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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Judgement reserved on: 06.07.2022

% *Judgement pronounced on: 15.09.2022*

\+ **W.P (C) 8215/2020, CM APPLs. 26623/2020& 34346/2021**

LOTUS PAY SOLUTIONS PVT LTD. & ANR. .....Petitioners

Through Ms Abiha Zaidi and Ms Nishtha Kumar, Advs.

versus

UNION OF INDIA & ORS. …Respondents

Through Mr Rajesh Gogna, CGSC with Mr Abhishek Khanna and Mr Akhilesh Suresh, Advocates for R-1.
Mr Gopal Jain, Sr. Adv. with Mr Ramesh Babu and Ms Manisha Singh and Mr Nisha Sharma, Advs. for R-2.
Ms Anshu Singh, Advocate for R-3.

CORAM:
HON'BLE MR JUSTICE RAJIV SHAKDHER
HON'BLE MS JUSTICE TARA VITASTA GANJU

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.:

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Preface:

1. This writ petition seeks to assail three clauses of the circular dated 17.03.2020 issued by respondent no.2 i.e., the Reserve Bank of India [hereafter referred to as "RBI"], titled "Guidelines on Regulation of Payment Aggregators and Payment Gateways"[hereafter referred to as "the 2020 Guidelines"].

1.1 The three clauses, to which, challenge is laid by the petitioners are Clause 3, Clause 4 and Clause 8.

2. Briefly, Clause 3mandates,that insofar as non-banking entities which offer payment aggregation services are concerned, they would have to obtain "authorisation" from RBI to continue their operations. The criteria fixed for obtaining the authorisation are outlined in various sub-clauses i.e., sub-clause 3.1 to 3.6.

3. Clause 4, *inter alia* requires Payment Aggregators [hereafter referred to as "PAs"] that were existing on the date of issuance of the 2020 Guidelines, to achieve a net worth of Rs. 15 crores by 31.03.2021, and to have the same scaled up to Rs. 25 crores by the end of the third Financial Year ("FY") i.e., on or before 31.03.2023.The PAs are required to maintain a net worth of Rs. 25 crores at all times after 31.03.2023. Pertinently, the timeline for applying for authorization and complying with the minimum positive net worth requirement of Rs. 15 crores for the FY ending on March 31, 2020, was extended till 30.09.2021 because of the RBI circular dated 21.05.2021.

3.1 Insofar as new PAs are concerned, they are also required to have a minimum net worth of Rs. 15 crores to be eligible for obtaining authorisation, which is required to be enhanced to Rs. 25 crores by the end of the third FY of grant of authorisation. Such PAs are obliged to maintain a net worth of Rs. 25 crores from that point onwards.

4. Clause 8 of the 2020 Guidelines, amongst others, mandates that all non-bank PAs shall ensure that the amount collected by them is placed in an escrow account, maintained with a scheduled commercial bank. Furthermore, this clause also provides, that for maintenance of the escrow account, the operations of the PAs shall be deemed to be "designated payment systems" under Section 23A of the Payment and Settlement Systems Act, 2007 [hereafter the "2007 Act"].

5. Importantly, Payment Gateways [hereafter referred to as "PGs"] which are considered as "technology providers" or "outsourcing partners" of banks or non-banks are neither required to seek authorisation nor comply with the capital requirements stipulated in Clause 3 and 4 of the 2020 Guidelines.

Background:

6. Petitioner no.1 is a company which is engaged in the business of providing "recurring payment solutions" for businesses in India *via* an authorised payment system known as the National Automated Clearing House ("NACH"). Petitioner no.2 is the founder and Chief Executive Officer (CEO) of petitioner no.1 company. Therefore, unless the context requires otherwise, they shall be collectively referred to as "petitioners".

7. The petitioners have, as noticed above, assailed the aforementioned three clauses of the 2020 Guidelines, which essentially concern PAs. However, the stated position of the petitioners before us, is that petitioner no.1 is largely functioning as a PG, but because one of its ten NACH sponsor banks i.e., ICICI Bank does not have an internal NACH system, it would have to function as a PA for ICICI Bank. Thus, the challenge to the aforementioned clauses of the 2020 Guidelines has to be seen in that backdrop.

8. Notice in this writ petition was issued on 05.11.2020, whereupon counter-affidavits were filed on behalf of RBI, as well as respondent no.3 i.e., National Payments Corporation of India ("NPCI"). The writ action has been defended by RBI, as its guidelines i.e., the 2020 Guidelines are under challenge.

8.1 Insofar as NPCI is concerned, it has filed a brief affidavit, the thrust of which is that it should be deleted from the array of parties, for the reason that it is neither a regulator, nor is it responsible for the issuance and/or amendment of the 2020 Guidelines. NPCI, however, has taken the position that it is instrumental in developing NACH, and its role is confined to providing electronic infrastructure for processing, transmitting and clearing transactions concerning participating member banks.

9. Thus, before we proceed further, it would be relevant to capture the submissions advanced on behalf of the petitioners and the RBI, which is, in effect, the contesting respondent.

Submissions of the petitioners:

10. On behalf of the petitioners, the arguments were advanced by Ms Abiha Zaidi, while submissions on behalf of RBI were made by Mr Gopal Jain, Senior Advocate, instructed by Mr Ramesh Babu, Advocate.

11. The arguments advanced by Ms Zaidi can be broadly paraphrased as follows:

11.1 The petitioners perform the role of an intermediary, and in doing so, carry out the following functions:

(a) Petitioner no.1 collects funds from customers on behalf of its clients i.e., merchant clients/e-commerce marketing companies. These funds are then placed in a special bank account, known as the "nodal bank account." The nodal bank account is maintained in a designated Nodal Bank.

(b) The funds are remitted from the nodal bank account to petitioner no.1's merchant clients/e-commerce marketing companies, as per pre-agreed terms and conditions contained in the Nodal Account Agreement. In effect, a three-day settlement period is provided for transmission of funds from the nodal bank account to petitioner no.1'smerchant clients/e-commerce marketing companies.

11.2 Petitioner no.1 has been carrying on the business of facilitating safe and secure online recurring transactions since 2016,in consonance with the instructions contained in the document dated 24.11.2009, titled "Directions for opening and operation of Accounts and settlement of payments for

electronic payment transactions involving intermediaries." [hereafter referred to as "2009 Directions"].

11.3 The 2009Directions were issued by the RBI in the exercise of powers under Section 18 of the 2007 Act.

11.4 The 2020 Guidelines, which have been issued by RBI, purportedly while exercising powers under Section 18read with Section 10(2) of the 2007 Act travel beyond the powers conferred upon it.

11.5 The prescription contained in Clause 3 of the 2020 Guidelines, requiring PAs to acquire authorisation from RBI to conduct their business is beyond the powers conferred upon RBI, under Section 18 and Section 10(2) of the 2007 Act.

11.6 Section 18 is limited to conferring power on the RBI to issue directions. Section 10(2) invests powers in the RBI to issue guidelines for proper and efficient management of payment systems. Neither of the provisions invest power in the RBI to mandate the requirement for PAs to secure authorisation from RBI to carry on their business and/or lay down criteria for issuance of such authorisation.

11.7 Section 4 of the 2007 Act, which *inter alia* provides that no person, other than RBI, shall commence or operate a payment system except under and in accordance with an authorisation issued by RBI does not apply to petitioner no.1, as it operates as an intermediary, in its functionality as a PA.

11.8 Section 4 of the 2007 Act, which empowers the RBI to issue authorisation is confined to those persons/entities which seek to commence or operate a payment system. PAs, PGs or intermediaries do not operate a payment system. Clause 3 of the 2020 Guidelines seeks to go beyond the provisions of Section 4 of the 2007 Act. The clause, thus, seeks to regulate entities which do not fall within the ambit of Section 4 of the 2007 Act.

11.9 The 2007 Act makes a clear distinction between "payment system"[1], "system participant"[2] and "system provider"[3]. Petitioner no.1 only provides an intermediary tool, which is used by the payment system to facilitate the remittance of payments received from the customers to the merchant clients/e-commerce marketing companies. The intermediary, thus, cannot be treated as a "payment system". The RBI, which is invested with the authority to regulate and supervise payment systems in the country, cannot regulate PAs, which act as intermediaries between merchant clients/e-commerce companies and banks. The PAs are, in effect, "system participants", as defined in Section 2(1)(p) of the 2007 Act.

12. That petitioner no.1 acts as an intermediary is recognised by the 2009 Directions. The petitioner no.1 and similarly circumstanced intermediaries are thus required to comply with not only the 2009 Directions, but also the 2020 Guidelines.

[1] See section 2(1)(i) of the 2007 Act.
[2] See section 2(1)(p) of the 2007 Act.
[3] See section 2(1)(q) of the 2007 Act.

12.1 The RBI, in its counter-affidavit, has accepted the fact that PAs and PGs act as third-party interfaces, which facilitate e-commerce sites and merchants in accepting various payment instruments issued by their customers, and thus do away with the need to create an independent system for themselves. Therefore, the RBI *via* the 2020 Guidelines cannot bring the PAs/intermediaries, which are, at best, system participants, within the definition of the payment systems.

12.2 Clause 4 of the 2020Guidelines, which requires that for an entity to act as a PA, it should have a minimum net worth of Rs. 15 crores to begin with, and to have it scaled up to Rs. 25 crores by the end of the third FY, is a condition, which is manifestly unreasonable and arbitrary, and hence violative of Article 14 of the Constitution of India. Furthermore, it is not prudent to treat all kinds of PAs and PGs similarly. Such classification is unreasonable and is also violative of Article 14 of the Constitution. The stipulation contained in Clause 4 of the 2020 Guidelines concerning net worth does not conform to the object and purpose provided in the 2007 Act- which is, the regulation and supervision of payment systems in India.

12.3 Clause 4 of the 2020 Guidelines would stifle innovation and drive out competition, by imposing a monetary condition which has no bearing on the functions carried out by a system participant.

12.4 This requirement fails to take into account, that most innovative and progressive financial solutions have their origins in small businesses or start-ups. There is no evidence, that a high net worth requirement will improve the efficiency of the payments industry. Petitioner no.1 has been operating

as a payment intermediary since 2016, with a capital of approximately Rs. 2 crores, without a single blemish.

12.5 In no jurisdiction across the world, have intermediaries been asked to abide by such burdensome monetary conditions. A case in point is "Go Cardless", a company based out of the United Kingdom, which commenced its business as a small tech-based start-up, and over the years has grown into a mega-corporate.

12.6 Clause 4 of the 2020 Guidelines seems to duplicate provisions of various regulations provided by the Security and Exchange Board of India (SEBI). SEBI, as a regulator, has prescribed minimum capital requirements *vis-a-vis* intermediaries, which deal with securities. These stipulations were provided, bearing in mind the specific nature of market infrastructure institutions. The stipulations were preceded by detailed deliberations carried out by the Bimal Jalan Committee. RBI has, it appears, erroneously applied the same yardstick to digital platforms i.e., entities such as petitioner no.1, which act as intermediaries between the customers and its merchant clients.

12.7 RBI's discussion paper, which was posted on its website on 17.09.2019, has accepted the position that it has not faced any major complaints regarding indirect regulation of intermediaries for at least ten years before the issuance of the 2020 Guidelines. Clause 4 of the2020 Guidelines would lead to the closure of a large number of small business enterprises, as it unnecessarily creates a trade barrier. The clause i.e., Clause 4 would be beneficial to, existing big businesses, *albeit* at the expense of small enterprises.

12.8 Clause 8 of the 2020 Guidelines, which obliges non-bank PAs to place the amount collected by them in an escrow account, disregards the fact that the PAs are presently functioning smoothly, by remitting the monies collected from the customers to the nodal accounts.

12.9 This condition ignores the fact, that the core function of PAs is limited to providing a technical interface, and therefore does not need to have a beneficial interest in the money held on behalf of their merchant clients.

12.10 Furthermore, the impugned clause i.e., Clause 8has a myopic approach. At present, every PA operates multiple nodal accounts, and thus spreads the risk. If nodal accounts are done away with, it will expose the PAs to operational risks, which shall be detrimental to their business interests, as it has the potential of causing financial instability.

13. RBI's stand, that by opening an escrow account, the amount credited to the said account remains safe from the vagaries of liquidation and acts of fraud is untenable, for the reason that the PAs have no direct access to funds, which are retained in the nodal accounts. At present, banks which maintain nodal accounts are mandated to make pay-outs to merchant clients automatically, within three days of the conclusion of the transaction in issue, thereby eliminating any security risk concerning monies that are available in the nodal accounts.

13.1 The 2020 Guidelines fail the test of proportionality, as they mandate restrictive conditions for the operation of PAs, even though less invasive measures are available. The 2020Guidelines fail to take into account,

recommendations and suggestions made by various stakeholders on net worth requirements.

13.2 The 2020Guidelines also do not conform to the suggestions set forth in the "2019 Report on Digitization of Payments" published by the RBI. *Inter alia*, the said report requires the regulator i.e., RBI to evaluate the risk of a player or product or scheme and then ensure that the regulatory overhead is proportional to the risk, leaving other decisions to the market. The report also requires the regulator/RBI to promote innovation, by encouraging tech-based non-banking companies to enter the market and expand the range of payment services available in the market. The impugned Clauses of the 2020 Guidelines have no bearing on data protection or good governance practices. RBI is needlessly conflating issues raised in the instant petition concerning the impugned clauses with the aforementioned aspects.

13.3 The 2020 Guidelines will act as a disincentive for creating a digital payment environment in the country, as it fails to set up a regulatory framework which promotes competition and innovation, and at the same time protects the interests of the consumers.

13.4 The Courts are empowered to intervene even in policy matters when the same violates Fundamental Rights. The impugned Clauses of the 2020 Guidelines violate Article 14 and Article 19(1)(g) of the Constitution of India. In support of the aforesaid pleas, reference was made to the following judgments:

1. ***State of T.N vs. P. Krishnamurthy (2006) 4 SCC 517 (paras 15,16)***
2. ***Union of India & Ors. vs. S. Srinivasan (2012) 7 SCC 683 (paras 21,32)***
3. ***Global Energy Ltd. vs. Central Electricity Regulatory Commission (2009) 15 SCC 570 (paras 36, 39)***
4. ***N.K. Bajpai vs. Union of India & Anr. (2012) 4 SCC 653 (paras 14 and 20)***
5. ***Ramana Dayaram Shetty vs. The International Airport (1979) 3 SCC 489 (paras 10 and 21)***
6. ***Elloy de Freitas vs. Permanent Secretary of Ministry of Agriculture, Fisheries, Land and Housing & Ors.[1983] 3 WLR 675 (page 9)***
7. ***Global Energy Ltd. vs. Central Electricity Regulatory Commission (2009) 15 SCC 570 (paras 36, 39)***
8. ***U.P. Stock Exchange Brokers' vs. Security and Exchange Board of India 2014 (6) AWC 5697 (para 53)***
9. ***Modern Dental College & Research Centre vs. State of M.P. (2016) 7 SCC 353 (para 60)***
10. ***Mohd. Faruk vs. State of Madhya Pradesh 1970 SCR (1) 156 (para 10)***
11. ***Mohd. Yasinvs. Town Area Committee AIR 1952 SC 115 (para 5)***
12. ***Om Kumar vs. Union of India, (2001) 2 SCC 386 (paras 28,30)***
13. ***Chintaman Rao vs. State of M.P. 1950 SCR 759 (para 6)***
14. ***Union of India vs. Dinesh Engineering Corpn. (2001) 8 SCC 491 (para 12)***
15. ***State of Rajasthan vs. Basant Nahata (2005) 12 SCC 77 (para 66)***

Submissions of respondent no.2/RBI:

14. Mr Gopal Jain, on the other hand, in response to and in opposition to the relief sought in the writ action, broadly made the following submissions:

14.1 Petitioner no.1, while acting as a PA provides services of aggregation in the online payment space, which *inter alia* involves collecting, netting and making payments. The term "payment system" as defined in Section 2(1)(i) of the 2007 Act captures the aforesaid activity. The provision defines a payment system as a system, that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service, or all of them, but does not include a stock exchange. Thus, the role of the PA, which, in effect, requires it to collect money from the payer, and facilitate its remittance to the beneficiary, is covered by the definition of the term payment system, as provided in section 2(1)(i) of the 2007 Act.

14.2 Under Section 3 of the 2007 Act, RBI has been declared as the "designated authority" for regulating and supervising payment systems, as envisaged under the 2007 Act.

14.3 Since Section 4 of the 2007 Act provides, in no certain terms, that no person, other than RBI, can commence or operate a payment system, except under and in accordance with an authorisation issued by RBI, the non-bank PAs, such as petitioner no.1, can continue their operations only if they obtain authorisation, and adhere to the 2020 Guidelines.

14.4 The argument advanced on behalf of the petitioners, concerning Clause 4 of the 2020 Guidelines, is completely baseless. The net worth requirements contained in the said clause fulfil the twin objectives of

providing safety to the customer and protecting the merchant client's interest. These two objectives can only be fulfilled by ensuring that the PAs are financially sound, and that their operations are viable.

14.5 The PAs collect funds on behalf of the customers. They are obliged to pool the money and transfer the funds to the merchant clients, after the stipulated timeframe. Thus, the requirement to have a baseline net worth provides insurance against breach of such obligations undertaken by PAs, and shores up the confidence of the customers.

14.6 The provision in the 2020 Guidelines for a baseline net worth was put in after RBI had received feedback from various stakeholders *vis-a-vis* the Discussion paper uploaded on its website on 17.09.2019.

14.7 Likewise, the provision made in Clause 8 of the 2020 Guidelines, which requires PAs to place the amount collected from customers in an escrow account was taken after a comprehensive and detailed discussion and examination of the issue by the Board for Regulation and Supervision of Payment and Settlement Systems [in short, "the Board"].

14.8 Under the 2009 Directions, PAs were allowed to open a nodal account, which was an internal account of the concerned bank. The nodal account was shown as a liability of the concerned bank and was not included in the balance sheet of the PAs. The PAs and/or merchant clients had no beneficial interest in the amount retained in the nodal account. Therefore, it was considered prudent to manage the funds collected by the PAs on behalf of the customers through an escrow account, while providing a return on the core portion of the money retained therein. The PAs not only have a

beneficial interest in the escrow account but are also entitled to interest on the core portion of the money retained in the escrow account. The purpose behind requiring PAs to retain money in an escrow account, *albeit* with a scheduled commercial bank, is to ensure that the funds collected by the PAs are put to proper use and effectively regulated.

14.9 It is submitted, that upon a review, PAs have now been allowed to maintain one additional escrow account in a different scheduled commercial bank, with the issuance of the circular dated 17.11.2020. Therefore, the argument advanced on behalf of the petitioners, that maintaining nodal accounts in different banks diversifies risks, and addresses business continuity concerns is answered by the issuance of the circular dated 17.11.2020.

15. Besides this, Section 23A of the 2007 Act empowers the RBI in public interest or, in the interest of the customers of designated payment systems or, to prevent the affairs of the such designated payment system from being conducted in a manner prejudicial to the interests of its customers: to require the system provider of such payment system to either deposit and keep deposited, the money so collected, in a separate account,or accounts held in a scheduled commercial bank, or maintain liquid assets in such manner and form as it may specify from time to time, of an amount equal to such percentage of amounts collected by the system provider of the designated payment system from its customers and remaining outstanding, as may be specified by the RBI from time to time.

15.1 Furthermore, sub-section (2) of Section 23A of the 2007 Act provides that the balance amount held in the account or accounts referred to in sub-section (1) of the very same provision shall not be utilised for any purpose other than for discharging the liabilities arising on account of the usage of the payment service by the customers or for repaying to the customers or for such other purpose as may be specified by the RBI from time to time.

15.2 The explanation to Section 23A of the 2007 Act defines "designated payment system" to mean a payment system or a class of payment system, as may be specified by the RBI from time to time, which is engaged in the collection of funds from their customers for rendering payment service. The PAs, while rendering aggregation services, are directly involved in the collection of funds, which are, after a particular time gap, transferred or remitted to their merchant clients.

15.3 It is important to bear in mind, that the intention behind treating PAs as designated payment systems under Section 23A of the 2007 Act is to protect the funds collected, which is in the interest of the customers. Sub-section (2) of Section 23A, as submitted above, mandates the utilisation of the amount held in the escrow account, only for discharging the liability of the customers, or for repaying the customers. Thus, even if a PA, such as petitioner no.1, were to undergo liquidation, the funds collected from its customers would remain protected and can be utilised only for discharging their liability or for repaying monies to them.

15.4 Likewise, sub-section (3) of Section 23A makes it clear, that the persons entitled to receive payment under sub-section (2) of the said provision shall have a first and paramount charge on the balance held in that

account, and the liquidator or receiver or assignee (by whatever name called) of the system provider of the designated payment system or the scheduled commercial bank concerned, whether appointed as provisional or otherwise, shall not utilise the said balance amount for any other purpose until all such persons are paid in full or adequate provision is made thereof. Pertinently, this sub-section opens with a non-obstante clause, and thus operates notwithstanding anything contained in the Banking Regulation Act, 1949 or the Companies Act, 1956 or the Companies Act, 2013, or even the Insolvency and Bankruptcy Code, 2016, or any other law for the time being in force.

15.5 Therefore, the contention advanced on behalf of the petitioners, that the RBI had arbitrarily declared PAs as designated payment systems in terms of Section 23A of the 2007 Act, is misconceived. This submission conveniently ignores the *bona fide* intentions of the RBI, which are to protect both the funds of the customers and ensure timely payments to the merchant clients. The impugned clause is necessary for ensuring effective regulation of PAs, which work in the online space.

15.6 The 2020Guidelines have been framed in public interest, which ought not to be interdicted unless found to be arbitrary or unreasonable. As submitted above, under the 2009 Directions, the regulation of operations carried out by PAs was indirect. Since in the recent past, the payment systems in India have undergone a massive change with the expansion of e-commerce activities, the regulator i.e., RBI had to step in and thus put in place, the 2020 Guidelines, so that the roles of PAs in the online space are

directly regulated in the interest of customers, merchant clients and the overall payment eco-system.

15.7 The 2020 Guidelines fall in the realm of economic policy decisions, and therefore the scope of judicial review is narrow. It is well established, that the fundamental right under Article 19(1)(g)of the Constitution of India i.e., the right to carry on trade, business or profession can be regulated, by putting in place, reasonable restrictions. Such restrictions cannot be held to be illegal, as they only regulate the operations of the PAs in the interest of other stakeholders, such as customers and merchant clients. The Courts, ordinarily, do not interfere with functions which fall within the realm of economic policy, as these are functions which are best left to the wisdom of the domain experts. [See : ***R.K Garg & Ors. v. Union of India & Ors.***(1981) 4 SCC 675;***Peerless General Finance and Investment Co. Limited v. Reserve Bank of India***(1992) 2 SCC 343]

Analysis and reasons:

16. Having heard the learned counsel for the parties, it is apparent, that the main plank of the petitioners' case rests on the argument, that PAs who perform the work of intermediaries do not fall within the scope and ambit of the definition of "payment system" incorporated in the 2007 Act.

16.1 To deal with this argument, one would have to examine the contours of the definition of the term payment system, outlined in Section 2(1)(i) of the 2007 Act. For the sake of convenience, the same is extracted hereafter-

"2. Definitions. - (1) In this Act, unless the context otherwise requires, -

……..

(i) "payment system" means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange;

Explanation. - For the purposes of this clause, "payment system" includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;"

16.2 Besides this, one will also have to set down what is the accepted work function of a PA.

16.3 Both parties in this regard have relied upon the RBI's Discussion paper, published on its website on 17.09.2019. The glossary section of the said Discussion paper defines a PA as "an intermediary in an online payment transaction accepting payments on behalf of the merchant from the customers and then transferring the money to the merchant's account."

16.4 Therefore, in any digital payment transaction, there is a payer and a beneficiary. The interface is the PA, which ensures that the money is transferred to the designated nodal account, and after a gap of a stipulated timeframe, which the petitioners say is three days, a settlement takes place and funds are transmitted to the merchant's account.

16.5 However, under Clause 8 of the 2020 Guidelines, the PAs are required to maintain an escrow account with a scheduled commercial bank, and thus the funds received from customers get placed in the escrow account and upon settlement, get transferred to the merchant's account.

16.6 The PAs, thus, not only provide, an integration system but also handle the funds of the customer. The definition of a PA, according to us, would include this work function. A close perusal of the definition of payment system would show, that it is meant to include a system, that enables, firstly, payment to be effected between a payer and a beneficiary and secondly, concerns clearing, payment or settlement service or all of them, but does not include a stock exchange.

16.7 While the term 'settlement' has been defined in section 2(1)(n) of the 2007 Act, there is no definition of the terms 'payment' and 'clearing'. The term settlement, as defined, means, settlement of payment instructions and includes the settlement of securities, foreign exchange or derivatives or other transactions which involve payment obligations.

16.8 Although there is no definition of 'payment service', in our opinion, the "updating principle" ought to apply, and services offered by PAs to the payer and beneficiary *via* the use of technology should fall within the ambit of the payment system. The principle referred to hereinabove, has been explained by this Court in the case of ***Rama Pandey v. Union of India & Ors. 2015 (221) DLT 756***. The relevant paragraphs of the aforesaid judgement are extracted hereunder: -

"9.1 It is not unknown, and there are several such examples that legislatures, usually, in most situations, act ex-post facto. Advancement in science and change in societal attitudes, often raise issues, which require courts to infuse fresh insight into existing law. This legal technique, if you like, is often alluded to as the "updating principle". Simply put, the court by using this principle, updates the construction of a statute bearing in mind, inter alia, the current norms, changes in social attitudes or, even advancement in science and technology. The principle of updating resembles another principle which the courts have referred to as the "dynamic processing of an enactment". The former is described in Bennion on Statutory Interpretation at page 890 in the following manner: -

"..An updating construction of an enactment may be defined as a construction which takes account of relevant changes which have occurred since the enactment was originally framed but does not alter the meaning of its wording in ways which do not fall within the principles originally envisaged by that wording.

Updating construction resembles so-called dynamic interpretation, but insists that the updating is structured rather than at large. This structuring is directed to ascertaining the legal meaning of the enactment at the time with respect to which it falls to be applied. The structuring is framed by reference to specific factors developed by the courts which are related to changes which have occurred (1) in the mischief to which the enactment is directed, (2) in the surrounding law, (3) in social conditions,(4) in technology and medical science, or (5) in the meaning of words…"

9.2 The updating principle on account of development of medical science and technique was applied in the following case: R v. Ireland, [1998] AC 147.

9.3 Similarly, change in social conditions have persuaded courts to apply the updating construction principle to inject contemporary meaning to the words and expressions used in the existing statute. See: Williams and Glyn's Bank v. Boland,[1981] AC 487 at page 511 placetum 'D' and R v. D, [1984] AC 778.

9.4 In respect of dynamic processing, the following observations in Bennnion on Statutory Interpretation, 5 Edition, at page 502, being apposite, are extracted hereinafter:-

"..Few Acts remain for very long in pristine condition. They are quickly subjected to a host of processes. Learned commentators dissect them. Officials in administering them develop their meaning in practical terms. Courts pronounce on them. Donaldson J described the role of the courts thus:

'The duty of the Courts is to ascertain and give effect to the will of Parliament as expressed in its enactments. In the performance of this duty the Judges do not act as computers into which are fed the statutes and the rules for the construction of statutes and from whom issue forth the mathematically correct answer. The interpretation of statutes is a craft as much as a science and the judges as craftsmen, select and apply the appropriate rules as the tools of their trade. They are not legislators, but finishers, refiners and polishers of legislation which comes to them in a state requiring varying degrees of further processing.

When practitioners come to advise upon the legal meaning, they need to take account of all this. The Act is no longer as Parliament enacted it; it has been processed." (emphasis is mine)

9.5 The fact that this is a legitimate interpretative tool, available to courts, is quite evident upon perusal of the ratio of the following judgements.

9.6 A classic example of application of the updating of construction principle, is the judgement, in the case of Fitzpatrick v. Sterling Housing Association Ltd, 1999 (4) All E.R. 705, where the word 'family' was read to include two persons of same sex who were cohabitating and living together for a long period of time with a mutual degree of inter-dependence."

(Also see : ***State (through CBI) v. S.J. Choudhary*** (1996) 2 SCC 428, paragraph 10)

16.9 Technology is changing at a rapid pace, and Courts have to keep that in mind at times, while examining the scope and ambit of legislation, such as the 2007 Act. There can be no dispute, that RBI, being the Central bank of our country, is *inter alia* responsible for regulating and supervising payment systems in India. As a matter of fact, a plain reading of the Statement of Objects and Reasons of the 2007 Act states so in so many words.

17. Importantly, the Statement of Objects and Reasons of the 2007 Act, as amended on 13.05.2015 ["The Payment and Settlements (Amendment) Act, 2015"] brings forth this aspect of the matter, and the rationale for making the amendments (i.e., to secure the interests of the customers to fore). The relevant part of the Statement of Objects and Reasons of The Payment and Settlements (Amendment) Act, 2015 are extracted hereafter-

> *"**Prefatory Note Statement of Objects and Reasons**. The Payment and Settlement Systems Act, 2007 (the said Act) was enacted for the regulation and supervision of payment systems in India and to designate the Reserve Bank of India as the authority for that purpose and for matters connected therewith.*
>
> *2. Subsequent to the enactment of the said Act, the country has witnessed orderly growth of payment systems, and these payments systems are granted authorisation on the principles of safety, security, soundness, efficiency and accessibility. After the global financial crisis in 2007-08, several developments took place, driven primarily by the G20, for reforming the Over the Counter derivatives markets. Some of these new initiatives include setting-up of Trade Repositories and Legal Entity Identification System.*
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> ……..
>
> *6. Further, there are some legal difficulties in securing the customers interest held in escrowed accounts in the event of insolvency or*

bankruptcy of prepaid instruments, operators, which are required to be addressed.

7. The amendments to the said Act have been proposed to increase transparency and stability of Indian Financial markets in line with globally accepted norms. The Payment and Settlement Systems (Amendment) Bill, 2014, inter alia, proposes

(a) to substitute sub-section (4) of Section 23 of the said Act so as to provide that where by an order of the court, Tribunal or authority, the system participant is declared as insolvent or is dissolved or wound-up, such order shall not affect any settlement that has become final and irrevocable prior to such order or immediately thereafter;

(b) to insert a new sub-section (5) in Section 23 of the said Act so as to provide that where an order under sub-section (4) of Section 23 is made with respect to a central counter party , the payment obligations and settlement instructions between the central counter party in accordance with the gross or netting procedure, as the case may be, approved by the Reserve Bank of India;

(c) to insert a new sub-section (6) in Section 23 of the said Act so as to provide that the liquidator or receiver of the central counter party shall not re-open the determination which has become final and irrevocable and after appropriating the collateral provided by system participants towards their settlement obligations, return the excess collaterals to system participants;

(d) to insert a new Section 23-A relating to protection of funds collected from the customers by the payment system providers;…"

17.1 It is pertinent to note, that because PGs do not handle funds, and are only concerned with providing technology infrastructure to route and/or facilitate the processing of online payment transactions, the impugned clauses of the 2020 Guidelines i.e., Clauses 3, 4 and 8 are not made applicable to them. The scope of the work function of a PG in the RBI's discussion paper reads thus:

"A technology infrastructure provider to route and facilitate processing of an online payment transaction, without any involvement in the actual handling of funds…"

17.2 Therefore, in our view, the answer to the poser, as to whether PAs fall within the ambit of the definition of payment system can only be in the affirmative, for the reasons given above. That being said, as alluded to above, there is, perhaps, merit in the responses received by the RBI to its Discussion paper, that separate legislation may have to be enacted for payment services. This aspect, however, falls in the domain of the legislators. The executive could consider this suggestion, and initiate necessary steps in that behalf.

17.3 Thus, the argument advanced on behalf of the petitioners, that the 2020 Guidelines, in particular, the impugned clauses are beyond the purview of the parent statute, is not tenable. Once it is accepted, that the work function performed by PAs comes within the definition of a payment system, then, as contended on behalf of RBI, it was well within its powers to frame the 2020 Guidelines, the source for which can be traced to Section 10(2) and Section 18 of the 2007 Act. These two provisions read as follows-

"10. Power to determine standards.-

……..

(2) Without prejudice to the provisions of sub-section (1), the Reserve Bank may, from time to time, issue such guidelines, as it may consider necessary for the proper and efficient management of the payment systems generally or with reference to any particular payment system."

"18. Power of Reserve Bank to give directions generally.—Without prejudice to the provisions of the foregoing, the Reserve Bank may, if

it is satisfied that for the purpose of enabling it to regulate the payment systems or in the interest of management or operation of any of the payment systems or in public interest, it is necessary so to do, lay down policies relating to the regulation of payment systems including electronic, non-electronic, domestic and international payment systems affecting domestic transactions and give such directions in writing as it may consider necessary to system providers or the system participants or any other person either generally or to any such agency and in particular, pertaining to the conduct of business relating to payment systems."

17.4 Furthermore, once it is held, that the work function of the PAs comes within the definition of a payment system, then axiomatically, the power to have them seek authorization from the RBI for operating as PAs gets traced to section 4 of the 2007 Act.

17.5 Therefore, we see no merit in the argument, that petitioner no. 1, if it chooses to function as a PA, should not be called upon to seek authorization from RBI, as per the criteria laid down in Clause 3 of the 2020 Guidelines.

17.6 Likewise, we find no merit in the submissions advanced on behalf of the petitioners concerning Clause 4 of the 2020 Guidelines, which obliges an applicant, who wishes to function as a PA, to have a minimum net worth of Rs.15 crores and have the same scaled up to Rs. 25 crores by the end of the third FY.

17.7 This requirement is stipulated in Clause 4, both for existing PAs and new PAs. In this context, the argument advanced on behalf of the petitioners, that the requirement to have a minimum net worth of Rs.15 crores would drive out small entrepreneurs and start-ups also, does not find resonance with us, the reason being that from a proposed net worth of

Rs.100 crores, the RBI has brought it down to Rs.15 crores, which, as indicated above, would have to be scaled up to Rs.25 crores by the end of third FY. This step modulation was brought about based on the responses received by RBI to the Discussion paper published on its website.

17.8 Contextually, it is relevant to note that RBI has taken an emphatic stand in its counter-affidavit, that it had received 57 responses to its Discussion paper, and that out of the 57 respondents, only 19 objected to a minimum net worth requirement of Rs 100 crores proposed in the Discussion paper. On behalf of the RBI, it has been conveyed to us, that despite a vast majority of respondents not objecting to a minimum net worth requirement of Rs.100 crores, it was deemed fit to reduce the minimum threshold to Rs 15 crores. This stand of the RBI clearly emerges upon a perusal of paragraph 18 of its counter-affidavit.

17.9 It needs to be emphasised, that when such eligibility criteria are fixed, or applicants who wish to venture into business are regulated by the State and/or its instrumentalities, there is an element of approximation. If such criteria are to be questioned, the only area, perhaps open for scrutiny would be: whether or not there was some application of mind and/or deliberation, before framing the impugned criteria. Once the State and/or its instrumentalities are able to show that a process was followed, and the issue was deliberated upon, it would leave very little scope for the Court to interfere in an Article 226 action.

18. In this case, RBI has demonstrated, that before the 2020 Guidelines were issued, the same was put up in the public domain in the form of a Discussion paper. The responses received were duly analysed, and as a

matter of fact, the criteria contained therein were sculpted and moderated. Thus, in our view, the argument advanced *qua* fixing of a threshold limit *vis-à-vis* minimum net worth seems untenable.

18.1 Furthermore, there is merit in RBI's stand, that since PAs will handle funds provided by customers, RBI would require such applicants to enter the industry who have some amount of financial wherewithal.

19. This brings us to the challenge laid to Clause 8 of the 2020 Guidelines. The petitioners seem to have a grave objection to the PAs being asked to switch from nodal bank accounts to escrow accounts. The objection is predicated on the argument, that PAs presently maintain multiple nodal accounts to spread the risk of the funds being lost, in case the bank concerned were to collapse on account of financial insolvency or otherwise. This submission, in our view, has some weight. That said, the alternative put in place by the RBI, in our opinion, is a more robust mechanism which protects the interests of all stakeholders i.e., the customers, merchant clients and PAs. As noted above, [while recording the submissions advanced on behalf of RBI] under section 23A of the 2007 Act, the RBI, in public interest or in the interest of customers of designated payment systems, or to prevent the affairs of such designated payment system from being conducted in a manner prejudicial to the interests of the customers, may require a system provider of such payment system to *inter alia* deposit and keep deposited monies in a separate account or accounts held in a scheduled commercial bank.

19.1 The RBI, thus, in consonance with the provisions of section 23A of the 2007 Act has provided, *via* clause 8 of the 2020 Guidelines, that PAs would deposit payments received from customers in an escrow account maintained with a scheduled commercial bank. There can be no doubt about RBI being invested with such power. There is also no doubt, that PAs would be operating a designated payment system, as defined in explanation (a) to section 23A of the 2007 Act.

19.2 As alluded to hereinabove, as a matter of fact, the RBI has issued a circular dated 17.11.2020 whereby PAs can maintain one additional escrow account. Therefore, the argument advanced on behalf of petitioners concerning the spreading of financial risk has been taken care of, to some extent, with the issuance of the said circular.

19.3 Besides this, since the operations of PAs are treated as designated payment systems, they would have the benefit of the firewall provided by sub-sections (2) and (3) of Section 23A. Sub-section (2) of section 23A, in no uncertain terms, provides that the balance held in the account or accounts referred to in sub-section (1) i.e., escrow accounts shall not be utilized for any purpose other than discharging the liabilities arising on account of the usage of payment service by the customers or for repaying to the customers or for such other purpose as may be specified by the RBI from time to time.

19.4 Likewise, subsection (3) of Section 23A, which opens with a non-obstante clause, provides that persons entitled to receive payment under subsection (2) of the very same section shall have a first and paramount charge on the balance held in that account and the liquidator or receiver or assignee (by whatever name called) of the system provider of the designated

system or the scheduled commercial bank concerned, whether appointed provisionally or otherwise, shall not utilize the said balances for any other purposes until all such persons are paid in full or adequate provision is made in that regard. This provision, thus, sanitizes the monies available in the escrow accounts, and in consonance with the well-established principle of law, overrides the provisions of all other laws for the time in force, including the Banking Regulation Act, 1949, Companies Act 1956, or Companies Act, 2013 or the Insolvency and Bankruptcy Code, 2016.

19.5 In our opinion, this protection is vital for securing fully, the interests of the customers and the merchant clients of the PAs. Added to that, the PAs can now get interest on the core funds available in the escrow accounts.

19.6 Therefore, we find nothing legally untenable, in the incorporation of Clause 8 in the 2020 Guidelines.

20. In the course of the submissions, one of the arguments proferred on behalf of the petitioners was, that they would now have to comply with not only the 2009 Directions but also 2020 Guidelines, making it difficult for the PAs to function smoothly. This argument, in our opinion, is misconceived. The 2009 Directions involved an indirect regulation and supervision of PAs. However, after RBI had put its Discussion paper in the public domain, the responses received by it were examined internally by the Board. The result of such deliberation convinced the RBI, that it should work on the third option outlined in the Discussion paper i.e., that which involved RBI's direct regulation and supervision of PAs since they were handling funds of customers. The difficulties put forth on behalf of PAs,

perhaps are a small wrinkle, which cannot be the reason for striking down the impugned clauses of the 2020 Guidelines.

21. In our view, the public interest element, which is imbued in the framing of the Guidelines, trumps the concerns raised by the petitioners.

Conclusion:

22. We find no merit in the writ petition.

23. The writ petition is, accordingly, dismissed.

24. Pending applications shall stand closed.

25. Parties will, however, bear their respective costs.

(RAJIV SHAKDHER)
JUDGE

(TARA VITASTA GANJU)
JUDGE

SEPTEMBER 15, 2022/tr