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Articles

R'BIting ฿itcoins

By **Noorul Hassan**

Currencies across the globe need to have universal application and acceptability and have been given sovereign validity, sanctity by the respective countries that issue them. Each country issues its own unique currency that is valid within its territory. Currencies like the United States dollar and the Euro are accepted in many countries and are freely convertible in almost all countries. The dawn of digital era has introduced a new form of currency i.e., virtual currency/ digital wallet that is gaining increasing acceptability and availability across many jurisdictions including India. The RBI has, recently, visualised potential risks that may arise while dealing with these currencies and issued a Press Release on 24 December 2013 cautioning users, holders and traders of virtual currencies while assuring that it is examining the legality of bitcoins under the present legal and regulatory framework. Consequently, almost all websites that had earlier allowed buying or selling the bitcoins have temporarily suspended their operations. It may therefore be apposite to comprehend this novel idea and its operational dynamics before delving into the apprehensions of the RBI.

What is a bitcoin?

The evolution of bitcoin can be attributed to distrust in the extant banking system. Bitcoin is a digital or virtual currency which is somewhat similar to traditional currencies but contrary to such currencies it has nothing to do with ATM cards or credit cards issued by the banks. Unlike a traditional savings account, these virtual currencies are saved in digital wallet(s) - a software application downloaded and installed on a computer system or a mobile phone. Just like using a physical wallet, one can buy or sell bitcoins from websites which are called Online Exchanges, by making payment from the digital wallet. Since there is no central regulating authority or clearing house, all the transactions involving bitcoins take place on a P2P (peer-to-peer i.e., one-to-one) basis in a decentralised manner outside the global banking system and is controlled only by its users with no regulatory oversight.

Background mechanics

The digital wallet of the user works on a public key infrastructure i.e., wallet address - a public key available to the outside world while the private key is held by the user to protect his coins inside. This is also called 'crypto-currency' meaning that it relies on cryptographic software protocols to generate the currency and validate transactions.

New bitcoins are generated by a process called 'mining'. A miner is a person who, with the use of software and specialised hardware, performs task of recording and validating transactions happening between P2P. For the services rendered by miners, they earn transaction fee and newly created bitcoins. Each digital transaction constitutes a 'block' and various blocks form a 'blockchain'. This blockchain tracks the flow of a bitcoin. This

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provides transparency and ensures safety of a transaction. For operational convenience, each bitcoin can also be sub-divided upto eight decimal places.

Payment advantages

Recently, Virgin Galactic announced accepting of bitcoin as the payment for its commercial space flight venture. A few business outlets in India have started accepting bitcoins as currency to replace the rupee. India has approximately 50,000 bitcoin fraternity. By and large the transactions in bitcoins appear to be for speculative purposes. There are some merits in the bitcoin usage. For example, a blockchain can be clearly tracked for ensuring validity of the payment. A merchant accepting bitcoins as consideration for goods sold/ services rendered is assured of the safety of bitcoins and can avoid the risk of being cheated by counterfeit currency. Further, the transaction costs are very minimal. There is also flexibility in dividing the bitcoins upto eight decimal places.

The issues

Whether legal or not, virtual currency is evolving in different countries such as US, EU, China, Japan, Germany, India, etc. Specific apprehensions or potential risks associated with this business are, whether it pegs black money; facilitates money laundering and criminal activities; helps in financing of terrorists; and taxation of e-commerce.

Scenario in the US

In USA, the Department of Treasury's Financial Crimes Enforcement Network's (FinCEN) regulations define currency as fulfilling triple determinants namely (a) designation of the coin or paper money as legal tender (b) circulation and (c) use as a medium of exchange in the country of issuance. Virtual currency is a medium of exchange that operates like real currency but does not have legal tender status in any jurisdiction. In addition, the Final Rule [1] made by FinCEN has extended the application of the Prepaid Access Rules to 'administrators' and 'exchangers' to register as 'money transmitters' [2], who are required to register, report and maintain records.

The US Treasury has been warning bitcoin businesses since March 2013 that they must comply with "Know Your Customer" (KYC) laws that require stringent identity checks, monitoring of accounts and reporting of suspicious activity. This effort would de-anonymize the bitcoin. To comply with federal regulations surrounding financial fraud, money laundering, identity theft, and financing of terrorism, Bitcoin companies are required to verify their customers by instituting policies on customer transactions.

The first Congressional Hearing on Virtual Currencies[3] had expressed concerns over websites like 'SilkRoad' which used bitcoins

1 On Definitions and Other Regulations Relating to Prepaid Access.

2 Guidance on Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies by Department of Treasury, Financial Crimes Enforcement Network

3 Held on 18-11-2013

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in transaction of illegal goods and services. However it eventually did not ban it but expressed the desire to regulate the sector to combat any potential threat considering that the legitimate use would far outweigh the malicious use of bitcoins. Thus the US regulator is not averse to dealing with virtual currencies as long as there is assurance that it is used for legitimate transactions and will eventually be brought into the purview of mainstream financial operations.

Scenario in other countries

The European Banking Authority has also sounded a note of caution to parties to the bitcoin transaction that users should be aware of the risks of such transaction before going ahead. It expressed concerns over the effect of hacking of exchange platforms or its seizure by government order for money laundering or terrorist financing investigations which could jeopardize the users and the money that they have invested.[4] Of late, Swiss Parliament has considered a postulate for treating bitcoin as a foreign currency[5]. However, Chinese government has banned financial institutions from trading in bitcoin[6]. Germany recognises bitcoin as "unit of account" and treats it as a financial instrument.

Legality in India

Transactions in bitcoins are not illegal in India *stricto sensu*. However users need to be very careful while dealing with this type of virtual currency. The RBI in its advisory opinion has clearly expressed its concern over the P2P anonymous/pseudonymous systems that could lead users to breach, even if unintentionally, the anti-money laundering laws or combating financing of terrorism laws. It has categorically warned about virtual currencies being prone to losses arising out of hacking, loss of password, compromise of access credentials, malware attack, etc. The users need to treat their e-wallets with the same care as their physical wallets and must compulsorily conform to the KYC norms followed by the bitcoin exchanges. Since they are not created by or traded through any authorised central registry or agency, the loss of the e-wallet may result in permanent loss of the currencies held in them. Additionally, in the absence of regulatory authority to oversee the payments, there is no framework to address customers' problems, disputes, chargeback, etc. The Enforcement Directorate (ED) is also involved in series of raids on bitcoin traders, probing for financial crimes and money laundering transactions. This warning coupled with ED's actions has led to the virtual closing down of the bitcoin exchanges in the country. It remains to be seen whether the bitcoin community will grow or die out after an initial flutter like many other earlier attempts for a single global currency.

Way forward

Today the reliability of fiat currencies is a point of concern. In an economic downturn with currency fluctuations and increasing

[4] http://www.eba.europa.eu/documents/10180/16136/EBA+Warning+on+Virtual+Currencies.pdf
[5] http://www.coindesk.com/swiss-lawmakers-bitcoin-foreign-currency/
[6] http://www.reuters.com/article/2013/12/05/china-bitcoin-idUSL4N0JK1KZ20131205

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unemployment, virtual currencies provide a more prudent investment opportunity for knowledgeable users. Moreover, with the developments in the field of cryptology, encryptions of commercial transactions prove a more feasible option that guarantees safety of an investment. It is therefore pertinent for governments to consider the US model and attempt at regulating the sector rather than letting it be held ransom by hackers. It might also be pragmatic to put in place appropriate security systems to plug any loop holes and avoid hacking. Before recognising bitcoins as private currency, it is important for the government to intervene and devise policies. It must be kept in mind that the purposes for which the bitcoins are used have to be regulated and not the business *per se*. The government may initially allow the business in a limited way under a centralised repository system before opening up the business fully in a decentralised way. This may be easier said than done but may pose many pertinent questions such as its treatment in foreign exchange dealings, taxation, etc.

As far as the users are concerned they should have the appetite for risk. As there can be no efficacious way to prevent hacking, it is advisable for users to choose their passwords and access credentials with utmost care to avert the loss of digital money. Nevertheless, with the recent introduction of the one-time password (OTP) card, the potential risk to one's account from a malicious party could be significantly mitigated[7]. They must also adhere to the AML/KYC norms at the respective bitcoin exchanges and avoid using technologies to hide their IP addresses to ensure greater transparency.

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The Real Estate Bill - An Overview

By **Shagun Jain**

The real estate sector in India, despite its large size and numerous players still remains outside regulatory purview and discipline and continues to be in the unorganized sector. One sided contracts in favor of the builder, large cash transactions, lack of standardization and quality and delay in delivery of completed projects continue to plague this unorganized sector. The Central Government introduced the Real Estate (Regulation and Development) Bill, 2013 ("the Bill") in the Rajya Sabha on August 14, 2013 with the objectives of protecting the interest of the consumers, promoting fair play in real estate transactions and ensuring timely execution of the projects.

Scope of the Bill

The Bill is applicable only to *residential* real estate projects. However, it does not bring under its ambit projects where the land area proposed to be developed is limited to a maximum of 1000 sq. mts. or the number of apartments proposed to be developed is limited

[7] https://www.mtgox.com/press_release_20131120.html

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to 12 (inclusive of all phases). This limit may vary between States/UTs but in no case will be more than the aforementioned limits.

Important definitions

The Bill proposes to standardize the commonly used terms in the sector by defining 'apartment', 'common areas', 'carpet area', 'advertisement', 'real estate project', 'prospectus' etc. The Bill also introduces an important concept of sale of apartments only on the basis of 'carpet area' which makes sale on basis of 'super built up area' (often used to mislead buyers) non-existent.

Establishment of RERA & REAT

The Bill proposes to establish a Real Estate Regulatory Authority ("RERA") in each State or jointly for two or more States by the 'Appropriate Government'. The Bill specifies the functions, powers, and responsibilities of the Authority such as exercising supervision over real estate transactions, appointing adjudicating officers for settlement of disputes and imposition of penalty and interest. The Authority would be empowered to impose penalties on the developers for violations of the Bill, including imprisonment up to 3 years. Further, establishment of a Real Estate Appellate Tribunal, constituting of a sitting or retired judge of the High Court, one additional judicial and one administrative/ technical member, has been envisaged, to hear appeals from the orders or decisions or directions of RERA and/or the adjudicating officer.

Registration of real estate agents and projects

It is compulsory for all agents, who intend to sell any immovable property, to register themselves with the RERA. This move is aimed to protect buyers/customer from frauds. Further, it is mandatory for promoters to register their projects after receiving all approvals from development/municipal authorities.

Duties of promoters

It will be mandatory for promoters to upload information relating to the registered project on the RERA's website, such as details of promoters, layout plan, land status, carpet area, status of statutory approvals, details of real estate agents, contractors, architect, structural engineer etc. Additionally, promoters have to provide (to RERA), the proposed advertisements relating to the project, formats of the agreements to be executed with buyers and lists of bookings in the project on the basis of the agreements with proposed buyers. This will further protect the interest of the buyers and avoid hardship due to one-sided agreements. The promoters have to comply with obligations relating to veracity of the advertisement for sale or prospectus, responsibility to rectify structural defects, and to refund money in cases of default.

Advances and Agreement of Sale

Promoters are restricted from accepting more than 10% of the "cost of apartment, plot or building" as advance without a written agreement of sale with the proposed buyer. The agreement must have all the relevant details with regard to the project as prescribed under the Bill. The practice of pre-launch booking of the projects will come to an end. However, interestingly, cost of apartment has not been defined in the Bill and therefore there is lack of clarity on the components that may be included

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by the developer/promoter in such cost to be recovered as an advance from the proposed buyers.

Mandatory escrow account

Promoters have to compulsorily deposit 70% or such lesser percent, as notified by the appropriate government, of the amounts realized from the allottees/buyers, for the purposes of the concerned project only, within 15 days of realization of the moneys.

Rights and duties of allottees

Allottees have been empowered to obtain information relating to the property booked, to know stage-wise time schedule of project completion, to claim possession of the apartment/ plot/building as per promoter's declaration, to claim refund with interest in case of default by the promoter, and to obtain necessary documents and plans after possession. Allottees have the duty to make necessary payments and carry out other responsibilities as per the sale deed.

Positive aspects of the Bill

It is hoped that the Bill will bring in a measure of standardization in the sector leading to the orderly growth of the industry through introduction of standard definitions, methodology (for sale, registration, documentation, disclosures and filings) across the sector. The Bill aims at consumer protection by making it mandatory for promoters to register all projects, prior to sale and only after having received all approvals from development/municipal authorities.

The Bill will ensure timely completion of projects and prevent fund diversion. Presently, the real estate market has experienced innumerable delays in project approvals and completion, thereby delaying delivery of possession of the apartments. However, the Bill has strict regulations in place to ensure timely completion of the projects and delivery of apartments as per schedule to the buyers. In case of long delays, the buyers will be entitled to full refund with interest. The Bill provides for a speedy and specialized adjudication mechanism to settle disputes between promoters, buyers and real estate agents, thereby de-clogging the civil courts and consumer forums, from disputes in the real estate sector.

The Bill makes it difficult to cancel a sale. Developers will not be allowed to cancel an agreement for sale unless they have sufficient cause to do so. In case there is structural defect or deficiency in the development of a building, the Bill allows the buyers to approach the developer for after sales service for a period of 2 years after delivery of possession. The Bill prohibits any pre-launch bookings by the developers. Usually developers commence sale of units much before obtaining mandatory approvals, which later proves to be a hassle for the buyers in case the approvals are delayed/not obtained. Now it is only after registration that an issuance of advertisement or booking of units would be permissible by the promoters.

Criticisms

The Bill covers only residential projects and it is applicable only to new real estate projects. Hence, projects sold prior to enactment of the Bill, which might still be in the process of obtaining clearances or which raised money on the basis of pre-launch are not included in the Bill. There are many buyers who would

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be deprived of the benefit of this Bill due to exclusion of past projects. There is lack of clarity on delays due to approvals/clearances from government departments as developers might be penalised or face financial loss due to no fault of theirs. Registration with RERA is not mandatory for projects covering less than 1000 square meters. Hence many small developers across metros like Mumbai, Bangalore, etc. may escape from registration requirements and regulator's control. New residential projects can be launched only after getting requisite clearances from the government, which ideally takes 2 to 3 years. Therefore, in short term there will be delays in the launch of new projects.

The Bill does not regulate 'construction' which is the domain of States and urban local bodies. The main concern of the developers is the need for a single window system for project approvals and clearances, for which the Ministry of Housing and Urban Poverty Alleviation has constituted an Expert Committee represented by industry bodies to recommend to the States on ways and means to set up a single window system. As far as the Bill is concerned, its mandate is limited to transactions, and thus regulates all parties involved in it.

Issues that remain unaddressed

The Bill does not recognise that the promoter, the agent and the allottee are not the only three players in the project. This chain includes the landowner, an attorney who investigates titles, the developer, the architect, the structural engineer, the approving authority, the contractor, the project manager who supervises construction, the agent and the purchaser. Registering only the developer and the real estate agent, and their projects, and expecting that this registration will bring about transparency and solve all problems, is a narrow approach.

The RERA should help the industry, both for ownership and rental. It should work with government and local authorities to improve coordination and expedite the grant of construction permissions, minimising the number of agencies giving clearances. It should present an annual report on its performance, just as companies do with their shareholders.

The government should take measures to ensure easy funding for developers. It should initiate institutional funding to the developers so that more realty projects are encouraged. The Bill lacks any mention of a single window clearance to enable speedier approvals and permissions for the developer projects.

Concluding remarks

The impact of the proposed regulatory Bill can be only assessed over time as to whether it is able to effectively address the issues facing the housing sector including standardization of sale agreements, efficacy in resolution of complaints and encouragement of private equity through effective regulations. This would also depend on the Government's commitment to regulate growth of the real estate housing sector. If implemented in its true spirit with requisite additions to the Bill, it may prove be a boon for the real estate sector and consumers.

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Notifications & Circulars

Holding-subsidiary relationship clarified: The Ministry of Corporate Affairs (MCA) has clarified that the shares held by a company or power exercisable by it in another company in a 'fiduciary capacity' shall not to be counted for the purpose of determining the holding-subsidiary relationship in terms of Section 2(87) of the Companies Act, 2013. General Circular No. 20/2013, dated 27-12-2013 has been issued in this regard.

FDI in pharma sector - Restriction on 'non-compete clause': The Department of Industrial Policy and Promotion (DIPP) has placed certain restrictions in respect of FDI in pharmaceuticals. Press Note No. 1 of 2014, dated 8th January 2014 states that 'non-compete clauses' shall not be allowed in commercial terms between parties for foreign investment in the pharmaceutical sector except in special circumstances. Approval of the Foreign Investment Promotion Board will also be required.

FIIs - Clarification on opaque structures: Foreign Institutional Investors required by its regulator or under any law to ring fence their assets and liabilities from other funds/sub-funds shall not be treated as having an opaque structure, so long as: a) the applicant is regulated in its home jurisdiction; b) each fund/sub-fund in the applicant satisfies broad based criteria, and c) the applicant gives an undertaking to provide information regarding its beneficial owners as and when SEBI seeks this information. SEBI Circular CIR/IMD/FIIC/21/2013, dated 19-12-2013 has been issued in relation to declaration and undertaking required to be provided by FIIs and their sub-accounts with regard to their opaque structure such as Protected Cell Companies (PCC), Multi Class Share Vehicles (MCV), etc.

FDI - Issue of non-convertible/redeemable bonus preference shares or debentures to non-residents: According to Reserve Bank of India's A. P. (DIR Series) Circular No.84, dated 6-1-2014, an Indian company may issue non-convertible/redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a court in India under the provisions of the Companies Act subject to no-objection from the Income Tax Authorities. The rules for issue of preference shares (excluding non-convertible/redeemable preference shares) and convertible debentures (excluding optionally convertible/partially convertible debentures) under the FDI scheme shall remain as it is.

FDI - Pricing Guidelines for instruments with options clauses: The Reserve Bank of India has decided that optionality clauses may henceforth be allowed in equity shares and compulsorily and mandatorily convertible preference shares/debentures to be issued to a person resident outside India under the FDI

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Scheme. The optionality clause will oblige the buy-back of securities from the investor at the price prevailing/value determined at the time of exercise of option to enable the investor to exit without any assured return. However, such clauses must be in line with the pricing guidelines issued by RBI in A.P. (DIR Series) Circular No. 86, dated 9-1-2014. Corresponding amendments have also been made in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 by Notification No. FEMA 291/2013-RB published in gazette on 31-12-2013.

Ratio Decidendi

Arbitration – Court dealing with arbitration application not to address issue on merits:

The Supreme Court of India has held that any court, while dealing with application under Section 11(6) of the Arbitration Act is not justified in addressing the same on merits as to whether it is a dispute relating to excepted matters under the agreement or not. It was held that the designate judge in the matter before it was in error by opining that the disputes raised, on amount due and payable, are not "billing disputes", for the same should have been left to be adjudicated by the arbitrator. The present appeal was filed against the High Court Order wherein the court, in an application under the Arbitration & Conciliation Act, 1996, dismissed the contention of the appellant that the disputes raised by it, relating to amounts due and payable, fell within the ambit of a billing dispute as per the Power Purchase Agreement and hence were not to be referred for arbitration but to an expert. The High Court also appointed an arbitrator in this regard. The appellant had treated the same as a 'billing dispute' and was of the view that a billing dispute is first to be resolved by an expert and on failure of settlement of dispute by the expert the same can be referred to arbitration.

The Court observed that in *SBP & Company v. Patel Engineering Ltd.* case the SC had held that on receiving an application for appointment of arbitrator, the Chief Justice or his designate has to look into territorial jurisdiction, existence of an arbitration agreement and existence of a live claim; that is, the claim has not lapsed. Thus, it is only for the purpose of finding out whether the arbitral procedure has to be started that the Chief Justice has to record satisfaction that there remains a live issue in between the parties. [*Arasmeta Captive Power Company Private Limited* v. *Lafarge India Private Limited* – Supreme Court order dated 12-12-2013 in Civil Appeal No. 11003 of 2013]

No prejudice on enquiry initiated by CCI:

Allahabad High Court has dismissed writ petition filed to set aside Order of Competition Commission of India (CCI) directing an enquiry by the Director General in the slump sale of certain sugar mills by Sugar Corporation and by Uttar Pradesh Rajya Chini Evam Ganna Vikas Nigam Limited. The CCI, under Section 19 of

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Competition Act, considering observations of CAG, had directed enquiry into the matter. The court held that no prejudice would be caused to the petitioner if the Director General causes an investigation and that the notice by DG was in nature of show cause notice and writ petition was not maintainable against an SCN.

Petitioner's contention that CCI had arbitrarily exercised its power under Section 19 of the Competition Act on its own motion, as there was no material available before it, was rejected by the court taking note of importance of CAG's report. The court further relying on Supreme Court Order in the case of *SAIL* held that the matter should not be kept in abeyance till the decision was pending, in writ before the High Court or the Supreme Court, as in the event of delay, the very purpose and object of the Competition Act was likely to be frustrated. Arguments that the objection raised by the CAG regarding auction of the sugar mills was under consideration before the Allahabad High Court in another writ petition and hence it was not proper that the same issue be adjudicated by a quasi-judicial authority, were hence negated. [*Namrata Marketing Pvt. Ltd.* v. *Competition Commission of India* – Allahabad HC Order dated 4-12-2013 in Civil Misc. Writ Petition No. 42783 of 2013]

Unwritten contract restraining competition is anti-competitive: Unwritten contract between the two opposite parties that it will not allow the competition of informant with one of the opposite parties was *prima facie* held as anti-competitive by the Competition Commission of India (CCI). It was held that arrangement or understanding between the opposite parties about clients amounted to an agreement under the Competition Act. The CCI in this regard relied upon e-mail correspondences of the informant with the opposite party, who had sold the printing machine to the informant, refusing to honor the Annual Maintenance Contract on undisclosed grounds. It was noticed that correspondence between informant and the opposite party made it *prima facie* clear that the opposite party had an agreement/ understanding with the other opposite party that in case the informant competes with the latter for its existing clients, then the former opposite party shall not provide service of maintenance of the machine to the informant. The CCI while directing the DG to investigate also held that there was *prima facie* violation of Section 4(2)(a)(i) of the Competition Act. [*Magnus Graphics* v. *Nilpeter India Pvt. Ltd.* – CCI Order dated 12-12-2013 in Case No. 65/2013]

Penalty for non-disclosure of share-holding pattern: Securities Appellate Tribunal recently upheld imposition of penalty under Section 15A(b) of Securities and Exchange Board of India Act, 1992 for non-disclosure of change in share-holding pattern under SEBI (Prohibition of Insider Trading) Regulations, 1992 though the same was disclosed to the stock exchanges and the SEBI under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The SAT in this regard rejected the contentions

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that requirement of disclosure under the former regulations was also met when the disclosures were made under the latter regulations. It was observed that even if disclosure under the 2011 Regulations be treated as disclosure under the 1992 Regulations, there is violation of the latter Regulations, inasmuch as the disclosure was not made in 2 days, as required. Absence of provisions like Regulation 29(4) of SAST Regulations, 2011 in the Insider Trading Regulations, cited as reason for non-disclosure, was also rejected after taking note of Regulation 13 read with Form D of the 2011 Regulations. The matter involved non-disclosure of sale of pledged shares after non-payment of loans by the company where appellant acted as promoter-director. [*Pranav Ansal* v. *Securities and Exchange Board of India* – SAT Order dated 7-1-2014 in Appeal No. 188 of 2013]

Penalty for non-disclosure was though upheld, but substantially reduced, by the Appellate Tribunal in another case where the appellant had failed to inform the stock exchanges about its acquisition of shares to the tune of 5.22% instead of 5%. The Tribunal in this case noted that the disclosure was made by the company whose shares were acquired and hence the public at large had knowledge of acquisition. [*Ambaji Papers Pvt. Ltd.* v. *Adjudicating Officer, Securities and Exchange Board of India* – SAT Order dated 15-1-2014 in Appeal No. 201 of 2013]

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