing such a progressive disclosure framework, SEBI can achieve 4-fold objectives:

- Investor protection through enhanced transparency.
- Allow SMEs to gradually build compliance capabilities.
- Maintain liquidity in the SME market as well as provide investment opportunities to small retail investors.
- Preserve the fundamental principle and original intent behind the SME market.

Moreover, the authors also suggest the introduction of escrow accounts to further strengthen the regulatory mechanism, which would act as an additional layer of protection for investors. By ensuring that funds are used only for the purpose given in the RHP, this mechanism addresses concerns about the misutilization of IPO funds. However, this model is not a final solution; rather, it is a starting point for a more nuanced and balanced approach for SEBI in future.

Ultimately, the future of SME IPO regulations should not lie in restrictive and substantive measures but in empowering investors by creating an ecosystem which is of a transparent nature, where the information can flow freely, compliances are gradual and support the growth of SMEs. Currently, at this juncture, SEBI stands at a very critical point where it can redefine its regulatory approach from a conservative and purely protective one to a more coordinated and growth-oriented framework.

ANNEXURE : A**I. TIER-BASED CLASSIFICATION SYSTEM**

Tier	Particulars
Tier 1: Early-Stage SMEs	<ul style="list-style-type: none"> ● Market Cap: Up to 100 crores ● Focus: Nascent companies with high growth potential. <p>Characteristics:</p> <ul style="list-style-type: none"> ➤ Innovative business models. ➤ Initial market exploration. ➤ Minimal operational history.
Tier 2: Emerging SMEs	<ul style="list-style-type: none"> ● Market Cap: 100-250 crores ● Focus: Establishing market presence. <p>Characteristics:</p> <ul style="list-style-type: none"> ➤ Emerging business model. ➤ Initial market traction. ➤ Growing operational capabilities.
Tier 3: Developing SMEs	<ul style="list-style-type: none"> ● Market Cap: 250-500 crores ● Focus: Consolidated market position. <p>Characteristics:</p> <ul style="list-style-type: none"> ➤ Proven business model. ➤ Consistent revenue streams. ➤ Established operational processes.
Tier 4: Mature SMEs	<ul style="list-style-type: none"> ● Market Cap: Above 500 crores ● Focus: Full market maturity <p>Characteristics:</p> <ul style="list-style-type: none"> ➤ Comprehensive operational track record. ➤ Alignment with main board IPO standards.

II. Disclosure Framework (Progressive Scale)

Tier 1 (Light-Touch Regulation)	
I. Financial Disclosures	Quarterly unaudited financial statements. Annual audited financial statements. Basic cash flow projections (semiannual).
II. Business Operations	Half-yearly business updates. Significant business changes (within 7 days). Basic order book status (halfyearly). Simplified related party transaction disclosure.
III. Risk Management	Annual basic risk assessment. Simplified business model overview. Key litigation disclosures.
Tier 2 (Intermediate Regulation) Includes all Tier 1 requirements, plus:	
I. Enhanced Financial Reporting	Quarterly unaudited financial statements with more detailed notes. Segment-wise revenue indication. Detailed cash flow projections. Working capital utilization overview.
II. Business Insights	Quarterly operational metrics. Basic competitor landscape analysis. Customer concentration insights. Supply chain risk overview.
III. Governance	Quarterly board meeting outcome summaries. Basic management discussion and analysis. Internal control system overview.
Tier 3 (Comprehensive Regulation) Includes all Tier 2 requirements, plus:	
I. Strategic Disclosures	Detailed industry analysis. Comprehensive market positioning strategy. Technology adoption and innovation roadmap. Detailed growth plan execution updates. Preliminary ESG compliance reporting.

II. Advanced Financial Metrics	Quarterly audited financial statements. Detailed segment reporting. Comprehensive cost structure analysis. Initial credit rating insights. Return on capital employed analysis.
III. Risk & Compliance	Detailed corporate governance reporting. Comprehensive regulatory compliance assessment. Enhanced stakeholder engagement reporting.

Tier 4 (Main Board Equivalent) Full alignment with ICDR (Issue of Capital and Disclosure Requirements) regulations
Complete main board IPO disclosure requirements. Comprehensive financial, operational, and strategic reporting. Full compliance with SEBI's main board listing obligations. Detailed corporate governance mechanisms.

III. Investment Thresholds

IV. Cumulative data of currently listed SMEs on NSE

NO. OF ENTITIES	MARKET CAP (IN CR. RS.)	%
44	>1000	6.04
19	750 - 1000	2.60
46	500 – 750	6.31
107	250 – 500	14.69
180	100 – 250	24.7
120	50 – 100	16.48
105	25 – 50	14.42
107	0 - 25	14.69
728		100



Regulating Algorithmic and High-Frequency Trading: Balancing Innovation and Risk

Abstract

The emergence of algorithmic and high-frequency trading (“HFT”) has dramatically reshaped the way trading has traditionally been in the financial markets. Even though technological innovation has largely been a boon for financial markets across the world in terms of enhanced transparency, efficiency, and lower transaction costs, these automated trading strategies, driven by sophisticated algorithms and executed at exceptional speeds, present both advantages and risks. While they contribute to enhancing market liquidity and efficiency, they also raise concerns regarding market manipulation, systemic risk, and amplified volatility. Additionally, access to these sophisticated trading algorithms can be limited to a section of the stakeholders, thus creating a technology-driven divide in financial markets.

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The authors look at how algorithmic trading and high-frequency trading have evolved, how they work, and their benefits and risks. Further, the authors look at the need to regulate algorithmic and high-frequency trades. From that moment forward, the paper examines the regulatory challenges and the approaches adopted by various jurisdictions. In this regard, the paper investigates existing regulations from different jurisdictions such as the United States, United Kingdom, China, Singapore, etc. and analyses the regulatory approach taken by these jurisdictions and how they compare in terms of efficacy and whether they have taken a strict regulatory approach or one that allows innovation to foster. In particular, the paper also discusses the regulatory approach of the Securities and Exchange Board of India (“SEBI”)(1) and how its approach compares to the regulatory regimes of other jurisdictions. By comparing SEBI’s approach to those of other jurisdictions, the study highlights the scope of potential improvements, especially to foster technological advancements in financial markets while ensuring investor protection.

Thereafter, the paper identifies the key regulatory challenges faced by regulators in their attempt to regulate algorithmic trading and HFT. The primary regulatory challenges include the complexity of the algorithms, including the often inexplicable logic behind how they function, the speed of transactions, and the potential for market manipulation. The paper analyses how regulators can adopt a balancing approach that minimizes the risks of HFT and algorithmic trading while allowing innovation to take its path for a more technologically advanced securities market ecosystem. The main objective of the research is to study the regulatory approaches taken by different jurisdictions to regulate high-frequency trading and algorithmic trading and to analyze whether a more stringent or more flexible regulatory approach is better suited. By examining the regulatory experiences of different jurisdictions and the challenges faced by regulators, the paper offers insights for policymakers aiming to strike an appropriate balance between innovation and risk management in financial markets.

1. The Securities and Exchange Board of India was Constituted as a non-Statutory body on April 12, 1988.

Keywords

Algorithmic Trading; High-frequency Trading; Automated Trading; Securities; Capital Markets; etc.

Research Objectives

The paper attempts to elaborate on the following research objectives:

1. To understand and analyse the evolution, mechanisms, benefits, and risks of algorithmic trading and HFT.
2. To compare and contrast the regulatory approaches adopted by different jurisdictions in respect of balancing risk mitigation and innovation.
3. To identify the key regulatory challenges faced by regulators in regulating algorithmic and high-frequency trading and to propose potential solutions to mitigate risks while fostering innovation.

Introduction

Technological advancements over the last three decades have revolutionised securities markets worldwide. From the dematerialisation of securities to lowering settlement cycles, these technology-driven changes have enhanced market efficiency and transparency, and lowered the risk of human error, while minimised the transaction costs in financial markets. The emergence of technology-driven automated trading has transformed how securities were traditionally traded. Started in 1971, the creation of National Association of Securities Dealers Automated Quotations (“NASDAQ”) can be considered the advent of large-scale electronic trading(2). A 2009 study suggested that over 70% of daily trading volume on the

2. Brian Bollen, ‘The history of Nasdaq from creation in 1971 to the present’ (Capital.com, 19 May 2017) <<https://capital.com/the-history-of-nasdaq-from-creation-in-1971-to-the-present>> accessed 2 January 2025.

New York Stock Exchange (“NYSE”) was generated by computer systems(3). Similarly, the National Institute of Financial Management (“NIFM”) found that over 50% of the total orders at the Bombay Stock Exchange (“BSE”) and the National Stock Exchange (“NSE”) in India were algorithmic trades (4). Similarly, in the United States, 80% of the daily trading volume was executed by algorithmic systems in 2018(5).

Even though algorithmic trading and high-frequency trades are often confused as the same, there is a significant difference between the two, one being a subset of the other. Algorithmic trading can be broadly defined as a trading mechanism that uses computer systems and programs to generate and execute trade orders electronically. Different aspects of such electronically executed orders are determined by computer algorithms that are mathematically programmed to automate trade decisions such as price points, timing, quantity, etc(6). While algorithmic trading automates the execution of orders in the financial markets to a point where it can completely do away with human intervention in decision-making, HFT is a subset or strategy of algorithmic trading wherein such trade decisions are taken at fractions of seconds, beyond human capability(7). All HFTs are algorithmic trading, while all algorithmic trading strategies may not necessarily be HFT, the difference being the time of execution of trade orders(8).

Algorithmic trading can take different forms, ranging from simple computer-based orders to automated trades using advanced technologies such as machine learning (“ML”) and artificial intelligence (“AI”)(9). The use of algorithms can range from completely automated trades to use in some if not all, stages of a trading cycle. Algorithms can be used to deter-

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3. Jon Stokes, ‘Computer-Trading Worries Grow as NYSE Builds New Datacenter’ (ars TECHNICA, 3 August 2009) <<https://arstechnica.com/tech-policy/2009/08/nyse-builds-computer-trading-mothership-worries-abound/>> accessed 2 January 2025.
 4. DEA-NIFM Research Team, ‘A Study on Algorithm Trading/High Frequency Trading in the Indian Capital Market’ (Arun Jaitley National Institute of Financial Management) <<https://www.ajnifm.ac.in/files/study-algorithm-tradinghigh-frequency-trading-indian-capital-market>> accessed 2 January 2025.
 5. Silvia Amaro, ‘Sell-Offs Could Be down to Machines That Control 80% of the US Stock Market, Fund Manager Says’ (CNBC, 5 December 2018) <<https://www.cnn.com/2018/12/05/sell-offs-could-be-down-to-machines-that-control-80percent-of-us-stocks-fund-manager-says.html>> accessed 2 January 2025.
 6. Morton Glantz and Robert Kissell, *Multi-Asset Risk Modeling: Techniques for a Global Economy in an Electronic and Algorithmic Trading Era* (Elsevier Inc. 2014).
 7. “Reznik and Pankratova, ‘High-frequency trade as a component of algorithmic trading: market consequences’ (2021) 2104 CEUR-WS <https://ceur-ws.org/Vol-2104/paper_174.pdf> accessed 2 January 2025.
 8. Jonathan Brogaard, ‘High-Frequency Trading and Volatility’ (2010) SSRN <https://www.researchgate.net/publication/228273562_High_Frequency_Trading_and_Volatility> accessed 2 January 2025.
 9. Oyeniyi, Ugochukwu and Mhlongo, ‘Analyzing the Impact of Algorithmic Trading on Stock Market Behaviour: A Comprehensive Review’ (2024) 11(02) WJAETS 437.

mine trading strategies and can be used at different stages of a trading cycle- pre-trade analytics, execution stage and post-trade analytics⁽¹⁰⁾. HFT strategies attempt to benefit from price discrepancies in very small-time frames ranging from nanoseconds to milliseconds. It seeks to predict price movements by identifying trends and patterns from masses of data on price history.

As discussed above, algorithmic trading can take different forms and has been a significant technological boon for enhancing the efficacy of financial markets over the last two or three decades in terms of their different use cases. However, different aspects of algorithmic trading, especially in association with AI and ML technologies, can pose multiple challenges to existing mechanisms used to execute trade orders in dematerialised securities. One significant benefit of algorithmic trading has been its ability to reduce the scope of human error in securities transactions, thus increasing the efficacy and transparency in financial markets. Algorithmic trading has lowered the transaction costs involved in securities trading while enhancing liquidity and facilitating more efficient price discovery. However, at the same time, large-scale algorithms can be used to trigger systemic risks in financial markets. For instance, in its report submitted to the Department of Economic Affairs, Ministry of Finance, NIFM identified instances of faulty algorithms causing deviations from naturally discovered prices. Some of these instances mentioned in the report include a flash crash in the stock price of Reliance Industries Limited, a flash crash on the BSE Mahurat trading session in 2011, etc., triggered by algorithm-driven execution of large volumes of sell orders⁽¹¹⁾.

The use of algorithmic trading also raises systemic risks of market manipulation by a handful of investors or traders who have access to sophisticated algorithmic systems, amplified short-term volatility, etc.⁽¹²⁾ Colocation, in particular, is a strategy used by HFT firms to benefit from price discrepancies. It involves locating sophisticated computer systems of HFT firms in close proximity to computer servers of stock exchanges, enabling quicker access to stock prices over split seconds than the rest of the public. Colocation results in an unfair advantage enjoyed by HFT firms having access to sophisticated algorithms and computer systems and leads to market inequality. Exchanges, on the other hand, benefit from this practice by charging HFT firms huge sums for the privilege of low-latency access in close proximity to the exchange's servers. Another such systemic risk posed by algorithmic trading is artificially induced high order-to-trade ratio, wherein high volumes of orders are placed by algorithmic systems to drive volumes to a suitable point and then cancel those

10. DEA-NIFM Research Team (N 3).

11. *ibid.*

12. Prakhar Dua, 'Algo Trading: Regulatory Framework, SEBI Proposals and Market Concerns' (NDA, 11 August 2022) <<https://www.nishithdesai.com/NewsDetails/6255>> accessed 2 January 2025.

orders in split seconds. This can be used for market manipulation and is a practice penalised and discouraged by both stock exchanges and the regulator in India. The order-to-trade ratio across all segments on NSE has increased from 7.07 in 2014-15 to 11.2 in 2016-17.

The risks discussed above highlight the need for regulation of the use of algorithmic trading and HFT. In its August 2016 discussion paper on ‘Strengthening of the Regulatory Framework for Algorithmic Trading & Co-location’ (2016 Discussion Paper), SEBI identified the need for regulating different aspects of algorithmic trading to ensure non-discriminatory access to algorithmic trading and more specifically, co-location facilities⁽¹³⁾. In its discussion paper, SEBI flagged price volatility, high order-to-trade ratios inducing artificially high volumes, the cost imposed by HFT on other investors and traders, the technological arms race, etc., as some of the key issues drawing regulatory attention⁽¹⁴⁾.

The Regulatory Landscape for Algorithmic Trading and HFT

Jurisdictions around the world have long recognised the regulatory issues concerning the use of algorithmic trading and HFT in capital markets. Regulators have adopted different approaches, including human supervision and direct market intervention⁽¹⁵⁾. In this section, the regulatory landscape across several key jurisdictions is examined with a view to identifying whether the regulatory regime adopted takes a stringent approach or one that allows innovation to be fostered relatively freely.

Regulation of algorithmic trading can take different forms, some of the most popular ones being use of human intervention in the form of inspection and audits to identify potential irregularities, and direct market intervention in the form of trading halts on detection of unusual price movements or use of circuit breakers. More specific regulatory mechanisms include use of minimum resting time, wherein time restrictions are used to restrict cancellation of orders placed with intention to create artificial volume. Maximum order-to-trade ratios are used by stock exchanges and regulators in order to restrict the practice of placing high volume of orders to drive volumes and then cancelling the orders in split seconds. Regulators also use randomisation of orders received during a particular time frame to tackle the competitive advantage that HFTs gain from speed. Registration of algorithmic

13. SEBI, ‘Discussion paper on ‘Strengthening of the Regulatory framework for Algorithmic Trading & Co-location’’ (Securities and Exchange Board of India, 5 August 2016) <https://www.sebi.gov.in/reports/reports/aug-2016/discussion-paper-on-strengthening-of-the-regulatory-framework-for-algorithmic-trading-and-co-location-_32940.html> accessed 2 January 2025.

14. *ibid.*

15. Lee and Schu, ‘Regulation of Algorithmic Trading: Frameworks or Human Supervision and Direct Market Interventions’ (2022) 33(2) EBLR 193.

trading developers and HFT firms is one key regulatory practice, used by regulators to extend oversight(16) .

Regulatory Framework in Foreign Jurisdictions

United States of America

The Securities and Exchange Commission (“SEC”) adopted a Market Access Rule in November 2010 requiring brokers and providers of algorithmic trading services to incorporate risk control measures(17). It restricts brokers and dealers from providing unrestricted access to exchanges or automated alternative trading systems. The Market Information Data Analytics System (“MIDAS”) is a surveillance system to monitor and analyse market activities in real-time. The SEC also approved a rule proposed by the Financial Industry Regulatory Authority, a self-regulatory body, requiring registration of algorithmic trading developers(18). The SEC has, however, implemented a relatively less strict regulatory approach in dealing with algorithmic trading and HFT, allowing a degree of innovation(19).

European Union

In the European Union (“EU”), regulations have been adopted and amended over the last one-and-a-half decades for the implementation of internal risk control measures by algorithmic traders(20). This internal control mechanism has been adopted by several member states of the EU. The EU implemented the Markets in Financial Instruments Directive (“MiFID”) in 2007 leading to the development of innovative market instruments(21). MiFID II is the second phase of this directive, which came into effect in 2018(22). MiFID II and its

16. DEA-NIFM Research Team (N 3).

17. SEC, ‘SEC Adopts New Rule Preventing Unfiltered Market Access’ (SEC, 3 November 2010) <<https://www.sec.gov/news/press/2010/2010-210.htm>> accessed 3 January 2025.

18. Kenneth W. McCracken, ‘SEC approves FINRA rule requiring registration of algorithmic trading developers’ (Bloomberg, 20 April 2016) <<https://www.bloomberg.com/professional/insights/trading/sec-approves-finra-rule-requiring-registration-of-algorithmic-trading-developers/>> accessed 3 January 2025.

19. Marc Lenglet, ‘Conflicting Codes and Codings: How Algorithmic Trading Is Reshaping Financial Regulation’ (2010) SSRN <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616043> accessed 3 January 2025.

20. *ibid.*

21. Francois Haas, ‘The Markets in Financial Instruments Directive: Banking on Market and Supervisory Efficiency’ (IMF, 1 October 2007) <<https://www.imf.org/en/Publications/WP/Issues/2016/12/31/The-Markets-in-Financial-Instruments-Directive-Banking-on-Market-and-Supervisory-Efficiency-21415>> accessed 3 January 2025.

22. Council Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) [2014] OJ L 173/349.

delegated provisions implement several requirements for credit institutions, investment firms and trading service providers in terms of controlling the risks of algorithmic trading(23). Several technical standards have been prescribed under MiFID II to be implemented by algorithmic trading firms that fall under Article 17 of the Directive. These technical standards have been prescribed under the Regulatory Technical Standard (“RTS”) 6 and have been developed by the European Securities and Markets Authority (“ESMA”) in consultation with regulators in the member states(24). Within the EU, Germany introduced an Act on the Prevention of Risks and Abuse in High-Frequency Trading way back in May 2013 (“HFT Act”), imposing a licensing regime for HFT firms while putting in place restrictions on such firms to implement in-built risk control measures to ensure that markets are not disrupted(25). The Act also requires exchanges to impose order-to-trade limits and excessive system usage fees on a product-specific basis.

United Kingdom

The Market Abuse Regulation adopted by the Financial Conduct Authority (“FCA”) follows a similar principle-based regulatory approach to that of the European Union(26). Both the United Kingdom and the EU have adopted a regulatory approach that allows for innovation to foster and encourages healthy competition and fair practices in the securities markets; however, they also ensure investor protection by imposing strict technical standards and internal control mechanisms on the development and working of algorithmic trading systems(27).

Australia

In Australia, even though the Australian Securities and Investments Commission (“ASIC”) was quick to release a consultation paper on regulating HFT back in 2013, it has not implemented any specific regulation for algorithmic trading or HFT, rather it periodically reviews HFT practices and algorithmic trading strategies in the Australian securities markets(28).

23. ECB, ‘Algorithmic trading: trends and existing regulation’ (European Central Bank) <https://www.bankingsupervision.europa.eu/press/supervisory-newsletters/newsletter/2019/html/ssm.nl190213_5.en.html> accessed 3 January 2025.

24. Lewis, Ocelewicz and Singh, ‘MiFID II RTS 6 – 5 years on: What have we learned?’ (KPMG) <<https://kpmg.com/uk/en/home/insights/2023/08/mifid-ii-rts-6.html>> accessed 3 January 2025.

25. Dechert, ‘The New German Rules on High Frequency Trading’ (Lexology, 28 June 2013) <<https://www.lexology.com/library/detail.aspx?g=bc929448-348a-4f52-b04e-2e7d36d998a6>> accessed 3 January 2025.

26. Financial Conduct Authority, ‘Market Abuse Regulation’ (Financial Conduct Authority, 3 March 2016) <<https://www.fca.org.uk/markets/market-abuse/regulation>> accessed 2 January 2025.

27. Lee and Schu (N 14).

28. Jhou H, Kalev PS and Frino A, ‘Algorithmic Trading in Turbulent Markets’ (2020) 62 PBFJ <<https://doi.org/10.1016/j.pacfin.2020.101358>> accessed 3 January 2025.

China

China, on the other hand, has adopted a more restrictive approach. The China Securities Regulatory Commission (“CSRC”) has adopted rules requiring testing and risk management and imposed strict disclosure norms for firms providing algorithmic trading and HFT services(29). Besides, the country has also put restrictions on foreign investment in development and innovation in the financial markets, thus discouraging innovation to some extent.

Regulatory Framework in India

In India, the Securities and Exchange Board of India (SEBI) and the two prominent stock exchanges, BSE and NSE, have published several proposals and measures to tackle the challenges of algorithmic and HFT in the country(30). In 2008, SEBI permitted stock brokers to provide direct market access (“DMA”) facility to their clients, wherein users could directly access the exchange trading system without any human intervention on the part of the broker(31).

However, it was only in March 2012 that SEBI for the first time issued guidelines on algorithmic trading(32). SEBI’s 2012 Circular titled ‘Broad Guidelines on Algorithmic Trading’ implemented several regulatory measures, including a requirement of stock brokers to acquire permission from stock exchanges in order to provide algorithmic trading services. Besides, stock brokers were instructed to implement several risk control measures in terms of price, quantity, order value and automated execution checks. In its 2016 Discussion Paper titled ‘Strengthening of the Regulatory Framework for Algorithmic Trading and Co-Location’, SEBI proposed several measures to deal with specific risks of algorithmic trading(33). To ensure equity in access to information, a ‘tick-by-tick data feed’ mechanism was prescribed to ensure relevant data is available to all market participants as a real-time

29. Yue Y and Yukun Z, ‘China’s Stock Exchanges to Tighten Controls on High-Frequency Trading’ (Caixin Global, 11 June 2024) <<https://www.caixinglobal.com/2024-06-11/chinas-stock-exchanges-to-tighten-controls-on-high-frequency-trading-102205030.html>> accessed 4 January 2025.

30. Dua (N 11).

31. Ranka, Shah and Desai, ‘SEBI introduces Direct Market Access facility’ (NDA, 4 April 2008) <<https://www.nishithdesai.com/SectionCategory/33/CorpsecHotline/12/55/CorpsecHotline/8420/5.html>> accessed 4 January 2025.

32. SEBI, ‘Broad Guidelines on Algorithmic Trading’ (Securities and Exchange Board of India, 30 March 2012) <https://www.sebi.gov.in/legal/circulars/mar-2012/broad-guidelines-on-algorithmic-trading_22471.html> accessed 2 January 2025.

33. SEBI, ‘Discussion paper on ‘Strengthening of the Regulatory framework for Algorithmic Trading & Co-location’’ (Securities and Exchange Board of India, 5 August 2016) <https://www.sebi.gov.in/reports/reports/aug2016/discussion-paper-on-strengthening-of-the-regulatory-framework-for-algorithmic-trading-and-co-location-_32940.html> accessed 2 January 2025.

feed. To reduce the order-to-trade ratio, a ‘minimum resting time’ mechanism was proposed, wherein time restrictions were proposed to be imposed on the cancellation of orders placed. Additionally, in 2018, SEBI announced several measures to ensure healthy competition in the domain of algorithmic trading(34). Mechanisms for equitable allotment of co-location facilities to eligible vendors were prescribed for co-location services. Besides, unique identifiers were prescribed for algorithms approved by stock exchanges. To facilitate innovation in this space, SEBI also proposed a simulated market environment facility for testing software systems. To highlight the risks of using algorithmic trading by retail investors, SEBI, in its Consultation Paper on ‘Algorithmic Trading by Retail Investors’ (“2021 Consultation Paper”), highlighted the risks associated with retail investors using Application Programming Interface (“API”) facilities of stock brokers to undertake automation of trades(35). The 2021 Consultation Paper put the onus on the stock brokers to get approval for algorithms used on APIs provided by them and to ensure that all such algorithms function on the brokers’ servers.

Recently, on February 04, 2025 SEBI released a new Circular titled ‘Safer Participation of Retail Investors in Algorithmic Trading’ which is set to become effective from August 01, 2025 (“February 2025 Circular”)(36). The Circular seeks to effectuate many of the propositions of the 2021 Consultation Paper. Among other things, the Circular requires brokers to act as the principal in providing algo trading through APIs, with the algo provider serving as their agents. Additionally, all algo orders are required to be tagged with a unique identifier provided by the Stock Exchanges. Brokers are required to authenticate access to their API via two-factor authentication. The fresh circular also requires Algos developed by tech-savvy retail investors, to be registered with the respective Stock Exchanges, through their brokers, on crossing a prescribed order per second threshold.

SEBI’s regulatory approach towards algorithmic trading and HFT can be termed as an innovation-friendly regime which has strived to ensure a healthy and competitive algorithmic trading ecosystem, imposing risk control measures on the stock brokers and putting the

34. SEBI, ‘Measures to strengthen Algorithmic Trading and Co-location / Proximity Hosting framework’ (Securities and Exchange Board of India, 09 April 2018) <https://www.sebi.gov.in/legal/circulars/apr-2018/measures-to-strengthen-algorithmic-trading-and-co-location-proximity-hosting-framework_38605.html> accessed 2 January 2025.

35. SEBI, ‘Consultation Paper on Algorithmic Trading by Retail Investors’ (Securities and Exchange Board of India, 09 December 2021) <https://www.sebi.gov.in/reports-and-statistics/reports/dec-2021/consultation-paper-on-algorithmic-trading-by-retail-investors_54515.html> accessed 2 January 2025.

36. SEBI, ‘Safer participation of retail investors in Algorithmic trading’ (Securities and Exchange Board of India, 04 February 2025) < https://www.sebi.gov.in/legal/circulars/feb-2025/safer-participation-of-retail-investors-in-algorithmic-trading_91614.html> accessed 28 February 2025.

onus on stock brokers to create an investor-friendly ecosystem. Besides, to restrict unfair advantage in terms of co-location facilities and information, SEBI has adopted several measures to facilitate equitable and timely distribution of the same to all eligible stakeholders.

Key Regulatory Challenges

Despite the benefits associate with algorithmic trading and HFT, they pose various risks and challenges to market stability(37). These challenges continue to persist at different scales despite regulatory intervention across jurisdictions.

Algorithmic trading, which uses computer-automated algorithms have been praised for the efficiency they bring to the trading ecosystem, but at the same time they have been criticised for their capability to aggravate market volatility. First, we have instances of flash crashes triggered by algorithmic trades. Flash crashes are a common example of algorithm-induced price manipulation, wherein large volumes of sale orders are executed in short periods, resulting in a rapid, sharp decline in the price of a security instrument, followed by a quick recovery. An in famous example of market volatility triggered by algorithmic trading is the US flash crash of 2010(38) . The equity markets in the US lost over 1 trillion USD in the span of about 30 minutes, and recovered to pre-crash levels within 2 hours(39) . Algorithmic trades are typically executed at large volumes aggravating even small price drops into market failures, evidenced by the US flash crash triggered by HFT firms selling their securities in large volumes. While algorithmic trading enhances market liquidity owing to large volumes, the same can potentially stimulate market volatility spiralling out of control in absence of human intervention in automated trade executions.

Transparency is one of the fundamental principles of market efficiency. Algorithmic trading and HFT also pose the challenge of lack of transparency. Normally, transactions in the securities markets are made public by the stock exchanges depending on the scale or parties involved. However, algorithmic traders and HFT firms often use “dark pools” to keep their transactions out of the public domain. Dark pools are private trading venues or alternative trading systems where securities are traded anonymously, outside the purview of regulated markets(40). Participating investors can signal a sub-group of investors their interest

37. Ayo Oladele, ‘The Role of High-Frequency and Algorithmic Trading’ (Velvetech, 8 June 2023) <<https://www.velvetech.com/blog/high-frequency-algorithmic-trading/>> accessed 4 January 2025.

38. Nathan D. Brown, ‘The Rise of High Frequency Trading: The Role Algorithms, and the Lack of Regulations, Play in Today’s Stock Market’ (2012) 11 AJL 209.

39. *ibid.*

40. Gebenga Ibikunle, ‘Dark trading: what is it and how does it affect financial markets?’ (Economics Observatory, 17 July 2023) <<https://www.economicsobservatory.com/dark-trading-what-is-it-and-how-does-it-affect-financial-markets>> accessed 5 January 2025.

in buying or selling a particular security. Accordingly, investors having access to the dark pools execute their trades based on such mutual interests outside the knowledge of investors in the regulated markets. There has been an increase of 300% in the use of dark pools in the US markets between 2002 and 2009(41).

Yet another challenge posed by algorithmic and HFT is that of “ghost liquidity”. Ghost liquidity refers to an artificial level of liquidity that is significantly higher than the actual liquidity available for trading. This discrepancy arises from the practice of placing duplicate orders across multiple trading venues, which are often cancelled immediately on successful execution on one venue. In essence, ghost liquidity contributes to a momentary illusion of market liquidity and trading opportunities owing to large volumes of orders placed by HFT firms, only to be cancelled momentarily. “Spoofing” is another aspect of ghost liquidity wherein HFT firms place fake buy or sell orders with no intention of executing them, aiming to manipulate market perceptions about supply and demand. Spoofing is considered illegal in the US and is classified as a form of market manipulation under regulations such as the Dodd-Frank Act, while in India, SEBI attempts to address such practices by penalising high-order-to-trade ratios.

Algorithmic trading and HFT also pose risks of manipulation that could seriously impact the retail investors. As a result, regulators such as SEBI in India are attempting to impose additional guardrails in order to protect investor interests while defining the responsibilities and liabilities of the stakeholders involved. Regulations in place seek to address the chance of manipulation by brokers as well as putting in place redressal mechanisms to address investor grievances. In this regard, SEBI’s 2021 Consultation Paper proposed a framework to address specific concerns related to retail investor participation in algorithmic trading. The paper observed that retail investors were using algorithms to execute trade orders through API access provided by stock brokers and accordingly proposed classifying all orders emanating from an API as algo orders in order to be able to distinguish between algo and non-algo orders. The Consultation Paper sought put the onus on the brokers to take approval of stock exchanges for all such algorithms accessed through APIs offered by them. Additionally, such algorithms were required to be operated on the servers of the stock brokers themselves. Besides, the paper proposed to make the broker responsible for such algorithms accessed through their APIs, for redressal of any investor disputes. As discussed earlier, SEBI’s February 2025 Circular gives effect to many of these propositions. Overall,

41. Nicolas Crudele, ‘Dark Pool Regulation: Fostering Innovation and Competition While Protecting Investors’ (2015) 9(2) Brook. J. Corp. Fin. & Com. <<https://brooklynworks.brooklaw.edu/cgi/viewcontent.cgi?article=1029&context=bjcfcl>> accessed 5 January 2025.

SEBI has put the onus on the stock brokers and the stock exchanges to rein in on the risks posed by participation of retail investors in algorithmic trading.

Way Forward: Balancing Innovation and Risk

There are two interconnected, usually competing concepts in the realms of financial market governance. The first theory is of “financial liberalisation” which advocates for a market free of regulatory interference. The argument being, that regulation restricts the flow of innovation in markets, preventing markets from realising their potential. On the contrary, the second theory is of “financial regulation” which argues for establishing rules and oversight mechanisms to ensure stability, fairness and transparency in the markets. The argument being, that unregulated, unlimited financial liberalisation make markets prone to failures.

Financial liberalisation talks about making the markets free from any interference, allowing market forces on their own to determine the interest rate, capital allocation and overall market functioning. More specific to the securities market, liberalisation argues for a market free of interference and technologically sound for more efficient price discovery. Financial regulation, on the other hand, talks about the imposition of rules and regulations to maintain market stability and address systemic risks. The experience of regulators around the world has firmly established the need for regulation in the securities markets, which is no longer a question of debate, especially since securities markets are heavily driven by technology, are fast paced, and involves investor interest. However, technological reforms have been a boon for the markets, evidenced by the significant transformations over the last few decades. Thus, there is a need to balance between the two approaches, which quite aptly highlights two of SEBI’s fundamental objectives enshrined in the preamble to the Securities and Exchange Board of India Act, 1992- the need to protect the interest of investors and to promote the development of securities markets in the country. An example of this balance can be seen in the manner the financial sector in China has evolved over the years. China has changed its stance from a liberalized financial market to a regulation-driven one. In the year 2018, China merged its banking and insurance sectors to improve oversight by creating the “China Banking and Insurance Regulatory Commission.”⁽⁴²⁾

The rapid expansion of the financial market with increasing technological advancements has become complex in relation to regulatory oversight and risk management. With the benefit of technological advancement, there is also the risks associated with it. Regulators

42. Martin Chorzempa and Nicolas, ‘Will China’s new financial regulatory reform be enough to meet the challenges?’ (Bruegel, 28 March 2023) <<https://www.bruegel.org/policy-brief/will-chinas-new-financial-regulatory-reform-be-enough-meet-challenges>> accessed 5 January 2025.

have faced the challenge of bridging the gap of safeguarding market stability and integrity while encouraging innovation. We cannot ignore the fact that the role of technology and innovation has changed the functioning of the market.

SEBI's February 2025 Circular shifts the onus heavily on stock brokers and stock exchanges to keep an eye on algorithmic trading practices. While the Circular is definitely a step forward towards enhanced transparency, mandatory reporting, real time monitoring and internal risk controls, the shifting of responsibility on brokers and exchanges to keep irregularities in check can discourage them from encouraging innovation to take its form. Instead, since technology is at the core of algo trading and HFT, the answer could somewhere lie in robust technology driven surveillance and monitoring tools, somewhat similar to what the SEC in the US has achieved with MIDAS.

Suggestions and Conclusion

The emergence of algorithmic trading, particularly HFT, has significantly transformed the equity markets. While these technologies have undoubtedly enhanced efficiency, transparency, and reduced transaction costs, they have also introduced new challenges and risks. The 2010 US Flash Crash made regulators worldwide reevaluate their approach to dealing with high-frequency and automated trading. To prevent the risks, regulators are increasingly adopting risk-based regulation strategies. For example, the EU came up with the Markets in Financial Instrument Directive II ("MiFID II") introducing stringent requirements for firms engaged in algorithmic trading. It includes the implementation of circuit breakers and the testing of algorithms to prevent market volatility. Similarly, in the US, the Securities Exchange Commission came up with a surveillance system- MIDAS(43) . It helps to detect potential market manipulation by monitoring trading patterns across multiple markets. Making a balance between technological advancement and the need for regulatory compliance is a delicate task. UK's FCA has come up with a regulatory sandbox that provides an environment for a firm to test new technological advancements and their consequences(44). It helps the company to assess the impact of these technologies while also helping them foster innovation.

43. Fred Sommers, 'U.S. Securities and Exchange Commission MIDAS Market Information Data Analytics System: An Observation' (SSRN, 11 September 2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3692464> accessed 5 January 2025.

44. JJ Goo, 'The Impact of the Regulatory Sandbox on the Fintech Industry, with a Discussion on the Relation between Regulatory Sandboxes and Open Innovation' (Science Direct, 6 June 2020) <<https://www.sciencedirect.com/science/article/pii/S2199853122004383>> accessed 5 January 2025.

As the financial market is not restricted to one country or region, there is a need for international cooperation to address the challenges of algorithmic trading and HFT. The International Organization of Securities Commissions (“IOSCO”), argues for global harmonization of regulatory standards. During the COVID-19 pandemic, IOSCO came up with a report highlighting the impact of the pandemic on algorithm trading, showcasing the need for cross-border collaboration to achieve resilience in securities markets worldwide. The Archegos Capital Management crash of 2021 highlights the ripple effect of volatility in one securities market on another(45). The incident emphasized the need of information sharing and cooperative collaboration between countries. There are some sectors, like the banking sector, which are trying to harmonize the regulatory approaches. For example, the Basel Committee on Banking Supervision’s Fundamental Review of the Trading Book (“FRTB”) aims to create a more harmonized and consistent framework for risk of capital requirements(46). However, there are still challenges associated with getting complete global regulatory consistency and harmonization. Different jurisdictions require different strategies as they have their own priority and regulatory experiences.

The rapid growth and adoption of algorithmic trading have also raised concerns about market stability, fairness, and transparency. The potential for systemic risks, such as flash crashes and market manipulation, has become a pressing issue. The use of dark pools and other opaque trading venues has raised questions about market transparency, as it can create information asymmetries between different market participants. Additionally, the increasing dominance of high-frequency traders has led to concerns about market inequality and the potential for predatory trading practices.

To address these challenges, regulators worldwide have been grappling with the task of developing effective regulatory frameworks for algorithmic trading and HFT. While some jurisdictions have adopted more stringent approaches, others have opted for a more principles-based approach that allows for innovation. The key challenge lies in balancing the need to promote market efficiency and innovation with the imperative to protect market integrity and investor interests. By fostering a regulatory environment that promotes innovation while safeguarding market stability, regulators can help to create a more efficient, fair, and transparent financial system.

45. Hayley McDowell, ‘The collapse of Archegos Capital Management’ (The Trade, 16 July 2021) <<https://www.thetradenews.com/the-collapse-of-archegos-capital-management/>> accessed 6 January 2025.

46. Sebastian, Gerhard, Stefan and Roland, ‘Basel “IV”’: What’s next for banks?’ (Mc Kinsey & Company, April 2017) <<https://www.mckinsey.de/~media/mckinsey/business%20functions/risk/our%20insights/basel%20iv%20whats%20next%20for%20european%20banks/basel-iv-whats-next-for-banks.pdf>> accessed 6 January 2025.

To effectively balance innovation with risk mitigation, regulators worldwide should foster international cooperation, invest in technology-driven surveillance tools, adopt principle-based regulations, require greater transparency and disclosure, prioritize investor protection, enhance market surveillance, and implement robust risk management frameworks for algorithmic trading firms. By adopting these measures, regulators can create a conducive environment for the development and use of these technologies while mitigating associated risks.

International cooperation among regulators can help establish harmonized standards and address cross-border challenges. Technology-driven surveillance tools can enhance regulatory effectiveness and reduce compliance burdens. Principle-based regulations can provide flexibility to accommodate technological advancements while ensuring adherence to core regulatory objectives. Greater transparency and disclosure can improve market understanding and reduce information asymmetries. Investor protection measures can shield retail investors from the complexities of algorithmic trading. Enhanced market surveillance can help identify and address potential risks associated with algorithmic trading and high-frequency trading. Robust risk management frameworks can mitigate systemic risks and protect market stability.



Voluntary Delisting in India: A Quandary of Promotor Prerogatives and Shareholder Protection

Abstract

Voluntary delisting is the process when a company chooses to withdraw its securities from the stock exchange on a permanent basis, rendering them no longer available for public trading. Between 2018 and 2023, there were hardly any notable examples of successful delisting among mid and large cap companies due to reasons like insufficient demand from public investors or the promoters themselves deciding to terminate the process.(1) As a response, the Securities & Exchange Board of India (“SEBI”) amended the Delisting Regulations via SEBI Delisting of Equity Shares (Amendment) Regulations, 2024(2) (“2024 Delisting Amendment”) and made several changes to the voluntary delisting regulations.

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1. Yashasvi Mohanram and others, ‘Voluntary Delisting Trends in India (2018-2023)’ (TouchStone Partners, January 9, 2024) <<https://touchstonepartners.com/voluntary-delisting-trends-in-india-2018-2023/>> accessed 10 January 2025.
2. See 2024 Delisting Amendment.

With this background, the paper begins with a comprehensive analysis of the key reforms brought about by the 2024 Delisting Amendment. Moving forward, the paper delves into the impact on stakeholders, providing a nuanced analysis from the perspectives of both public shareholders and the promotor. It then evaluates the limitations of the 2024 amendment, particularly the 90% delisting threshold conundrum, lack of squeeze-out provisions and potential price manipulation by the promotor in the newly implemented fixed price offer mechanism. To address these concerns, the authors draw comparisons with the U.K. and U.S. Delisting Regulations, advocating for reducing the 90% threshold with practical solutions, inclusion of squeeze-out provision and the role of an independent committee specifically tasked with safeguarding the interests of minority shareholders within the delisting process. While acknowledging the potential drawbacks of this proposal, the authors conclude that the benefits of this approach outweigh the limitations. The proposed mechanism is envisioned as a critical step toward nurturing a balanced approach, assuring convenience for promoters while reinforcing investor confidence, which is crucial for developing a robust and future ready delisting ecosystem in India.

Keywords

Voluntary Delisting, Shareholder Protection, Investor Confidence, SEBI, Fixed Price Offer

Introduction To Voluntary Delisting Framework In India

Under the SEBI (Delisting of Equity shares) 2021 Regulations⁽³⁾ (“Delisting Regulations”), delisting is defined as the “permanent removal of equity shares of the company from

3. Securities & Exchange Board of India (Delisting of Equity Shares) Regulations, 2021 <https://www.sebi.gov.in/legal/regulations/nov-2024/securities-and-exchange-board-of-india-delisting-of-equity-shares-regulations-2021-last-amended-on-november-28-2024-_89265.html> accessed 07 January 2025 (“Delisting Regulations”).

the trading platform of a recognised stock exchange, either by way of voluntary or compulsory method.”⁽⁴⁾ Compulsory delisting happens when a firm fails to meet regulatory criteria or the conditions of its stock exchange listing agreement.⁽⁵⁾ On the other hand, voluntary delisting is when a company independently chooses to withdraw its securities from the stock exchange on a permanent basis.⁽⁶⁾ Because the securities are no longer available for trading on any stock exchange, delisting can have a major impact on public shareholders and hence needs to be executed with care. Prior to the 2024 delisting amendment, voluntary delisting was commonly executed through the reverse book building (“RBB”) method.⁽⁷⁾

Under the RBB method, the voluntary delisting of a company’s shares from stock exchanges is a multifaceted process, starting with the acquirer making the first announcement to the concerned stock exchanges, thereby apprising the public for the first time of its intention to delist.⁽⁸⁾ Upon the issuance of the initial announcement, the company’s board is duty bound to sanction the delisting scheme within a stipulated timeframe of 21 days.⁽⁹⁾ Subsequently, a special resolution is required by the shareholders within a period of 45 days, including a minimum of 66% of votes from the public shareholders⁽¹⁰⁾, thereby conferring formal sanction on the delisting process. Subsequent to securing shareholders consent, the delisting process unfolds with the company’s application to the stock exchange for in-principle approval.⁽¹¹⁾ Concurrently, the acquirer must create an escrow account, where 25% of the total payment is to be deposited within a week of receiving shareholder approval.⁽¹²⁾

Upon receipt of in-principle approval, the acquirer is mandated to issue a detailed public announcement, disseminated across newspapers, apprising the public of the delisting offer.⁽¹³⁾ This announcement precipitates the commencement of the bidding or tendering period, which remains open for a duration of 5 working days.⁽¹⁴⁾ During this interval, public shareholders tender their shares. A critical component of this process is the pricing

4. *ibid*, Reg 2(j).

5. Securities & Exchange Board of India, ‘FAQs-Delisting’ <https://www.sebi.gov.in/sebi_data/docfiles/20626_t.html> accessed 07 January 2025.

6. *ibid*.

7. ‘Reverse Book Building’ (National Stock Exchange, 03 January 2023) <<https://www.nseindia.com/products-services/initial-public-offerings-reverse-book-building>> accessed 07 January 2025.

8. Delisting Regulations, Reg 8.

9. *ibid*, Reg 10.

10. *ibid*, Reg 11 (1), (4).

11. *ibid*, Reg 12.

12. *ibid*, Reg 14.

13. *ibid*, Reg 15.

14. *ibid*, Reg 17.

mechanism, wherein the floor price**(15)** is determined as the minimum offer price by the acquirer. The acquirer may opt to offer an indicative price,**(16)** which shall surpass the floor price with a suitable premium. The discovered price is then determined which serves as the benchmark for share acceptance. It is the price at which shareholder bids are deemed eligible and accepted.**(17)**

The delisting process reaches a critical juncture with the determination of the discovered price. Should this price match the floor or indicative price, the acquirer is compelled to accept the shares offered by shareholders.**(18)** However, a discovered price that exceeds these thresholds grants the acquirer the flexibility to propose a counter offer.**(19)** The delisting offer is deemed successful if the total shareholding of the acquirer post delisting issue attains a threshold of at least 90% of the total share capital.**(20)** In the absence of the acquirer attaining the requisite 90% threshold, the delisting offer will be considered unsuccessful, thereby ensuring the public shareholders consent the process. The RBB method has been a shield for the investors, but has remained a rein for the promoters, which is analysed as follows.

Unpacking the 2024 Delisting Amendment

i) Levelling the Playing Field: The Introduction of Fixed Price Offer Mechanism

The above-mentioned RBB process highlights that the discovered price is set by the public shareholders based upon the bidding system. The main concern was that the discovered price can exceed both the floor price and indicated price (if specified), with no upper limit on it. This greatly benefitted the public shareholders because they could bid at any price they wish to gain extensive premiums on their shares. However, this approach presented a core issue by allowing public shareholders to exert excessive influence over the delisting process. They got the unfettered power to place bids at disproportionately high prices, hence driving the discovered price to unreasonable levels.**(21)** Since the RBB method allowed shareholders to submit any number of bids at inflated prices, this system disrupted the

15. *ibid*, Reg. 19A.

16. *ibid*, Reg. 20(4).

17. *ibid*, Reg. 20; Sch II.

18. *ibid*, Reg. 22(1).

19. *ibid*, Reg. 22(3), (4).

20. *ibid*, Reg. 21.

21. Siddhant Mishra, 'Reverse book-building process: Ideal for stakeholders, bane for promoters' (Regstreet Law Advisors, 26 July 2023) <<https://regstreetlaw.com/news/reverse-book-building-process-ideal-for-stakeholders-bane-for-promoters/>> accessed 02 January 2025.

balance between fair valuation and equitable exits for both acquirers and shareholders.⁽²²⁾ This unchecked power created inefficiencies and controversies because the predictability of the exit pricing process got highly imbalanced, making it unviable for the promoter/acquirer to go ahead with the offer.⁽²³⁾

Evidence shows that one of the key factor for the failure of delisting offers from 2018 to 2023 was the rejection of the discovered price by the acquirer himself.⁽²⁴⁾ It accounted for 21% of the total factors responsible for failing of the delisting process. For example, in the case of Vedanta Limited delisting, the offer was rejected because the discovered price premium went 266.8% above the floor price.⁽²⁵⁾ Another example is of Brady and Morris Engineer Limited, where the premium went up to 1128.7% more than the floor price.⁽²⁶⁾ This approach highlights an unfettered liberty to the minority shareholders to skyrocket the prices and ultimately defeat the entire delisting process just because they want to seek unreasonable financial gains from the delisting process.

Hence to curb this issue, SEBI came up with the introduction of fixed price offer mechanism.⁽²⁷⁾ This mechanism allows the promotor/acquiror to delist the securities at a particular predetermined price. To avoid potential misuse of this change and to protect the interest of the minority shareholders, a safety mechanism has been established in which the set price must be no less than 15% greater than the floor price to be provided by the promotor/acquirer.. This approach will provided a lot of certainty and stability than the earlier RBB method⁽²⁸⁾ Where there was entirely speculative bidding and the prices were completely inflated based upon the whims and fancies of the public shareholders. Including the fixed price offer method in the delisting is essential because it would give more flexibility to the

22. Yatin Mota, 'Linde India Delisting Fails As Promoters Reject Discovered Price' (NDTV Profit, 25 January 2019) <<https://www.ndtvprofit.com/markets/linde-india-delisting-fails-as-promoters-reject-discovered-price>> accessed 02 January 2025.

23. Rajesh Mascarenhas, 'Ineos Styrolution delisting failure to have bearing on other ongoing delistings' (The Economic Times, 25 July 2020) <<https://economictimes.indiatimes.com/markets/stocks/news/ineos-styrolution-delisting-failure-to-have-bearing-on-other-ongoing-delistings/articleshows/77167717.cms?from=mdr>> accessed 02 January 2025.

24. Yashasvi Mohanram and others (N 1).

25. ET Bureau, 'Vedanta delisting fails; company to return all the shares tendered' (The Economic Times, 10 October, 2020) <<https://economictimes.indiatimes.com/markets/stocks/news/vedanta-delisting-fails-company-to-return-all-the-shares-tendered/articleshows/78592860.cms?from=mdr>> accessed 03 January 2025.

26. 'Voluntary Delisting Current Trends: A detailed report' (2020) Cyril Amarchand Mangaldas, page 6 <<https://www.cyrilshroff.com/wp-content/uploads/2020/11/Report-on-Delisting-Deals-Current-Trends.pdf>> accessed 05 January 2025.

27. Delisting Regulations, Reg 20A.

28. Sapna Kataria and others, 'Voluntary Delisting: A Look at the New Amendments' (Nishith Desai Associates, 30 September 2024) <<https://www.nishithdesai.com/NewsDetails/15146>> accessed 05 January 2025.

promotor/acquirer to delist the company successfully.⁽²⁹⁾ The requirement of a 15% premium in the case of a fixed price offer safeguards the minority shareholders' interests while ensuring fair treatment in price determination.

ii) *A Second Chance at Delisting?: Revised Thresholds for Counter-Offers*

1. Relaxation of Counter-Offer Eligibility Criteria

The delisting framework, prior to the 2024 amendment, imposed specific conditions on the acquirer's ability to make a counter-offer. If the revealed price exceeds the floor or indicative price, the acquirer may reject it and make a counter-offer.⁽³⁰⁾ However, this was contingent upon the acquirer's post-offer shareholding, inclusive of publicly tendered shares, meeting the 90% threshold of total issued shares. If the promoter/acquirer failed to mobilize a minimum of 90% of the total share capital of the company post the first delisting offer, the delisting process was deemed to have failed.

This created an issue because the threshold for making a counter-offer was the same as the threshold for the delisting process to fail. In other words, only if the promoter/acquirer met the minimum requirement of 90% post issue share capital holding, it would be allowed to make a counter-offer. This approach placed an undue burden on the acquirer/promoter and lead to the failure of a delisting offer, even when the majority of the company's shareholders support the delisting and have submitted their shares.⁽³¹⁾ Even in cases where public shareholders demonstrate a strong willingness to participate in the delisting process by tendering their shares, the outcome was not solely determined by their actions. Even if an acquirer held 85% of the total share capital, he would still be unable to make a counter-offer simply because he could not reach the exorbitant 90% threshold.

The 2024 delisting amendment marks a notable departure from previous regulations, offering promoters/acquirers greater flexibility in their negotiations. By reducing the required post-offer shareholding to 75%, the amendment has acknowledged the complexities of shareholder participation. Furthermore, the stipulation that at least half (50%) of the public shareholders must have tendered their shares ensures a meaningful level of public support for the

29. 'India Snapshots: Voluntary Delisting Offers' (2024) Khaitan & Co. Advocates, page 8 <<https://www.khaitanco.com/sites/default/files/2024-08/Voluntary%20Delisting%20Snapshot.pdf>> accessed 05 January 2025.

30. Delisting Regulations, Reg 22 (3), (4).

31. Swapneil Akut and Siddharth Urs, 'Proposed Amendments to the Voluntary Delisting Process' (S&R Associates, 12 September 2023) <<https://www.snrlaw.in/proposed-amendments-to-the-voluntary-delisting-process/>> accessed 05 January 2025.

delisting effort.⁽³²⁾ This approach will potentially provide some relief to the promoter/acquirer by allowing them to make a counter-offer and have a second chance to successfully conclude the delisting process, which was not feasible under the earlier 90% threshold. The 75% threshold is a reasonable limit because it is already a well-established benchmark under the Securities Contracts (Regulation) Rules, 1957 for the minimum public shareholding (25%)⁽³³⁾ and is also a part of eligibility criteria mentioned in the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Take-over Regulations”), for making a re-attempt at delisting the company once the first process has failed.⁽³⁴⁾

Therefore, if a promoter/acquirer breaches the 75% permitted limit, it implies that he has a substantial shareholding in the company and clearly intends to delist the company. Hence, they should at least be allowed a chance to make a counter-offer to increase the total post-issue shareholding to 90%. While considering this lowered threshold in silos, it seems concerning for the minority shareholders because there could be circumstances where the promoter already holds more than 70% of the shares but less than 75% limit. In this case, if he is able to make it more than 75% (quite easy for him), that does not reflect the true interest of the public shareholders, who might not have tendered their shares to such promoter.

To tackle such scenarios, the additional requirement of tendering of at least 50% public shares serves as a protective measure to prevent misuse by the acquirer/promoter. For instance, even if the promoter holds 74% of the shareholding and only 26% is with the public, at least 50% of the public shareholders (13% actually) must tender their shares to the acquirer/promoter. This ensures that the majority of public shareholders agree to the delisting process at all times. While the normal threshold for the delisting process to be successful remains at 90%, the newly introduced thresholds of 75% (overall shareholding) and 50% (public shareholding tendered) for making a counter-offer represent a significant step forward for the successful implementation of the delisting process.

2. Revisiting pricing of Counter-Offers for a balanced approach

Now that we have a sufficiently safe procedure for making a counter-offer by the promoter/acquirer, the pricing of the counter-offer warrants attention. The 2024 delisting amendment has ushered in a new type of counter-offer pricing, marked by a shift away from the

32. Delisting Regulations, Reg 22 (4).

33. Securities Contracts (Regulation) Rules 1957, Rule 19A.

34. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011, Reg. 5A (6) (“Takeover Regulations”).

earlier book value benchmark.(35) Instead, the counter-offer price must be higher than the weighted average price of shares tendered in the first round and the same must exceed the indicative price (if any).(36) This adds an additional layer of protection for shareholders because the earlier criteria which related to the book value of the company might be a feasible metric for the company's financial status, but it may not be the true representation of the expectation by the investors, which is very crucial for the success of the delisting process. Investor expectations must be given due consideration, as this is the primary reason why the initial offer by the promoter/acquirer could not meet the 90% threshold, necessitating a counter-offer.

To align with these expectations, the new parameters take into account the average price of the shares tendered by the shareholders in the first round as well as the indicative price and ensure that the counter-offer is made at a price acceptable to the shareholders while remaining meaningful for the success of delisting process also.(37) If these two parameters are not considered, the counter-offer is likely to fail again, defeating its purpose. Hence, the amendment seeks to balance both interests, where it gives the promoter/acquirer a second chance to make a counter-offer by lowering the threshold from 90% to 75%, while ensuring that the offer price reflects the investor expectation as well for the success of delisting process.

iii. Floor price determination: A new approach towards effective valuation

Prior to the amendment, the floor price was calculated as provided under the Takeover Regulations which included parameters like historical trading price, recent market price (in shares traded frequently), or valuer determined price (if share not frequently traded).(38) These characteristics were largely concerned with the market value of the company's shares, which is computed when making open offers and the company stays listed after the offer. However, they were insufficiently strict to represent the underlying financial situation of the company's assets throughout the delisting process. Given that the company will no longer be listed, setting the floor price should take into account the fair market worth of its assets.(39)

35. Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021 [Last amended on August 3, 2021] Reg 22(5).

36. Delisting Regulation, Reg 22(5).

37. Vanshika and Ishita, 'From Vedanta to Reform: SEBI's Push for a Hassle-Free Delisting Process' (IRCCL, 27 October 2024) <<https://www.irccl.in/post/from-vedanta-to-reform-sebi-s-push-for-a-hassle-free-delisting-process>> accessed 06 January 2025.

38. Takeover Regulations, Reg 8.

39. Manendra Singh and others, 'Amendments to Delisting Regulations: Introduction of Fixed Price Process for Voluntary Delisting' (2024) Economic Laws Practice, page 5 <<https://elplaw.in/wp-content/uploads/2024/10/Amendments-to-Delisting-Regulations.pdf>> accessed 06 January 2025.

Under the 2024 amendment, the floor price is no longer calculated as per the Takeover Regulations but rather as per the Delisting Regulations. While most characteristics remain comparable to those under the Takeover Regulations, one notable innovation is the inclusion of the company's adjusted book value, as confirmed by a valuer.⁽⁴⁰⁾ This approach considers the value of the company's assets and guarantees that if the company's financial status deteriorates, it is not burdened with an excessively high floor price based only on share valuation. It serves as a safeguard for the promoter/acquirer, ensuring that the floor price accurately represents the company's financial status, as assessed by incorporating its assets.

The 2024 delisting amendment has introduced changes to the reference date for calculating the floor price as well. The acquirer's first announcement to the stock exchanges regarding the delisting offer is put forth for board's approval.⁽⁴¹⁾ Once the board approves the delisting proposal by the acquirer, they are required to notify the recognized stock exchange. Prior to the amendment, the date on which the stock exchange was notified of the conclusion of the board meeting was used as the reference date to calculate the floor price.

This reference date caused uncertainty since there was a time lag between the first open announcement, when the acquirer initially disclosed its intention to delist to the stock exchange(s), and the date when the final board approval was informed to the stock exchange. This gap disrupts the actual price calculation, as trading activity in the market following the initial public announcement introduces significant risk. Since the share value of the company was a key factor in determining the floor price, this trading activity often resulted in an inflated figure caused by the uncertainty-driven rush among investors.⁽⁴²⁾ The floor price needs to be calculated on an unaffected price⁽⁴³⁾, which can only be computed on the first day that the delisting offer is made public.

To address this, the 2024 amendment has streamlined the delisting process by revising the reference date for floor price calculation. This date is now directly tied to the initial public announcement,⁽⁴⁴⁾ providing a clear and transparent benchmark. This step will help curb

40. Delisting Regulations, Reg. 19A (1) (iii).

41. Delisting Regulations, Reg. 10.

42. Freny Patel, 'Delisting Roadblock?' (2023) India Business Law Journal <<https://law.asia/sebi-fixed-price-delisting-india/>> accessed 06 January 2025.

43. Securities & Exchange Board of India, 'Consultation Paper on Review of Voluntary Delisting norms under SEBI (Delisting of Equity Shares) Regulations, 2021' (2023) page 9 <https://www.sebi.gov.in/reports-and-statistics/reports/au-g-2023/consultation-paper-on-review-of-voluntary-delisting-norms-under-sebi-delisting-of-equity-shares-regulations-2021_75335.html> accessed 06 January 2025 ("Delisting Consultation Paper").

44. Delisting Regulations, Reg. 19A (2).

speculative activity and ensure the floor price better reflects current market conditions. This amendment marks another step toward aligning the Takeover Regulations with the Delisting Regulations.⁽⁴⁵⁾

iv. Delisting of Investment Holding Companies: A Three-Step Process for Fair Investor Exit

An Investment Holding Company (“IHC”) is a company primarily engaged in holding investments in various types of companies, both listed and unlisted.⁽⁴⁶⁾ They may also hold other assets, such as property, etc. Some IHCs are listed on stock exchanges and their shares often trade at a discounted price compared to the intrinsic value of their investments, because they do not do any business.⁽⁴⁷⁾ Instead, they invest money and then hold it for long term. Dividends are the primary source of income generated by such investments. Hence, in terms of uptake by investors, shares of such companies are often illiquid.⁽⁴⁸⁾

Previously, there was no specific framework for the delisting of IHCs. Delisting for such IHCs was mainly conducted through the usual RBB process to determine the exit price for public shareholders. However, this method had significant limitations for public shareholders. One major issue was that the equity shares of IHCs often traded at lower rates compared to the intrinsic value of their investments.⁽⁴⁹⁾ The Delisting Regulations set the floor price based on share price of the IHC, but the discounted price of IHC shares often failed to adequately reflect the true value of the underlying investments. This led to a biased pricing mechanism, which may have been favourable for the acquirer but did not ensure a fair valuation for public shareholders, potentially prejudicing their interests.

To address these challenges, the 2024 amendment introduced a separate delisting framework for IHCs. The eligibility criteria apply only to listed IHCs where at least 75% of the overall fair value is derived from direct investments in equity shares of other listed compa-

45. Takeover Regulations, Reg 5A (2)(a); Raghubir Menon and others, ‘Key amendments to the SEBI Delisting Regulations– Introduction of a fixed price offer in Voluntary Delistings’ (2024) Shardul Amarchand Mangaldas <<https://www.amsshardul.com/wp-content/uploads/2024/10/Update-Delisting-Amendment-Regulations-2024-002.pdf>> accessed 06 January 2025.

46. Delisting Regulations, Reg 2 (ra).

47. ‘Holding Company Stocks’ (The Economic Times, 06 January 2025) <<https://economictimes.indiatimes.com/markets/stock-screener/holding-company-stocks/screens/scrid-3594?from=mdr>> accessed 06 January 2025.

48. ‘Can holding companies create shareholder value?’ (Upstox, 24 October 2024) <<https://upstox.com/news/upstox-originals/investing/can-holding-companies-create-shareholder-value/article-124534/>> accessed 07 January 2025.

49. Delisting Consultation Paper (N 42), page 10.

nies.⁽⁵⁰⁾ The process is threefold.⁽⁵¹⁾ The first step is transfer of listed investments, where the IHC must transfer the shares of the underlying listed companies it holds to its public shareholders in proportion to their shareholding. The second step is compensation for unlisted investments, where the public shareholders must be compensated in cash for the value of the IHC's investments in unlisted companies and other assets. After these two steps, the third step involves extinguishment of public shareholding through a share capital reduction scheme approved by the court under Section 66 of the Companies Act, 2013.

This new mechanism directly accounts for the intrinsic value of the IHC's listed and unlisted investments before the reduction of share capital. It effectively addresses valuation challenges while ensuring fair treatment for public shareholders, thus encouraging voluntary delisting. With this change, public shareholders receive a fair exit price, and promoters are provided with a viable mechanism to delist IHCs.

III. Implications for Stakeholders: Shareholder Protection or Promoter Flexibility?

i) Shareholders' Perspective

To begin with, the 2024 delisting amendment focuses on stabilizing the floor price by calculating it based on the adjusted book value of the company, reflecting the company's actual financial condition at the time of delisting. This might be unfavourable to the public shareholders because the company might not be in its best financial condition when it decides to delist. To curb this, a minimum premium of 15% to be offered to public shareholders, provide them with some premium for their shares.

Moving forward, the counter-offer amendment requires that 50% of public shareholders have submitted their shares in the previous round before an acquiror can make a counter-offer, and the acquirer must make a counter-offer based on the weighted mean of shares provided in the previous round. Shareholders can then decide whether to accept the counter-offer or withhold their shares again (leading to failure of delisting process). This ensures that public shareholders receive a fair compensation and the acquiror makes a meaningful offer in the counter-offer basis the demand in previous round. Another protection for the public shareholders is that the acquirer has to still take at least 66% approval from the public shareholders before commencement of the bidding period.⁽⁵²⁾

50. Delisting Regulations, Reg 38A (3).

51. *ibid*, Reg 38A (2).

52. *ibid*, Reg 11 (1), (4).

The introduction of the IHC delisting process further reinforces investor protection through a three-stage process outlined in the amendment where the listed investments held by the IHC have to be transferred to the public shareholders in proportion to their shareholding. For the unlisted investments, the compensation has to be paid in cash to public shareholders and these two steps, the IHC will be allowed to delist. At each stage, the framework ensures that shareholders receive fair compensation. This implies that successful delisting in India still requires the majority approval of public shareholders, and their trust must be protected before prioritizing ease of business for the acquirer.

ii) Promoters' Perspective

A major impact on the acquirer/promotor is that the fixed price offer method will allow them to arrange funds in advance with greater certainty. Under the delisting regulations, the acquirer is mandated to open an escrow account with a scheduled commercial bank and deposit 25% amount of the total consideration⁽⁵³⁾ in this escrow account within 7 days of getting the shareholder approval for the delisting process. The remaining 75% has to be deposited in the account after taking in-principle approval from the stock exchange and before giving detailed public announcement in the newspapers.⁽⁵⁴⁾

After this, the bidding will open within 7 days of detailed public announcement and on determination of the discovered price, the acquirer will have to submit the additional amount in the escrow amount to complete the sum payable to public shareholders. This process becomes futile if the discovered price is for example 200 times more than the floor/indicative price, hence making it difficult for the acquirer to arrange such large amount of additional funds and hence leads to a lot of pressure of the acquirer. Since the acquirer will know the exact price at which the shares are to be purchased, it becomes easier for them to secure the necessary funds and deposit them in the escrow account, as mandated.

Another major implication with the introduction of the fixed price method is that the acquirer now has the option to make another delisting attempt through the fixed price method if the first delisting process fails.⁽⁵⁵⁾ This second attempt must occur within 12 months of the first delisting failure but not within six months of the failure.⁽⁵⁶⁾ In other words, the second

53. *ibid*, Reg 14 (1).

54. *ibid*, 14(3).

55. Raghbir and others (N 44), page 3.

56. Delisting Regulations, Reg 23 (2) (c); Takeover Regulations, Reg 5A (6) (a).

attempt must be made after six months but before 12 months from the date of the first failed attempt. Previously, the subsequent delisting effort had to be done only through the RBB method and that too at the discovered price. However, with the implementation of the fixed pricing approach, the second attempt may now be completed fully at the new set price.

Addressing Quagmires and Paving the Way Forward for Delisting Regime in India

a. The 90% Threshold Conundrum

Certain challenges still pertain with respect to the delisting process. The first one being that shareholders still retain substantial influence over the delisting process since the overall 90% post issue shareholding threshold remains unchanged for the acquiror. This means that irrespective of the changes introduced in the amendment, the acquiror has to make sure that he has 90% of the shares issued of that class at the end of the delisting process, which reflects substantial public shareholders support at all times for successful delisting. Particularly in the fixed price offer method, which is a 'yes' or 'no' approach, the acquirer will have to restart the delisting process from scratch if public shareholders do not tender their shares at the fixed price, failing to reach the 90% threshold. It can lead to situations where a small group of shareholders can block the entire delisting process, even if a significant majority of shareholders support it. By reconsidering the 90% threshold, SEBI can better facilitate the delisting attempts in India.

As a viable solution, it could reduce it to 75% post-issue shareholding in that class along with minimum 50% tender of shares by public shareholders. The reasoning for this suggestion is that the company is already permitted to gain control up to a maximum of 75% while being listed.⁽⁵⁷⁾ To achieve this 75% control, listed companies already have available methods like buy-back of shares, capital reduction etc.⁽⁵⁸⁾ However, when a listed company breaches the 75% threshold, it denotes that it intends to take substantial control in the company (beyond 75%). At this point, we can consider the company to be thinking of delisting. Nevertheless, only keeping the 75% criteria as a threshold would prejudice the interests of the remaining public shareholders. To avoid this, an additional 50% tender of shares by public shareholders is a safeguard. This means at any given point of time, at least majority of its existing public shareholders must have tendered their shares for the company to delist successfully.

57. The Securities Contract (Regulation) Rules, Rule 19A.

58. The Companies Act 2013, Ss. 68, 66.

For better understanding, the delisting framework of U.K. warrants attention. U.K. was chosen as a jurisdiction for comparison because 25% of the total companies listed on the London Stock Exchange have gone private (delisted) over the past decade, driven by a sustained decrease in IPO activity and several notable delisting.⁽⁵⁹⁾ To delist a company from the London Stock Exchange, the shareholders must approve the delisting through a special resolution, requiring at least 75% majority support in a general meeting.⁽⁶⁰⁾ In case the issuer himself or with any other person together has a controlling stake (30% or more) in the voting process, then a majority of the votes of the independent shareholders must be taken into account for the purpose of special resolution.⁽⁶¹⁾ It is similar to the Indian framework where we need minimum 66% public shareholders approval during special resolution. Given the sensitive market and investor awareness in India, such relaxed provisions would not be in favour of public investors. That is why the 75% post-delisting criteria in addition to 50% tender of shares by public shareholders is the best suitable and safe option for a viable delisting framework.

This threshold has a dual function as it would protect investor interest and also takes into account promoters perspective. This suggestion also has merit because the shareholders still have stringent protection under the delisting framework, starting from 2/3rd of public shareholders approval at the initial special resolution⁽⁶²⁾ and further providing the dissenting public shareholders with a 1 year exit window after the delisting process.⁽⁶³⁾

b. Mandatory Squeeze-Out with Safeguards

To further improve the delisting process, apart from reducing the 90% threshold, a mandatory provision should be introduced for squeezing out dissenting shareholders after the 1 year exit window. The current delisting framework does not outline a clear mechanism for how these shareholders can exit once the 1 year window closes. Retaining dissenting shareholders creates an unnecessary burden on the promoter, who would otherwise have to

59. Prarthana Prakash, 'London Stock Exchange listings have dropped 25% in 10 years, but its CEO says the U.K. is still 'punching above its weight'' (Fortune, 16 May 2024) <<https://fortune.com/europe/2024/05/16/london-stock-exchange-ceo-julia-hoggett-not-concern-uk-drop-listings/>> accessed 10 January 2025.

60. Global Public M&A Guide United Kingdom, 'Delisting' (2022) <<https://resourcehub.bakermckenzie.com/en/resources/global-public-ma-guide/europe-middle-east-and-africa/united-kingdom/topics/delisting>> accessed 09 January 2025.

61. Financial Conduct Authority Listing Rules, Rule 5.2.5 <<https://www.handbook.fca.org.uk/handbook/LR/5/2.html?date=2024-06-13#D42>> accessed 09 January 2025.

62. Delisting Regulations, Reg 11(4).

63. *ibid*, Reg 27.

acquire their shares through an approved scheme under Section 235 of the Companies Act, 2013. This process is both time-consuming and complex. Introducing a dedicated provision within the delisting framework for the mandatory acquisition of such shares would ensure a smoother transition, protect minority shareholders from being locked into an illiquid investment, and reduce procedural delays for the promoter.

The provision for squeezing out dissenting shareholders should only be applicable if the promoter has attained at least 90% post-issue shareholding. This is because it acts as a safeguard against potential manipulation by the promoter. If the threshold were lowered (say 75%), a promoter could coerce a large number of public shareholders into selling at a price they don't want. By ensuring that the promoter holds at least 90% of the total shares before initiating the squeeze-out, the framework guarantees that only a few shareholders (10%) are dissenting and it would prevent any undue advantage being taken at the expense of minority shareholders.

c. Delisting without a Safety Net: The Risks of Fixed Price Offers

Another issue pertains within the fixed price offer method itself i.e. of limited scrutiny. The simplicity of the fixed price offer process leaves little room for scrutiny or negotiation regarding the pricing of the shares. The fixed price offer method lacks any counter-offer mechanism as there is in RBB, meaning that the offer is either accepted or rejected outright. This might raise concerns as there have been instances⁽⁶⁴⁾ where promoters were involved in price-setting before the delisting process and attempted to manipulate regulations to proceed with predetermined delisting prices. Such practices could jeopardize the interests of public shareholders in the Indian capital market.

Therefore, we would suggest some changes for minority shareholders protection based upon the U.S. delisting framework.⁽⁶⁵⁾ U.S. was taken as a reference for comparison because similar patterns were identified by the authors in the delisting framework of both the countries, which is discussed as under. In the U.S., the delisting process is referred to as

64. Whole Time Member, 'Order in the matter of Astrazeneca Pharma India Ltd.' (2020) Securities & Exchange Board of India <https://www.sebi.gov.in/enforcement/orders/jun-2020/order-in-the-matter-of-astrazeneca-pharma-india-ltd-_46785.html> accessed 06 January 2025.

65. Martin Gelter and Steven Thel, 'Delisting in the United States' (2024) Fordham Law Legal Studies Research Paper No. 4973561 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4973561> accessed 07 January 2025.

a 'going private transaction'.⁽⁶⁶⁾ To safeguard minority interests, Delaware courts have applied the 'Business Judgment' Rule⁽⁶⁷⁾, a well-known doctrine developed by them. This rule states that the management of a company must act in good faith and make decisions in the best interests of the company (similar to Section 166 of the Indian Companies Act 2013). If they do so, they are shielded from legal liability, even if the business decision turns out to be unsuccessful.

In the case of *Kahn v. M&F Worldwide Corp.*,⁽⁶⁸⁾ the Delaware Supreme Court interpreted the Business Judgment Rule and determined that a successful delisting requires permission from both an independent committee and the majority of minority owners.⁽⁶⁹⁾ An independent committee negotiates the exit price on behalf of minority shareholders. The committee must be empowered to select its own advisors, remain free from any association with the company's management, and negotiate a fair price on behalf of minority shareholders.⁽⁷⁰⁾

The rationale for such protective measures is that promoters (or called controlling shareholders in US) possess significant power to influence the transaction in their favour, making such transactions inherently biased. The *Kahn* case highlights a broader trend in U.S. courts, where the focus is on crafting rules that protect minority shareholders, reduce judicial scrutiny of transactions by allowing boards to structure the delisting processes but by requiring them to provide robust safeguards, such as arms-length negotiations through independent committee, to ensure minority interests are upheld.⁽⁷¹⁾ A similar mechanism of an independent committee exists in the existing delisting framework by SEBI.⁽⁷²⁾ After the detailed public announcement, it is an obligation for the company to form a committee of independent directors which shall give reason recommendations. However, there is nothing much provided on the role of this committee except providing reasoned recommendations. SEBI should clarify the role of this committee.

66. Marcia Ellis, 'Coming Home – Overview of Going Private Transactions of U.S.-Listed Chinese Companies' (Morrison Foerster, 22 August 2024) <<https://www.mofo.com/resources/insights/200825-private-transactions>> accessed 06 January 2025.

67. Bharat Vasani, 'The Business Judgment Rule: The Indian context' (Cyril Amarchand Mangaldas, 20 December 2023) <<https://corporate.cyrilamarchandblogs.com/2023/12/the-business-judgment-rule-the-indian-context/>> accessed 07 January 2025.

68. 88 A.3d 635 (Del. 2014).

69. 'Kahn v M&F Worldwide Corp.' (2015) 128(6) Harv. L. Rev. 1818 <<https://harvardlawreview.org/print/vol-128/kahn-v-mf-worldwide-corp/>> accessed 09 January 2025.

70. *ibid.*

71. Martin and Steven (N 64).

72. Delisting Regulations, Reg 28.

We suggest that the committee should include a representative of the minority shareholders who will negotiate on behalf of minority shareholders and ensure that the interests of minority shareholders are adequately protected. Proper timelines have already been established for the committee to submit its report i.e. at least two working days before the commencement of the bidding period. A potential drawback of this approach is that it could lead to some challenges for the promoter since it would involve negotiating the delisting price, making the process lengthy and increasing regulatory burden for the promoter. However, the advantages outweigh this drawback. Even if it imposes a burden on the promoter, it will facilitate better price discovery for them by knowing the expectations of the public investors well in advance and could avoid failure of delisting process due to insufficient tender of shares. Further, in the absence of a counter-offer provision in fixed price method, the independent committee can help convey the expectations of public shareholders to the acquirer. This mechanism would serve as a check on the fixed-price method and has the potential to prevent any misleading practices.

Both the suggestions of setting up an independent committee and lowering the 90% threshold complement each other. By clarifying the role of the independent committee, SEBI can ensure that minority shareholders' interests are protected. This committee would make an independent assessment of the procedure and negotiate on behalf of minority shareholders, ultimately safeguarding their shareholder interests. With this safeguard in place, the 90% threshold could also be reconsidered. By lowering the threshold, SEBI can facilitate smoother delisting attempts while maintaining public shareholder protection through the independent committee, allowing for a more balanced approach to delisting.

Conclusion

The 2024 Delisting Amendment has the potential to shift India's voluntary delisting landscape, which has been struggling to gain traction. It directly addresses the major issues contributing to the failure of the delisting process in India. Nonetheless, certain aspects warrant further attention. The existing 90% post-issue shareholding threshold often makes the delisting process rigid and revising the threshold to 75% post-issue shareholding, accompanied by a minimum of 50% public shareholder participation makes the framework align with global best practices and facilitate a smoother delisting process while ensuring that the majority of public investors actively consent to the exit.

At the same time, a structured squeeze-out mechanism after obtaining at least 90% shareholding is necessary to prevent dissenting shareholders from being left with illiquid shares post-delisting and unduly burdening the promoter. This dual approach of modifying

the delisting threshold while introducing a conditional squeeze-out strikes an optimal balance between regulatory efficiency and investor protection. Further, the introduction of the fixed price offer mechanism, in particular, necessitates additional safeguards to prevent price manipulation and protect minority shareholder interests. By drawing lessons from the U.S. delisting framework and advocating for an active role of the independent committee, this paper again proposes a balanced approach that reconciles promotor convenience with investor confidence. Ultimately, a robust and future-ready delisting ecosystem in India will depend on the effective interplay of regulatory reforms, promotor friendliness and minority shareholder protections.



Double Trouble: Unmasking The Antitrust Puzzle of Google Pay And PhonePe



Abstract

Introduction of Unified Payments Interface (UPI) by National Payments Corporation of India (NPCI) has been a game changer in the digital payments sector of the country.(1) With Quick Response (QR) codes being omnipresent, UPI has witnessed an exponential growth by leaps and bounds. However, there lurks a danger of market concentration, where two foreign-owned players PhonePe and Google Pay control at least 85% of the total market share together, raising barriers to entry for smaller players and new entrants. In order to break the duopoly, NPCI suggested a market share cap of 30% on every third-party application, but this paper argues that such a measure is inadequate to address the deeper anti-trust issues. This article sheds light on the revenue model underpinning the UPI ecosystem and identifies predatory pricing strategies employed by the incumbents to exclude other competitors from the market. The author argues that the incumbents have engaged in “mar-

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1. ANI, ‘Nobel Laureate Paul Michael Romer Praises India’s Digital Revolution, Says Success is Unique’ (The Free Press Journal,21 October 2024) <<https://www.freepressjournal.in/business/nobel-laureate-paul-michael-romer-praises-indias-digital-revolution-says-success-is-unique>> accessed 20 January 2025.

ket share buying” behaviour to obtain dominance while reeling under losses. The paper relies on the theory of leveraging to examine the emerging trend of integrating various financial services on UPI payment platforms and how it enables the incumbents to enter other related markets. In the end, the author proposes a pragmatic solution of imposing asymmetric interchange fees on UPI transactions to promote a more inclusive and sustainable digital payments ecosystem.

Keywords

UPI Ecosystem, Antitrust Law, Predatory Pricing, Market Share Buying, Bundling of Services, Asymmetric Interchange Fees

Introduction

India’s payments sector is currently witnessing a revolution spearheaded by the Unified Payments Interface (UPI) technology.⁽²⁾ From being predominantly cash and card-dominated economy, UPI did not struggle to make space for itself and in fact, ended up redefining the entire payments ecosystem. The growth trajectory of UPI makes for a remarkable success story on digitization and financial inclusion.⁽³⁾ In today’s time, UPI has permeated every nook and corner with its Quick Response (QR) Codes present everywhere – from roadside vendors to a five-star restaurant. The rapid adoption begs this one question: what catalyzed UPI’s significant rise? While the convenience of real-time, instant payments undoubtedly played an important role, having to pay zero transaction charges was the real deal, incentivizing both users and merchants alike.⁽⁴⁾ In fact, to keep the UPI revolution

2. *ibid.*

3. ET Online, ‘India is scanning more QR Codes! UPI becomes top transaction mode in rural, semi-urban India: Report’ (Economic Times, 17 December 2024) <<https://economictimes.indiatimes.com/news/economy/finance/india-is-scanning-qr-codes-upi-becomes-top-transaction-mode-in-rural-semi-urban-india-report/articleshow/116392323.cms?from=mdr>> accessed 20 January 2025.

4. Shayan Ghosh, ‘Indians pick UPI over debit cards for ease of use, zero fees’ (Mint, 5 June 2023) <<https://www.livemint.com/economy/indians-pick-upi-over-debit-cards-for-ease-of-use-zero-fees-11685903405304.html>> accessed 20 January 2025.

going, the National Payments Corporation of India (NPCI) has reaffirmed its commitment to maintain zero charges on normal UPI payments, barring payments routed through wallets.(5)

Considering these unique features offered by UPI, one would normally expect a vibrant ecosystem of competing apps. Instead, there looms a threat of market concentration where nearly 85% of the market share is commanded by two foreign-owned players – Walmart-backed PhonePe and Google Pay.(6) This alarming imbalance has drawn a lot of scrutiny and the Parliamentary Standing Committee on Communication and Information Technology also raised a flag concerning the high market share of the two players and called for promotion of local payment apps, like the indigenously developed BHIM UPI.(7) To break this duopoly, the NPCI introduced a 30% market share cap for third-party applications with the objective to provide diverse opportunity in the UPI ecosystem.(8) However, by reducing this entrenched dominance to merely a play of market shares, this paper will argue that such a measure fails to deal with the larger antitrust concerns posed by the conduct of the two behemoths.

Against this backdrop, the paper will be divided into four main parts. The first part of the paper will examine how the incumbents, by employing predatory pricing strategies, lured an enormous consumer base, while also eliminating effective competitors from the market. To further solidify the argument on predatory pricing, the second part of the paper will throw light on the inherent equitable infrastructure of the UPI model and how despite that, the incumbents distorted the UPI market by gaining an unfair advantage through predation. The third part of the paper goes a step further and highlights the anti-competitive effects involved in the emerging trend of cross-selling financial services on UPI payments app. And lastly, the author presents a solution to the duopoly problem and suggests imposing asym-

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5. Singh Rahul Sunilkumar, 'NPCI says no charge on 'normal' UPI payments; but is free service sustainable?' (Hindustan times,30 March 2023) <<https://www.hindustantimes.com/technology/npci-says-no-charge-on-normal-upi-payments-but-is-free-service-sustainable-101680176734294.html>> accessed 20 January 2025.
 6. Shashank Reddy, Shruti Mittal, 'The one thing that threatens India's booming UPI market' (The Indian Express,18 October 2024) <<https://indianexpress.com/article/opinion/columns/india-booming-upi-market-threats-9626886/#:~:text=Instead%20of%20a%20vibrant%20competitive,to%20balance%20risk%20and%20growth>> accessed 20 January 2025.
 7. Saptaparno Ghosh, 'What did the Parliamentary Committee recommend with respect to local fintech players? | Explained' (The Hindu,19 February 2024) <<https://www.thehindu.com/business/Industry/what-did-the-parliamentary-committee-recommend-with-respect-to-local-fintech-players-explained/article67864664.ece>> accessed 20 January 2025.
 8. NPCI, Guidelines on volume cap for Third Party App Providers (TPAPs) in UPI (NPCI/UPI/OC-159/2022-23) 2 December 2022; See also Mayur Shetty, 'PhonePe, GPay get 2 years more to cut UPI market share' (Times of India,1 January 2025) <<https://timesofindia.indiatimes.com/business/india-business/phonepe-gpay-get-2-years-more-to-cut-upi-market-share/articleshow/116843059.cms>> accessed 20 January 2025.

metric interchange fees on UPI payments to encourage a more economically sustainable UPI ecosystem.

Monopolizing Money: Antitrust Concerns In The Duopoly

As the old adage of antitrust law goes, “dominance is not bad; abuse of dominance is”.⁽⁹⁾ In this part, the author analyses how the entrenched duopoly of the two leading players – PhonePe and Google Pay – is not only harmful for the competition, but has also raised significant barriers to entry for smaller and emerging players in the UPI ecosystem.

For an effective antitrust analysis, it is crucial to first understand the revenue model underlying the UPI infrastructure. As mentioned before, UPI levies no transaction fees, unlike credit card networks. It operates under a zero Merchant Discount Rate (MDR) regime, which means that the payment applications do not earn any processing charges.⁽¹⁰⁾ The payment app, issuing bank and the acquiring bank bear the cost of a transaction. But since the payment app also has to bear an additional expense of acquiring merchants and customers, the loss incurred by these apps is much greater.⁽¹¹⁾

This unsustainable revenue model is exemplified by PhonePe, which, despite being an industry leader, continues to incur losses. Payment processing charges alone constitute a sizable 15% of its total expenses which are estimated at Rs. 1,166 crore.⁽¹²⁾ The dominance of the incumbents can majorly be attributed to their deep pockets and the financial capacity to absorb such losses. Smaller fintech platforms, on the other hand, face insurmountable challenges due to their limited capital reserves, stripping them off their ability to compete effectively in this loss-driven environment.

Despite the losses, third-party payment apps still continue to participate in the UPI ecosystem because that is what is driving repeated app usage and traction. In other words, third-party payment apps are somewhat compelled to participate in the UPI ecosystem, other-

9. Shepherd B. George, ‘Antitrust and Market Dominance’ (2001) 46(4) Antitrust Bull. 835 <<https://heinonline-org.rgnul.remotexs.in/HOL/P?h=hein.journals/antibull46&i=867>> accessed 20 January 2025.

10. Neha Dharukar, Karan Mahajan ‘Analysis of charges levied on digital payments’ (pwc, September 2022) <<https://www.pwc.in/industries/financial-services/fintech/payments/analysis-of-charges-levied-on-digital-payments.html> accessed 20 January 2025> accessed 20 January 2025.

11. Nikhil Subramaniam, ‘Can Payment Apps Venture Beyond UPI Hype To Fix Weak Revenue Models, Plug Losses?’ (Inc42, 9 July 2020) <<https://inc42.com/features/can-payment-apps-venture-beyond-upi-hype-to-fix-weak-revenue-models-plug-losses/>> accessed 20 January 2025.

12. Jyoti Banthia, ‘PhonePe trims losses, revenue up by 74%’ (Hindu Businessline, 21 October 2024) <<https://www.thehindubusinessline.com/companies/phonepe-trims-losses-revenue-up-by-74/article68778588.ece>> accessed 20 January 2025.

wise there will be no user revenue.**(13)** It is worth noting that despite the loss-making revenue model of UPI, PhonePe and Google Pay have shown phenomenal growth.**(14)** It is argued that strategies like offering free rewards and cashbacks, have helped the two players obtain dominance in the market. These strategies, however, have semblance of predatory pricing.**(15)**

Under the Competition Act, 2002 (“The Act”), predatory pricing is seen as an abuse of dominant position under Section 4 and is defined as the sale of goods or provision of services at a price which is below the cost of production, with a view to reduce competition or eliminate competitors. Furthermore, the test of predatory pricing, as laid down by the Competition Commission of India (CCI) in *MCX Stock Exchange Ltd. & Ors. v. National Stock Exchange of India* (“MCX case”),**(16)** is two-pronged – firstly, whether the pricing scheme would drive competitors out of the market and secondly, whether the company can recoup its losses.**(17)**

In the context of UPI, as third-party apps operate under the zero MDR regime, there is no extra charge paid by the users; transactions are essentially free. However, as explained before, the costs borne by these payment apps to facilitate transactions, already forces them to operate below cost. When cashback offers and free rewards are added to the equation, the financial burden becomes even more pronounced, ultimately preventing smaller players from coming in. A case in point can be illustrated by the growth trajectory of the indigenously-developed BHIM UPI app. When the app was newly launched, it rolled out attractive cashback offers, and gained wide acceptance amongst users. It had secured nearly 40% of the market shares.**(18)** However, as offering cashbacks on every transaction was economically unsustainability, the app had to discontinue rolling out such offers in

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13. Nikhil Subramaniam, ‘The UPI Paradox’ Inc42 (15 October 2023) <https://inc42.com/features/the-upi-paradox/> accessed 21 January 2025.
 14. Sukriti Vats, ‘PhonePe and Google Pay reach saw steep growth in rural India during pandemic, industry study shows’ (The Print, 2 March 2022) <<https://theprint.in/india/phonepe-google-pay-reach-saw-steep-growth-in-rural-india-during-pandemic-industry-study-shows/855411/>> accessed 21 January 2025.
 15. Neelanjit Das, ‘Rupay credit cards on UPI will now earn same reward points like other RuPay cards including UPI transactions’ (Economic Times, 8 August 2024) <<https://economictimes.indiatimes.com/wealth/spend/rupay-credit-cards-will-now-earn-same-reward-points-like-other-rupay-cards-including-on-these-upi-transactions/articleshow/112336389.cms?from=mdr>> accessed 21 January 2025.
 16. *MCX Stock Exchange Ltd. v. National Stock Exchange of India Ltd.* Case No. 13/2009.
 17. Muskan Agarwal, ‘Non-Dominant Enterprises’ Offers and Schemes: Predatory Pricing or Not?’ (IndCorpLaw, 7 December 2018) <<https://indiacorplaw.in/2018/12/non-dominant-enterprises-offers-schemes-predatory-pricing-not.html>> accessed 21 January 2025.
 18. Shashidhar K J, ‘The weaponisation of cashbacks on UPI by Google Pay’ (ORF, 28 October 2019) <<https://www.orfonline.org/expert-speak/the-weaponisation-of-cashbacks-on-upi-by-google-pay-57099>> accessed 21 January 2025.

2019. This led to a steep decline in its market share to less than 1% today.(19) Meanwhile, incumbents like PhonePe and Google Pay show no signs of scaling back their cashbacks and continue to dominate the market.

The second prong of the predatory pricing test – recoupment of losses – examines whether the dominant firm that engaged in predation and undertook losses, would exhibit a profit recovery later.(20) The underlying idea is whether the below-cost pricing would ultimately render the pricing strategy profitable. If it does, there will be no case of predatory pricing.(21) Considering that new entrants often resort to below cost pricing to enter and establish themselves in the market, the recoupment analysis test is very important. For instance, in the quick commerce industry, when Zepto was newly launched, it offered attractive offers like no shipping charges and heavy discounts. Once it had successfully entered the market and gained a good consumer base, it started to scale back its offers to recuperate its initial losses. Therefore, heavy discounting or offering cash backs are not per se illegal unless it is proved that recoupment of losses is improbable.(22)

It has been nearly 8 years since the two incumbents entered the UPI market and surprisingly so,(23) neither entity has shown signs of limiting their offers or recouping their losses. Such a situation poses serious concerns about the market dynamics as the incumbents' pricing strategy reflects that they are not looking for long-term profitability, but instead want to exert dominance by eliminating competition. Given this fact, it is fair to assume that there is a prima facie case of predatory pricing, warranting intervention under antitrust law.

The Two Sided Dichotomy

At its core, UPI operates as a banking technology infrastructure which permits real-time Peer-to-Peer (P2P) and Peer-to-Merchant (P2M) transactions. When looked at (P2M)

19. Suraksha P, 'BHIM looks to bulk up with ONDC to take digital payment heavyweights' (Economic Times, 4 May 2024) <<https://economictimes.indiatimes.com/tech/technology/bhim-opens-for-business-on-ondc-soon-to-take-on-digital-payment-heavyweights/articleshow/109824857.cms?from=mdr>> accessed 21 January 2025.

20. M/s. Transparent Energy Systems Pvt. Ltd. v. TECPRO Systems Ltd. 09/2013.

21. Shrijitha Bhattacharya & Gargi Bohra, 'Is Zero Pricing Predatory Unfair: MCX Stock Exchange Ltd. v. National Stock Exchange' 2015 1 RSRR 2 <https://www.rsrr.in/_files/ugd/286c9c_02e770b0aeaf4c12a88f488b123c7671.pdf?index=true> accessed 21 January 2025.

22. Shubham Gandhi & Tanish Gupta, 'Gauging the Scheme of Predatory Pricing: The Case of Shopee Pvt. Ltd.' IndCorpLaw (26 April 2022) <https://indiacorplaw.in/2022/04/gauging-the-scheme-of-predatory-pricing-the-case-of-shopee-pvt-ltd.html> accessed 21 January 2025.

23. Antony Peyton, 'PhonePe and Yes Bank unveil India's first UPI-based payments app' FintechFutures (30 August 2016) <https://www.fintechfutures.com/2016/08/phonepe-and-yes-bank-unveil-indias-first-upi-based-payments-app/> accessed 21 January 2025.

transactions, it hosts two categories of users – individuals and merchants. As an intermediary platform, it coordinates between these two categories of users to allow them to engage in transactions, thus making UPI superficially appear like a “two-sided market”. A similar two-sided nature can also be seen in credit card networks where the interaction between banks and cardholders is mediated to facilitate transactions.(24)

In two sided markets, the platform’s success is dependent on achieving a balance between both sides of the market. In simpler words, when an increase in users on one side of the platform, enhances its value for the users on the other in two-sided platforms and such a phenomenon is known as “indirect network effects”. For example, in the e-commerce industry, websites like Amazon or eBay act as an intermediary platform between the vendors and the buyers. The more vendors there are that sell their goods, the more valuable that website becomes for buyers as they will have access to a greater variety of goods.(25)

However, upon a closer examination of the UPI ecosystem, we find a critical distinction: despite its apparent two-sided nature, UPI is not inherently characterized by “indirect network effects”. This distinction can be attributed to UPI’s interoperability.(26) Merchants and users can transact seamlessly regardless of the payment app they use, as the QR Codes and the Virtual Payment Address (VPA) remain static across all platforms. Interoperability ensures that users of one app, such as FamPay, can effortlessly transact with merchants who use different app, such as Google Pay. Therefore, there is no incentive at play to drive users to a particular payment app simply because it hosts more number of merchants, or vice versa.

The UPI infrastructure as designed by the NPCI is such that it ensures a level playing field across all platforms and no single application can claim dominance by excluding others. However, despite such an equitable infrastructure, the incumbents have secured dominance by engaging in predatory pricing strategies, giving rise to a “lock-in effect”.(27) While

24. Duy D. Pham, ‘Visa-Mastercard and the Identification of Collusive Practices in Two-Sided Markets’ (2016) 29 *Can Competition L Rev* 1.

25. YSH, ‘eBay – The Perfect Store(y) of network effects’ (Digital Innovation and Transformation, 4 October, 2015) <<https://d3.harvard.edu/platform-digit/submission/ebay-the-perfect-storey-of-network-effects/>> accessed 21 January 2025.

26. Ajinkya Kawale, ‘RBI allows interoperability between PPIs like wallets for UPI payments’ (Business Standard, 27 December 2024) <https://www.business-standard.com/economy/news/rbi-allows-interoperability-between-ppis-like-wallets-for-upi-payments-124122700993_1.html> accessed 21 January 2025.

27. Göneç Gürkaynak, Öznur Ýnanýlýr, Sinan Diniz, Aybe Gizem Yapar, ‘Multisided markets and the challenge of incorporating multisided considerations into competition law analysis’ 2017 5 *Journal of Antitrust Enforcement* 1, Pages 100–129.

technically there are no switching costs in UPI apps, many users are reluctant to change their payment applications as they perceive re-registering with a new app, linking bank accounts, and undergoing verification as cumbersome.(28) As a result, the existing user base is unlikely to migrate to other payment apps, thus solidifying the incumbents' hold over the market and creating a "lock-in effect".

The problem of dominance at hand is unique in a way that it has not actuated to profitability of the incumbents(29). The firms, by engaging in predatory pricing, may have gained high market shares but have failed to generate commensurate revenue.(30) Such a practice is labelled as "buying market shares" because firms deliberately price their services below cost primarily to gain market share, even when it leads to reduced profitability.(31) The one advantage that the incumbents have achieved by buying market shares is a giant user base. PhonePe, at present boasts a user base of 500 million.(32) Such scale and reach would have been unattainable without the support of UPI's infrastructure and the financial burn undertaken by these firms.

By amassing a wide user base, the incumbents are now in a position to leverage their dominance in one market, to enter into other adjacent markets. And to do this, PhonePe, like many other fintech platforms, plans to expand its financial services and cross-sell other products and services.(33)

Moving Beyond Payments

A recent trend observed in the fintech industry is that firms are striving to become a 'one-

28. Rounak Kumar Gunjan, 'Why people don't change their UPI apps even when they hate them' (The Ken, 26 December 2024) <<https://the-ken.com/kaching/why-people-dont-change-their-upi-apps-even-when-they-hate-them/>> accessed 21 January 2025.
29. Monisha Purwar, 'Who should bear the cost of UPI' (Financial Express, 4 September 2022) <<https://www.financialexpress.com/business/banking-finance-who-should-bear-the-cost-of-upi-2654749/>> accessed 21 January, 2025.
30. Ajinkya Kawale, 'PhonePe brings down losses to Rs. 1,996 crore in FY24, revenues up 85%' (Business Standard, 21 October 2024) <https://www.business-standard.com/companies/results/phonepe-q2-result-losses-cut-down-to-rs-1-996-cr-in-fy24-revenue-up-85-124102100441_1.html> accessed 21 January 2025.
31. Christopher R. Thomas & Brad P. Kam, 'Buying Market Share: Agency Problem or Predatory Pricing' (2006) 2 Rev L & Econ 1.
32. Peerzada Abrar, 'Walmart-owned PhonePe crosses 500 million lifetime registered users' (Business Standard, 7 November 2023) <https://www.business-standard.com/companies/news/walmart-owned-phonepe-crosses-500-million-lifetime-registered-users-123110701116_1.html> accessed 21 January 2025.
33. Ajinkya Kawale, 'Fintech major PhonePe eyes replicating UPI success via diversification' (Business Standard, 4 December 2024) <https://www.business-standard.com/companies/start-ups/phonepe-eyes-to-replicate-upi-success-on-its-expanding-financial-verticals-124120401110_1.html> accessed 21 January 2025.

stop-shop' for financial services, with the aim to achieve higher customer loyalty.⁽³⁴⁾ PhonePe, for example, has expanded its platform to offer insurances, investments and lending services to its existing user base. The repeated app usage caused by frequent UPI transactions has provided incumbents with a wide user base, which they are now leveraging to enter into other related markets. Such a strategy aligns with the leveraging theory, which posits that dominant firms spread its market power to enter into new, competitive markets and establish a second monopoly in the new market.⁽³⁵⁾ Under Section 4(2)(e) of the Act, such conduct is considered as an abuse of dominance where a firm uses its dominant position in one market, to enter into other relevant market.

Even the Reserve Bank of India (RBI) in its Report on Currency and Finance highlighted that leveraging existing customer relations to cross-sell other financial services may raise anti-competitive concerns due to bundling of services.⁽³⁶⁾ These fintech platforms, by cross-selling financial services, provide the added convenience to users to avail two or more financial services from one platform, thus giving rise to bundling.⁽³⁷⁾ A notable case in this context is that of Baglekar Akash Kumar v. Google LLC ("Gmail case")⁽³⁸⁾ where the CCI examined the integration of Google Meet, a video-conferencing app, with Gmail as an abuse of dominance under Section 4(2)(e) of the Act. The CCI, rejecting the complaint, ruled that since users are not under any coercion to use Google Meet and are free to use any other app, Google has not abused its dominance.

However, it is contended that the Gmail case does not factor in the uniqueness of bundling that occurs on digital platforms. To analyse bundling in such settings, three critical factors must be considered: separate products, coercion and foreclosure of competitors.⁽³⁹⁾

Firstly, bundling occurs when products or services from different markets are offered together. In the context of UPI payment apps, the payments sector and the insurance or investment or the lending sector form completely different markets. By integrating other

34. BL Mumbai Bureau, 'Cross-selling and embedded finance models may raise anti-competition concerns: RBI' (Hindu Businessline, 29 July 2024) <<https://www.thehindubusinessline.com/money-and-banking/cross-selling-and-embedded-finance-models-may-raise-anti-competition-concerns-rbi-report/article68461305.ece>> accessed 21 January 2025.

35. Sean Heather, 'Unlocking Antitrust: Tying & Monopoly Leveraging' (US Chamber of Commerce, 8 March 2021) <<https://www.uschamber.com/finance/unlocking-antitrust-tying-monopoly-leveraging>> accessed 22 January 2025.

36. Reserve Bank of India, Report on Currency and Finance (2024).

37. Daniel Mandrescu, 'Tying and Bundling by online platforms – Distinguishing between lawful expansion strategies and anti-competitive practices' (2021) 40 Computer Law & Security Review.

38. Baglekar Akash Kumar v. Google LLC 39/2020.

39. Stefan Holzweber, 'Tying and Bundling in the Digital Era' (2018) 14 Eur Competition J 342.

financial services on an application which was predominantly for UPI payments, the incumbents are engaging in bundling of services. Moreover, leveraging can take place only when there are at least two different markets – a dominated and a non-dominated market. PhonePe and Google Pay are dominant in the payments sector, but the same cannot be said for the other markets. Therefore, it can be said that the test of separate products stands satisfied in the present case.**(40)**

Secondly, as per the traditional bundling analysis, it has been long established that the consumers must be forced to purchase the bundled or tied products together, as also seen in the Gmail case. However, in *United States v. Microsoft Corp.* (“Microsoft case”),**(41)** the European Commission expanded this understanding, and clarified that coercion in digital markets is not necessarily required to be overt. Such a rationale was given against the backdrop of the theory of leveraging. While compulsion to buy the tied or bundled product may result in transfer of market power, the same can also happen even with a mere incentive. These incentives can either be of financial nature or it can be just convenience. In digital settings, incentives need to be considered from the perspective of rationality of consumers. Consumers often exhibit inertia or some bias towards choosing the easiest option, making them susceptible to even subtle nudges.**(42)**

The Microsoft case is a brilliant example of how a dominant entity can exploit user inertness to transfer market power. Microsoft integrated Internet Explorer into the Windows operating system by preinstalling the application, which incentivized consumers to use the preinstalled web browser rather than exploring and downloading other alternatives. This was also substantiated by an empirical study conducted by the European Commission which revealed that more than 50% of the users were reluctant to download a different web browser application. It is apparent that in a digital setting, consumer bias of choosing the more convenient option is prominent. The dominant entity tries to exploit this very tendency of the consumer and extend its market power to the non-dominated market. Microsoft tried to do the same again by integrating LinkedIn into its operating system after their merger. The European Commission, however, prohibited the integration and observed that preinstalling LinkedIn will cause a substantial rise in membership of LinkedIn, and hence, its competitors will be foreclosed.**(43)**

40. Ibid.

41. Case T-201/04 Microsoft (2014) ECLI:EU:T:2007:289.

42. Ibid.

43. Press Release, Antitrust: Commission accepts Microsoft commitments to give users browser choice, European Commission IP/09/1941.

We find that a similar tendency of exploiting consumer inertia is displayed by fintech companies by integrating other financial services on their platforms. Providing multiple services or by following the ‘one-stop-shop’ principle, users may gravitate towards buying the other financial services for sake of convenience, even if other competitors provide superior alternatives.

Lastly, the market foreclosure test is a very important analysis in cases of tying and bundling. The European Court of Justice has unequivocally described this test as determining whether the dominant firm’s practices create an exclusionary effect, ultimately harming competition and consumers. In order to prove foreclosure, all the relevant circumstances and factual details of a case need to be considered.⁽⁴⁴⁾ For instance, UPI payments being the biggest game in town, has served as a gateway for the incumbents to tap into the potential of a huge consumer-base to venture into different markets like insurance and lending. And as a result, the traditional institutions are found at a disadvantageous position as they are prevented from accessing the same consumer behavioural data. This asymmetry not only stifles competition but also distorts the broader market by inhibiting innovation and choice for consumers.

By using their dominant position in the payments sectors, these firms are able to spread their undue influence in other related markets, thereby reducing opportunities for smaller players to compete effectively. While bundling of services may offer short-term convenience to consumers, it is also important to consider the long-term risks it may pose to the market at large.

Ending the Politics of Market Share

As explored earlier, the unique duopoly of PhonePe and Google Pay has mostly revolved around their dominance in market share. This dominance was achieved through a strategy commonly referred to as “buying market shares”, where both platforms offered attractive incentives while absorbing the cost of these promotions to attract and retain customers. This strategy, however, has created a two-fold problem – firstly, the other competitors, especially the local fintech players are struggling to enter the market and secondly, the consumers are subsequently left with limited options to choose from.

To address these issues and encourage smaller players to participate in the UPI ecosystem, NPCI introduced a 30% market share cap for every third-party application. However, this solution only scratches the surface of the problem by focusing solely on market share distri-

44. Ibid.

bution. It overlooks a critical issue inherent in the UPI ecosystem – the absence of transaction fees.

The zero-transaction fee structure of UPI has inadvertently discouraged smaller players from entering the market while allowing incumbents with deep pockets to dominate.⁽⁴⁵⁾ The RBI, in its Discussion Paper on Charges in Payments Systems,⁽⁴⁶⁾ highlighted the rationale behind prescribing charges in payment systems. It mentioned that payment system operators start with an initial outlay capital and then incur varied expenses to operate a safe and secure payment system. So to ensure continued operations of these payment systems, there should be generation of sufficient returns. Keeping in mind the double-sided nature of such platforms, it further recommended that payment systems should be priced in such a manner where both the user and the service provider are incentivised to use and offer them, respectively. Operating payment systems is an economic activity and there seems to be no reason for a free service, unless it has an element of public good.

A potential solution involves implementing an interchange fee similar to the model used for payments made via prepaid payment instrument (PPI) wallets.⁽⁴⁷⁾ For instance, an interchange fee of 1.1% could be levied on transactions exceeding a specified threshold. This fee would be collected from the merchant's account rather than the customer, ensuring that users remain unaffected. Such a model would encourage new entrants by providing a viable revenue stream and subsequently increase competition in the market. It is expected that such a model would also help gradually decentralize the market and provide more choices to consumers.

The concept of interchange fees can be further refined by drawing inspiration from mobile termination rates (MTRs) in the telecom industry. MTRs are fees paid by one telecom operator to another for completing a call on its network. In simple words, it is a price paid by one operator to another for connecting a call to a user on its network. While designed to

45. Asmita Dey, 'UPI duopoly revives fee debate' (Times of India, 11 March 2024) <<https://timesofindia.indiatimes.com/city/mumbai/upi-duopoly-revives-fee-debate-regulatory-concerns-over-phonepe-and-google-pays-dominance-in-upi-spark-discussions-on-merchant-transaction-fees/articleshow/108375995.cms>> accessed 22 January 2025.

46. Reserve Bank of India, Discussion Paper on Charges in Payment Systems (2022).

47. Anulekha Ray, 'Which UPI payments will attract interchange fee? Will you have to bear the cost?' (Economic Times, 8 December 2023) <<https://economictimes.indiatimes.com/wealth/spend/upi-merchant-transactions-ppi-which-upi-payments-will-attract-interchange-fee-will-you-have-to-bear-the-cost/articleshow/99087712.cms?from=mdr>> accessed 22 January 2025.

ensure fair compensation for facilitating calls, MTRs were subject to intense debate over fairness, given the different cost structures of every operator.

To address these concerns, some regulators imposed asymmetric MTRs, where incumbents charged lower rates while smaller operators or new entrants charged higher rates.⁽⁴⁸⁾ The rationale behind asymmetric MTRs was to assist entrants in competing with incumbents. As per the guidelines issued by the European Commission on setting MTRs, asymmetric rates were given to new entrants for a transitional period of up to four years as that was an adequate period by which the new entrants can achieve sizable market share.⁽⁴⁹⁾ The similar principle could be applied to UPI payments by introducing asymmetric interchange fees. The logic is that a smaller player or a new entrant, which does not have the level of scale to compete with the two incumbents, can generate greater revenue from charging a higher interchange rate and help keep its operations going.

For example, PhonePe and Google Pay will charge a paltry interchange fee for all P2M and P2P transactions and the other smaller or new entrants can charge a higher interchange fees, relatively. It is important to note that the interchange fee will be collected from the merchant's account thus, the customer would remain unaffected. The pricing structure would be such that the incumbents don't incur losses. They can operate at cost or with little margin. As it is only natural to expect that the existing consumer base would not immediately switch to other applications, the pricing structure of the smaller player or new entrants should be such that they can continue their operations despite having limited users on-board.

The introduction of asymmetric interchange fees offers a pragmatic solution to address the dominance of incumbents like PhonePe and Google Pay. Apart from promoting a level-playing field, such a measure will also encourage greater innovation and competitiveness in the market. However, its success will hinge on careful regulatory oversight and commitment to revisiting these measures once market conditions stabilize. Only then can the UPI ecosystem evolve into a truly inclusive and competitive landscape.

Conclusion

India has embraced the UPI revolution with arms wide open but its success is being overshadowed by dangers of market concentration and a lack of level-playing field. NPCI's suggestion of imposing a market share cap on the payment apps is myopic and misses the

48. Gregory Sidak, Andrew P. Vassallo & Leonard Sabetti, 'Did Asymmetric Mobile Termination Rates Help Entrants Gain Market Share?' (2017) 2 *Criterion J on Innovation* 701.

49. Directive (EU) 2018/1972.

underlying cause of the reigning duopoly. This paper has demonstrated that given the loss-making revenue model of the UPI ecosystem, the incumbents, with their deep pockets have been able to dominate the market through their predatory cashbacks and offers. Through this, the incumbents have eliminated effective competitors like BHIM UPI from the market and distorted market dynamics. The paper goes one step further and analyses an emerging trend of payment apps offering other financial services on one platform. By basing its analysis on the theory of leveraging, the author highlights the long-term anti-competitive effect of bundling such services and cautions against the likelihood of incumbents forming a second monopoly in other related markets. Ultimately, the author attacks the heart of the problem – lack of revenue generation in the UPI infrastructure. Therefore, in the end, for a more sustainable path forward, the paper highlights the need to empower smaller players and suggests imposing asymmetric interchange fees. The author argues that asymmetric interchange fees will incentivize smaller players to enter the market and compete with the incumbents on merit.



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