

Legal Opinion: Stock Market fair

From information that has been provided to me, I have discerned that StockMarketfair is proposed to be an enterprise operating a portal on which users/participants may bet on whether Stock Indices would, at the close of the day, end below, equal to or above, a certain pre-determined value set by the operators of the portal/the enterprise. Value of bets i.e., ratio of investment qua returns, is computed electronically through appropriate software, on the basis of market and betting trends.

This legal opinion addresses the following issues:

- i) Legality of the Business model;
- ii) Applicability of Security Laws to the Business Model;

1. Legality of Business model

The principal law that may affect the legality of the proposed business is that governing, regulating and prohibiting gambling. Besides the fact that activities associated or connected with gambling barring few exceptions is an offence in most States, Contracts/Agreements that relate to gambling would be deemed void-ab-initio under Section 23 of the Indian Contract Act, 1873 for consisting of a consideration that is forbidden in law and opposed to public policy, and hence such Contract/Agreements would be unenforceable.

It is therefore quintessential to analyse whether the proposed business would fall within the confines of the term "gambling". What constitutes

gambling has been considered by the Courts including the Hon'ble Supreme Court of India at multiple instances. The preponderant case in this regard is that of *R.M.D. Chamarbaugwalla vs. Union of India*.¹ The Petitioners in that case had approached the Hon'ble Apex Court claiming that their fundamental right to carry on trade and business had been violated by a certain statute that prohibited prize competitions. In its Judgment, the Hon'ble Supreme Court of India distinguished between "games of chance" and "games of skill" and held that only the former fell within the term "gambling" and as regards the latter, the Court held that operators of such activities were protected by Article 19(1)(g) of the Constitution of India. Competitions/games of skill it was held, were those which involved *substantial degree of skill*.

Most forms of Gambling are prohibited in most states and as has already been mentioned activities connected or associated with gambling are prescribed as offences in most States, through State Legislations. Most of these legislations specifically exempt "games of skill" from their scope. It maybe noted that even in States where games of skill have not been exempted by the State legislation governing acts of gambling, in view of the judgment of the Hon'ble Supreme Court in *R.M.D Chamarbaugwalla*² such an exemption is to be presumed- and in case any game of skill is expressly forbidden absolutely through a statute, the said statute to that extent is unconstitutional.

The determining question therefore is whether the betting in the proposed business involves a substantial degree of skill. While the Hon'ble Apex Court has considered and held other individual activities/games to be

¹ AIR (1957) SC 628

² Supra

games of skill,³ there is yet to be any judicial consideration of activities similar to or closely resembling the proposed business.

Consequently, as far as legality is concerned, the proposed business is in unchartered territory and maybe subject to judicial scrutiny before its legality is concretely determined. For the purposes of the current opinion, important factors of skill and chance shall be laid out and compared to analyse whether the betting involves a substantial degree of skill.

Factors of skills that may determine bets include:

- i) Conception and computation of mathematical probabilities;
- ii) Understanding of economy;
- iii) Understanding of Behavioural patterns especially of investors in stocks of the relevant index in matters related to trading of securities;
- iv) Understanding of significance and effect of business decisions;
- v) Identification of patterns, trends and moves to conceive future movement of indices.

Factors of chance that may determine bets include:

- i) Possibility of exclusive reliance on raw intuitions;
- ii) Vagaries of the stock market;
- iii) Difficulties associated with short-term predictions;
- iv) Precision of bet.

The first two of the above-two factors of chance may be said to persist in some form or the other in most activities. There is always the possibility of

³ See State of Andhra Pradesh vs. K. Sathyanarayanan, 1968 SCR (2) 387 where the game of rummy was held to be a game of skill. Further see, Dr. K.R. Lakshmanan vs. State of Tamil Nadu, 1968 SCR (2) 387, where betting on horse racing was held to be a game of skill.

an individual with no skill taking part in an activity purely on the basis of intuitions and doing well. But such intuitions, other than in exceptional cases, may not survive in the long run. Even if such an individual with absolutely no skill in forecasting movement of stock indices participates for a long duration and returns with a net profit, the same would at least require an analysis of daily bets rather than stock markets and the movement thereof, and adjusting risks and anticipated returns accordingly. Therefore any form of sustained participation requires a certain degree of skill.

As far as the vagaries of the stock market goes, the same maybe said to exist in any field. The question therefore is whether a system of prediction rooted in analytical foundations exists which has been able to forecast movement of stock markets with a high degree of precision. The above-mentioned factors of skill and their regular usage by experts, investors and regulators are proof enough of the fact that there are analytical methods of forecasting stock markets. The contest in the long-run then boils down to whose skills are sharper, are better trained and possesses superior precision.

As far as the issue of the difficulty in short-term predictions involved in the current business goes, the question is whether an analytical forecast can be made as to the value at which indices would close at the end of the day. A look at opinions and comments of business and investment experts reveals that a close watch of relevant facts at the minutest level of detail of multiple companies, industries and policies, does provide an analytical means of forecasting the trend of daily movement of stocks with higher degree of precision.

As far as the issue of precision of bet is concerned, it must be admitted that this is where the element of chance arises. Analytical forecasts may result in predicting a range at which a particular index might close at the end of the day. The higher the degree of skills, the smaller the size of the predicted range. Where the value offered by the operators on which the bet is to be made, falls within the predicted range, there arises an element of chance. But as such, an element of chance arises in most spheres of life, and hence cannot completely dominate determination of the nature of activity where there is a substantial amount of skill involved.

Another issue which arises is as to how the operator's pre-determined value is arrived at and whether it is random or designed to always fall at the centre of a range arrived at through standard means at forecasting. Without delving into the issue, it is stated that this opinion is formed on the basis that the pre-determined value is arrived at randomly without any form of analysis or forecast of relevant facts that might affect the movement of stock indices.

On the basis of the analysis made hereinabove, I am of the opinion that sustained quality and precision of bets requires a substantial degree of skill. Therefore, betting under the proposed business may said to be a game of skill and therefore exempt from gambling laws and protected under Article 19 and 21 of the Constitution.

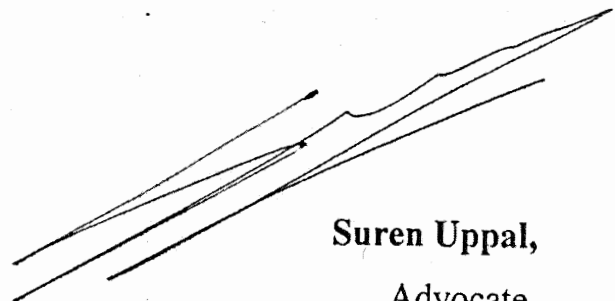
2. Applicability of Security Laws to the business Model

As there is no trade in securities taking place and there is no effect on the transaction of any securities involved, Security Laws ordinarily wouldn't apply.

An issue may arise as to whether the contract between the Operator and the better/user constitutes a derivative for the purposes of the Securities Contract (Regulation) Act. On closer inspection, it's found that a Contract in the nature of that which would be entered into between the operator and better/users in the proposed business model would not fall within the definition of a "derivative" for the purposes of the Securities Contract (Regulation) Act, 1956, on two grounds. Firstly, the contract between the operator and the better/user would not be proprietary in nature and therefore can in no case said to be proprietary in nature. Secondly, there is no case of the contract deriving its value from the value of an underlying security- as the contract is not proprietary in nature, it doesn't have an independent value of its own at which it maybe transferred- the only value that is dependent on performance of a large pool of shares is the value of returns/consideration under the Contract.

I am therefore of the opinion that contracts between the operator and users under the proposed business model would not fall within the definition of "securities" for the purposes of law dealing with Securities including the Securities Contract (Regulation) Act, 1956 and hence the Laws on Securities would not apply to the proposed business.

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