

# ANALYSING INTERNET AND MOBILE ASSOCIATION OF INDIA v. RBI: THE CASE THAT RESURRECTED VIRTUAL CURRENCIES IN INDIA.

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*"What we want is fully anonymous, ultra-low transaction cost, transferable units of exchange. If we get that going... the banks will become the obsolete dinosaurs, they deserve to become."*

*- Adam Back on purpose behind the creation of cryptocurrency*

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## **FACTS OF THE CASE:**

RBI on 6th April 2018, pursuant to its power under the RBI Act issued a Circular<sup>2</sup> that prohibited banks and other entities regulated by it from both dealing in Virtual Currencies, as well as from providing services to any individual or entity dealing with or settling Virtual Currencies. The effect of the prohibition was that exchanges through which Virtual Currencies were traded could no longer maintain and operate a bank account, thereby putting an end to the business of Virtual Currencies trading that required conversion from fiat currencies using formal banking channels. Pertinently, at the time the Circular was issued, there was no legislative ban on the use and trading of VCs in India, and by the RBI's proscription, Virtual Currencies were ring-fenced from the formal economy.

The Circular was based on the RBI's concerns that VCs were prone to hacking; that there could be speculation on account of there being no underlying asset and the resultant volatility could lead to significant losses; and that VCs could potentially lead to money laundering and terrorist financing.

## **ISSUES INVOLVED IN THE CASE:**

- Do cryptocurrency come under the definition of money and thus under the regulatory powers of RBI.
- Whether RBI pursuant to its power under the RBI Act has power to ban cryptocurrency.

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<sup>2</sup>Available at [https://www.rbi.org.in/Scripts/BS\\_CircularIndexDisplay.aspx?Id=11243](https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11243) Titled "Prohibition on dealing in Virtual Currencies (VCs)."

### **ARGUMENTS FROM SIDE PETITIONER:**

- Virtual currency does not fall under the definition of money hence outside the regulatory purview of the RBI.
- That the impugned Circular is a colorable exercise of power and tainted by malice in law, in as much as it seeks to achieve an object completely different from the one for which the power is entrusted.
- That the impugned measure of banning virtual currency is extreme in law and that it is disproportionate in nature.
- That the petitioner's right to do business and trade under Article 19(1)g is violated.

### **ARGUMENTS FROM SIDE RESPONDENT:**

- "Firstly, the respondents contended that RBI has not prohibited Virtual currencies in the country. The RBI has directed the entities regulated by it to not provide services to those persons or entities dealing in or settling Virtual currencies because the RBI thinks that they are harmful in nature.
- The second argument the respondents contended that corporate bodies/entities who have come up with the challenge are not 'citizens' and hence, not entitled to maintain a challenge under Article 19(1)(g).
- The third objection of RBI was that there is no fundamental right to purchase, sell, transact, and/or invest in VCs and that therefore, the petitioners cannot invoke Article 19(1)(g).

### **JUDGEMENT:**

After taking all the contention by both the parties the court finally laid down the following points in the case of Internet and Mobile Association of India v. RBI.<sup>3</sup>

### **RBI HAS THE AUTHORITY TO REGULATE CRYPTOCURRENCY**

The court opined that the respondent (herein the RBI) had the power to regulate virtual currency as even though virtual currency may not be strictly classified into the definition of money, as there exists four features of money – medium of exchange, unit of account, store of value, and whether it is socially accepted as money/ legal backing by a central authority. The virtual currency lacked legal recognition by the

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<sup>3</sup> MANU/SC/0264/2020.

government, but the court held that since it has the capability and may act or perform functions of fiat money, RBI will have necessary powers under the statute to issue directions.

## **RBI'S CIRCULAR WAS NOT REASONABLE/ PROPORTIONAL TO THE THREAT IT SEEKED TO CONTROL.**

Having held that VCs were amenable to regulation by the RBI, the Court proceeded to examine whether the RBI's Circular satisfied the test of proportionality. The court opined that the petitioners' fundamental right to trade, as recognized by the Constitution, was affected since the Circular had the effect of putting multiple VC exchanges out of business. While the petitioners accepted that the right to trade could be subjected to reasonable restrictions, the restrictions had to be a measure which was proportionate to the concerns. It was highlighted that the doctrine of proportionality required that if alternative and less intrusive measures existed, those should have been adopted.

The Court accepted the submission and held that the Circular was disproportionate because none of the RBI's regulated entities had 'suffered any loss or adverse effect directly or indirectly, on account of the interface that the VC exchanges had with any of them'. Furthermore, by relying on the regulatory approaches in other jurisdictions, the Court held that there were alternative regulatory means through which the RBI could have achieved its stated objectives. The thrust of the Court's conclusion in this regard was that regulation would be a more proportionate response than prohibition.

### **ANALYSIS OF THE JUDGEMENT:**

The author for easy understanding has divided this section into different subtopics for better comprehension.

### **RULE OF INTERPRETATION USED:**

The court applied ***Golden Rule of Interpretation*** in the present judgement and did not restrict its interpretation to merely the ***literal words*** of the said Act. To interpret whether virtual currency will come under the ambit of the RBI Act, the court went into the object and purpose of the act, and the preamble to said RBI Act, and held that the purpose of the Act was to regulate the economic activity in the country and since virtual currency were able to perform in certain instances functions of real money (in some cases as a way of barter), and therefore RBI will be presumed to have the power over crypto currency exchanges and could give directions for its functioning. The court went to the ***Statement of Objects and Reasons*** for the Banking Regulation Act, 1949 and opined that one of the main features of the Bill as indicated in the Statement of Objects and Reasons was "widening the powers of RBI so as to enable it to come to the aid of the banking companies in times of emergency". Section 5 of the Banking Regulation Act, 1949 which contains the ***interpretation clause (Internal aid of Interpretation used by the court)*** defines the

expression “banking policy” under clause (ca) of Section 5. This definition reads as follows: 5(ca)“ banking policy” means any policy which is specified from time to time by the Reserve Bank in the interest of the banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resources.”

The court also took account of the ***preamble (Internal aid of Interpretation used by the court)***<sup>4</sup> to the said RBI Act which suggested, the object of constitution of RBI was threefold namely (i) regulating the issue of bank notes (ii) keeping of reserves with a view to securing monetary stability in the country and (iii) operating the currency and credit system of the country to its advantage.

The court also applied the ***ejusdem generis***<sup>5</sup> principle as under the RBI Act section 45W states “Power to regulate transactions in derivatives, money market instruments, etc.—(1) The Bank may, in public interest, or to regulate the financial system of the country to its advantage, determine the policy relating to interest rates or interest rate products and give directions in that behalf to all agencies or any of them, dealing in securities, money market instruments, foreign exchange, derivatives, ***or other instruments of like nature*** as the Bank may specify from time to time.” The court applied ***literal interpretation*** to interpret it as although in none of the provisions of the RBI Act, explicit provision was made with respect to cryptocurrencies., it being only a recent creation, as late as 2008 when Bitcoin a very famous cryptocurrency came into existence.

However, it is to be noted that the court construed the power of the RBI under the act by remaining ***Ex Viserbis Actus*** as the court held that “A careful scan of the RBI Act, 1934 in its entirety would show that the operation/regulation of the credit/financial system of the country to its advantage, is a thread that connects all the provisions which confer powers upon RBI, both to determine policy and to issue directions<sup>6</sup>.”

The court deeming it necessary to see how VCs were defined (i) by regulators in different jurisdictions and<sup>7</sup> (ii) by the governments and other statutory authorities of various countries, through statutory instruments and non-statutory directives<sup>8</sup> and (iii) by courts of different jurisdictions took help of ***External aids of Interpretation***. The court relied on the judgment of a US court in ***SEC v. Trendon Shavers***<sup>9</sup>, that: “It is clear that bitcoin can be used as money. It can be used to purchase goods or services and as Shavers stated, used to pay for individual living expenses. The only limitation of bitcoin is that it is limited to those

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<sup>4</sup> See Page 48 of the judgement.

<sup>5</sup> See Page 55 of the judgement, describing power of RBI to regulate different market entities ending in “other instruments of like nature”.

<sup>6</sup> See Page 56 of the judgment.

<sup>7</sup> See Page 70 of the judgment.

<sup>8</sup> See Page 75 of the judgment.

<sup>9</sup> Case No. 4: 13-Cv-416 (August 6, 2013)

places that accept it as currency. However, it can also be exchanged for conventional currencies such as the US dollar, euro, yen and Yuan. Therefore, bitcoin is a currency or form of money..."

### **THEORY OF JUSTICE USED BY THE COURT:**

The Supreme Court in the current instance applied the ***Libertarian approach to justice***. The petitioners had approached the court to uphold their right to trade and business, as it was violated because of the ban put by the RBI. The court held their right in the affirmative and held that while the corporations and companies may not have fundamental right to carry on business and trade, but the shareholders and directors of the same has sufficient rights to carry on such business or occupation and therefore can effectively exercise such right and a result of the ban their fundamental rights have been grossly violated, thus the court overruled the ban on crypto currency exchanges.

The court also applied ***Economic Egalitarian theory of justice*** to the instant case, as right to equality and economic freedom was given a toss as a result of the ban put by the RBI on entities governed by it, whereas on the other hand trading of virtual currency was not banned to people who bought and sold through other means, e.g. peer to peer exchange of bitcoins were still valid, and there was no ban on holding of such cryptocurrencies by a person as explicitly stated by the RBI<sup>10</sup>, nor was the act of holding, selling, buying of virtual currency was banned or termed illegal, it was only the exchanges under the power and control of RBI who were prohibited to indulge in such an activity, on the pretext that such activities may cause harm to the banking environment. The court held that this exchanges also had the same right with respect to dealing in virtual currencies as their other counterparts, all members of a just society should have equal access to wealth, in absence of a legitimate law by the legislative, the RBI can't put such a restriction and violate their right to equality by merely just issuing the impugned circular which is disproportionate to their interests and rights and thus violative of their right to economic equality.

### **ANALYZING WHETHER JUSTICE WAS DONE IN THE INSTANT CASE.**

The court rightly decided in this case, that the act of the RBI in banning crypto currency exchanges from dealing with virtual currency was disproportionate as there were less intrusive measures to which the RBI could have made use of to achieve its objective, by asking for more stringent KYC norms, and identity proofs, etc to promote its objective that is i.e. prevention of money laundering, tax evasion, regulating banking activities to prevent terrorist financing etc. The court held that banking channels provide the lifeline to any businesses, trade or profession, especially so in the light of the restrictions on cash transactions contained in Sections 269SS and 269T of the Income Tax Act, the RBI's act on banning was extreme because the court held that the moment a person is deprived of the facility of operating a bank account, the

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<sup>10</sup> See page 42 of the said judgement.

lifeline of his trade or business is severed, resulting in the trade or business getting automatically shut down as in the case of virtual currency many of which were shut down as a result of the ban put by the RBI. The court held that in such a situation it is the burden of RBI to show that larger public interest warranted such a serious restriction bordering on prohibition, is heavily on RBI and it must prove the same by facts and evidence and not just a mere suspicion. The court relied on the test laid down in ***Modern Dental College and Research Centre v. State of Madhya Pradesh***<sup>11</sup>. These four tests are (i) that the measure is designated for a proper purpose (ii) that the measures are rationally connected to the fulfillment of the purpose (iii) that there are no alternative less invasive measures and (iv) that there is a proper relation between the importance of achieving the aim and the importance of limiting the right. The court in the said case held that a mere ritualistic incantation of “money laundering” or “black money” does not satisfy the first test and that alternative methods should have been explored.

The court also referred to its judgement in ***State of Maharashtra v Indian Hotels and Restaurant Association***<sup>12</sup> there must have been some empirical data about the degree of harm suffered by the regulated entities (after establishing that they were harmed). The court held that it is not the case of RBI that any of the entities regulated by it has suffered on account of the provision of banking services to the online platforms running VC exchanges. Hence, the claim made by the respondent (The RBI) regarding virtual currency being risky and harmful to the economy, in absence of concrete proof, the court held that the ban was not good in law. The author thinks that court applied its mind correctly and the judgment was a well thought and reasoned judgment setting precedent that there should be enough satisfactory evidence to justify an act such as a ban, which is an extreme measure in law, which categorically through its implication hampers fundamental rights of the citizens.

Justice was although categorically done in the present case, the court however neglected the rights of persons under this provision to persons who buy and sell crypto currency as a way of hobby. The court held that the act of buying and selling of crypto currencies through VC Exchanges can be by way of hobby or as a trade/business. The court held that the distinction between the two is that there may or may not exist a profit motive in the former, while it would be in the latter case. The court held that persons who engage in buying and selling of virtual currencies, just as a matter of hobby cannot pitch their claim on Article 19(1)(g), for what is covered therein are only profession, occupation, trade or business. Therefore hobbyists, who are one among the three categories of citizens (hobbyists, traders in VCs and VC Exchanges), straightaway go out of the challenge under Article 19(1)(g). The court applied ***Literal rule of Interpretation*** in the current instance and only those categories enumerated in Article 19(1)(g) were taken into consideration to hear and decide for the violation of fundamental right and they were excluded.

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<sup>11</sup> MANU/SC/0495/2016.

<sup>12</sup> MANU/SC/0702/2013.

The author personally feels that in the correct sense of justice such provision should not hold good. If the virtual currency exchanges can conduct, the same right should also be provided to other citizens who might trade other than the purpose of business.

The court should have applied ***Egalitarian theory of justice*** in its true spirit which would have yielded a more effective approach to protect rights of its citizens and bring about justice in its true sense, as under the present judgement only the right of people who trade virtual currency as a matter of business activity was upheld but not their other counterparts, like people who do it as a matter of hobby. The author feels that there should be no distinction between people who trade virtual currency as a business activity and people who do it as a matter of hobby, because equality is the soul of liberty; that there is, in fact, no liberty without it, and therefore the author feels we cannot construct Siberian prisons in the tropical landscapes of our country.