

# Closing the Gap

– Indian Online Intermediaries and a liability system not yet fit for purpose

Prepared on behalf of the Global Network Initiative  
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#### **About GNI**

The Global Network Initiative (GNI) is a multi-stakeholder group of companies, civil society organizations (including human rights and press freedom groups), investors, and academics dedicated to protecting and advancing freedom of expression and privacy in the Information and Communication (ICT) sector. To learn more, visit [www.globalnetworkinitiative.org](http://www.globalnetworkinitiative.org).

#### **About Copenhagen Economics**

Copenhagen Economics is a European-based economic consultancy with expertise in regulation, competition and trade. It is the leading economic consultancy in the Nordic region. Founded in 2000, the firm has approximately 40 employees – of various nationalities and with in-depth economics qualifications – making it one of the largest groups of professional economists on continental Europe. According to the Global Competition Review, Copenhagen Economics is one of the top 20 economic consultancies in the world.

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## **Preface by Jermyn Brooks, GNI Board Chair**

The Global Network Initiative (GNI) has asked Copenhagen Economics to assess the potential economic benefit of online intermediaries in India.

India is a country of particular importance to GNI. As the world's largest democracy, India trails only the United States and China in the number of Internet users, despite an Internet penetration rate of only 10 per cent. Hundreds of millions of Indians are on the verge of gaining Internet access, particularly via mobile devices, with huge opportunities for users as well as serious challenges. India's robust tradition of freedom of expression and its dynamic ICT sector are threatened by anxieties around issues such as hate speech, political criticism, and obscene content. India's Information Technology Act, hurriedly amended in 2008 and updated with rules for Internet intermediaries in 2011, is ill suited to deal with ICT innovations such as social media and user-generated content, with negative consequences for intermediaries and users alike.

GNI has commissioned this report, the first in a series addressing the Internet in India, to explore how freedom of expression and privacy can help to promote innovation and economic opportunity. Reforming the liability regime for India's Internet intermediaries, particularly the Information Technology Act, would not only help to protect the rights of users, but would also bring significant economic benefits for India's Internet economy.

GNI thanks Google for its financial support for this report. Several GNI members, representatives from online intermediaries, users of online intermediaries, investors, legal experts, and others have provided valuable input into and comments on the study. Particular thanks go to the Centre for Internet and Society for their help with the case studies, and to every person and institution who helped with the data and provided input for the study.

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## Executive summary

Online intermediaries provide significant economic benefits: this is why major economies across the world have a safe harbour regime to limit liability for online intermediaries when there is unlawful behaviour by intermediary users. We conclude that in India, provided that the existing safe harbour regime is improved, online intermediaries can become a significant part of the economy and their GDP contribution may increase to more than 1.3 per cent by 2015. This potential corresponds to \$41 billion by 2015; we expect this to be a conservative estimate, with the true potential being even larger.

However, the current legal regime results in higher costs to run an intermediary business in India, which we see as a growth-dampening factor – with virtually no benefits associated. Additional growth is possible in India due to online intermediaries, yet the potential \$41 billion GDP contribution could be lost if the safe harbour regime for online intermediaries' liability is not improved.

Simply put, online intermediaries are companies providing a platform for exchange of goods, services, or information between third parties on the Internet. For instance, when purchasing an item on quikr.in or snapdeal.com, when 'liking' the wedding picture a cousin posted on Facebook, or when doing a search on the Internet, one makes use of online intermediary services.

Online intermediaries play a crucial role for Internet users, because they organise information by making it accessible and understandable to users. Take, for instance, the simple task of looking for a specific consumer good – e.g. a new DVD player, a vacuum cleaner, or fancy sunglasses: it is a much more complicated and time-consuming task without the aid of an e-commerce platform or a search engine.

India's Internet economy is in its initial stages as compared to other countries with respect to share of GDP - indicating its significant growth potential. Broadband access, digital readiness, regulatory regimes, and several other factors can explain discrepancies between national levels of Internet use. However, as important as Internet access can be, another necessary brick is relevant content - for instance, the content made available thanks to online intermediaries.

Online intermediaries enhance economic activity, reduce costs, and enable market entry for SMEs, thus inducing competition, which at the end of the day leads to lower consumer prices and more economic activity. However, protection against legal responsibility for third-party content is a crucial framework condition for these benefits to materialise and prosper. The liability regime for Indian online intermediaries is defined by the Information Technology Act and the Copyright Act; however, the legal framework has been criticised for being unclear and open to interpretation, leading to legal uncertainty for online intermediaries.

It is costly for intermediaries to have the legal resources to determine the legality of takedown notices and handle legal risk. Uncertainty creates excessive costs for online intermediaries and new start-ups, which could otherwise contribute more to the economy and give greater benefits to firms and consumers. This uncertainty implies that these firms will not have viable business cases at the outset and consequently India misses out on economic growth.

We conclude that online intermediaries can become an important part of India's Internet economy and their GDP contribution may increase to more than 1.3 per cent by 2015, provided that the liability regime is improved. In addition, an increase in the use of online intermediaries will have positive productivity effects and generate consumer surplus from free services. Indirect productivity gains to the economy may in fact be higher in India than in other countries.

## Chapter 1

# The role of online intermediaries

In this chapter, we describe the role of online intermediaries - who they are, what they do, and how they add value. Online intermediaries enhance economic activity, reduce costs, and enable market entry for SMEs, thus inducing competition, which at the end of the day leads to lower consumer prices.

### 1.1 Online intermediaries – who are they?

Online intermediaries provide platforms for online exchange, without taking title to exchanged items or information: transactions or exchanges occur between two or more third parties via the platform. The intermediary may not have any direct dealings with buyers or sellers. The OECD discusses the concept of intermediaries in the publication “The Economic and Social Role of Internet Intermediaries” and we take their definition as a starting point to our analysis (see Box 1 below).

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#### Box 1 The OECD definition of online intermediaries

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“Internet intermediaries bring together or facilitate transactions between third parties on the Internet. They give access to, host, transmit and index content, products and services originated by third parties on the Internet or provide Internet-based services to third parties.”

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Note: In the context of this definition it is important to note that there are very different types of intermediaries fitting this description. Significant distinctions occur with regard to the type of service, and the customers served. Intermediaries can also fulfil different functions fitting the description, or a set of intermediary and non-intermediary activities under one umbrella brand, service, or organisation.

Source: OECD (2010), The Economic and Social Role of Internet Intermediaries.

For the purpose of this study and to quantify potential economic impacts of online intermediaries in India (see Chapter 3), we focus on the categories of intermediaries outlined in Table 1, below.

It should be kept in mind that many Internet companies provide a variety of services matching several of these categories. For example, Quikr is an online store (a platform for third parties to sell their products), but it also allows users to post comments, thus hosting third-party content. Furthermore, Quikr can be used as a search engine for product searches.

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**Table 1 Overview of online intermediaries categories**


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 Internet access and service providers

Data processing and web hosting providers

Internet search engines and portals

Third-party platforms for e-commerce

 Social media (participative platforms)
 

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Note: In OECD (2010) online payment systems also qualify as intermediaries. We have not included these in our assessments, consequently underestimating the value of online intermediaries in the quantitative economic contribution.

Source: Copenhagen Economics

**Internet access and service providers** are companies providing *subscribers with a data connection, allowing access to the Internet through physical transport infrastructure*.<sup>1</sup> In addition, they may also provide related services such as web page hosting and hardware or consulting services related to network infrastructure.

Indian examples include Aircel, Bharat Sanchar Nigam Limited (BSNL), Bharti Airtel, Indusind, Reliance Communications, Sify, Tata Communications, Tata Teleservices, Vodafone and others.

**Data processing and web hosting providers** provide infrastructure for hosting or data processing services. Data processing firms offer services to transform data, prepare data for dissemination, or place data or content on the Internet for others. Web hosting providers supply server space and Internet connectivity that enable content providers to 'serve' content to the Internet. They may offer specialised hosting activities, such as web hosting, streaming services, or application hosting. They also provide application services or general time-share mainframe facilities to clients.

This category includes cloud services that provide mobile access to data and offer consumers and businesses the benefit of insurance against data loss on a unique device, thereby facilitating more efficient business operations.

### **Internet search engines and portals**

Search engines generate and maintain extensive databases of Internet addresses and content in an easily searchable format. They often provide additional Internet services, such as e-mail, links to other websites, auctions, news, and other limited content. Besides enabling online searches, they provide efficient ways to advertise, which is in many instances a part of their business model.

Indian examples include Bixee, Guruji, JustDial, Monster, Naukri, Rediff, Sify, and Zoho.

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<sup>1</sup> OECD (2010)

### Third-party e-commerce platforms

Third-party e-commerce platforms are e-commerce sites that connect buyers and suppliers and enable Internet transactions between them. They often provide a range of bundled services, such as fixing prices or transaction processing and co-ordination. Matching 'buyer' and 'seller' lies at the core of their business. This can include private consumers buying from a retailer, or second-hand trade among private consumers, as well as one business buying from another business.

Examples of third-party e-commerce platforms are eBay, Expedia, Fashion N You, Flipkart, HomeShop18, and India Mart.

**Social media** facilitate social communication and information exchange; they enable users to contribute to developing, rating, collaborating, and distributing Internet content and developing and customizing Internet applications.

Table 2 below lists a range of examples of social media.

**Table 2 Examples of social media**

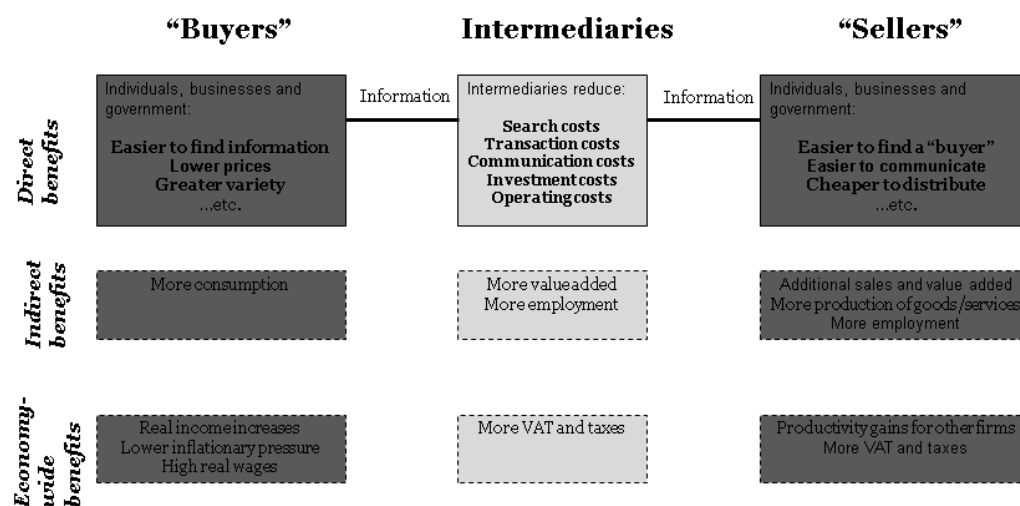
Type of Platform	Examples
Blogs	Blogs such as BoingBoing, Engadget, Ohmy News; Blogs on sites such as LiveJournal, Windows Live Spaces, Cyworld, Skyrock
Wikis and other text-based collaboration formats	Wikipedia, Wiktionary; Sites providing wikis such as PBWiki, Google Docs
Instant messaging	Skype, Trillian, Windows Live Messenger
Mobile	Mobile versions of social networking sites and applications such as Facebook
Sites allowing feedback on written works	FanFiction.Net, SocialText, Amazon
Group-based aggregation	Sites where users contribute links and rate them such as Digg, Reddit Sites where users post tagged bookmarks such as del.icio.us
Photo-sharing sites	Kodak Gallery, Flickr
Podcasting	iTunes, FeedBurner (Google), WinAmp, @Podder

Source: OECD (2010), "The Economic and Social Role of Intermediaries"

## 1.2 Benefits for users and society

Online intermediaries provide benefits directly to users and to the wider economy. First, the services reduce costs for users – both buyers and sellers. Second, they establish a competitive market with lower entry barriers, ultimately benefiting consumers by competing down prices. As illustrated in Figure 1, these direct benefits extend into the wider economy.

**Figure 1 How online intermediaries deliver benefits to the economy**



Source: Copenhagen Economics

Direct benefits accruing to third-party users - consumers, firms, and governments – indirectly benefit the wider economy by creating economic activity leading to more employment, higher productivity, and lower inflationary pressure. We discuss these derived effects in more detail in Chapter 3. For now, we focus on the direct benefits stemming from reduced costs.

As already exemplified in previous sections, online intermediaries deliver several cost-reducing benefits. In the view of an economist the cost reductions for users (firms, consumers, and governments) all match one or more well-known economic concepts such as: search costs, transaction costs, communication costs, and investment/operating costs.

- Search costs are costs in terms of time and hassle to find the product with the features, quality, and price that match consumers’ preferences. Online intermediaries reduce these costs; e.g. price comparison platforms make it an easy task to find the cheapest product and an intermediary like Mouthshut provides consumers with information to avoid poor services.
- Transaction costs are the cost of completing a transaction, denoted in monetary units or in the form of saved time. Online intermediaries reduce transaction costs: for example, by concluding orders online rather than in a store.
- Communication costs can be reduced by, for example, posting information on participatory platforms such as Facebook or LinkedIn rather than reaching out to many individuals.
- Investment and operating costs can be reduced by using third-party hosting and processing services (such as cloud computing).

### **How online intermediaries deliver benefits to firms, especially SMEs**

Especially for SMEs, the use of an online e-commerce platform can reduce the cost of selling; investments in own online-shops can be substantial and costly. Through participation on e-commerce platforms firms can avoid upfront capital expenditure and pay per transaction, as well as leverage the intermediary's investments in technology, marketing, payments, and fulfilment, which is particularly attractive to smaller firms. Furthermore, entering the market through an established e-commerce platform helps to create traffic on the websites of firms.

An example of a start-up using an e-commerce platform as a stepping stone to expansion is the Indian florist franchise chain, Ferns n Petals. The company used the scalable model of marketing through e-commerce platforms and gained from variable instead of fixed costs at the outset (see Box 2).

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#### **Box 2 SME case – Ferns n Petals**

Ferns n Petals started out as a local florist with a small shop opening in Delhi in 1994. In 2004 they began advertising on Indiatimes and a little later also joined other e-commerce platforms. This decision escalated sales and they experienced demand from across the country. In 2007 Ferns n Petals launched their own online shop, but continued advertising through e-commerce platforms. Today the company employs more than 100 people and has 140 franchised flower shops in 55 cities, covering deliveries of flowers and other gift items in 150 cities across India.



Source: Interview with Pawan Gadia, Founder and CEO of Ferns n Petals

In addition, firms benefit from various kinds of social media services providing advertising opportunities and feedback mechanisms for products and new developments.

### **How online intermediaries deliver benefits to consumers**

Consumers save time and money when they search for products, and they gain from easy access to knowledge resources and interaction with other Internet users through e-mail, online games, picture sharing, and more. The investment and innovation in the field of search and e-commerce has challenged and provided opportunities for traditional retailers by widening geographic markets. Consumers have gained access to a large pool of potential suppliers and benefit from increases in competition. In a more competitive market, firms are encouraged to do their utmost to maintain high standards of product information and customer service, keeping prices down and quality up. Especially the use of price comparison sites, which are in some instances also categorized as intermediaries, will naturally lead to tougher competition as consumers get very easy access to price information (see Box 3). Finally, the so-called long tail effect is beneficial; larger markets leave room for selling specialized products, which would not be marketable to a more limited customer base.

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### Box 3 E-commerce reduces prices

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The effect of price comparison sites has been investigated in several studies. One study showed that a one per cent increase in traffic to a leading price comparison website decreased price dispersion - that is, the difference between the average and minimum price for a particular good - by 1.1 per cent. Earlier empirical studies show a 10-15 per cent aggregate reduction of prices as a result of e-commerce. Another study estimated that buyers in France, Germany and the UK save around 17 per cent on average for a range of new products by purchasing on eBay rather than in an offline store.

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Note: Several other studies have reached similar conclusions.

Source: See Tang, Smith & Montgomery (2010), Frontier Economics (2010), and Brynjolfsson & Smith (2000).

Consumers also benefit from the use of other intermediaries: web hosting products make content available from different devices and places; and search engines and social media, for instance, create social benefits through information exchange.

### 1.3 Importance of the liability regime

A crucial framework condition for online intermediaries is the safe harbour regime limiting liability for the content exchanged between platform participants. Online intermediaries do not have direct control per se of what information or products are exchanged via their platforms. Therefore it is likely that intermediaries are not per se aware of potential illegal content. Legal regimes, so-called *limited liability regimes*, that prescribe exceptions from liability rules for third-party intermediaries are in place in many countries, including the United States and the European Union, and these are a necessary regulatory foundation for online intermediaries. Likewise, India has a liability regime, defined by the IT Act and the Copyright Act. However, as we will discuss in Chapter 2, the regime has been subject to critique and the undertakings concerned perceive the legislation as unclear and inadequate.

Important objectives, such as protection of copyrights or fighting racism or hate speech, may require removal of online content. However, an adequate regime includes a principle whereby, for certain activities, online intermediaries may lose their liability exemption if they do not act expeditiously to remove or disable access to illegal information upon receiving actual knowledge of its illegal nature.

Requiring intermediaries to monitor the legality of the online content simply poses an insurmountable task. Take, for instance, the video-sharing site YouTube. With more than 100 hours of video uploaded per minute, it would be a huge task to look through all content and assess compliance with different laws. Even *if* monitoring the legality of each piece of information by intermediaries against all applicable legislation were possible or desirable, the cost might be prohibitively high.

Online marketplaces and other intermediaries are in some respects comparable to a traditional city square marketplace. The city mayor makes a square available to merchants, but the city is not held liable for the items traded on that marketplace. However, if the city

mayor is made aware of illegal traders on the city square, he/she is obliged to ensure that they are removed and their trading is discontinued.

To provide another parallel example, a telephone network operator is not held legally responsible for crimes discussed over its lines, or forced to monitor all calls for possible criminal activities.

### **The economic rationale for a safe harbour limiting liability**

There are substantial economic arguments for a safe harbour limiting the liability of online intermediaries. We highlight three features, which constitute an economic rationale for limiting the liability of online intermediaries:

- Network externalities
- Asymmetric information
- Efficiency of monitoring

The economic term *network externalities* refers to a situation where the individual valuation of a good is higher the more that other individuals are using or purchasing the good. The classic example is a telephone: a telephone is not worth much if you are the only telephone owner; however, the more that friends, family members, and other contacts own a phone, the more you will appreciate having one. To take the example of an e-commerce platform: online sellers want to put their products on sale on platforms with many potential buyers, and buyers want to spend time searching for products on platforms with many sellers. Buyers and sellers both benefit from a larger volume on the platform.<sup>2</sup> The same logic holds for other types of platforms.

The online intermediary sets prices and access conditions such that many users on both sides of the platform make use of its services. Accordingly, the intermediary helps create benefits to both buyers and sellers that would not occur without the platform. As a result of the positive externality, the online intermediaries are more useful to everyone. Without a well-functioning intermediary, there will be underinvestment in the online intermediary services, with too low a quantity and too low a price charged relative to the social optimum. Because of the low transaction, search, and access costs, as discussed in the previous section, online intermediaries reduce costs for buyers and sellers and facilitate exchanges that would otherwise not be viable in a comparable offline environment. This brings about a larger network of users and thereby greater value.

There is an initial hurdle for getting these kinds of activities rolling, however. The challenge is the *information asymmetry* between sellers and intermediaries. Sellers know about the legitimacy of their product or content, but the intermediary does not. Asymmetric information often implies a suboptimal volume of trade<sup>3</sup>. One reason is that transactions may not happen - despite the possible gains from trade - because of the risk that a seller withholds important information. This information asymmetry can lead to adverse

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<sup>2</sup> The same logic applies to search engines, where there is a similar self-reinforcing positive circle between the number of users and the number of advertisers and content providers.

<sup>3</sup> See Rochet & Tirole (2005) for a further discussion of two-sided markets, and Halaburda & Yehezkel (2013) for a discussion of information asymmetry in two-sided markets.

selection and moral hazard problems, as pointed out by Akerlof (1970). *Without a regime protecting online intermediaries from liability in certain circumstances, these problems of information asymmetry will be transferred to the intermediary and the incentive to provide such services will decrease.*

If the intermediary is held liable for the goods or information exchanged over the platform without its having knowledge of any illegality, the intermediary will be reluctant to let third-party sellers on board the platform, and the platform will be less attractive to buyers, and the positive circle may never begin<sup>4</sup>. If the intermediary is protected from being held liable for illegal content it was not aware of, this concern is reduced, and the initial hurdle for getting the online platform started is removed. Removing the risk of being held responsible for third-party content is no guarantee of success, as online intermediaries will still have to compete on prices, service levels, and features, but it is a basic requirement.

Finally, intermediaries are experts in intermediation and not experts in determining whether products or information (in many different fields) is illegal or not. From an economic efficiency standpoint, this is best left to brand owners/rights holders, officers within the judicial system, or other specialised groups.

We have now introduced the concept of online intermediaries and conclude that they enhance economic activity, reduce costs, improve competition, and create lower consumer prices. There are substantial economic arguments for offering limited liability to online intermediaries, because these benefits will not materialise if online intermediaries are responsible for the legality of third-party content per se.

All of the above factors affect not just the entrepreneurs and managers wishing to develop an online intermediary business. They also will unavoidably affect the decisions of investors such as venture capitalists. Any legal uncertainty surrounding the operation of an online intermediary business in a given country will counter the effect of these factors and reduce the economic impact of online intermediaries. Furthermore, legal uncertainty will deter investors from pursuing opportunities in that area. Lack of investment capital will constrain the ability of online intermediaries to tap into the above three factors and to deliver economic benefit.

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<sup>4</sup> When the platform is up and running, online user reviews may provide additional consumer trust in online shops.

## Chapter 2

# The legal regime affecting online intermediaries in India

In this chapter, we start by briefly presenting the rules in place in India to define the legal responsibility of online intermediaries<sup>5</sup>: specifically, the rules concerning an online intermediary's responsibility vis-à-vis content which originates from any of the third parties using their intermediary services. We consider that the current Indian legal liability regime for online intermediaries presents several challenges. We will discuss these and present a set of legal cases showing the range of liability issues which have affected intermediaries in India over the past few years.

As economists, we are particularly concerned with the impact of the legal regime on the firms affected by it. We conclude this chapter by explaining how the current set of rules results in higher costs to run an intermediary business in India, which we see as a growth-dampening factor for India's Internet economy.

However, the shortcomings identified are not unsolvable. There is a clear opportunity for Indian policymakers to introduce small yet effective fixes that can ensure that the law in India is a support factor for legitimate intermediary activities, rather than a source of risk and undue burden on Internet businesses and thus a drag on India. For this reason, we briefly discuss proposed modifications of the secondary legislation which are likely to maximise growth in the internet sector.

### 2.1 The Indian liability regime for online intermediaries: key characteristics and challenges

The key pieces of legislation defining the liability regime for Indian online intermediaries are the IT Act (as amended in 2008) and the Copyright Act (as amended in 2012). Secondary legislation under the above acts also plays a role. In particular, the 2011 Information Technology (Intermediary guidelines) Rules contain provisions that are designed to guide the conduct of online intermediaries.

The evolution of the IT Act reflects the tension behind modernising India's legal architecture so as to keep up to speed with the evolution of information and communications technologies and their impact on business and government. The 2000 IT Act allowed India, in line with the UN model law on e-commerce, to delineate the legal aspects of e-commerce transactions and e-government interactions (cf. Box 4). For instance, while no electronically certified signature was stipulated as necessary for e-commerce, this was instituted as a requirement for e-government. Thus the legislators in 2000 had clearly in

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<sup>5</sup> The description of the Indian liability regime applying to online intermediaries is based on our interviews with experts of the Indian legal framework. It is meant to provide a basic understanding of the relevant legal regime and does in no case constitute a legal analysis of it. Readers with an interest in legal analysis on this subject may, for instance, refer to the India Law and Technology Blog <http://www.iltb.net/> or the Rishabh Dara 2011 study.

mind that private commercial transactions should be subject to fewer burdens than government-related interactions.

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#### **Box 4 The aims of the IT Act, 2000**

An Act to provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as "electronic commerce", which involve the use of alternatives to paper-based methods of communication and storage of information, to facilitate electronic filing of documents with Government agencies and, further, to amend the Indian Penal Code, the Indian Evidence Act, 1872, the Bankers' Books Evidence Act, 1891, and the Reserve Bank of India Act, 1934, and for matters connected therewith or incidental thereto

Note: Preamble of the act

Source: Information Technology Act, 2000, available at: <http://deity.gov.in/content/view-it-act-2000>

The next legislative phase of relevance to intermediaries started in 2008. Many commentators, legal experts and members of the Indian online business community have had no hesitation in associating the IT Act amendment of 2008 with the furore surrounding the arrest of Avnish Bajaj, then CEO of Baazee.com. The legal action affecting Baazee.com was caused by an e-commerce posting generated by a third-party user of the site. Nonetheless, enforcers saw fit under the existing 2000 IT Act legislation to arrest the CEO of the intermediary company.

Legislators thus decided to update the IT Act so as to modernise it and ensure that it was best-suited to developments in e-commerce such as the advent of online intermediaries. In doing so, legislators brought some provisions of the IT Act more in line with similar legislation in other jurisdictions, such as the EU E-commerce Directive. However, it has been noted that key differences between the law in India and the EU (such as in the definition of intermediaries) have resulted from the text approved as the 2008 Amendment to the IT Act.<sup>6</sup>

As a result of the 2008 IT Act, a regime was introduced that allows, in theory, a degree of safeguard for online intermediaries from legal liability. The Act also envisages at a generic level a process by which third parties can notify the intermediary of content which is considered unlawful, thus seeking a removal by the intermediary of that content.

Under the IT Act, the Government issued secondary legislation in the form of the Information Technology (Intermediary guidelines) Rules, 2011. These aim to specify in greater detail what steps intermediaries should take in order to remain compliant with the IT Act. However, these guidelines remain open to wide differences in their interpretation, which leads to uncertainty about what content must be removed on request. The language in the guidelines is generic to the point that the guidelines cannot fully achieve their objective to provide unambiguous guidance to Indian industry, enforcers, or citizens (cf. Box 5).

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<sup>6</sup> According to interviews with legal experts and the Rishabh Dara 2011 study "Intermediary Liability in India: Chilling Effects on Free Expression on the Internet", available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2038214](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2038214)

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## Box 5 Information Technology (Intermediary guidelines) Rules, 2011

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*... "grossly harmful", "harassing", "blasphemous", "defamatory", "obscene", "pornographic", "paedophilic", "libellous", "invasive of another's privacy", "hateful, or racially or ethnically objectionable", "disparaging"...*

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Note: Select expressions used in the 2011 Guidelines

Source: Information Technology (Intermediary guidelines) Rules, 2011

The degree to which the 2011 Guidelines are open to interpretation has the effect of creating:

- A mismatch in expectations as to what is legal and what is not between certain users who access content via an intermediary (e.g. read a blog post) and other users who produce content (e.g. write a blog post)
- A mismatch in expectations as to what procedure should be followed between aggrieved parties and online intermediaries
- A mismatch in interpretation of the law by different members of the enforcement community (e.g. different members of the judiciary, or different police officers)<sup>7</sup>

According to economic theory, businesses are expected to pursue the actions that maximise their profits. When, under the 2011 Guidelines, intermediaries receive a notice from a party aggrieved about a third party's content, intermediaries face a relatively short interval of time to react (36 hours for a first reaction). In response to each notification, they should in theory make a judgment on the legality of the third-party content. This decision is not neutral in terms of its economic consequences. High legal costs and legal risks can only ensue if the intermediary chooses not to agree with the request to take down the content.

If, instead, intermediaries take down the content (even when there are no legitimate reasons to do so), legal costs and risks are very limited. While intermediaries do in fact face a litigation risk from their users if they take down content, this has not yet been an active trend in India. Unsurprisingly, research in the Rishabh Dara study found that a large majority of online intermediaries operating in India appear to automatically take down content upon notification – irrespective of the apparent legitimacy of the claim.

As a consequence of the guidelines, intermediaries either remove content automatically upon each notification or must spend a considerable amount of money (given the high number of potentially aggrieved party in India today) on legal resources to evaluate the legitimacy of claims or even to face the huge risk and cost of being the target of legal action.<sup>8</sup>

When receiving an unclear or unjustified notification, online intermediaries face the dilemma between choosing what is right and what is expedient. The Rishabh Dara 2011

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<sup>7</sup> This is signalled by divergence in outcomes across similar legal cases, as has emerged in interviews with legal experts.

<sup>8</sup> India Law and Technology Blog, interviews with legal experts, Rishabh Dara study (2011)

study provides an indication that in many cases the trade-off is such that expediency prevails and content is removed without question – even in unwarranted cases. Nonetheless, under the existing legislation a considerable set of legal cases involving intermediaries has emerged in India. We present in the boxes below a set of key examples of cases involving intermediary liability.

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### **Box 6 Court case - Indijobs**

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The blogger Indijobs posted on hubpages.com about the guru Nirmal baba, among other things calling him a “fraudstar”. One of the guru’s followers notified hubpages.com of the comments, requesting removal. hubpages.com refused to remove said content and advised contacting the blogger directly, without being willing to provide contact information in absence of a court notice.

Followers of the guru sued the website and the blogger, obtaining a court order forcing the website to take down the content. The website did not remove content, which caused it to be found in breach of the IT Act for not complying with the takedown regime for intermediaries. Ultimately, the website was obliged to disclose the identity of the blogger.

The court deemed the hubpages.com blogging site to have editorial control and, thus, that it could not benefit from the intermediary safeguards in the IT Act. The court claimed jurisdiction over foreign intermediaries open to Indian users (or with ads targeted to India).

Finally, the court order forces hubpages.com to monitor any future posts to pre-empt defamation against Nirmal baba. The court order is directed also to the web register, which has to block all access to hubpages.com unless the latter removes the blog page found to be defamatory.

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Source: Copenhagen Economics

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### **Box 7 Court case - Ahmad Zamal**

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Ahmad Zamal is a cyber (i.e. internet) cafe owner. A user of his cyber cafe accessed material deemed obscene. As a result of this, the cyber cafe owner was charged for showing obscene material. He lodged an appeal at Allahabad High Court, arguing that he could not be held liable due to section 79 of the IT Act.

The court rejected the appeal on the grounds that the cyber cafe owner had not taken any measures to prevent such material from being shown at his cyber café.

The High Court remanded the matter back to the lower court, where it is currently pending.

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Source: Copenhagen Economics

### **Copyright and intermediary liability**

The area of copyright is particularly relevant to online intermediaries, given that intermediary business models involve the transmission of third-party content of the kind which could be subject to copyright (e.g. videos). Indian legislation provides further provisions which affect intermediaries here, in the form of the Copyright Act, as amended in 2012.

As shown by the pivotal cases in the boxes below, intermediaries have been involved in litigation relative to copyright aspects.

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### **Box 8 Court case - M/s.R.K. Productions Private Ltd - Movie “3” case**

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Producers of the movie “3” filed and got a John Doe injunction from the High Court against a large number of ISPs to block certain websites.

One of the ISPs (Vodafone India Ltd) lodged an appeal with the Madras High Court.

The Court clarified its order and blocked only specific URLs. The Court also relied on the case of Super Cassettes to justify a John Doe order, a blanket injunction even before the release of the movie, as well as an order without impleading the infringing websites as parties in the suit.

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Source: Copenhagen Economics

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### **Box 9 Court case - Guruji.com**

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Guruji.com was a music search engine platform allowing users to locate and play music from sites such as songs.pk, musicplug.in, pz10.com, and bollymobile.in, among other websites.

Following a First Information Report from Super Cassettes Industries Limited (“SCIL”), the police arrested the CEO of Guruji.com, along with other executives, on charges of making available the copies of the copyrighted musical works owned by T-Series. However, the uploading of these works was an action by a third party and not of Guruji.com.

The website is not functional at the time of writing.

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Source: Copenhagen Economics

Yet, even in the field of copyright, where dedicated legislation (beyond the IT Act) exists that could provide even more specific guidelines to online intermediaries, we observe room for potential ambiguity in the interpretation of the law. In particular, it is unclear under which conditions intermediaries are protected against liability. Specifically, Sections 52(1)(b) and 52(1)(c) of the Copyright Act (as amended in 2012) refer to the concept of “transient and incidental storage” – as shown in Box 10.

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### **Box 10 Copyright Act, revised liability rules: Section 52(1)(c)**

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(c) transient or incidental storage of a work or performance for the purpose of providing electronic links, access or integration, where such links, access or integration has not been expressly prohibited by the right holder, unless the person responsible is aware or has reasonable grounds for believing that such storage is of an infringing copy.

Provided that if the person responsible for the storage of the copy has received a written complaint from the owner of copyright in the work, complaining that such transient or incidental storage is an infringement, such person responsible for the storage shall refrain from facilitating such access for a period of twenty-one days or till he receives an order from the competent court refraining from facilitating access and in case no such order is received before the expiry of such period of twenty-one days, he may continue to provide the facility of such access;

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Source: The Copyright (Amendment) Act, 2012, available at:  
[http://www.copyright.gov.in/Documents/CRACT\\_AMNDMNT\\_2012.pdf](http://www.copyright.gov.in/Documents/CRACT_AMNDMNT_2012.pdf)

Therefore, according to the Copyright Act, exemption from liability is only available to intermediaries who facilitate “transient and incidental storage of work for providing electronic links, access or integration”. However, “transient” and “incidental” have not been defined in the enactment. This lack of precision makes the future application of the recent amendments to the Copyright Act unpredictable.<sup>9</sup> Thus it is to be expected that online intermediaries will have to face substantial legal risks and costs before court jurisprudence can add clarity to the boundaries in which they have to operate.

Finally, the legal regime has been criticised for the mismatch between the copyright legislation and the IT Act legislation on a detailed yet important point.<sup>10</sup> In fact, Rule 3(2) of the Information Technology (Intermediary guidelines) Rules, 2011 states that an intermediary will not be liable if it takes down certain content, among other things in response to notifications of parties aggrieved for reasons of alleged copyright infringement. No further specifications are added in this respect. Thus, under the IT Act Intermediary Rules there is no obligation on the intermediary to restore access to the content in case the copyright infringement allegation was unfounded. On the contrary, such an obligation is imposed on online intermediaries according to the copyright legislation.

## **2.2 The business impact of managing intermediary liability**

The intermediary liability regime in India has generated criticism from Indian commentators due to implications of restricting freedom of speech and other constitutional rights, such as freedom to set up business. However, as economists, our particular interest is what impact the existing rules have on the businesses which they affect.

Based on interviews with a range of players, which include both home-grown Indian ventures and Indian firms which are part of international groups, we have realised that online intermediaries face a burden of costs and risks which are associated with the current legal regime – costs and risks that could be much reduced with improvements in the

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<sup>9</sup> India Law and Technology Blog, interviews with legal experts

<sup>10</sup> India Law and Technology Blog, interviews with legal experts

rules. For instance, it is costly for intermediaries to have the legal resources to determine the legality of the takedown notices they receive. It is also costly to handle legal processes across the various local jurisdictions that are relevant within the Indian federal judicial system. Of course, there will always be some costs of these kinds, but in the current situation there are excessive costs with no benefits associated.

This is not a phenomenon restricted to some specific businesses and high-profile cases but instead is quite widespread. Companies which perform online intermediary activities have gone through a large number of court cases.<sup>11</sup> Table 3 shows a range of these court cases; note that this is an illustrative and not exhaustive list of cases.

**Table 3 Examples - court cases involving online intermediaries**

Case	Court
Ahmad Zamal	Allahabad High Court
Visaka Industries Limited	Andhra Pradesh High Court
Dr. Ashwin B. Mehta	Mumbai High Court
Maulana Mahmood Masad Madani	Delhi High Court
Nirmaljit Singh Narula v. Indijobs	Delhi High Court
Super Cassettes Industries Limited v. Rediff, Myspace, et al.	Delhi High Court
Jitender Bagga et al.	Delhi High Court
V.R. Radhakrishnan et al.	Kerala High Court
M/s.R.K. Productions Private Ltd	Madras High Court
Shaheen Dadha, Renu Srinivasan	Palghar Sessions Court
Vinay Rai v. Google, Facebook	Delhi High Court
Sharda University v. Mouthshut.com	Bombay High Court
Doctor Health Clinic v. Mouthshut.com	Bangalore Civil Court
Kumar Builders	Pune Court
Mufti Aijaz Arshad Qasmi	Delhi High Court
Sify / Amway	N/A

Source: Copenhagen Economics, based on interviews with legal experts

A very telling example of Indian online businesses which are detrimentally affected by shortcomings in the legislation is the consumer review platform Mouthshut.com. Mouthshut.com is a user-generated content website, which allows Indian consumers to post product or service reviews (similar to other international sites such as Yelp, Ciao.co.uk, DooYoo) (see Box 11).

Mouthshut.com covers 600,000-700,000 products within 300 categories. In fact, Indian consumers value access to reviews and, for instance, more than 60 per cent of people with internet access read a review online before watching a movie. The firm plans to expand its business by pursuing multiple revenue streams:

- Advertising
- Subscription model for brands (who can then contact users after reviews, etc.)

<sup>11</sup> India Law and Technology Blog, interviews with Indian online intermediaries and legal experts

- E-commerce enabler, earning commission when viewers click through to a reviewed firm's website, leading to e-purchases
- Integration into reviewed firms' CRM processes, with the Mouthshut.com platform used by those firms to gain feedback after online or offline purchases

Moreover, according to standard economic theory, the perfect functioning of a market requires that perfect information about supply and demand is freely and widely available – one of the most important conditions to avoid market failures. Review websites such as Mouthshut.com help move the real world a bit closer to the economic theory benchmarks by allowing consumers to gain valuable information on supply. On the other hand, Mouthshut.com has also started to help suppliers understand demand better.

Thus, if there were no review sites, it would be a strong loss for both Indian consumers and for the best-performing Indian businesses across any product or service area, whose value would not be recognised. Moreover, review sites enable business (online or offline) even where the sites do not capture the externality of the value of the review information shared on their site.

However, this entrepreneurial success story is unfortunately also a cautionary tale for budding Indian online entrepreneurs, showing the unwarranted constraints that legal uncertainty puts on internet business growth in India (cf. Box 11).

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**Box 11 Mouthshut.com: the burden of managing unwarranted legal risk**

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Since its inception, Mouthshut.com has been subject to legal challenges from aggrieved businesses for the mere reason that a website user posted a review whose content was questioned by the business. What started as two to three legal notices per month has now grown to approximately 100 per month. This deluge of legal threats creates three obstacles to business growth.

First, Mouthshut.com has to run higher staff costs to handle this barrage of legal claims: a team of five people on top of executive time. According to Mouthshut's CEO and founder, Faisal Farooqui, this team working on intermediary liability issues is one of the largest amongst online firms in India (which include large international online firms). If Mouthshut.com had to monitor all the user-generated content, then they would no longer be competitive in the marketplace.

Second, if user reviews challenged by the businesses reviewed had to be removed, this would curtail the users' very incentive to read reviews on the website – since users could rightly assume that results could be biased by the businesses' legal actions. This would hit any reviews website business model fundamentally.

Third, the systematic removal of user reviews would have a chilling effect on citizens' expression online, leading to vast consumer detriment and reduction of citizens' freedom. According to Faisal Farooqui, "the concept of being honest online will go away" since potential reviewers will be scared by the removal of certain reviews. This has also, in his view, a strong business implication as, with greater legal clarity, there could be more new Indian internet players, both in the same space as Mouthshut.com and in other areas. For instance, there could be more social media players beyond Facebook and, in general, more Indian home-grown start-ups founded by staff of the large international internet companies.

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Source: Copenhagen Economics

Beyond the impact that the present rules have on the business of a now established company such as Mouthshut.com, the rules can also have a detrimental impact on new ventures, which in economic terms can be quite damaging. Faisal Farooqui's experience as a start-up founder, and more recently as a business mentor to start-ups, shows that intermediary liability rules in India can affect small intermediaries. According to him, for start-up entrepreneurs the emotional aspect of dealing with legal challenges is huge: the large liability headache is disruptive as it saps the energy out of the entrepreneurial project. On the contrary, a start-up CEO should be focused on growing the business.

According to Faisal Farooqui, several firms other than Mouthshut face the same issues. Ultimately, "India's knowledge economy will not prosper under the present intermediary liability rules". In turn, this is sad news for Indian economic growth, which is more than ever dependent on realising all the growth potential from its internet sector.

**Heterogeneity in enforcement and legal uncertainty**

A key consideration when assessing the business impact on intermediaries of legal uncertainty is that this is much compounded by the heterogeneity in law enforcement across the country. Moreover, it would appear that over time there is very limited (or slow) convergence in enforcement practices. We have become aware of a considerable number of

cases involving online intermediaries in India (cf. Table 3). These show a material degree of heterogeneity in how judiciary power and police enforcement have been administered. In particular, when online intermediaries are involved in a legal case, they face much heterogeneity across State courts and at different court levels.<sup>12</sup>

For a firm wishing to invest in serving customer needs across the whole of India, the fact that the wording of the law and regulations allow this heterogeneity provides a clear disincentive to roll out services across India and instead will stick to what is more familiar. However, this runs against the spirit of internet businesses, which succeed when internet connectivity can provide access to markets irrespective of location.

Any disruption to the development of online intermediaries risks diminishing the development potential of the Indian e-commerce economy. In fact, online intermediaries contribute to e-commerce just as intermediaries in general can contribute to bricks-and-mortar commerce. In fact, in the “offline world”, retailers with own-brand stores also sell in department stores or open up shops within malls run by third-party intermediary companies (which focus on other functions like managing the real estate, etc.).

However, while the rules informing the behaviour of offline (e.g. bricks-and-mortar) intermediaries are clearly understood by all parties, this is not the same in the online sphere, as shown in the following box.

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<sup>12</sup> Interviews with legal experts

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**Box 12 eBay.in: what scope for intermediary liability?**

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eBay India has noted that the regulatory framework for intermediaries in India presents some legal uncertainty which can affect the business. While the 2008 IT Act revision mainly focused on specifying what an intermediary should not do to qualify for safeguard, the positive “what to do” was not equally covered. While the 2011 Intermediary Guidelines have provided more information on the timeline for intermediaries to act on a notification, not many judicial pronouncements have been issued to support this. Furthermore, considerable variation remains in the enforcement of the IT Act across States: it seems as if in some States the provisions of the IT Act are not understood in full among the officers overseeing their enforcement.

The company has been sued notwithstanding the provision which should in theory safeguard online intermediaries. In fact, SSIL sued eBay India when counterfeit goods were listed on its website, seeking that eBay should monitor proactively the content listed. eBay opposed this on grounds of the impracticality to monitor all content and that it would lose its intermediary status and safeguard if it did so. In April 2013, the Indian Supreme court agreed with eBay’s position. The court specified that, in case there were any further eBay listings of products affecting SSIL, it was the latter’s responsibility to notify eBay.

In conclusion, according to eBay India, IT Act liability rules remain a key backdrop for any entrant wishing to run an intermediary business in India. In fact, the liability regime creates a disadvantage for all intermediaries, even if the wider growth potential in India is fortunately a source of some attraction to developing entrepreneurship and investment in internet businesses. Thus internet firms will still enter this space, yet it appears that the full potential of the Indian (internet) economy is not being realised due to constraints such as the liability rules applicable to online intermediaries.

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Source: Copenhagen Economics

A further example which provides much food for thought is that of Quikr.in, a home-grown Indian internet intermediary. The company is exposed to legal risks due to its online intermediary business model, but at the same time it also finds legal channels obviously insufficient to redress its own grievances vis à vis unlawful behaviour against its site.

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**Box 13 Quikr.com**

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Quikr is an Indian company which allows sellers and buyers to post classified ads, which are then seen by online audiences interested in the various categories covered. Those who contribute to user-generated content (posting a classified ad) can obtain this service for free, while the site generates revenue via related advertisements.

Like many other online firms in India, Quikr maintains a team specifically dedicated to monitoring all user-generated content and searching for anything contentious which could expose the firm to the threat of litigation or in general might affect the user experience. This is no small team: in fact, Quikr employs 100 people to monitor content out of a full-time staff of 400.

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Source: Economist Intelligence Unit

Cases such as that of Quikr show that the legal and regulatory environment underpinning the operation of an Indian online intermediary presents issues of over-enforcement. This

is because firms like Quikr have to bear higher costs due to a high risk of being sued for third-party content (even with the existing intermediary liability safeguards). Reducing this unjustified risk is a reason why online intermediaries maintain a content-monitoring team.

The misguided level of legal protection surrounding intermediaries results in higher costs of doing business. This can only discourage a greater level of entrepreneurship and growth in this area.

### **2.3 Ways to improve the rules for intermediaries**

In this chapter, we have so far presented the key features of the liability framework for online intermediaries operating in India. Many challenges have been highlighted, all of which affect the performance of the Indian internet economy. Thereafter, we have discussed the business impact of the shortcomings in the legal regime.

However, all is certainly not lost for India, which has made considerable efforts over the past years to ameliorate the legislative framework. Past efforts were aimed at keeping up with technology and market developments – a challenge shared by legislators in all major economies, not just in India.

We consider that a set of incremental ameliorations to the current framework can do much to remove barriers to enhanced growth for online intermediaries. The best-suited means for legislators to provide these changes would be a revision of the 2011 Intermediary Guidelines – a revision which, in fact, was the subject of a cross-party informal agreement at the time when the Guidelines were passed.<sup>13</sup> 2011 may seem recent, but given the speed at which internet markets in India are being reshaped and developed, this is not necessarily so. In fact, policymakers wishing to tap into the internet engine of growth for India may find that now is the right time to consider simple yet effective changes to the 2011 Intermediary Guidelines.

Technologies in the internet sphere continue to evolve fast and contribute to making rules less up-to-date over time – and internet time runs fast. As the internet industry context evolves, rules can become less effective and place a brake on potential business growth. As internet technologies and market changes vault national borders, keeping rules up-to-date is a challenge for policymakers across the globe.

For instance, since 2011 EU decision-makers have fostered developments that are strengthening the safe harbour for online intermediaries, by reducing the legal uncertainty faced by them. First, in 2012, the European Commission adopted a Communication presenting 16 targeted initiatives aimed at doubling the share of e-commerce in retail sales.<sup>14</sup> Its action plan aimed, inter alia, to improve the rules informing how internet firms and enforcement agencies manage the removal of illegal content – by setting up a hori-

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<sup>13</sup> Interviews with legal experts

<sup>14</sup> European Commission Communication “A coherent framework to build trust in the Digital single market for e-commerce and online services”. COM(2011) 942. Available at: [http://ec.europa.eu/internal\\_market/e-commerce/communications/2012/index\\_en.htm](http://ec.europa.eu/internal_market/e-commerce/communications/2012/index_en.htm)

zontal European framework for notice and action procedures. Second, the Court of Justice of the EU issued important decisions reinforcing the principle that an online intermediary should never be subjected to proactive monitoring obligations, e.g. searching for similar content to that at a specific URL, or searching for similar content that might appear in the future.<sup>15</sup>

These recent developments in Europe show the value of increasing legal certainty for online intermediaries. The EU experience is particularly relevant to India since the Indian IT Act 2008 is based on the same concepts and approach as the EU e-commerce directive. Given this similarity, the latest developments in Europe are a clear signal that India also should benefit from considering strengthening its safe harbour regime for online intermediaries.

Given the challenges that we have observed as part of our discussion of the relevant legal framework in India, we consider that the following types of revisions could deliver great benefits to the Indian online intermediary ecosystem (and thus indirectly to all users):

- A clear statement of intent in the Guidelines, specifying explicitly the imperative to safeguard intermediaries from liability where a third party is the source of the content at stake
- Qualified immunity for intermediaries, as long as they comply with court orders, e.g. on content takedown or disclosure of user identity to aggrieved parties

We consider that many implementation problems have emerged in India since the 2008 reform of the IT Act. India's federal constitutional framework and the wide degree of diversity in State-level and local enforcement imply that vaguely written legislation (whether primary or secondary) can lead to much heterogeneous enforcement. For online firms, whose life and death depends on the ability to scale fast and roll out services across the entire country (and also internationally), this legal heterogeneity creates a great barrier to growth. This lesson had not been fully learned at the time of the 2011 Intermediary Guidelines.

Thus, it is mindful of this lesson that we have proposed the above changes to the 2011 Intermediary Guidelines, since we reckon that they would help make the legal framework as easy and clear to implement as possible. They would provide the clearest possible signal from Government about the need to maintain a balanced approach to enforcement in the internet intermediary area and to ensure clear compliance by intermediaries and clear expectations by aggrieved parties as to what can be achieved via legal recourse.

Updated Intermediary Guidelines would likely enable Indian online intermediaries and their users (firms and consumers) to generate the full potential in terms of economic gains over the next few years. Moreover, any improvements in the online intermediary ecosystem can also have a wider impact on India's internet economy. In fact, in a country where the take-up of internet access has still a great potential ahead, content (such as that mediated by online intermediaries) and infrastructure (such as internet connectivity) are complements.

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<sup>15</sup> Court of Justice of the European Union decisions SABAM v. Scarlet and SABAM v. Netlog NV

In other words, better-functioning online intermediaries can promote wider content (e.g. social media and e-commerce handled in a wider range of local languages) and thus promote demand (and ultimately supply) of internet access. Furthermore, improving the rules surrounding internet intermediaries is a policy measure that involves no government budget expense and yet – by simply reducing legal uncertainty – it can help generate wider economic benefits and promote growth in India.

## Chapter 3

# Economic impact of online intermediaries in India

While still in its infancy, the Indian Internet economy offers substantial growth potential. As described in Chapter 1, online intermediaries play a central role in the Internet economy and heavily depend on a predictable limited liability regime. As discussed in Chapter 2, such framework conditions are not present in India today.

To shed light on the magnitude of the potential economic impact of online intermediaries, we have quantified the potential share of Indian Gross Domestic Product (GDP) attributable to online intermediaries in 2015. We have based our estimates on existing forecasts covering the economic impact of the entire Indian Internet economy and carved out the share relating to online intermediaries. Those intermediaries rely on the liability regime in order to function and grow.

**We conclude that online intermediaries can become an important part of India's Internet economy. Their GDP contribution may increase to more than 1.3 per cent by 2015 (\$41 billion) – provided that the liability regime is improved.**

**In addition, an expansion of service provision from online intermediaries to a bigger share of the population will boost positive productivity effects and generate a consumer surplus from free services (such as web search, reviews, free access to information, etc.).**

### 3.1 Potential GDP impact by 2015

In this section, we quantify how much economic activity and growth is at stake, if important framework conditions for online intermediaries, in particular an adequate limited liability regime, are not put in place. In assessing the share of GDP attributable to online intermediaries, we have used the expenditure approach. We rely on the methodology outlined in the OECD Digital Economy Paper, No. 226, “Measuring the Internet Economy”, which has also been used in several studies on the impact of the Internet economy in different countries around the world.

Total GDP consists of household consumption, government spending, private investment, and net export. To assess the contribution from online intermediaries, we identify, quantify, and aggregate online intermediary activities, contributing to each of these GDP elements.

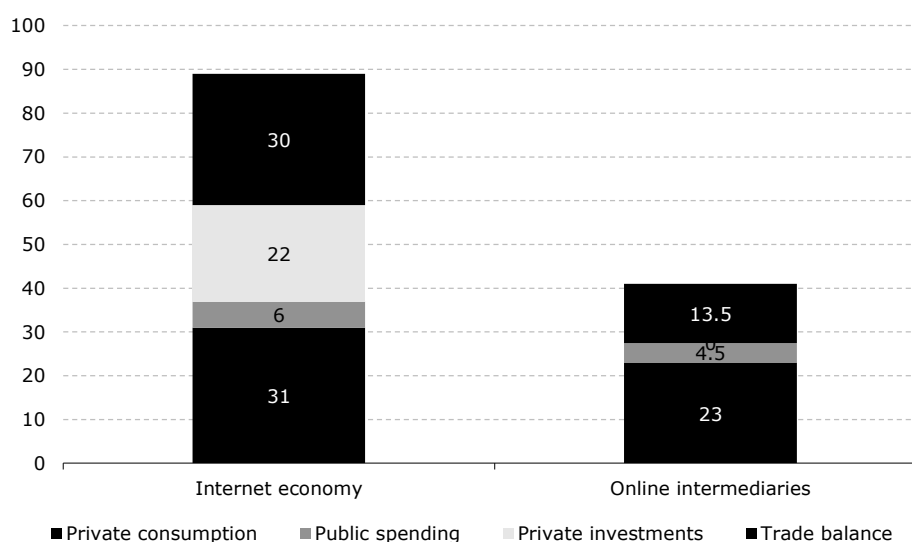
**Private consumption** attributable to online intermediary activity has a potential of at least \$23 billion by 2015. Potential **government spending** amounts to at least \$4.5 billion in 2015. Both estimates consist of three elements:

1. *E-commerce conducted on an e-commerce platform*, such as in an electronic marketplace. We base our estimate on total B2C e-commerce revenue figures for India's largest e-retailers.
2. *Internet access expenditures*. Internet Service Providers are by definition online intermediaries, their revenue adding to the direct GDP contribution of the sector.
3. *The share of ICT spending related to use on online intermediaries*. Our estimate is based on existing forecasts for Internet-related ICT expenditures and available data on how consumers use the Internet.

**Private investments** are left out of our calculation. Similar to our intermediary study for Europe from 2012, we have no basis for assessing how big a share of private investment comes from intermediary services; hence we do not include it in the GDP estimate. Depending on the magnitude of Internet investments that involve digital intermediation services, we will underestimate the GDP contribution.

**Trade balance** is comprised by the last element in the calculation. Imports and exports of ICT and e-commerce goods and services both contribute to the trade balance. Our conservative estimate forecasts that the trade balance amounts to at least \$13.5 billion.

**Figure 2 Gross share of GDP attributable to the Internet economy and to online intermediaries, 2015, forecast**



Note: Based on the expenditure approach

Source: Copenhagen Economics based on Internet retailer ASIA TOP 500 GUIDE, pp. 36-37, comScore MMX and McKinsey & Company, "Online and upcoming: The Internet's impact on India", pp. 5

### 3.2 Contribution beyond GDP

While the previous section illustrates potential direct GDP contributions from online intermediaries, we are well aware that the economic benefits of online intermediaries expand beyond measures that can be quantified with confidence, such as GDP. In line with what we have found to be the case when evaluating the impact of online intermediaries elsewhere (for example, across Europe), we consider a series of channels by which the activities of intermediaries contribute to social welfare.

In this section, we qualitatively describe these “beyond GDP” effects. We also discuss which effects are likely to be of particular significance in the context of economic growth in India.

#### Productivity effects

Over time, a range of positive productivity effects increase Indian social welfare through intermediary activities. These effects have both static and dynamic components. In other words, the activities of online intermediaries not only immediately make other sectors of the economy more productive, but they can also induce greater productivity in these sectors over time.

There is a broad range of channels by which these effects can have an impact on overall economic activity in India. In practice, the greatest benefits are likely to emerge from **more efficient procurement, search and scale effects, and from cloud computing**. These can be described as follows:

- e-procurement makes it easier for both private and public sector organisations to find inputs at lower prices, improving competitiveness and, as a result, increasing the number of potential buyers over time.
- e-sales makes it easier to reach customers and thus increases the productivity of the sales force. A Eurostat analysis found that a 10 per cent increase in e-sales leads to a 3.1 per cent increase in productivity in the wholesale and retail sectors.<sup>16</sup>
- Productivity effects from lower search costs. These effects were first identified in the work by Varian<sup>17</sup>; greater productivity is a result of time saved by private and public sector employees who use online search tools instead of conducting re-search using offline resources such as a library.
- Cloud computing offers scale effects to businesses and consumers who can access software, scalable storage, and IT infrastructure via the Internet.

Thus, due to the economic impact channels identified and described above and on top of the direct GDP contribution from online intermediaries, the Indian economy will benefit from increased productivity. **Compared to areas such as Europe or the US, we would expect that online intermediaries can create an even greater impact in the area of e-procurement and e-sales in India. Limitations in infrastructure and the availability of structured information create a greater opportunity for online intermediaries to boost productivity in India via e-procurement and e-sales.**

### Further impact

Moreover, there is a different set of effects that are part of the “beyond GDP” economic contributions yet which are unrelated to productivity considerations. We have identified four such major contributions as follows:

- Business-to-business (B2B) platform-related revenues are an entity that was not included within the components of the GDP impact estimates presented in the previous section.<sup>18</sup> Online intermediaries enable not just transactions involving consumers but also B2B. According to the IAMAI ICT adoption survey on Online B2B, Indian platform-related B2B e-commerce transactions were worth \$31 billion in 2007.
- Online advertising generates revenue for the advertisers; moreover, the gain that advertisers obtain from placing online ads is likely to be equal or higher than the cost of the online ad itself.
- Cultural diversity is another channel by which online intermediaries can contribute to Indian society. Benefits generated include demand-side effects, such as easier access to a wider choice of content for Indian citizens. Secondly, they en-

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<sup>16</sup> Eurostat (2008), “Information society: ICT impact assessment by linking data from different sources”, available at: [http://epp.eurostat.ec.europa.eu/portal/page/portal/information\\_society/methodology](http://epp.eurostat.ec.europa.eu/portal/page/portal/information_society/methodology)

<sup>17</sup> Varian (2011), “Economic value of Google”, available at: <http://cdn.oreillystatic.com/en/assets/1/event/57/The%20Economic%20Impact%20of%20Google%20Presentation.pdf>

<sup>18</sup> This is because, consistent with the expenditure approach to estimating GDP, direct GDP impact should reflect only final retail sales to consumers rather than intermediate transactions.

compass supply-side effects: online intermediaries make it easier and cheaper to supply new cultural content and enhance free speech.

- Consumers benefit from free services, reflected in the consumer surplus that is obtained when consumers do not pay for services for which they would be willing to pay, less any loss of consumer value due to exposure to advertisements; these include externalities from online services to offline.

The major impact channel we would like to highlight as particularly relevant for India is the consumer benefit from free services. Online search is usually the type of service that comes to mind everywhere in the world when considering free services provided by online intermediaries. But the spectrum is much wider: a user who accesses consumer reviews collected for a specific brand or product is also the beneficiary of a free service. An economy without review sites would be a setback for both Indian consumers and the best-performing Indian businesses across any product or service area. Without reviews, a signalling issue arises where the true value of good and bad companies remains hidden. Moreover, review sites induce consumers not only to shop online (which would be captured by our direct GDP estimates) but also to conduct transactions offline. An instance of this occurs when people shop for clothing online and then visit a store to try on items. When this happens, the online intermediary does not gain any monetary value, but its services generate a positive externality on (offline) trade.

We would like to conclude by stressing the pivotal role of online intermediaries in promoting cultural diversity in India. Different classes of online intermediaries stand to contribute enormously by enabling citizens to add diverse, creative, and unique contributions to the web. First, ISPs can allow users across India to communicate and express their views (including private communication like email). Second, social media platforms and other sites enabling user-generated content allow Indian citizens to create content and disseminate it in an interactive way, thereby contributing to public debates and enriching the cultural capital of India. Lastly, all of the above forms of communication (enabled by online intermediaries) can disseminate, change, and enrich viewpoints across different cultures and languages and shape a more closely connected and diverse India.

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