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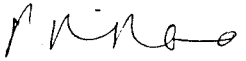
FROM THE PRINCIPAL'S DESK

Constant new legislation has become a necessity to meet the demands of a frenetically changing world and society. Law students today have a challenging task of not only assimilating and analysing the implications of modern laws but also to review the changing applicability and relevance of established laws in contemporary times. A college Law Review provides an excellent opportunity for the students to explore the depths of the ocean of legal knowledge and perhaps add to it a small drop of their own.

Articles in this issue of the Law Review revisit amendments to old legislations as well as give a fine insight into most recent – Corporate, International, Procedural and IPR related laws. The rich blend of topics and the fact that some articles have been written by junior students augurs well for our institution.

Articles submitted for publication are evaluated by the Law Review Committee of the college. The short listed ones are then sent to members of the Editorial Board. Changes, comments and suggestions of the editors are incorporated prior to submission to the Editor-in-Chief for the final round of editing.

Our Editorial Board consists of some of the most distinguished legal personalities in the country. I thank them for devoting their time and imparting their expertise to ensure the high standard of this publication. I am grateful to our contributories, who as in the past continue to be our pillars of strength, for their spontaneous and wholehearted support. Lastly, I am proud of the faculty and students of the Law Review Committee whose painstaking hard work has made this Law Review in form and substance easily one of the best amongst such publications.



Mrs. P. R. Rao

Principal, Government Law College

FOREWORD

I have great pleasure in writing this brief introduction to this issue of the Law Review of the Government Law College, Mumbai.

All the articles published in the Law Review are an eloquent tribute to the scholarship of the students. The articles published herein show that the writers have spent considerable time in studying their respective subjects. The writers have elaborated upon their subjects with remarkable depth and understanding.

Meghna Rajadhyaksha's article on "*Universal Jurisdiction in International Law*" has put the position succinctly by saying that the concept of universal jurisdiction has no fixed definition in International Law, and therefore, all definitions of 'universal jurisdiction' are derived from the writings of scholars and international jurists.

Nandish Vyas and Durgaprasad Sabnis' article on "*The Governor's Power to Dissolve the Legislative Assembly*" deals with the relatively unexplored areas of the Indian Constitution, which involve sensitive issues in relation to the Governor's power to dissolve the Legislative Assembly. It has been a sad experience that the said power is occasionally used for purposes for which it is not designed.

Pinakin Masurekar and Krunal Gadhia's article on "*Women And the Coparcenary Law - Unsolved Questions*" deals with the legal aberration of the exclusion of daughters from participating in the ownership of co-parcenary property, merely by reason of their sex. I am sure that the young ladies of today will take a clue and inspiration from the article. They ought to fight for their rights with a missionary zeal.

Rukhmini Bobde's article on "*Data Protection and the Indian BPO Industry*" deals with a topic of recent growth relating to Business Process Outsourcing. The author has rightly underscored the unprecedented growth in offshore outsourcing of business processes in developing countries like India, China and the Philippines.

Venkateshwar Satyanarayan's article on "*Governmental Secrecy and Right to Information*" deals in depth with various aspects of Governmental secrecy in relation to people's Right to Information. The author has highlighted effectively how *The Official Secrets Act, 1923*, was designed by the British for protecting their own imperial interest and keeping the Indians under subjugation and control.

Swanand Ganoo's article on "*A Teetotaller's Tall Claims*" deals with a subject which ought to engage the keenest attention of the youth today. It is a disturbing thought that, according to the writer, the youth of today are being swept away into a world of controlled alcoholism. It is sad and disturbing that the observation of

the writer discloses that any gathering of today's youth in metropolitan cities is befogged by bottles of champagne and occasional beer brawls.

Juthika D. Choksi's article on "*The Sarbanes Oxley Act, 2002: Implications for India*" deals with a branch of law with which even the people of law are not very familiar. Truly, as the author says, the unearthing of scams has produced a debilitating effect on investors' confidence, which has triggered intense introspection in the corporate world.

Ashish Aggarwal's article on "*The Arbitration and Conciliation Act, 1996: In Search of a Complete Code*" answers the need for a true exposition of the implications of the Arbitration Act of 1996. The author has, frankly but respectfully, discussed the judgments of the High Courts and the Supreme Court. His assessment of the judgment of the Supreme Court in *Bhatia International* v. *Bulk Trading S.A.* is thought provoking.

Hariharan G's article on "*Basmati, Turmeric and Neem – Patenting and Related Issues*" deals with the burning topic of the day. The intellectual property rights, as observed by the author, have come under intense scrutiny in the light of grant of patents to Basmati, Turmeric and Neem. Every Indian ought to be concerned with the patents claimed and granted in respect of these articles of food.

Gauri N. Walawalkar's article on "*Securitisation: Bankruptcy Remoteness and other issues*" contains a precious observation that the passing of any Act is but the first manifestation of the process of crystallization and that the flesh and blood gets infused in an Act only after years of judicial interpretation.

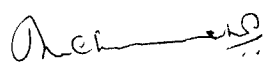
Shibani A. Rao's article on "*The Illegal Proliferation of Small Arms – A Global Dilemma*" expatiates upon the famous saying of Kofi Annan, Secretary General of the United Nations, that "*there is probably no single tool of conflict so widespread, so easily available and so difficult to restrict as small arms*". In the world of today, we are sadly experiencing the proliferation of small arms, which has shaken the foundations of the civilised society.

Kruti Desai's article on "*Defence Mechanisms Under the Takeover Code*" examines whether the procedural requirements of the Takeover Code are lax as compared with the other codes which operate in countries like the US and U.K. Her view that the Takeover Code tends to takeovers goes to the root of the problem and requires a serious consideration.

The article "*The Dawn of Copytrust*" by Ashika Visram deals with a subject which has contemporary relevance. The hypothesis of the writer that Copyright Law is not suited to deal with the problem of Natural Monopoly Formation in Computer Operating Systems is a novel concept. But, more novel the view of a

writer, the more demanding it is that the reader looks at the writer's point of view with an open mind.

It is a happy thought that all the articles are written by students of the Government Law College. It augurs well for the writers and the Institution which they have enriched by their deep and abiding interest in Law and Justice. It is difficult to say which particular article can be ranked as the best but I can say confidently that each article is better than the best.



Mr. Justice Y. V. Chandrachud (Retd.)
Former Chief Justice of India

UNIVERSAL JURISDICTION IN INTERNATIONAL LAW[†]

Meghna Rajadhyaksha[*]

I. INTRODUCTION

The concept of universal jurisdiction has no fixed definition in International Law. There is no treaty or convention that clearly mentions the term. Hence all definitions of universal jurisdiction are derived from the writings of scholars and other modern international jurists. In January 2001, a body comprising of such eminent persons assembled at Princeton, USA drafted a body of principles known as the Princeton Principles on Universal Jurisdiction.[1] They defined universal jurisdiction as: "*...criminal jurisdiction based solely on the nature of the crime, without regard to where the crime was committed, the nationality of the alleged or convicted perpetrator, the nationality of the victim, or any other connection to the State exercising such jurisdiction.*"

Another often quoted definition states: "*Universal Jurisdiction provides every state with jurisdiction over a limited category of offences generally recognised as of universal concern, regardless of the situs of the offence and the nationalities of the offender and the offended. While the other jurisdictional bases demand direct connections between the prosecuting state and the offense, the universality principle assumes that every state has an interest in exercising jurisdiction to combat egregious offences that states universally have condemned.*"[2]

Criminal jurisdiction in International Law has traditionally limited itself to crimes that have some connection to the prosecuting State. There are, thus five traditionally acknowledged principles on which States base such jurisdiction. The 'Territoriality' principle provides for jurisdiction over offences that occur in the State's territory. It includes offences that have a direct effect on the State's territory or are committed on board a craft flying the flag of the State. The

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[†] This article reflects the position of law as on March 15, 2003.

[*] The author is a student of Government Law College, Mumbai and is presently studying in the First Year of the Five Year Law Course.

[1] Princeton Principles on Universal Jurisdiction, 2000, Program in Law and Public Affairs, Princeton University, at 28.

[2] Kenneth C. Randall, "Universal Jurisdiction in International Law", *Texas Law Review*, 66 Tex. L. Rev. 785, March 1998 at 788. *See also* Doug Cassel, "Symposium: Universal Jurisdiction: Myths, Realities, and Prospects: Empowering United States Courts to Hear Crimes Within the Jurisdiction of the International Criminal Court", *New England Law Review*, 35 New Eng. L. Rev. 421 at 428 (2001).

'Nationality' principle applies to acts committed by the nationals of the State, irrespective of the locus of the offence. The 'Passive Personality' principle concerns offences in which the victim is a national of the prosecuting State and the 'Protective Personality' principle comes into play when an extraterritorial act threatens the State's security or a basic governmental function.[3]

The principle of *aut dedere aut judicare* is the one most closely allied to universal jurisdiction. It enjoins upon States the duty to either extradite or prosecute offenders found on their territory.[4] Scholars have often used this term interchangeably with universal jurisdiction. *Aut dedere aut judicare* is generally found as a clause in various treaties and conventions.

All these principles, however, failed to punish or censure offences that occurred in regions and States where there was either a lack of authority or a lack of will to try the offenders. The lack of authority was noticeable in the crimes of piracy and slave trade. Piracy occurred on the high seas, where no State could claim sovereignty. Slave trade was a transnational offence – the trader and the slave could be from different countries and the eventual destination of the slave could be a third nation. In both these offences, no one State could exercise complete authority over the criminal. Terrorism, hijacking and international trafficking of women and children are modern offences that evidence such a conflict of judicial authority of several States.

The lack of will to enforce the law was evidenced in crimes committed during armed conflicts – war crimes, genocide and crimes against humanity. In international armed conflicts, the defeated State suffered a total collapse of all systems including legislative and judicial mechanisms. The victorious State, on the other hand, showed no interest in prosecuting its own officials for justice in the conquered territories. The situation was even worse in internal armed conflicts, like those in Chile, Argentina, Cambodia and Rwanda. They saw violent revolutions in which the parties that won the struggle and formed governments were themselves responsible for several egregious human rights abuses. In such cases, justice and relief were out of question. Suppression of dissent and an absence of accountability were the hallmarks of such regimes.

In this background, the concept of universal jurisdiction developed on the ideal that there are certain crimes so abhorrent to every sense of humanity that all nations have an interest in suppressing them. However, universal jurisdiction still remains a developing concept in International Law, without well-defined principles or standards.

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3 Ian Brownlie, *Principles of Public International Law* at 298-303 (Oxford University Press 3rd ed. 1973).

4 C. Enache-Brown and A. Fried, "Universal Crime, Jurisdiction and Duty: The Obligation of *aut dedere aut judicare* in International Law", *McGill Law Journal*, 43, McGill L.J. 613 (1998).

II. Evolution Of Universal Jurisdiction

A. Piracy

Piracy was the first crime for which universal jurisdiction was recognised uniformly. It was a common evil facing trade and commerce of all nations for centuries. With the arrival of the Industrial Revolution and the increasing dependence of Europe on sea-routes for trade, the law of piracy and its jurisdictional applications were developed in the domestic laws of most sea faring nations between the 1600s and 1800s.[5]

Piracy is generally committed only over the high seas and outside the territorial jurisdiction of States. With the development of the concept of 'freedom on the high seas', States began to recognise that all nations had an equal right to navigate the high seas, and that no State could claim sovereignty over them. Hence security on these waters was a matter of concern to all nations and they had an interest in suppressing acts that threatened such security.[6]

Piracy also saw an absence of the authority of any one nation to assert complete jurisdiction. In most cases, the victim and the offender belonged to different nations. In the case of merchant vessels, the State to which the goods were bound also had an interest in the matter. In the face of such conflicts, universal jurisdiction allowed any State that could apprehend the offender the right to punish him.

The universal condemnation of pirates also came from the concept of *hostis humani generis* or 'enemy of all mankind'[7]. Acts of piracy were considered particularly heinous offences[8] of violence and depredation[9], committed indiscriminately against subjects and properties of all nations. Thus, piracy was first recognised as an offence inviting universal jurisdiction under customary International Law.[10]

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5 M. Cherif Bassiouni, "Universal Jurisdiction for International Crimes: Historical Perspectives and Contemporary Practice", *Virginia Journal of International Law*, 42 Va. J. Int'l L. 81 (2001), at 110.

6 See Randall *supra* note 2 at 793.

7 *United States* v. *Brig Malek Adhel*, 43 U.S. (2 How.) 210, 232 (1844): "A pirate is deemed, and properly deemed, *hostis humani generis*... Because he commits hostilities upon the subjects and property of any or all nations without any regard to right or duty."

8 Bonnet's Trial, 15 State Trials (Howell) 1231, at 1235 (Am. Vice Adm. 1718).

9 Harvard Research in Int'l Law, Draft Convention and Comment on Piracy, *American Journal of International Law*, 26 Am. J. Int'l L. 739 at 743.

10 See *United States* v. *Smith*, 18 U.S. (5 Wheat.) 153, at 158 (1820); J. Brierly, *The Law Of Nations*, at 311-14 (Oxford University Press 6th ed.1963).

In the twentieth century, however, with the development of modern methods of travel and communication, piracy on the high seas ceased to be a serious problem. Yet, with the concreteness of International Law, treaties on the subject explicitly recognised universal jurisdiction for the offence. This is illustrated by Article 105 of *The United Nations Convention on the Law of the Sea, 1982*[11], which is identical to Article 19 of *The Convention on the High Seas, 1958*[12] (Convention).

In spite of its presence since ancient times, the definition of piracy has always been a problem. In as late as 1932, authors of Harvard Research in International Law concluded, "*there is no authoritative definition*".[13] The United Nations Sixth Committee, which negotiated the Convention agreed, after a heated debate, to define piracy as: "*Any illegal acts of violence, detention or any act of depredation, committed for private ends by the crew or the passengers of a private ship or a private aircraft...*"[14]

This definition emphasises the private nature of acts of piracy. State acts were excluded from it and hence the Convention aimed at preventing universal jurisdiction over piracy from being a source of interstate conflict.[15] However, piratical acts in this century are often not for private purposes as illustrated by the Achille Lauro incident[16] and the conventional definition fails to encompass these. Hence, though scholars still differ over the piratical acts that call for universal jurisdiction, there is general agreement that universal jurisdiction for the crime of piracy is firmly established in positive International Law[17].

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11 United Nations Convention on the Law of the Sea of December 10, 1982, U.N. DOC. A/CONF. 62/122, Article 19: "On the high seas, or in any other place outside the jurisdiction of any State, every State may seize a pirate ship or aircraft, or a ship taken by piracy and under the control of pirates, and arrest the persons and seize the property on board. The courts of the State which carried out the seizure may decide upon the penalties to be imposed, and may also determine the action to be taken with regard to the ships, aircraft or property, subject to the rights of third parties acting in good faith."

12 1958 Convention on the High Seas, 450 U.N.T.S. 82.

13 See Harvard Research *supra* note 9 at 749, noting: "a great variety in opinions as to the scope of the term."

14 1958 Convention, *supra* note 12, Article 15.

15 M.H. Morris, "Universal Jurisdiction: Myths, Realities, And Prospects: Universal Jurisdiction In A Divided World: Conference Remarks, *New England Law Review*, 35 New Eng. L. Rev. 337 (2001) at 340.

16 In October 1985, four armed Palestinian terrorists hijacked an Italian ship called Achille Lauro with 400 passengers on board. They demanded the release of fifty Palestinian prisoners held in Israel. *The New York Times*, Oct. 9, 1985, at A10, col. 1; The New York Times, October 10, 1985, at A11, col. 1; See also Randall *supra* note 2.

17 See Bassiouni *supra* note 5 at 111.

The *Lotus Case*[18] of 1927 before the Permanent Court of International Justice (PCIJ) commented on the jurisdictional principles on one such offence found analogous to piracy. The case was disputed between France and Turkey. On August 2, 1926, a French vessel *SS Lotus* collided with a Turkish one called the *Boz Court* resulting in the death of eight people on board the latter ship. Turkey arrested and tried the French lieutenant commanding *SS Lotus*. France challenged his conviction on the grounds that it violated International Law. In this context, the PCIJ held: "*International Law leaves States in this respect a wide measure of discretion, which is only limited in certain cases by prohibitive rules; as regards other cases, every State remains free to adopt the principles which it regards as best and most suitable.*"

In most subsequent crimes over which universal jurisdiction was exercised, the prosecuting courts found it necessary to draw an analogy between that particular crime and piracy. Piracy, therefore, is the quintessential crime recognised under universal jurisdiction.

B. Slave Trade And Slavery

After piracy, universal jurisdiction began to be recognised for the offences of slave trade and slavery. However, the essential difference between piracy and slave trade was that the former was always a criminal offence, but the latter evolved into a crime.[19] In fact, slave trading was legal in several civilised nations of the world till the late nineteeth century.[20]

The condemnation for slave trade came about because of its association with piracy. At the time when slave trade was at its highest, the sea was the main route for the transport and sale of slaves. In 1815, the Declaration of the Congress of Vienna equated traffic in slaves with piracy.[21] Hence the first treaties that accorded universal jurisdiction on the crime, required the offenders to be found on the high seas. Many of them were initiated by Great Britain in the nineteeth century and aimed at the suppression of the practice by targeting ships indulging in slave trade.[22] These treaties allowed naval vessels to board and search merchant vessels involved in slave traffic and provided details on how such

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18 "Lotus" Case P.C.I.J., Series A, No 10 (1927) available at www.worldcourts.com/pcij.

19 J.B. Jordan, "Universal Jurisdiction In A Dangerous World: A Weapon For All Nations Against International Crime", *Michigan State University-DCL Journal of International Law*, 9 MSU-DCL J. Int'l L. 1 (2000) at 11.

20 USA recognised the right to keep slaves until the Thirteenth Amendment of 1865 abolishing slavery; US Const. amend. XIII.

21 See Bassiouni *supra* note 5 at 113. *See also* http://www.udhr.org/history/timeline.htm

22 Treaty of Ghent, December 24, 1814, United States-Great Britain, Article 10, 8 Stat. 218, at 223, T.S. No. 109; Treaty for the Suppression of the African Slave Trade, December 20, 1841, 92 Parry's T.S. 437 at 441; Treaty for the Suppression of African Slave Trade, Apr. 7, 1862, United States-Great Britain, 12 Stat. 1225 at 1225-26, T.S. No. 126.

vessels should be detained and the offenders prosecuted.[23]

With the development of humanitarian law in the twentieth century, slavery began to be recognised as a heinous crime irrespective of its connection with the high seas or pirates. Between 1874 and 1996, there were forty-seven conventions relating to slavery, elevating the crime to the status of a *jus cogens*[24] international crime, inviting universal condemnation. However, whether such universal condemnation would also legitimise the exercise of universal jurisdiction is a question that such treaties have not resolved. In fact, no treaty on slavery explicitly recognises universal jurisdiction for the offence. Most of them require signatory states to take effective measures to prevent and suppress slavery, and also provide specific obligations as to criminalisation and punishment, extradition and mutual legal assistance. Such provisions can be best characterised as reflecting the concept of *aut dedere aut judicare.*

In fact, the decidedly neutral position of International Law on jurisdiction over slave trade is expressed in *The Convention for the Suppression of the Traffic in Persons and of the Exploitation of the Prostitution of Others, 1950*[25], Article 11 of which states: "*nothing in the present Convention shall be interpreted as determining the attitude of a Party towards the general question of the limits of criminal jurisdiction under International Law.*"

The practice of slavery has all but disappeared in the twentieth century, and where it exists, law does not protect it. This has made it simpler for States and jurists to recognise universal jurisdiction over the offence. However, there is very little State practice to evidence the application of the principle to all forms of slavery and slave-related practices, though it finds wide support in *opinio juris.*

C. *War Crimes And Crimes Against Humanity*

The expansion of the universality principle began in the post-World War II trials of individuals who had committed various wartime offences, including war crimes and crimes against humanity.[26] In many such trials, the courts of

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[23] See Jordan *supra* note 19 at 13.

[24] Vienna Convention on the Law of Treaties, 1969, 8 ILM 679, Article 53 defines 'jus cogens' as "... a peremptory norm of general International Law accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted."

[25] Convention for the Suppression of the Traffic in Persons and of the Exploitation of the Prostitution of Others, 1949, 96 UNTS 271.

[26] See Randall *supra* note 2 at 800.

one state frequently tried and punished war crimes committed outside the State by foreign nationals.[27]

In 1945, after the defeat of the Axis Powers, the Allies (The United States of America, Great Britain, France and the Soviet Union) signed *The London Agreement*[28] (London Agreement) setting up the International Military Tribunal[29] (IMT) at Nuremberg to try major German war criminals whose offences had "*no particular geographical localization*"[30]. At this point in history, the victors had a clear choice between the summary executions of the war criminals or fair trials.[31] Justice Robert Jackson, who was one of the chief architects of the London Charter, was instrumental in getting post war tribunals in place. In his opening statement at Nuremberg he said: "*The real complaining party at your bar is civilization. Civilization asks whether the Law is so laggard as to be utterly helpless to deal with crimes of this magnitude by criminals of this order of importance.*"[32] This quote is considered to be the first acknowledgement of universal jurisdiction in the modern world.

Several commentators, however, do not consider the jurisdiction of the Nuremberg trials to be universal. They find that the Nuremberg tribunal's jurisdiction was based on the Allies' governmental authority within post-war Germany.[33] *The Berlin Declaration* of June 5, 1945[34] stated: "*The Governments of the United States of America, the Union of Soviet Socialist Republics and the United Kingdom, and the Provisional Government of the French Republic, hereby assume supreme authority with respect to Germany, including all the powers possessed by the German Government, the High Command and any state, municipal, or local government or authority.*"

Hence, many experts agree that the jurisdiction of the IMT arose from the

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27 O. Schachter, International Law In Theory And Practice (Kluwer Law International, 1st ed. 1985) 240-65 at 262.

28 London Agreement , 82 U.N.T.S. 280.

29 Agreement for the Prosecution and Punishment of the Major War Criminals of the European Axis, and Establishing the Charter of the International Military Tribunal (I.M.T.), annex, August 8, 1945, 59 Stat. 1544, 82 U.N.T.S. 279 (hereinafter Nuremberg Charter).

30 This phrase derives from the Moscow Declaration, 9 Dep't. St. Bull. 310, 311 (1943), signed by Roosevelt, Churchill, and Stalin.

31 H.T. King Jr. "Universal Jurisdiction: Myths, Realities, And Prospects: Universal Jurisdiction: Myths, Realities, Prospects, War Crimes and Crimes Against Humanity: The Nuremberg Precedent", *New England Law Review*, 35 New Eng.L. Rev. 281 (2001) at 281.

32 Justice Robert Jackson, Opening Statement at Nuremburg Trials, reprinted in Telford Taylor, *The Anatomy Of The Nuremberg Trials: A Personal Memoir*, at 171. (Alfred E. Knopf 1st ed. 1992)

33 See Morris *supra* note 15 at 343.

34 Berlin Declaration, June 5, 1945 60 Stat. 1649 at 1650.

victorious Allies' assumption of whatever jurisdiction Germany would have had over the specific offences. As the supreme authority in Germany, the Allies may have had jurisdiction to define and punish the vast majority of the offences under the territoriality, nationality or passive personality principles.[35]

One of the biggest problems faced by the Nuremberg trials was reconciling the legal systems of the four triumphant Allies so as to bring about uniformity in the trials. The English and the Americans followed the Anglo-Saxon legal system while the Soviet Union and France followed the Continental system. Hence there were several differences between the parties on matters like the procedure at the trial, the language to be used, the definitions of various terms and the individual political aims of the four countries after the War.[36] However, there was a general air of urgency in the post-war efforts, because the four victors were at least in agreement about the fact that the Nazis needed to be punished, and punished in a well-documented trial. Hence, at the Conference on Military Trials held at London from June 26 to August 2, 1945, all such differences were hammered out, resulting in the signing of the London Agreement on August 8, 1945. The IMT Charter clearly laid out the legal basis for the trials, incorporating the basic principles of international and humanitarian law as recognised by the civilized nations of the world.[37]

The trials of the IMT addressed several questions that International Law had never faced before. All the parties, except the United States (US) were concerned that the Tribunal would apply ex post facto law as the actions of the Germans were not crimes at the time they were committed, but were only defined as criminal by the victors after the war ended. Also, International Law had never prosecuted a government for crimes against its own people and had never held individual members of a warring state criminally liable. It had always been considered that it was within any State's sovereign power to launch a war and there was never any criminal liability for it.[38]

Hence the Nuremberg precedent has its champions as well as its critics. The former maintain that these trials went a long way in establishing principles of International Law, still valid today. The latter find, that the IMT trials were an arbitrary exercise of power by the Allies – a hypocritical victors' justice.[39]

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35 See Randall *supra* note 2 at 806.

36 S. Fogelson, "The Nuremberg Legacy: An Unfulfilled Promise", *Southern California Law Review*, 63 S. Cal. L. Rev. 833 (1990) at 846.

37 T.W. Murphy and J.E. Whitfield, "Excerpts from the Nuremberg Trials", *United States Air Force Academy Journal of Legal Studies*, 6 USAFA J. Leg. Stud. 5 (1996) at 162.

38 See Fogelson *supra* note 36 at 842.

39 See Generally M. Lippman, "Crimes Against Humanity", *Boston Third World Law Journal*, 17 B.C. Third World L.J. 171 (1997); "The Fifth Annual Ernst C. Steifel Symposium: Critical Perspectives On The Nuremberg Trials And State Accountability", *New York Law School Journal Of Human Rights*, 12 N.Y.L. Sch. J. Hum. Rts. 453.

However, relatively few judgments of the IMT refer to the universality principle, and the references are sometimes vague. The main such reference usually cited is: "*The Signatory Powers created this Tribunal, defined the law it was to administer, and made regulations for the proper conduct of the Trial. In doing so, they have done together what any one of them might have done singly; for it is not to be doubted that any nation has the right to set up special courts to administer law.*"[40] Commentators believe that this passage could conceivably have meant a claim to the exercise of universal jurisdiction if emphasis were placed on the words 'any nation'.

However, the more explicit references to universal jurisdiction were noted in the proceedings of zonal tribunals and various other tribunals constituted by single States.[41]

After the IMT had concluded its trials, the US tried Germans in Nuremberg, which was in the American occupied zone. These trials were conducted under the Control Council Law No. 10. In one such case, the *United States* v. *List Case*[42], German officers were charged with the responsibility for execution of thousands of civilians held hostage in Greece, Yugoslavia and Albania. In its judgment, the Tribunal explained: "*an international crime is . . . an act universally recognized as criminal, which is considered a grave matter of international concern and for some valid reason cannot be left within the exclusive jurisdiction of the state that would have control over it under ordinary circumstances... A state that captures the perpetrator of war crimes either may surrender the alleged criminal to the state where the offence was committed, or . . . retain the alleged criminal for trial under its own legal processes.*"[43]

Similarly, in the *Almelo Trial*[44] of 1945, German defendants facing a British military court sitting in the Netherlands were charged with the commission of war crimes in Almelo, Holland. Here again the court held that: "*Under the general doctrine called Universality of Jurisdiction over War Crimes, every independent state has in International Law jurisdiction to punish pirates and war criminals in its custody regardless of the nationality of the victim or the place where the offense was committed.*"[45]

Another US Military Commission sitting in Shanghai in 1947 assumed

40 International Military Tribunal (Nuremberg), Judgment and Sentences, *American Journal of International Law* 41 Am. J. Int'l L. 172, 216 (1947) at 216.

41 Case transcripts available at http://www.ess.uwe.ac.uk/genocide/trials.htm.

42 The Hostages Trial: Trial Of Wilhelm List And Others, Case No. 47, United States Military Tribunal, Nuremberg; in United Nations War Crimes Commission Law Reports Of Trials Of War Criminals [hereinafter L. Rep. Trials War Crims.]. Volume VIII, 1949.

43 *Ibid* at 54.

44 The Almelo Trial: Trial Of Otto Sandrock And Three Others, Case No. 3, British Military Court For The Trial Of War Criminals, Almelo, Holland; in L. Rep. Trials War Crims, Volume I, London, HMSO, 1949.

45 *Ibid* at 42.

jurisdiction over defendants who were German nationals and who after Germany's surrender continued military efforts against the US by assisting the Japanese in China.[46] They argued that since they were Germans residing in China, they would be subject to only Chinese law and jurisdiction. The tribunal rejected this argument by saying: "*A war crime . . . is not a crime against the law or criminal code of any individual nation, but a crime against the jus gentium. The laws and usages of war are of universal application, and do not depend for their existence upon national laws and frontiers.*"

Besides these, the *Zyklon B Case*[47] of 1946, tried by a British military Court in Hamburg and the *Hadamar Trial*[48] of 1945 by the United States Military Commission in Wiesbaden provide the most explicit references to universal jurisdiction in the trials by the Allies after the Second World War. However, even these trials considered universality as one of the applicable principles among others. Universal jurisdiction was never the sole jurisdictional basis and other principles like the territoriality, passive personality or protective personality principles were always at the forefront.

The first post-war trial that relied solely on universal jurisdiction was when Adolf Eichmann was tried in Israel, first by the District Court[49] in 1961 and then by the Supreme Court[50] in 1962. The Eichmann cases are considered to be the landmark cases for the definition and elaboration of the universality principle.

Adolf Eichmann was head of the Department for Jewish Affairs in the Gestapo from 1941 to 1945. He had the primary responsibility over the persecution, deportation, and extermination of hundreds of thousands of Jews and others in Germany and certain occupied territories. He was also expected to supervise the 'final solution' of the Jewish question.'[51] At the end of the War, Eichmann fled an American internment camp in Germany and lived in Argentina under an assumed name for over ten years. In 1960, Israeli Mossad agents kidnapped him from Argentina and brought him to trial in Jerusalem under Israel's *Nazis and Nazi Collaborators (Punishment) Law, 5710-1950.*

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46 Trial of Lothar Eisentrager, 14 Law Reports of Trials of War Criminals 8 (1949).

47 The Zyklon B Case: Trial Of Bruno Tesch And Two Others, Case No. 9, British Military Court, Hamburg, in L. Rep. Trials War Crims, Volume I, London, HMSO,1947 at 94.

48 The Hadamar Trial: Trial Of Alfons Klein And Six Others, Case No. 4, United States Military Commission, Wiesbaden, Germany, in L. Rep. Trials War Crims, Volume I, London, HMSO, 1947 at 47.

49 See *Attorney Gen. of Isr.* v. *Eichmann*, 36 I.L.R. 18, 273-76 (Isr. Dist. Ct.—Jerusalem 1961), aff'd, 36 I.L.R. 277 (Isr. Sup. Ct. 1962), available at: http://www.nizkor.org/hweb/people/e/eichmann-adolf/transcripts/.

50 *Ibid* at 342.

51 See Randall *supra* note 2, at 810. *See also* Lippman, "The Trial of Adolph Eichmann and the Protection of Universal Human Rights Under International Law", *Houston Journal of International Law,* 5 Hous. J. Int'l L. 1, 6 n.28 (1982) at 2.

Eichmann was a German living in Argentina and the crimes he committed were against the Jews of Germany. Israel did not even exist as a State at the time of these crimes! Hence the Courts had to rely on the universality principle for his prosecution. The judgments contained comparisons of the offences to those of piracy in order to draw a parallel and further addressed Israel's right to apply the principle.

Hence, the District Court of Israel declared, "*The jurisdiction to try crimes under International Law is universal.*" The Supreme Court of Israel elaborated on this stand further by saying: "*not only do all the crimes attributed to the appellant bear an international character, but their harmful and murderous effects were so embracing and widespread as to shake the international community to its foundations. The State of Israel therefore was entitled pursuant to the principle of universal jurisdiction and in the capacity of a guardian of International Law and an agent for its enforcement to try the appellant. That being the case no importance attached to the fact that the State of Israel did not exist when the offenses were committed.*"[52]

Eichmann was sentenced to death and executed on May 31, 1962.

In 1949, the four Geneva Conventions[53] codified the laws of war. Two additional Protocols[54] were added to these Conventions in 1977. They aimed at protecting certain classes of persons during an armed conflict. The common articles of the four Geneva Conventions identified certain offences as grave breaches[55].

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52 See *Attorney Gen. of Isr.* v. *Eichmann supra* note 50 at 304.

53 Convention for the Amelioration of the Condition of the Wounded and Sick in Armed Forces in the Field, August 12, 1949, 75 U.N.T.S. 31 (hereinafter Geneva Convention I); Convention for the Amelioration of the Condition of Wounded, Sick and Shipwrecked Members of the Armed Forces at Sea, August 12, 1949, 75 U.N.T.S. 85(hereinafter Geneva Convention II); Convention Relative to the Treatment of Prisoners of War, August 12, 1949, 75 U.N.T.S. 135 (hereinafter Geneva Convention III); Convention Relative to the Protection of Civilian Persons in Time of War, August 12, 1949, 75 U.N.T.S. 287 (hereinafter Geneva Convention IV). The four Geneva Conventions will be referred to collectively as the Geneva Conventions.
Available at: http://www.unhchr.ch/html/intlinst.htm.

54 Protocol I Additional to the Geneva Conventions of August 12, 1949, opened for signature at Berne December 12, 1977, U.N. Doc. A/32/144, Annex I [hereinafter Protocol I]; Protocol II Additional to the Geneva Conventions of August 12, 1949, opened for signature at Berne December 12, 1977, U.N. Doc. A/32/144, Annex II.

55 Geneva Convention I, *supra* note 53, Article 50, 75 U.N.T.S. 31, at 62; Geneva Convention II, *supra* note 53, Article 51, 75 U.N.T.S 85, at 116; Geneva Convention III, *supra* note 53 Article 130, at 104, 75 U.N.T.S. 135, at 236; Geneva Convention IV, *supra* note 53, Article 147, 75 U.N.T.S. 287, at 386 stated as: "wilful killing, torture or inhuman treatment, including biological experiments, wilfully causing great suffering or serious injury to body or health, and extensive destruction and appropriation of property, not justified by military necessity and carried out unlawfully and wantonly."

The Geneva Conventions further provided that "*each party shall be under the obligation to search for persons alleged to have committed, or to have ordered to be committed, such grave breaches, and shall bring such persons, regardless of their nationality, before its own courts. It may also, if it prefers, and in accordance with the provisions of its own legislation, hand such persons over for trial to another party concerned....*"[56]

Thus, the Geneva Conventions allow universal jurisdiction to all major war crimes, irrespective of the prosecuting State's involvement in the conflict. These Conventions are now regarded as a part of Customary International Law.

The two decades after World War II saw the sudden awakening of the world's conscience with respect to human rights and the need to protect them. The necessity of apprehending and punishing Nazi war-criminals was felt so strongly that all possible forms of jurisdiction were summoned. Thus, universal jurisdiction found most support and activity in this period.

D. Genocide

Genocide is defined by *The Convention on the Prevention and Punishment of the Crime of Genocide 1951*(Genocide Convention).[57] However, genocide was recognised as an international crime under Customary International Law even before the existence of the Genocide Convention. It was prosecuted at the IMT as an extension of 'crimes against humanity' and 'war crimes' by applying the universality principle.

On December 11, 1946, the United Nations General Assembly passed a resolution unanimously affirming the "*principles of International Law recognized by the Charter of the Nuremberg Tribunal and the Judgment of the Tribunal.*"[58] This resolution is widely recognised to have declared genocide as an international crime liable to prosecution under universal jurisdiction. On the same day, the General Assembly also instructed the Economic and Social Council to draft a

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56 Geneva Convention I, *supra* note 53, Article 49, 75 U.N.T.S. 31, at 62; Geneva Convention II, *supra* note 53, Article 50, 75 U.N.T.S 85, at 116; Geneva Convention III, *supra* note 53, Article 129, at 104, 75 U.N.T.S. 135 at 236; Geneva Convention IV, *supra* note 53, Article 146, 75 U.N.T.S. 287, at 386.

57 1951 Convention on the Prevention and Punishment of the Crime of Genocide, December 9, 1948, 78 U.N.T.S. 277 (entered into force January 12, 1951) [hereinafter Genocide Convention], defined Genocide in Article 2 as: "any of the following acts committed with intent to destroy, in whole or in part, a national, ethnical, racial or religious group, as such: (a) Killing members of the group; (b) Causing serious bodily or mental harm to members of the group; (c) Deliberately inflicting on the group conditions of life calculated to bring about its physical destruction in whole or in part; (d) Imposing measures intended to prevent births within the group; (e) Forcibly transferring children of the group to another group."

58 G.A. Res. 95, U.N. Doc. A/64/Add. 1, at 188 (1946).

convention outlawing genocide.[59] This led to the formation of the Genocide Convention.

The attempt of the Nazis towards the elimination of Jews was the modern world's first introduction to genocide. Subsequently, however, genocide has been seen in several conflicts, especially in internal civil wars between two ethnic groups. Clashes in the former Yugoslavia, Rwanda, East Timor, Cambodia, etc. have evidenced such attempts of one group of people to eliminate the other. Genocide has been associated with extremely inhuman acts ranging from mass murder and rape to forced sterilisation and conversion.

The fact that such human rights violations occur, and that too on a scale large enough to attract international attention, points to a collapse of law and order that not only provides impunity to offenders but also implicitly supports and protects them. In face of such a lack of accountability, universal jurisdiction provides the only hope for justice to victims.

The Genocide Convention has been widely criticised for its failure to provide for universal jurisdiction in its text. It was proposed but rejected during the negotiations for the Convention due to strong opposition from the USSR, US and France. The main concern was that universal jurisdiction for genocide would become a source of inter-state conflicts.[60] Hence Article 6 of the Convention provided only for territorial jurisdiction or jurisdiction of international penal tribunals only with the consent of the States concerned.[61]

However, universal jurisdiction over genocide has been recognised as a part of Customary International Law[62] irrespective of the terms of the Convention and a large number of prosecutions have also been undertaken on the basis of this principle. Scholars maintain that though Article 6 of the Convention makes it obligatory for States to exercise territorial jurisdiction over crimes in their land, it does not expressly prevent the exercise of universal jurisdiction when genocide is not committed on their territory. The Convention simply recognises

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59 G.A. Res. 96, U.N. Doc. A/64/Add. 1, at 188 (1946).

60 Memorandum of the United Nations Secretary General, Historical Survey of the Question of International Criminal Jurisdiction, at 137, Appendix 13; See also U.N. GAOR 6th Comm., 3d Sess., pt. I, Summary Records, 394-406 (1948).

61 Genocide Convention *supra* note 57, Article 6: "Persons charged with genocide ... shall be tried by a competent tribunal of the State in the territory of which the act was committed, or by such international penal tribunal as may have jurisdiction with respect to those Contracting Parties which shall have accepted its jurisdiction."

62 Theodor Meron, "International Criminalization of Internal Atrocities", *American Journal of International Law,* 89 Am. J. Int'l L. 554, at 569 (1995), Christopher C. Joyner, "Arresting Impunity: The Case for Universal Jurisdiction in Bringing War Criminals to Accountability", *Law and Contemporary Problems*, 59 Law & Contemp. Probs. 153, 159-60 (1996), Randall, *supra* note 2 at 837, Bassiouni *supra* note 5 at 122.

territoriality as the primary jurisdictional principle applicable but does not preclude the use of other jurisdictions. The Israeli District Court in the Eichmann case confirmed this when it said: "*reference to Article 6 (of the Genocide Convention), territorial jurisdiction is not exhaustive... every sovereign state may exercise its existing powers within the limits of Customary International Law.*"[63]

Recently, India had to face the question of universal jurisdiction for genocide due to the events that occurred in Gujarat in February and March 2002. In India, several noted activists and commentators sought to call the attention of the world at large towards the State support to the atrocities committed against the minority ethnic group. In the event of the inability or unwillingness of the Indian State to take action against such perpetrators, they sought the trial of such offenders in other countries under the Genocide Convention. Pursuant to this, the families of three British Muslims killed in the carnage filed proceedings against the Gujarat Government in courts in the UK.[64] However, no further action has been reported in the matter. Under the circumstances, the Chief Minister of Gujarat faces arrest only if he travels to the UK.

E. Other Crimes

Universal jurisdiction has been recognised in recent years for various crimes of international nature. These crimes are either abhorrent to all human sense of justice and law or they occur in regions where the State of the offender cannot or will not assert jurisdiction. Such crimes include hostage-taking, hijacking, apartheid, torture, crimes against humanity, etc.[65]

Various Conventions have a clause that is widely interpreted as allowing universal jurisdiction over the offence that is the subject matter of the treaty. Such treaties include the *Hijacking Convention, 1963*[66], the *Montreal Convention on Hijacking, 1988*[67], *The Convention on the Suppression of Unlawful Acts Against the Safety of Maritime Navigation 1988*[68], *The Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons, Including Diplomatic*

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63 See *Attorney Gen. of Isr.* v. *Eichmann supra* note 49 at 29, 39-40.

64 Luke Harding, "Hindus called to account over killing of Britons", *The Guardian Unlimited*, April 30, 2002.

65 See Randall *supra* note 2 at 840.

66 Convention on Offences and Certain Other Acts Committed on Board Aircraft (Tokyo Hijacking Convention), September 14, 1963, Article 3(3), 704 U.N.T.S. 219.

67 Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, adopted by the International Civil Aviation Organization, February 24, 1988, Article 3, 27 I.L.M. 627.

68 Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation, done at Rome, March 10, 1988, Article 7(4, 5), 27 I.L.M. 668.

Agents 1973[69], *The Convention Against the Taking of Hostages 1979*[70], *The Convention on the Safety of United Nations and Associated Personnel 1994*[71], *Single Convention on Narcotic Drugs 1961*[72], *The Convention on the Suppression and Punishment of the Crime of Apartheid 1974*[73], *Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment 1984*[74], among others.

The conventions on Torture, Hijacking and those under negotiation for Terrorism endorse universal jurisdiction more clearly than most others. They contain the following provision with insignificant variations: "*The State Party in the territory of which the alleged offender is found shall, if it does not extradite him, be obliged, without exception whatsoever and whether or not the offense was committed in its territory, to submit the case to its competent authorities for the purpose of prosecution, through proceedings in accordance with the laws of that State.*"[75]

Many of the trials for universal jurisdiction in the 1990s have involved the crime of Torture under the Torture convention. In a US case in the Second Circuit court, *Filartiga* v. *Pena-Irala*, the Court observed, "*The torturer has become – like the pirate and slave trader before him – hostis humani generis, an enemy of all mankind.*"[76]

The Apartheid Convention of 1973 also provides explicitly for universal jurisdiction. However, with the end to the practice in South Africa, the Convention lost its significance and saw little or no implementation. Scholars contend that this Convention should now be expanded to cover apartheid-like practices as well.

Crimes against humanity form another category of crimes that invite universal jurisdiction. There is no separate convention dealing with crimes against

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69 Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons, Including Diplomatic Agents (New York Convention), opened for signature at New York, December 14, 1973, Article 3, 1035 U.N.T.S. 167.

70 International Convention Against the Taking of Hostages, concluded at New York, December 17, 1979, Article 5, 18 I.L.M. 1456.

71 Convention on the Safety of United Nations and Associated Personnel, opened for signature at New York, December 15, 1994, Article 10, U.N. Doc. A/49/742 (1994).

72 Single Convention on Narcotic Drugs (Single Convention), signed at New York, March 30, 1961, Article 36(4), 14 I.L.M. 302.

73 Convention on the Suppression and Punishment of Apartheid, adopted on November 30, 1974, Article 5 1015 U.N.T.S. 243 (hereinafter Apartheid Convention).

74 Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, G.A. Res. 39/46, U.N. GAOR 39th Sess., Supp. No. 51, U.N. Doc. A/39/51 (1984) (Torture Convention).

75 See Randall *supra* note 2 at 819.

76 470 U.S. 1003 (1985); *Filartiga* v. *Pena-Irala*, 630 F.2d 876, at 890 (2d Cir. 1980).

humanity. However, they are defined by the Statutes of the International Criminal Tribunal for Yugolslavia[77] (ICTY), International Criminal Tribunal for Rwanda[78] (ICTR) and the International Criminal Court[79] (ICC). The concept of crimes against humanity in International Law is still rather amorphous. Hence, they have for long been allied to war-crimes and prosecuted along with them. Theoretically though, crimes against humanity should warrant universal jurisdiction even in times of peace. However, State practice does not support this assumption, as unlike war-time situations, nations at peace have a law and order system in place that the international community traditionally respects.

Universal jurisdiction may also extend to offences that are violations of obligations *erga omnes* and *jus cogens* norms.[80] While *jus cogens* norms are defined in *The Vienna Convention on Law of Treaties*[81], obligations *erga omnes* have been recognised by the International Court of Justice (ICJ) as: "*the obligations of a State towards the international community as a whole...are the concern of all States. In view of the importance of the rights involved, all States can be held to have a legal interest in their protection; they are obligations erga omnes.*"[82]

Offences violating these precepts can be considered as international crimes and their suppression would find support in Customary International Law.

III. The Roadblocks

A. State Sovereignty

To several conservative jurists and writers, universal jurisdiction represents a revolutionary concept because it seeks to challenge the concept of State sovereignty that has traditionally been the cornerstone of all relations between

77 Statute of the International Criminal Tribunal for the Former Yugoslavia, S.C. Res. 808, U.N. SCOR, 48th Sess., 3217th mtg., Annex, U.N. Doc. S/RES/808 (1993) (hereinafter ICTY Statute), Article 5 available at http://www.un.org/icty.

78 Statute of the International Criminal Tribunal for Rwanda, S.C. Res. 955, U.N. SCOR, 49th Sess., 3453d mtg., Annex, U.N. Doc. S/RES/955 (1994) (hereinafter ICTR Statute), Article 3, available at http://www.ictr.org.

79 Rome Statute of the International Criminal Court, Article 7, 37 I.L.M. 999 (1998) (hereinafter ICC Statute), Article 7: "[c]rimes when committed as part of a widespread or systematic attack against any civilian population on national, political, ethnic, racial or religious grounds comprising murder, extermination, enslavement, deportation, imprisonment, torture, rape, persecutions on political, racial and religious grounds, other inhumane acts.", available at www.un.org/law/icc.

80 M. Cherif Bassiouni, "Accountability For International Crime And Serious Violations Of Fundamental Human Rights: International Crimes: Jus Cogens And Obligation Erga Omnes", *Law and Contemporary Problems*, 59 Law & Contemp. Prob. 63 at 63 (1996).

81 *Supra* note 24.

82 Barcelona Traction, Light and Power Co. Ltd. (*Belgium* v. *Spain*), 1970 I.C.J. 3, 32 (February 5).

nations. It was one of the principles on the basis of which the United Nations was founded.[83] The concept expects that all States have the sovereign right to regulate their own affairs and no other State can interfere in the internal matters of a sovereign State. State sovereignty rests on the notion that for one State to submit to the jurisdiction of another is "*offensive to the 'dignity' of that State*"[84].

In today's scenario, the application of universal jurisdiction in States where judicial authorities are already in place is rather inconceivable and would be construed as deliberate interference in the internal matters of another nation.

Outside the idealistic rhetoric, there are the more realistic problems of collection of evidence, finding and protecting witnesses and co-operation from local authorities. The moral and legal standards acceptable to human life vary significantly from nation to nation.

Universal jurisdiction is feared both by developed as well as under developed nations. Developed States like the US and the UK fear politically motivated trials by rogue states like Iraq or North Korea. Since such nations have been acting as the 'guardians of law and order' for the rest of the world, they fear that their leaders and military officials will be questioned for their roles in various armed operations.

This was well illustrated when a Yugoslav court in Belgrade tried the world leaders responsible for the 1999 NATO bombings *in absentia*, for inciting an aggressive war, war-crimes against the civilian population and the use of banned combat means. It issued arrest warrants for, among others, US President Bill Clinton, Britain's Prime Minister Tony Blair, German Chancellor Gerhard Schroeder, and French President Jacques Chirac and awarded each a prison sentence of twenty years![85]

The developing countries of the world suspect universal jurisdiction to be a form of neo-colonialism of the West. They perceive it as an attempt to impose Western standards and judgments on their systems when they are culturally and materially different from those of the developed world.

However, in the recent years, with the development of International Law and the strengthening of international institutions, the concept of complete state

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83 Charter of the United Nations, Article 2(1), available at http://www.un.org/aboutun/charter/.

84 Charles Pierson, "Pinochet and the End of Immunity: England's House of Lords Holds that a Former Head of State is Not Immune for Torture", *Temple International and Comparative Law Journal,* 14 Temp. Int'l & Comp. L.J. 263 at 269-70 (2000).

85 "NATO leaders sentenced by Belgrade court", CNN, September 21, 2000, at http://www.cnn.com/2000/WORLD/europe/09/21/yugoslavia.court/.

sovereignty has been significantly reduced.[86] In the case of *Prosecutor* v. *Tadic*[87] before the ICTY, the court recorded that: "*It would be a travesty of law and a betrayal of the universal need for justice, should the concept of State sovereignty be allowed to be raised successfully against human rights. Borders should not be considered as a shield against the reach of the law and as a protection for those who trample underfoot the most elementary rights of humanity.*"

B. Sovereign Immunity

Sovereign immunity is another unresolved question that confronts the principle of universal jurisdiction. Sovereign immunity prevents the prosecution of persons who are Heads of States. The rationale behind this prevention is that since Sovereigns have official duties to perform for the State, criminal charges against them would adversely affect the functioning of the State as a whole.

The Nuremberg Charter refused to recognise sovereign immunity when it stated: "*the official position of defendants, whether as heads of state or responsible officials in government departments, shall not be considered as freeing them from responsibility or mitigating punishment.*"[88] It was also addressed in the case for Augusto Pinochet's extradition when the House of Lords in Britain refused to recognise his immunity as a former Head of State.[89] Belgium, too, had to address this issue in the case of the ex-foreign minister of Congo Mr. Yerodia Ndombasi. Belgium's universal jurisdiction law does not recognise sovereign immunity. However, the ICJ, deciding this matter in the case concerning the arrest warrant of April 2000[90] said: "*throughout the duration of his or her office, a Minister for Foreign Affairs when abroad enjoys full immunity from criminal jurisdiction and inviolability.*"

Thus, though the international community still clings to the concept of immunity for persons holding government office, progress is being made in prosecuting former Heads of State and former government officials. With the acknowledgement of principles like command responsibility, it seems rather unacceptable that the person who presided over mass human rights violations should go scot-free while his underlings should be tried for obeying his commands.

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86 B.S.Brown, "Universal Jurisdiction: Myths, Realities, And Prospects: The Evolving Concept Of Universal Jurisdiction", *New England Law Review*, 35 New Eng.L. Rev. 383 (2000) at 390.

87 International Criminal Tribunal For The Former Yugoslavia: Decision In *Prosecutor* v. *Dusko Tadic*, Case No. IT-94-1-AR72, *International Legal Materials*, 35 I.L.M. 32 (1996), at 52.

88 See Nuremberg Charter *supra* note 29, Article 7.

89 See *infra* note 115 and accompanying text.

90 See *infra* note 109 and accompanying text.

C. *Amnesty*

An amnesty occurs when a government agrees not to hold persons liable for past criminal acts. Though there is wide state practice that supports amnesties in several countries, *opinio juris* of experts generally looks down upon such pardons. Amnesties are generally given after internal conflicts or civil wars in the interest of progress.

Universal jurisdiction can be upheld even against an amnesty if such an amnesty is contrary to International Law or seeks to cover offences that are crimes under Customary International Law norms. Hence an amnesty given by a government to itself to exonerate itself or its agents for human rights violations would not be a defence.[91] Similarly, an amnesty that prevented prosecution of genocide or crimes against humanity could be easily challenged.[92]

Given these challenges, universal jurisdiction remains a concept that is not uniformly recognised. The legal principles and situations that would warrant its exercise still remain unclear.

IV. Universal Jurisdiction In The Laws Of States

For almost four decades after World War II, the only official recognition for universal jurisdiction in the national legislations of States was for the crimes of the Nazis in Germany during the World War. However, with the reopening of international diplomacy with the close of the Cold War, the concept of universal jurisdiction found passing mention in numerous international treaties and instruments.[93] Several States began to find it necessary to incorporate provisions allowing for the practice of universal jurisdiction in their national laws. The acts criminalised by four Geneva Conventions, the Torture Convention and the Genocide Convention, however, remained the primary acts that such national laws sought to address. However, such laws now cover even hijacking and terrorism.

Universal jurisdiction has garnered most support in the developed Western world, especially in Europe with significant laws in Belgium and Spain due to the higher standards of human rights in such countries. However, the US has lagged behind notably in any such implementation.

A. *United States of America*

After leading the initial rush of international judicial activity in the aftermath of

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91 K. Gallagher, "No Justice, No Peace: The Legalities and Realities of Amnesty in Sierra Leone", *Thomas Jefferson Law Review*, 23 T. Jefferson L. Rev. 149 at 168-71 (2000).

92 See Hans, *infra* note 107 at 391.

93 See *supra* notes 66 to 74.

World War II, the US found itself embroiled in the politics of the Cold War. In its reluctance to relinquish its own sovereignty, the US failed to ratify several human rights treaties. Even the four Geneva Conventions were ratified by the US in 1988, almost forty years after their codification! Hence the movement to implement universal jurisdiction in the modern world has largely bypassed the US.[94] With its dubious record in Vietnam, Iraq and the NATO bombings in Yugoslavia, the US remains one of the main dissenters even to the formation of the International Criminal Court.

Although universal jurisdiction for piracy existed in the US law books since 1819, the first true recognition of the principle came about in 1974 with *The Anti-hijacking Act*[95], passed pursuant to the obligations under *The Convention for the Suppression of Unlawful Seizure of Aircraft.* Prosecutions could now proceed irrespective of the nationality of the offender or the locale of the offence.

In 1984, *The Taking of Hostages Act* was passed under the obligations of the *International Convention Against Taking of Hostages 1984*[96]. The Act implicitly recognised the universality principle by its terms, which stated that the US could exercise jurisdiction if "*the offender is found in the United States*". This act was used in the case of *United States* v. *Yunis*[97] wherein the court noted that: "*In light of the global efforts to punish aircraft piracy and hostage taking, international legal scholars unanimously agree that these crimes fit within the category of heinous crimes for purposes of asserting universal jurisdiction.*"[98] In this case, the appellant Fawaz Yunis was the leader of a group of Lebanese nationals that hijacked a Jordanian aeroplane on June 11, 1985. There were two American citizens aboard the said plane. When their demands were not met, the hijacker released the passengers, blew up the aeroplane and fled.

After the US identified Yunis as the leader of the operation, the Federal Bureau of Investigation (FBI) lead 'Operation Goldenrod' in 1987 to apprehend him. Undercover FBI agents lured Yunis onto a yacht in the eastern Mediterranean Sea with promises of a drug deal, and arrested him once the vessel entered international waters. Yunis was tried in Washington D.C. for conspiracy, aircraft piracy, and hostage-taking charges. The jurisdictional bases quoted were the passive personality principle due to the presence of American nationals on

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94 J. G. White, "Nowhere To Run, Nowhere To Hide: Augusto Pinochet, Universal Jurisdiction, The ICC, And A Wake-Up Call For Former Heads Of State", *Case Western Reserve Law Review*, 50 Case W. Res. 127 (1999) at 140.

95 Antihijacking Act of 1974, Pub. L. No. 93-366, 88 Stat. 409 (1974).

96 Act for the Prevention and Punishment of the Crime of Hostage-Taking (Hostage Taking Act), Pub. L. No. 98-473, 98 Stat. 2186 (1984).

97 *United States* v. *Yunis* 924 F.2d 1086 (D.C. Cir. 1991).

98 *Ibid* at 1090; *See also: United States* v. *Rezaq* 899 F.Supp 687, at 709 (D.D.C. 1995).

board the hijacked aircraft as well as universal jurisdiction under International Law. Yunis was convicted in 1991.

The 1990s heralded the gradual recognition of the universality principle in several US statutes. US Courts began to provide civil remedies for torts committed in violation of Customary International Human Rights Law abroad by the revival of acts like *The Alien Tort Claims Act* (ATCA)[99] and the passage of *The Torture Victims Protection Act*[100] of 1991. However, both these aimed at civil action and not criminal proceedings[101] and provided monetary relief as against arrests and imprisonments. In 1994, the US Criminal Code was modified pursuant to the ratification of *Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment.* The new provisions now held: "*any U.S. national or person physically located within the United States could be held criminally liable for torture he or she commits anywhere against anyone*".[102]

The Restatement (Third) of the Foreign Relations Law of the US[103] also firmly recognises universal jurisdiction for several crimes by noting: "*A state has jurisdiction to define and prescribe punishment for certain offenses recognized by the community of nations as of universal concern, such as piracy, slave trade, attacks on or hijacking of aircraft, genocide, war crimes, and perhaps certain acts of terrorism . . .*"

B. Belgium

Belgium probably provides for the most extensive exercise of universal jurisdiction over human rights crimes of any country.[104] In 1993, Belgium passed the Act of June 16, 1993[105] Concerning the Punishment of Grave Breaches of the Geneva Conventions of August 12, 1949 and their Additional Protocols I and II of June 16, 1977. By this codification, Belgium gained the responsibility of prosecuting or extraditing persons committing crimes during international conflicts under the laws of the Geneva Conventions.

In 1999, Belgium modified its 1993 law by passing the Act of February 10,

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99 Alien Tort Claims Act, 28 U.S.C. § 1350 .

100 Torture Victims Protection Act, Pub. L. No. 102-256, 106 Stat. 73 (March 12, 1992).

101 Hari M. Osofsky, "Domesticating International Criminal Law: Bringing Human Rights Violators to Justice", *Yale Law Journal,* 107 Yale L.J. 191, (1997) at 210.

102 18 U.S.C. § 2340.

103 Louis Henkin, *Restatement of the Law, Third: Foreign Relations Law of the United States,* (American Law Institute, 1987).

104 See Bassiouni *supra* note 5 at 145.

105 Act of June 16, 1993 concerning the punishment of grave breaches of the Geneva Conventions of August 12, 1949 and their Additional Protocols I and II of June 18, 1977 (Belg. Official Journal, August 5, 1993).

1999 Concerning the Punishment of Grave Breaches of Humanitarian Law.[106] This law covered grave breaches of international humanitarian law including war-crimes in internal or international armed conflicts, genocide and crimes against humanity. It gave Belgian courts the competency to try crimes committed by non-Belgians outside Belgium against non-Belgians, even without the presence of the accused in Belgium. However, the most significant change to the 1993 Act by the 1999 Amendment was the elimination of immunity for State officials.[107]

Belgium has been a pioneer for promoting universal jurisdiction. Since 1988, Belgium has charged more than seven political figures with crimes against humanity, including Israel's current prime minister Ariel Sharon.[108] Also, it has been the first State to try persons for war crimes that did not directly affect itself. Belgian trials take place before a civilian jury and not a military or international tribunal as seen in most other nations assuming universal jurisdiction. The Belgian law also does not require that the accused be present in Belgium when the trial is initiated.

Though Belgium's law has been widely lauded for giving weight to the legitimacy of universal jurisdiction, it has also caused negative consequences for Belgium. Heads of States often fear visiting Belgium due to prospects of being arrested for their crimes. This is especially problematic given that Belgium hosts the headquarters of the European Union.

Belgium's elimination of sovereign immunity has also been a source of controversy. On April 11, 2000, the Belgian court of first instance issued an international arrest warrant against Mr. Abdoulaye Yerodia Ndombasi, the acting Minister of Foreign Affairs for the Democratic Republic of Congo. It sought his extradition for "*crimes of International Law committed by action or omission against persons or property protected by the Geneva Conventions of August 12th 1949 and the Additional Protocols I and II to those Conventions*" and requested leave to try him *in absentia.* Ndombasi had made several inflammatory speeches in Congo inciting the Congolese population to kill ethnic Tutsis at the beginning

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106 Act Concerning The Punishment Of Grave Breaches Of International Humanitarian Law, *International Legal Materials,* 38 I.L.M. 918 (1999).

107 M. Hans, "Providing for Uniformity in the Exercise of Universal Jurisdiction: Can Either the Princeton Principles on Universal Jurisdiction or an International Criminal Court Accomplish this Goal?", *The Transnational Lawyer,* 15 Transnat'l Law. 357 (2002) at 370.

108 *Ibid.* The others include former Cambodian Heads of State and government, Khieu Samphan and Nuon Chea; Ieng Sary, foreign minister in Cambodia's Khmer Rouge regime; Hojjatoleslam Ali Akbar Rafsanjani, the former Iranian president; erstwhile Moroccan interior Minister Driss Basri; and Abdoulaye Yerodia, a former foreign minister from the Democratic Republic of Congo.

of the rebellion against Congolese President, Laurent-Desire Kabila, in August 1998.

On October 17, 2000, Congo filed an Application with the ICJ, requesting the Court to annul this warrant. The warrant was challenged on two grounds. Congo first questioned Belgium's right of extra territorial jurisdiction over Mr. Yerodia. Secondly, Congo contended that Article 5 of the Belgian law that negates sovereign immunity contravened the provisions of *Vienna Convention on Diplomatic Relations, 1969.*

However, in its written submission and in the subsequent arguments, Congo relied only on the second issue and did not debate on the concept of universal jurisdiction. The Court finally decided in Congo's favour stating that the issue and circulation of the said arrest warrant "*constituted violations of a legal obligation of the Kingdom of Belgium towards the Democratic Republic of the Congo, in that they failed to respect the immunity from criminal jurisdiction and the inviolability which the incumbent Minister for Foreign Affairs of the Democratic Republic of the Congo enjoyed under International Law*".[109]

Belgium has been acting as the world's court system for human rights litigation.[110] The Courts have been flooded with a massive number of suits for this purpose. Hence, it planned to revisit its law on universal jurisdiction in July 2001, and discuss further amendments in 2002-03.

C. Spain

Spain's laws on universal jurisdiction came into focus during the celebrated case of Augusto Pinochet. Pinochet was the dictator of Chile for over seventeen years from 1973 to 1990 and presided over several grave human rights violations during this reign. Chile was a former colony of Spain and Spain received several complaints of atrocities against Spanish nationals. In 1999, Spain attempted to extradite him from the UK to stand trial for his crimes.[111]

Spain provides for the exercise of universal jurisdiction under Article 23 of *The Organic Law of the Judicial Power.* This provision, enacted in 1985, grants Spanish courts universal jurisdiction over crimes against humanity as well as those crimes Spain has a duty to prosecute under treaties to which it is a party. As a

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[109] International Court Of Justice: Case Concerning The Arrest Warrant Of April 11, 2000 (*Democratic Republic Of The Congo* v. *Belgium*) *International Legal Materials,* 41 I.L.M. 536 (2002). Available at: http://www.icj-cij.org.

[110] Rights Groups Support Belgium's Universal Jurisdiction Law (November 26, 2001), available at http://www.fidh.org/communiq/2001/cu2611a.pdf.

[111] See *infra* notes 141-143 and accompanying text.

part of Spain's domestic criminal law, Article 23 gives Spain universal jurisdiction over crimes proscribed by the treaties it ratifies.[112]

Spain's power to exercise universal jurisdiction over genocide, torture, and terrorism under Article 23 has been upheld by its highest court, the *Audiencia Nacional.* The court determined that Spain had universal jurisdiction because it ratified and wrote the Geneva Conventions into its official publication of laws, allowing it to assert jurisdiction under Article 23.[113]

The second question confronting the Court in the Pinochet case was whether Spain could exercise universal jurisdiction retroactively for crimes committed before the universal jurisdiction laws came into place in 1985. Here too, the *Audiencia Nacional* held that the exercise of universal jurisdiction is considered a procedural law and hence was applicable to acts committed before the law came into existence.[114]

Spain first used its universal jurisdiction laws in seeking the extradition of Pinochet from Britain in 1999 for torture and conspiracy to commit torture. Extradition was sought under the Torture Convention and the principle of universal jurisdiction was used because some of the charges against Pinochet were not limited to acts against Spanish nationals. In May 1999, the House of Lords ruled in their Decision on the Extradition of General Pinochet that the alleged torture and hostage taking by General Pinochet's regime in 1970s were international crimes, for which there is universal jurisdiction, which overrides the immunity of former heads of State.[115] This judgment was taken as recognition of the legitimacy of the use of universal jurisdiction by the international community.

However, subsequent developments in the political sphere in Europe prevented the actual extradition of General Pinochet.

D. Other States

The universal jurisdiction principle has been recognised to varying degrees in the laws of several developed States. The French Penal Code provides for universal jurisdiction if required by treaty and if domestic implementing

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[112] Fiona McKay, "Universal Jurisdiction In Europe: Criminal Prosecutions In Europe Since 1990 For War Crimes, Crimes Against Humanity, Torture And Genocide" (1999), at http://www.redress.org/publications/unijeur.html.

[113] Decision of the Audiencia Nacional (Sala de lo penal) of December 13, 2000 (genocide in Guatemala).

[114] See Hans, *supra* note 107 at 376.

[115] *Regina* v. *Bartle*, UK House of Lords, March 24, 1999, *International Legal Materials,* 38 I.L.M. 581 (1999), available at http://www.parliament.the-stationery-office.co.uk/pa/ld199899/ldjudgmt/jd990324/pino1.htm.

legislation is in place.[116] However, case law in France has shown limited acceptance of universality, especially in trying persons associated with the conflicts in Rwanda and Chile.[117]

In Britain, the *British War Crimes Act, 1991* allows proceedings to be brought against any British citizen or resident of the UK, irrespective of his or her nationality at the time of its commission, for an alleged World War II offence (murder, manslaughter or culpable homicide) that constituted a violation of the laws and customs of war.[118] In Britain too, the *Pinochet Case* has been the landmark precedent for all actions based on universal jurisdiction.

Canada provides for the exercise of universal jurisdiction only if there is some territorial connection. *The War Crimes Act of Canada*[119] allows for retrospective jurisdiction over the crimes of genocide, crimes against humanity, and war crimes, provided that, at the time of the crime, the conduct constituted a crime under International Law as well as under Canadian law, the defendant was within the territorial jurisdiction of Canada, Canada was at war with the country when the crime occurred, and the crime occurred in the territory of that country or was committed by one of its citizens.

In Germany, Section 6 of *The German Criminal Code* provides universal jurisdiction for several acts including genocide and acts covered by an international agreement binding on the Federal Republic of Germany.[120] However, the German Federal Supreme Court required a 'legitimizing connection' before jurisdiction in Germany would attach. Such connection could be a familial link or a former domicile.[121] Italy's penal code requires a similar nationality or territorial connection.[122]

Switzerland's *Code Penal Militaire*, enacted by the Federal law of June 13, 1927 and amended up to February 29, 2000, contains a jurisdictional basis for universal jurisdiction.[123] Hence Switzerland has legislation extending universal jurisdiction over the three crimes of genocide, crimes against humanity, and war crimes.

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116 See Bassiouni *supra* note 5 at 140.

117 See Mckay *supra* note 112.

118 Thomas Hetherington and William Chalmers, "War Crimes: Report Of The War Crimes Inquiry", (Stationery Office Bookes,1989), at 45.

119 Crimes Against Humanity And War Crimes Act, S.C. 2000, c. 24 s.6, available at laws.justice.gc.ca/en/C-45.9/.

120 Penal Code of the Federal Republic of Germany, Section (6): Conduct outside Germany affecting internationally protected interests.

121 Decision of February 13th 1994 in the case of Dusko Tadic.

122 Article 7.5, Penal Code of Italy.

123 Article 2.9, Military Penal Code of Switzerland, Book 1.

V. Recent Developments[124]

Except for the *Eichmann Trial* of 1962, the decades after the World War II saw no developments in the principle of universal jurisdiction. The Cold War between the USSR and USA from the 1960s to the early 1990s brought with it the mutual suspicion and distrust of the Western and Eastern blocks.[125] It triggered an obsession with non-interference in domestic affairs that saw several human rights violations hidden by the veil of State sovereignty.[126]

The 1980s brought with it a rediscovery of universal jurisdiction with the growing concern for atrocities that the international community condemned but found impossible to prevent or punish.

A. Trials In The United States Of America

In 1980, the Second Circuit Court in USA decided the case of *Filartiga* v. *Pena-Irala*[127] based on the *Alien Tort Claims Act.*[128] This statute has remained dormant for over two centuries and mentioned in only a handful of cases. In the present case, a seventeen year old Paraguayan, Joelito Filartiga, had been tortured and killed by Americo Norberto Pena-Irala a Paraguayan police official in Paraguay. In 1980, the sister of Filartiga, who was a political refugee in Washington D.C. brought in proceedings against Pena-Irala who was residing as an illegal immigrant in the US. The Court, while awarding Filartiga damages amounting to about $10,000,000 held "*deliberate torture perpetrated under color of official authority violates universally accepted norms of the International Law of human rights, regardless of the nationality of the parties.*"

US Courts again addressed the question of universal jurisdiction in 1986 in the trial of *Demjanjuk* v. *Petrovsky*[129]. Demjanjuk had been a US citizen since 1951. However, in the 1980s, he was identified as 'Ivan the Terrible', the guard at the Nazi Concentration Camp of Treblinka. Israel issued a request for his extradition from the US. In dealing with this request, the Sixth Circuit relied heavily on the universality principle, stating *inter alia*, "*The 'universality principle' is based on the assumption that some crimes are so universally condemned that the perpetrators are the enemies of all people....when proceeding on that jurisdictional premise, neither the*

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[124] Unofficial translations of European cases quoted obtained from http://www.icrc.org/ihl-nat.nsf.

[125] Antonio Cassese, "On the Current Trends towards Criminal Prosecution and Punishment of Breaches of International Humanitarian Law", *European Journal of International Law*, Vol 9 (1998) No.1, available at http://www.ejil.org/journal/Vol9/No1/art1.html.

[126] See White *supra* note 94, at 129.

[127] See *supra* note 76.

[128] See *supra* note 99.

[129] *John Demjanjuk* v. *Joseph Petrovsky,* 776 F.2d 571 (6th Cir. 1985) at 583.

nationality of the accused or the victim(s), nor the location of the crime is significant. The underlying assumption is that the crimes are offences against the law of nations or against humanity and that the prosecuting nation is acting for all nations. This being so, Israel or any other nation, regardless of its status in 1942 or 1943, may undertake to vindicate the interest of all nations by seeking to punish the perpetrators of such crimes."

Demjanjuk was deported to Israel for trial. He was tried by the Israeli District Court and sentenced to death. However, the Israeli Supreme Court overturned the verdict as it found the evidence insufficient to prove conclusively that he was indeed 'Ivan the Terrible'.

B. International Criminal Tribunals

The 1990s saw thawing of relations between nations of the world. In the aftermath of the Cold War, development of International Law once again found itself on the priority list of the more developed nations of the world. This lead to the formation of the two International Criminal Tribunals in Rwanda and the former Yugoslavia.

The ICTY was set up as a reaction to the conflict in the former Yugoslavia, when the seriousness of the human rights violations in the region reached the rest of the world. On May 25, 1993, the Security Council of the United Nations (UN) unanimously passed Resolution 827 creating the Yugoslavia Tribunal pursuant to Chapter VII of the UN Charter and adopted its Statute.[130]

The formation of the ICTR followed a similar procedure. The Commission of Experts established by the Security Council in the to examine the violence in Rwanda in 1994 found evidence of genocide and other crimes against humanity perpetrated by ethnic Hutus and Tutsis against one another.[131] On November 8, 1994, the ICTR was established by a Security Council resolution[132] similar to the one adopted for establishing the ICTY.

Most writers maintain that the jurisdiction of these tribunals was not universal. It was limited geographically to the territories of former Yugoslavia and Rwanda

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[130] Statute of the Tribunal, Resolution 827, adopted by the Security Council at its 3217th meeting on May 25, 1993, U.N. Doc. S/RES/827 (1993). (hereinafter ICTY Statute).

[131] Letter dated December 9, 1994 from the Secretary-General addressed to the President of the Security Council, Final Report of the Commission of Experts, established pursuant Security Council resolution 935 (1994), December 9, 1994, UN Doc S/1994/1405 at 1, 6-25, 35-36.

[132] Statute of the International Criminal Tribunal for Rwanda, Resolution 955, adopted by the Security Council on 8 November, U.N. Doc S/RES/955 (1994) (hereinafter ICTR Statute).

respectively and temporally to those atrocities committed within the time period of the conflicts.[133] However, these Tribunals went a long way in enunciating certain principles of International Law as also recognising the universal condemnation of certain crimes.

For example, the ICTY's Appeals Chamber in the *Tadic Case*, in connection with genocide, stated "*universal jurisdiction is nowadays acknowledged in the case of international crimes*".[134] Similarly, the ICTR held in the case of *Prosecutor* v. *Ntuyahaga* that universal jurisdiction exists for the crime of genocide.[135] Both the ICTY and ICTR have also refused to recognise any form of sovereign immunity in their Statutes.[136] They also mark the first time when systematic rape has been recognised as a form of genocide. The work of both these tribunals is still in process.

The practice of the UN with respect to such international tribunals has remained rather inconsistent. While tribunals were set up for Yugoslavia and Rwanda, the 'killing fields' of Cambodia and the atrocities in East Timor remained unpunished raising questions of 'selective justice'. Also there is a question of 'tribunal fatigue' – given the time, costs and political considerations that go into setting up such an ad-hoc tribunal, few nations remain interested in the process.

C. *Other Trials*

Following the establishment of the International Criminal Tribunals, and plausibly as a result of the incentive created by that initiative, national courts in Denmark, Germany, Austria and Switzerland, among others, have begun to try and prosecute persons accused of committing atrocities in war-torn nations like Rwanda, the former Yugoslavia, Israel and Congo. The influx of refugees into Europe resulted in victims encountering violators in States where judicial remedies were possible and hence European Courts began receiving suits to punish egregious human rights abuses that did not occur on their territory or against their people.

Hence, in November 1994, a Danish court convicted a Bosnian Muslim, Refik Saric, of brutally torturing prisoners of war in a Croat-run prison camp in Bosnia, and sentenced him to eight years' imprisonment.[137] In Germany, Novislav

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133 S.R.Ratner and J.S.Abrams, *"Accountability for Human Rights Atrocities in International Law: Beyond the Nuremberg Legacy"*, at165-177 (Oxford University Press 1997).

134 See *supra* note 121 at 50.

135 International Criminal Tribunal For Rwanda: *The Prosecutor* v. *Bernard Ntuyahaga,* Case No. ICTR-98-40-T, *International Legal Materials,* 38 I.L.M. 866 at 869 (1999).

136 See ICTY Statute *supra* note 130, Article 7(2) and ICTR Statute *supra* note 132, Article 6(2).

137 The *Prosecution* v. *Saric*, Eastern Division of High Court (Third Chamber), November, 25 1994.

Djajic[138] was convicted in May 1997 and sentenced to five years of imprisonment for war-crimes and Nikola Jorgic[139] was convicted in September 1997 and sentenced to life imprisonment for genocide and murder. Both were Bosnian Serbs accused of crimes against Muslims in the former Yugoslavia. In a similar case, in April 1999, a Swiss military court convicted N, a Rwandan national, of having committed war crimes in Rwanda.[140]

The *Pinochet Case* in UK brought universal jurisdiction into the spotlight in 1998. General Augusto Pinochet was the military dictator of Chile from 1973 to 1990. He was known to have presided over several human rights violations including torture, forced disappearances and murders during his reign. In Spain, Judge Baltasar Garzon was formally investigating such crimes against Spanish nationals in Chile. In 1998, when Pinochet visited England for medical treatment, Spain applied to UK for his extradition to Spain to stand trial for torture.[141]

Pinochet was subjected to three hearings before the courts in England – one in the Queens Bench Division, and two in the House of Lords. These hearings addressed several questions of International Law including jurisdictional problems and sovereign immunity[142]. In the meantime, France and Belgium also joined in with requests for Pinochet's extradition. However, in March 2000, the British Home Secretary, Jack Straw, ruled that General Pinochet would not be extradited to Spain as he was medically unfit to stand trial.[143] However, the *Pinochet Case* has been held as a precedent in attempts at accountability for heads of State and dictators.

In February 2000, the trial of Hissene Habre in Senegal indicated that universal jurisdiction had reached even developing nations. Habre was the former dictator of the neighbouring Chad from 1982 to 1990. His reign, like that of most dictators, was marked by widespread human rights abuses and torture. After being deposed in 1990, Habre fled to Senegal. In February 2000, Senegal, acting

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138 *Public Prosecutor* v. *Djajic*, No. 20/96 (Sup. Ct. Bavaria, 3d Strafsenat, May 23, 1997) (reported in *American Journal of International Law,* 92 AJIL 528 (1998)).

139 Dusseldorf Supreme Court, Nikola Jorgic case, April, 30 1999, 3StR 215/98.

140 See Mckay *supra* note 112.

141 See White *supra* note 94 at 132; see also Pierson *supra* note 84; D. Cassel, "The Pinochet Case: Expanding International Accountability", *Northwestern Journal of International Affairs,* 1 Nw J. Int'l Aff. 35 (1999); E. C. Merrigan, "Notes & Comments: The General And His Shield: The Extradition Process Against General Pinochet Ugarte", *Temple International and Comparative Law Journal,* 15 Temp. Int'l & Comp. L.J. 101 (2001).

142 See *supra* note 115.

143 G.Sison, "A King No More: The Impact Of The Pinochet Decision On The Doctrine Of Head Of State Immunity", *Washington University Law Quarterly*, 78 Wash. U. L. Q. 1583 at 1596 (2000).

on complaints from Chadian victims, indicted Habre on the charge of torture. However, an Appeals Court quashed the indictment in July 2000, a move perceived by many as politically motivated. However, the Habre arrest marked for the first time an African country bringing human rights charges against another nation's Head of State, and it signaled the first use of the 'Pinochet precedent' outside Europe.[144]

Belgium has been at the forefront with respect to the application of the universality principle. The Case concerning the Arrest Warrant of April 11, 2000 that was fought between Belgium and the Democratic Republic of Congo in the International Court of Justice, saw several judges commenting on universal jurisdiction though the case was not decided on this principle. The Court found in favour of Congo on the principle of sovereign immunity.[145] Also the Court refused to recognise universal jurisdiction *in absentia*.[146]

This judgment has however not seemingly deterred Belgium's commitment to universal jurisdiction as seen by the June 2001 conviction of four Rwandans for their role in the genocide in Rwanda in 1994. They were given prison sentences ranging between twelve and twenty years.[147]

In June 2001, Belgium, acting on the complaint of twenty two Palestinians and Lebanese nationals, charged Ariel Sharon, the current Prime-Minister of Israel for his role in the 1982 massacres at the Sabra and Shantila refugee camps in Beirut in which almost 3500 civilians were murdered by Israeli forces.[148] However, on June 26, 2002, the Belgian Court ruled that it could not try Sharon as he was not present in Belgium.[149] This decision was widely criticised by several human rights groups as a set back to international justice.

D. The International Criminal Court [150]

The need for an International Criminal Court (ICC) was felt as long ago as

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144 See generally R. Brody, "Universal Jurisdiction: Myths, Realities, And Prospects: The Prosecution of Hissene Habre An "African Pinochet", *New England Law Review*, 35 New Eng.L. Rev. 321 (2001); see also Inbal Sansani, "The Pinochet Precedent in Africa: Prosecution of Hissene Habre", *Human Rights Brief*, 8 Hum. Rts. Br. 32 (2001).

145 See *supra* notes 109-110 and accompanying text.

146 Separate opinion of Judge Guillame, Case concerning the Arrest Warrant of April 11, 2000.

147 See Hans *supra* note 107 at 373; see also http://www.hirondelle.org/hirondelle.nsf/.

148 Laurie King-Irani, "Prevent another Massacre: End Ariel Sharon's Impunity for War Crimes Now", at http://electronicintifada.net/features/articles/020312laurie.shtml; See also www.indictsharon.net.

149 Ian Black, "Judges Decide Belgian War Crimes Law Cannot Be Used to Try Sharon", *The Guardian*, June 27, 2002, available at http://www.guardian.co.uk/israel/Story/.

150 See official website of the International Criminal Court at www.un.org/law/icc.

1949. The ICJ was found inadequate as it could only resolve disputes between States. There was no accountability for individuals in International Law. From 1949 to 1953, the International Law Commission (ILC) worked on a draft statute for such a court. However, the work was shelved due to various definitional and jurisdictional problems.

In the 1990s, the proposal for an ICC came up once again in the face of the atrocities witnessed in a large number of civil wars. In 1994, the ILC completed the first draft statute of the ICC. On July 17, 1998, the Rome Statute of the ICC was adopted by the United Nations Conference of Plenipotentiaries on the Establishment of an International Criminal Court. The adoption saw a vote with one hundred and twenty nations in favour, seven against and twenty-one abstentions. The ICC Statute came into force on July 1, 2002. As of today, it has one hundred thirty nine signatories and eighty nine parties. However the Court has not yet started functioning.

The ICC has a mandate to try individuals rather than States and to hold them accountable for the most serious crimes that are of concern to the international community – genocide, war crimes and crimes against humanity, and eventually, the crime of aggression. However, the ICC is entitled to try such crimes only if the national courts of the State concerned are unwilling or unable to do so.

A State accepts the jurisdiction of the ICC by ratifying the Rome Statute. This, in itself, is a major advancement in International Law, as prior to this, the additional consent of a State was required whenever it was named a party to a case at an international forum. Hence, with regards to State parties, the ICC has jurisdiction when one or more of the parties involved is a State Party, the accused is a national of a State Party, the crime is committed on the territory of a State Party; or a State not party to the Statute may decide to accept the court's jurisdiction over a specific crime that has been committed within its territory, or by its nationals. Hence in most cases, the jurisdiction of the ICC is not universal and requires the consent of the States involved.[151]

However, the Security Council of the UN, acting under Chapter VII of the UN Charter, may refer certain situations to the ICC, where it believes that crimes falling within the definitions outlined by the Statute have occurred. Chapter VII of the UN Charter charges the Security Council with the responsibility to determine acts that constitute a threat to peace and attempts at aggression. In the case of such referrals, the Prosecutor of the ICC initiates his investigation irrespective of whether the States involved are parties to the Statute or not. In such cases, the jurisdiction of the ICC becomes universal.

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[151] Nicolaos Strapatsas, "Universal Jurisdiction and the International Criminal Court", *Manitoba Law Journal*, 29 Man. L.J. 1 (2002).

The ICC aims at a jurisdiction that is complementary to that of national courts in the States involved. Under this principle of complementarity, the ICC will only exercise its jurisdiction when the courts of the nation concerned are unwilling or unable genuinely to do so. This includes situations where there is evidence of undue delays, partiality, external influence over the judiciary and blatant attempts at shielding the accused.[152] However, if a national court is willing and able to exercise jurisdiction, the ICC cannot intervene and no national of that State can be brought before it except in cases referred to it by the Security Council under Chapter VII of the UN Charter.

The jurisdiction of the ICC is not retroactive. Hence it applies only to crimes committed after July 1, 2002. Also, the ICC suffers from a certain amount of lack of credibility because two major nations – the USA and China – have not ratified the Rome Statute. The US was a major dissenter even at the Rome Conference in 1998 on the question of jurisdiction and the applicability to non-party States.

E. Universal Jurisdiction And India

Section 4 of *The Indian Penal Code, 1860* provides for extra-territorial jurisdiction of India when the offence in question is committed by an Indian citizen anywhere in the world or when it is committed on board a ship or aircraft that is registered in India. Also, India recognises universal jurisdiction for offences under the four Geneva Conventions of 1949 by *The Indian Geneva Conventions Act, 1960.*[153] So far, there have been no trials under it.

However, India, in the recent years, has become increasingly possessive of its own sovereignty. In face of questions on the Government's conduct in conflict zones like Kashmir and Punjab, India fears international interference in matters that it believes are of solely internal concern.

This attitude has been reflected in India's stand with regards to the ICC as well. At the Rome Conference where the statute of the ICC was adopted, the Indian delegation raised strenuous objections on the principle of National Sovereignty and the applicability of the Rome Statute to States that had not acceded to it by way of referrals from the Security Council. These objections stemmed from two primary grounds. Firstly, the applicability of the Statute to non-State parties, according to India, was in clear violation of Article 34[154] of the *Vienna Convention on the Law of Treaties.* Secondly, India, questioned the authority of the Security Council with respect to the situations it could refer to the Court, given that two

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[152] See ICC Statute, *supra* note 79, Article 17.

[153] Indian Geneva Conventions Act 1960, Sections 3(1) and 3 (2).

[154] Law of Treaties, *supra* note 24, Article 34: General rule regarding third States – "A treaty does not create either obligations or rights for a third State without its consent".

permanent members, viz. the US and China had credible reservations about the Statute.[155]

The Indian delegation at Rome had assumed that they were legislating for exceptional situations where the world saw a total collapse of law and order and State machinery in a particular region. However, they found the final Statute that had been adopted was found to be too broad in scope and feared its misuse for political purposes. As put by the delegation leader Mr. Dalip Lahiri, "*What the zealots have achieved, therefore, is a contradiction in terms: a Court framed with Armageddon in mind is set in Utopia.*"[156]

India was one of the seven countries that voted against the ICC Statute.

On December 26, 2002, the Foreign Secretary of India, Kanwal Sibal, and the US Ambassador to India, Robert Blackwill signed an agreement whereby neither country would surrender persons of the other country to any international tribunal without the other country's expressed consent. Both nations expressed concern over national sovereignty and the conflict of national judicial processes with those of such international tribunals. Though this agreement did not specifically mention the ICC, it was widely perceived to be a part of the US initiative against it.[157]

VI. Conclusion

Though the concept of universal jurisdiction has been present on the international consciousness for over three centuries, it is still in the process of evolution. The practice of States as regards this principle has seen sudden spurts of activity after the Second World War and the Cold War. However, the inaction in the interim period speaks for the lack of uniformity evidenced in the practice. Even now, there are no internationally recognised rules or policies which regulate the exercise of universal jurisdiction by States.

Given such inconsistencies, fears of politically motivated trials, abuses of the judicial processes, human rights violations and such potential threats to world order are around. Many also perceive universal jurisdiction as hegemonistic

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155 Usha Ramanathan, "India And The ICC", *The Frontline*, Volume 18 – Issue 07, March 31 - April 13, 2001; *See also* Marcus R. Mumford, "Symposium Issue: The International Criminal Court: Building Upon A Foundation Of Sand: A Commentary On The International Criminal Court Treaty Conference", *Michigan State University-DCL Journal Of International Law*, 8 MSU-DCL J. Int'l L. 151 (1999).

156 Explanation of vote on the adoption of the Statute of the International Criminal Court, Statement by Mr. Dilip Lahiri, Additional Secretary (UN) on July 17, 1998, available at: http://www.indianembassy.org/policy/ICC/ICC_Adoption_July_17_1998.html.

157 Amit Baruah, "India, U.S. Not To Surrender Nationals To Any Tribunal", *The Hindu*, Friday, December 27, 2002.

jurisdiction that can be exercised by Western powers against developing nations. The tensions that would potentially arise on the international scene as a result of jurisdictional conflicts and other such diplomatic and pragmatic concerns are also issues to be addressed.[158]

However, when the choice is between impunity for offenders and their prosecution in a foreign nation, the scales clearly tilt in favour of the latter option. The Security Council has been rather inconsistent in creating international criminal tribunals like the ICTY and ICTR. Also, the ICC, when it comes into existence, will not have jurisdiction over nationals of non-party States for offences committed in non-party States.[159] In the face of such failure of international prosecution, universal jurisdiction seems the only possible solution to bring internationally condemned criminals to justice, irrespective of where they choose to run.

However, it is also essential to recognise that there is a limit to what universal jurisdiction can achieve. While it serves to bring perpetrators of egregious human rights abuses to justice, it does not stop such abuses from occurring.[160] Hence until universal jurisdiction is allied with a universal right to humanitarian intervention irrespective of the locus of human rights abuses, the utility of the principle is limited.

Yet, in a world of global terrorism and sophisticated weaponry, universal jurisdiction is an essential concept[161] that needs to be recognised by all peace-loving nations of the world. As the famous English barrister, Geoffrey Robertson, wrote in his book *Crimes against Humanity*: "*Jurisdiction over ordinary crimes depends on a link, usually territorial, between the State of trial and the crime itself, but in the case of crimes against humanity, that link may be found in the simple fact that we are all human beings.*"[162]

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158 See Bassiouni *supra* note 5 at 155.

159 See Morris *supra* note 15 at 360.

160 See Brown *supra* note 86 at 397.

161 See Jordan *supra* note 19 at 31.

162 Quoted in A.G. Noorani, "Crimes Without Borders", *Hindustan Times*, Tuesday, August 6, 2002.

THE GOVERNOR'S POWER TO DISSOLVE THE LEGISLATIVE ASSEMBLY - JUDICIAL REVIEW AND OTHER FACETS†

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I. INTRODUCTION

The Governor of every State has, under the Constitution of India (Constitution), been accorded the power to dissolve the State Legislative Assembly under Article 174. The actual exercise of the power of dissolution has raised quite a few controversies in the past, and has thrown up certain extremely interesting constitutional questions of great importance, which have so far not been conclusively decided. This article attempts to venture into these relatively unexplored areas of our Constitution, which involve issues that are extremely delicate in nature. The article deals with the powers of the Governor to dissolve the State Legislative Assembly and the scope of judicial review thereof. It seeks to examine the nature of the power conferred upon the Governor in this regard, the constitutional and other legal provisions that affect the judicial review of such an action, the circumstances under which judicial review is available, the possibility of reinstating a dissolved Assembly if the power is found to be exercised in a manner not permissible and other related issues.[1]

† This article reflects the position of law as on February 16, 2003.

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1 The approach of the authors has been to put forth an objective and neutral view of these matters. The purpose of this article is not to make out a strong case for or against judicial review, but to examine the possibilities and practicality of the same. With this purpose in mind, the authors have first enlisted the steps of caution that must be taken before the power of judicial review is exercised, analysed the constitutional provisions that may affect or prevent the judicial review of such an action and have then examined the limited scope of judicial review. Most importantly, wherever conflicting views and interpretations exist, the authors have discussed both the views on the matter. Since these constitutional issues are such where extreme views may exist, the authors have attempted to examine the issues in detail and present to the readers the actual legal position keeping in mind the ultimate supremacy of the Constitution, with a hope that the article invokes constructive discussions on these issues. The views presented in this article are solely those of the authors.

II. The Nature Of The Power Conferred Upon The Governor By Way Of Article 174

In order to understand the position of the Governor and before proceeding to discuss whether judicial review of an order of dissolution of the Legislative Assembly is available, one must first look at the nature of power vested in him under Article 174.

Article 174 provides: "*174. Session of the State Legislature, prorogation and dissolution- (1) The Governor shall from time to time summon the House or each House of the Legislature of the State to meet at such time and place as he thinks fit, but six months shall not intervene between its last sitting in one session and the date appointed for its first sitting in the next session.*

"*(2) The Governor may from time to time - (a) Prorogue the House or either house; (b) Dissolve the Legislative Assembly.*"

The second clause of this Article thus confers upon the Governor the power to (i) prorogue the House or either House or (ii) to dissolve the Legislative Assembly.

In *State of Punjab* v. *Satya Pal Dang and others*[2], the Supreme Court has held, while dealing with Article 174(2): "*Article 174(2)(a) which enables Governor to prorogue the Legislature does not indicate any restrictions on this power.*"

In *Luizinho Faleiro* v. *State*[3], a case where Article 174(2)(b) was considered in great detail, the Hon'ble High Court of Bombay at Goa held: "*If the language of the Statute is plain and no ambiguity appears on the plain reading of the provisions of the statute, the Courts would not be justified in reading down the provisions, what the legislature did not intend. The power under Art 174(2)(b) is certainly an enabling provision, enabling the Governor to dissolve the Assembly. However, it is to be remembered that the exercise of that power, which is specifically conferred on the Governor by the said provisions of the Constitution, does not put any restriction on the exercise of that power.*"

The said Article does not contemplate that the Governor has to be subjectively satisfied on the basis of some material before the Assembly can be dissolved. Placing of material before the Governor for his subjective satisfaction is alien to Article 174(2)(b). The concept of 'satisfaction' enshrined in Article 356 is not incorporated in the present Article.

Further, in the words of Durga Das Basu[4], "*it has been held by the Supreme Court*[5]

2 AIR 1969 SC 903.

3 2002(1) Goa L.T 403 at para 29 (per Hardas, J.).

4 Durga Das Basu, *Shorter Constitution of India*, at 734 (Wadhwa and Company 13th Ed. 2001).

5 *Supra* note 2.

that neither the legislature nor its members have any constitutional right to have it undissolved till the expiry of the term specified in Art. 172(1)."[6] Thus, there is no legal right in a Member of the Legislative Assembly to have the Assembly continue for five years. On the contrary, the words of the Article 174(2), namely 'from time to time', are an indication that there is no constitutional provision prohibiting the dissolution before its term.

Therefore, the right to exercise this prerogative is not curtailed by the provisions of the Constitution.[7]

However, all these observations have to be read in the background of the fact that although there are no express words of limitation in Article 174(2)(b), still the Governor's power will have to be read subject to limitation implied in the scheme of the Constitution keeping in mind that rule of law, responsible and representative parliamentary democracy are essential features of the Constitution. Limitations on the power of the Governor can further be spelt out from the preamble to the Constitution to constitute a democratic republic and the oath to be taken by the Governor to preserve, protect and defend the Constitution and the law (Article 159).

Therefore, it is submitted that an attempt must be made to harmonise the obvious constitutional limitations with the observations about the unfettered nature of the power under Article 174 to correctly understand the true spirit in which this power is conferred upon the Governor.

A. Whether the Governor is Bound to Follow the Advice of the Council of Ministers

To further understand the nature of the Governor's power to dissolve the Legislative Assembly, it is also necessary to examine whether the Governor is bound to follow the aid and advice of the Council of Ministers in this regard, because in a large number of cases, the dissolution takes place on the advice of the Council of Ministers.

Article 163(1) of the Constitution, which deals with this aspect, reads: "*There shall be a Council of Ministers with the Chief Minister at the head to aid and advise the Governor in the exercise of his functions, except in so far as he is by or under this Constitution required to exercise his functions or any of them in his discretion.*"

From a plain reading of the Article, it is clear that the aid and advice or the sole discretion of the Chief Minister has no relevance at all. It must also be noted that there is a contrast in this Article and Article 74(1), wherein there is no mention of 'discretion'.

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6 *Samsher Singh* v. *State of Punjab* AIR 1974 SC 2192.

7 *Supra* note 3.

In the case of *Samsher Singh* v. *State Of Punjab*[8], the Supreme Court held: "*We declare the law of this branch of our Constitution to be that the President and Governor, custodians of all executive and other powers under various articles shall, by virtue of these provisions, exercise their formal constitutional powers only upon and in accordance with the advice of their Ministers save in a few well – known exceptional situations. Without being dogmatic or exhaustive, these situations relate to (a) the choice of Prime Minister (Chief Minister), restricted through this choice is by paramount consideration that he should command a majority in the House; (b) the dismissal of a Government which has lost its majority in the House, but refuses to quit office; (c) the dissolution of the House where an appeal to the country is necessitous, although in this area the head of State should avoid getting involved in politics and must be advised by his Prime Minister (Chief Minister) who will eventually take the responsibility for the step. We do not examine in detail the constitutional proprieties in these predicaments except to utter the caution that even here the action must be compelled by the peril to democracy and the appeal to the House or to the country must become blatantly obligatory.*"

While discussing the provisions in England, the Supreme Court of India observed in *P. Joseph John* v. *State of Travancore*[9]: "*It is an elementary principle of democratic Government prevailing in England and adopted in our Constitution that the Rajpramukh or the Governor as head of the State is in such matters merely a Constitutional head and is bound to accept the advice of his Ministers.*"

Therefore, subject to certain discretionary functions or powers of the Governor, the Constitution envisages a parliamentary system of Government both at the Union and State levels which means that neither the President nor the Governor is to exercise any functions personally.[10] He is the constitutional head of the Executive and his powers are to be exercised on the advice of the Council of Ministers and through Ministers or other officers to whom functions may be allocated according to rules of business made under Article 166(3).

While dealing specifically with the dissolution of the Legislative Assembly, the Report of the Committee of Governors[11] recommends: "*Normally a Governor should exercise the power of dissolution on the advice of the Council of Ministers. If a Chief Minister who enjoys majority support advises dissolution, the Governor must accept the advice, but if he advises dissolution after losing his majority, the Governor need accept his advice only if the Ministry suffers a defeat on a question of major policy and the Chief Minister wishes to appeal to the electorate for a mandate on the policy.*"

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8 (1974) 2 SCC 831 at para 154.

9 AIR 1955 SC 160.

10 *Supra* note 8.

11 Report of the Committee of Governors on the Role of Governors, at 55.

The opinion expressed by the Sarkaria Commission[12] is that the advice of the Chief Minister enjoying majority is normally binding on the Governor. The recommendations of the Sarkaria Commission in this regard are as under :

"*The Council of Ministers may advise the Governor to dissolve the Legislative Assembly on the ground that it wishes to seek a fresh mandate from the electorate. If the Ministry enjoys a clear majority in the Assembly, the Governor must accept the advice.*"

The aforesaid recommendation would clearly establish that if the Ministry enjoys a clear majority in the Assembly, the Governor must accept the advice. The said Commission further makes the following observations: "*It is a well-recognised principle that, so long as the Council of Ministers enjoy the confidence of the Assembly, its advice in these matters, - unless patently unconstitutional - must be deemed as binding on the Governor. It is only where such advice, if acted upon would lead to an infringement of a Constitutional provision, or where the Council of Ministers has ceased to enjoy the confidence of the Assembly, that the question arises whether the Governor may act in the exercise of his discretion.*"

It is submitted that in view of the positive observations of the Supreme Court in *S.R. Bommai* v. *Union of India*[13] (*Bommai Case*) in respect of these reports, the recommendations made in the reports can be heavily relied upon.

B. Exceptional Circumstances Under Which The Governor May Choose Not To Follow The Advice Given By The Council Of Ministers.

There are, however, certain situations where the Governor may not follow the advice of the Council of Ministers to dissolve the Assembly. These are discussed below.

In the paragraph from *Samsher Singh* v. *State of Punjab*[14] that has been quoted earlier, the Supreme Court has acknowledged that there exists an exception when the Governor may not follow the advice of the Council of Ministers, namely illustration (c) in the paragraph, relating to the dissolution of the House where an appeal to the country is necessitous.

The judgment of the Supreme Court in *B. R. Kapur* v. *State of T. N.*[15] also recommends that the Governor must exercise his discretion to prevent dangerous and absurd situations that can be created by the advice of the Council of Ministers. This must be read with the observations in the *Bommai Case* to the effect that 'it would also be a case of highly irrational exercise of the power', where the Chief Minister himself expresses inability to cope with his majority

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12 Sarkaria Commission Report on Centre State Relations, 1988, para 4.11.17.

13 (1994) 3 SCC 1.

14 *Supra* note 8 at para 154.

15 (2001) 7 SCC 231 at 330.

legislators, recommends to the Governor for dissolution, and the House is dissolved accordingly.

The Sarkaria Commission[16] also recommends that in case the dissolution is advised by a Ministry 'that has lost majority or appears to have lost majority', the Governor may act in his discretion.

It is thus observed that the Governor can exercise his discretion in a few exceptional circumstances and the advice and discretion of the Council of Ministers is not always absolute. These situations are the exceptions to the general rule, and therefore, it is submitted that 'the combined effect of all these observations is that the advice of the Council of Ministers is normally, but not always, binding on the Governor'.

III. The First Step Of Caution – A Prima Facie Cogent Case

Even before considering the scope of judicial review, the Court must, in such matters, refuse to exercise its jurisdiction where no case is made out by the petitioner. At the very outset, it must be examined as to whether or not a strong and cogent *prima facie* case is made out on the basis of averments made and the material relied upon.

This proposition is made on the basis of the observations in *S. R. Bommai* v. *Union Of India*[17], wherein it was categorically stated thus: "*Before exercise of the court's jurisdiction sufficient caution must be administered and unless a strong and cogent prima facie case is made out, the President i.e. the Executive must not be called upon to answer the charge.*"

The same view has been reiterated by Justice Jeevan Reddy[18] in the following words: "*We agree that merely because a person challenges the validity of the Proclamation, the court would not as a matter of course call upon the Union of India to produce the material / information on the basis of which that President formed the requisite satisfaction. The court must be satisfied, prima facie, on the basis of the averments made by the petitioner and the material, if any, produced by him that it is a fit case where the Union of India should be called upon to produce the material / information on the basis of which the President formed the requisite information.*"

This approach, which was recommended by the majority in *Bommai's case*, has also been adopted by Justice Daga in the case of *Luizinho Faleiro* v. *State of Goa*[19].

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16 *Supra* note 12.

17 *Supra* note 13.

18 *Ibid.*

19 per Daga,J., at page 45 of his unreported judgment (Goa Assembly Dissolution Case). Reference was made to Daga, J. because of difference of opinion between Aguiar, J. and Hardas, J.

The question to be asked first, therefore is – can it be said that any *prima facie* case is made out to establish that the decision of the Governor was arbitrary or *mala fide*? If the answer to it would be no, then any petition, if without any support and substance, and based completely on hypothetical premises and untrue allegations, must be dismissed.

A. Further Caution Before Exercising Judicial Review

The Doctrine of Separation of Powers has been broadly adopted by the Supreme Court.[20] It was also recognised as one of the basic features of the Constitution by Hon'ble C. J. Sikri in *Kesavananda Bharti* v. *State of Kerala*[21]. There are well recognised limitations on the power of the Court making inroads into the legitimate domain of the legislature. The supremacy of each of the three organs of the State, that is, Legislature, Executive, Judiciary in their respective fields of operations needs to be emphasised. The power of judicial review of executive and legislative action must be kept within bounds of the constitutional schemes so that there may not be an occasion to entertain misgivings about the role of judiciary in out-stepping its limits by unwarranted judicial activism.[22]

In case of unconstitutional acts, it is no doubt true that judicial review is indeed possible. Yet, it would be improper to read into Article 174 limitations that do not exist. Therefore, proving an act to be unconstitutional as violative of Article 174(2)(b) itself would be extremely difficult. It has been clearly accepted in the *Goa Assembly Dissolution Case*[23] that judicial review of the decision of the Governor in dissolving the Assembly pursuant to the exercise of the powers under Article 174(2)(b) is available to the extent of whether the dissolution is contrary to or in breach of any constitutional provisions or whether it is in excess of the powers conferred under Article 174(2)(b).

However, "*in order to hold any action as unconstitutional, it is imperative for the petitioners to establish that the said action is against or in violation of any constitutional provision. Article 174(2)(b) of the Constitution does not impose any restrictions on the exercise of power. Therefore, it cannot be contended that the dissolution is unconstitutional qua Article 174(2)(b) of the Constitution.*"[24]

Therefore, the scope of judicial review would be limited only to certain other aspects and other constitutional provisions, which have been discussed later.

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20 *National Textile Workers Union* v. *E.K. Ramakrishnan* (1983) 1 SCC 228.

21 AIR 1973 SC 1461.

22 *M.P. Oil Extraction* v. *State of Madhya Pradesh* (1997) 7 SCC 592.

23 *Supra* note 3.

24 *Supra* note at para 55.

Further, observations made on Article 356 cannot be considered to be directly applicable to Article 174. It is an admitted position that the ruling of the Apex Court in the *Bommai Case* with regard to Article 356 is not binding as far as Article 174 is concerned. In fact, the Bombay High Court in *Pratapsingh Raojirao Rane* v. *Governor of Goa and others*[25] observed: "*In our opinion, the ruling of the Apex Court in Bommai's Case (AIR 1994 SC 1918) (supra) would not be attracted to the fact situation in the case before us. Bommai's case (supra) was with reference to the challenge to the Proclamation under Article 356.*"

These are the various factors that have to be kept in mind before considering whether judicial review of the order of a Governor is possible. Of course, a lot would also depend upon the facts and circumstances of each case where such an action is challenged. As stated earlier, if the facts do not reveal any necessity to entertain the petition, there would no question of going further into the matter.

IV. An Examination Of The Relevant Provisions Of The Constitution And Other Enactments

A Nine Judge Bench of the Supreme Court in *S. R. Bommai* v. *U.O.I.*[26] declared, "*judicial review is a basic feature of the Constitution. The Supreme Court / High Courts have the constitutional duty and responsibility to exercise judicial review as sentinel on the qui vive. Judicial review is not concerned with the merits of the decision, but with the manner in which the decision was taken*". Judicial review has been held to be a part of the basic structure of the Constitution.[27, 28]

The classic, memorable and oft-quoted observations of Justice Bhagwati on judicial review in the case of *State of Rajasthan* & *Others* v. *Union of India*[29], read as follows: "*Of course, it is true that if a question brought before the Court is purely a political question not involving determination of any legal or constitutional right or obligation, the Court would not entertain it, since the Court is concerned only with adjudication of legal rights and liabilities. But merely because a question has a political complexion, that by itself is no ground why Court should shrink for performing its duty under the Constitution if it raises an issue of constitutional determination. Every constitutional question concerns the allocation and exercise of government power and no constitutional question can, therefore, fail to be political. ... It will, therefore, be seen that merely because a question has a political colour, the Court cannot fold its hands in despair and declare "Judicial hands off". So long as a question arises whether an authority under the Constitution has acted within the limits of its power or exceeded it, it can certainly be decided by the Court. Indeed it would be its constitutional obligation to do*

25 AIR 1999 Bombay 53.

26 *Supra* note 13 at para 255.

27 *Minerva Mills* v. *Union Of India* (1980) 3 SCC 625 at para 87.

28 *L. Chandrakumar* v. *Union Of India* (1997) 3 SCC 261.

29 1977 (3) SCC 590 at para 149.

so. ... Where there is manifestly unauthorised exercise of power under the Constitution, it is the duty of the Court to intervene. ... The Court cannot and should not shirk this responsibility, because it has sworn the oath of allegiance to the Constitution and is also accountable to the people of this Country."

With specific reference to the Governor, in the very recent landmark case of *B. R. Kapur* v. *State of T. N.*[30] (popularly known as the *Jayalalitha Case*), the Supreme Court, having relied on the above observations, observed: "*The Governor is a functionary under the Constitution and is sworn to "preserve, protect and defend the Constitution and the law" (Article 159). The Governor cannot, in the exercise of his discretion or otherwise, do anything that is contrary to the Constitution and the laws.*" In the same case, the view enunciated is that if any action is taken by the Governor even in the matter of appointment of the Chief Minister, and if the action of the Governor is found to be contrary to the Constitution, the Court will have the power to strike it down.

In *Pratapsingh Raojirao Rane* v. *Governor of Goa*[31] it was observed that the orders passed by the Governor fall in four broad categories :

(i) The exercise of executive power in accordance with the provisions of the Constitution by or under the Order of the Governor wherein full judicial review is available;

(ii) Orders passed by the Governor on aid and advice of the Council of Ministers headed by the Chief Minister wherein full judicial review is available;

(iii) Orders like grant of pardon under Article 161 and the order passed by the President on the report on account of which limited judicial review is available; and

(iv) Where The Governor acts without aid and advice of the Council of Ministers headed by the Chief Minister and acts in his own discretion and judicial review is not available.

In view of the observations made in the above judgment, there arises a matter capable of generating great controversy and heated debate, namely, whether the Governor acts in his own discretion 'while accepting the advice of the Council of Ministers'. In other words, does the order of dissolution fall within the second category or the fourth category? The answer to this question would have great implications. There are obviously, therefore, two conflicting views on this issue.

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30 (2001) 7 SCC 231.

31 *Supra* note 25.

- The case for judicial review: The order of the Governor which is in challenge, if based on the aid and advice of the Council of Ministers, clearly falls within the second category, and thus full judicial review is available. If the Governor has not acted in his sole discretion but based his judgment on the aid and advice of the Council of Ministers, his action is not immune from challenge in the Court. The essence of this argument is that the very fact that the Governor has been advised to dissolve the Assembly and he then follows the advice, clearly puts such an order directly into the second category.

- The case against judicial review: The Governor exercises discretionary power when he accepts advice of the Council of Ministers and no court would enquire into such advice tendered by the Council of Ministers. The very decision of the Governor to accept the advice of the Council of Ministers is an act of discretion. The Governor is not bound to accept the advice of the Council of Ministers, unlike the President of India, who is bound to act as per the advice of the Council of Ministers, and to that extent therefore, the action of the Governor in dissolving the Assembly, though on the advice of the Council of Ministers, is a discretionary exercise of his powers. The discretionary power is not subject to challenge in view of the provision contained in Article 163(2) of the Constitution of India.

  Article 163(2) reads thus: "*If any question arises whether any matter is or is not a matter as respect which the Governor is by or under this Constitution require to act in his discretion, the decision of the Governor in his discretion shall be final, and the validity of anything done by the Governor shall not be called in question on the ground that he ought or ought not to have acted in his discretion.*"

In view of the decision in *Samsher Singh's Case*[32], the proposition that the Governor is required to act in his discretion only by express provisions, is no longer good law, for, both the judgments (of A. N. Ray, C. J. and Krishna Iyer J.) ruled that in some cases the Governor had power to act in his discretions a matter of necessary implication.

Further, it has been clearly held that "*the Governor has a discretion or elbow room to accept the advice or to decline to accept the advice of the Council of Ministers*".[33] It is also obvious that the action of the Governor cannot be faulted on the ground that the Governor in the exercise of his discretionary power ought or ought not to have acted in a particular manner[34], 'as the Court cannot substitute its own opinion for that of the Governor'.

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32 *Supra* note 8.

33 *Supra* note 7 (per Hardas, J).

34 *Ibid.*

It has been accepted that the Courts cannot enquire if any, or what advice was tendered by the Council of Ministers. The Courts cannot probe into the reasons for dissolution and sit in appeal, nor can they examine whether the reasons justify the action of dissolution.

In such a situation, it would be "*extremely hazardous for the Court to venture an opinion that the Governor ought not to have accepted, in his discretion, the advice of the Council of Ministers without the same being supplemented by other material.*"[35]

A. Article 163(3)

While considering any case where dissolution of the Assembly has taken place on the advice of the Council of Ministers, the provisions of Article 163(3) are extremely relevant. This Article provides: "*The question whether any, and if so what, advice was tendered by the ministers to the Governor shall not be enquired into in any Court.*"

Once again, there are two divergent views about the actual effect of this article in cases of dissolution.

1. The Case For Judicial Review

While dealing with Article 163(3) of the Constitution, it must be remembered that the words of this clause are identical to Article 74(2), except that in place of the word 'President', the word 'Governor' has been used.

In view of this similarity, the learned author H. M. Seervai, has opined in his monumental work, *Constitutional Law of India*, while dealing with the *Bommai Case* : "*A number of judges considered the effect of Article 74(2) which provides that the question whether any, and if so what, advice was tendered by Ministers to the President shall not be inquired into in any Court...It is submitted that the view taken by all the judges as to the effect of Article 74(2) is correct and the same would apply equally to the provisions of Article 163(3).*"[36]

Therefore, the interpretation of Article 74(2) in the *Bommai Case* and other cases is extremely relevant.

The object of Article 74(2) was not to exclude any material or documents from the scrutiny of the courts but to provide that an order issued by or in the name of the President could not be questioned on the ground that it was either contrary to the advice tendered by the Ministers or was issued without obtaining any advice from the Ministers.[37] The restrictive

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[35] *Ibid.*

[36] H. M. Seervai, *Constitutional Law of India*, at 3098 (N. M. Tripathi Pvt. Ltd. 4th Edn. 1996).

[37] *Supra* note 13 at para 83 (per Sawant, J. for Kuldip Singh, J. and himself).

clause under Article 74(2) and the wider power of this Court under Article 142 need to be harmonised.[38] *The limited provision contained in Article 74(2) cannot override the basic provisions in the Constitution relating to judicial review.*[39]

In decided cases, the Court has held that there is nothing to prevent the Court to compel production of the materials upon which the advice or its reasoning was based, *because the 'material' cannot be said to be the part of the advice.*[40] *In other words, the bar of judicial review is confined to the factum of advice but not the reasons, i.e. the material on which the advice is confounded.*[41]

Thus, it is clearly established by the Supreme Court that "*although Article 74(2) bars judicial review so far as the advice given by the Ministers is concerned, it does not bar scrutiny of the material on the basis of which the advice is given. The courts are not interested in either the advice given by the Ministers to the President or the reasons for such advice. The courts are, however, justified in probing as to whether there was any material on the basis of which the advice was given, and whether it was relevant for such advice and the President could have acted on it.*"[42]

The Supreme Court has categorically stated: "*The argument that the advice tendered to the President comprises material as well and, therefore, calling upon the Union of India to disclose the material would amount to compelling the disclosure of the advice is, if we can say so respectfully, to indulge in sophistry. The material placed before the President by the Minister / Council of Ministers does not thereby become part of advice. Advice is what is based upon the said material. Material is not advice.*"[43]

2. The Case Against Judicial Review

In *Ram Nagina* v. *Sohani*[44], the Court held that the question *whether any advice* was tendered to the Governor by the Ministers shall not be inquired into in by any Court. Further, the question as to 'what advice' was tendered by the Ministers to the Governor shall also not be inquired into in any court.

Article 174(2)(b) does not contemplate that the Governor has to be subjectively satisfied on the basis of some material before the Assembly can be dissolved. Placing of material before the Governor for his subjective satisfaction is alien to Article 174(2)(b). *If this is so, apart from the advice of the Council of Ministers, which may be oral or written, the Governor, really speaking has no material before him.*

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38 *Supra* note 13 at para 205.

39 *Supra* note 13 at para 321.

40 *Gupta, S. P* v. *Union of India* AIR 1982 SC 149.

41 *R. K. Jain* v. *Union of India* (1993) 4 SCC 119 at paras 54-55.

42 *Supra* note 13 at para 86 (per Sawant, J. for Kuldip Singh, J. and himself).

43 *Supra* note 13 at para 324.

44 AIR 1976 Pat. 36.

With regard to Article 74(2), which is couched in the same language as Article 163(3) except for the use of the word 'President' in place of 'Governor', it is observed: "*Even though after the 1976 amendment of Cl. (1), the President is bound to act according to the advice of the Council of Ministers, the Court are powerless to compel the President to take advice of the Council of Ministers on any matter and then to compel production of the advice, or the reason behind that advice*[45]*, if any, tendered by the Council of Ministers.*"[46]

In many cases what is placed before the Governor is the advice and nothing more. Keeping this in mind, it must be noted that Article 163(3) precludes the Court from inquiring into this question.

B. Article 361

Further, the scope of Article 361 in such matters has also been dealt with in *S. Dharmalingam* v. *Governor, State of T. N.*[47]. The Court considered the views in *K. A. Mathialagan* v. *The Governor*[48] and held: "*The Governor exercises three kinds of powers:-1)The executive power taken in the name of the Governor; 2)The power exercised by him with the aid and advice of the Council of Ministers headed by the Chief Minister; and 3)the power exercised by him in his sole discretion. Though the immunity under Art 361 is not available with regard to the first two categories of exercise of power, viz., the executive power and the power exercised by the aid and advice, in so far as it relates to matter where the power of the Governor comes to be exercised solely in his discretion, he is completely immune and his action cannot be called in question.*"

The Governor as per Article 361 enjoys 'personal immunity' and would not be answerable to any Court for the exercise and performance of powers and his duties subject to the exceptions; such as blatant or serious violation of Constitutional provisions, lack of power, etc. The protection offered by the Article extends not only to the official acts and omissions but also to acts and omissions which can be said to be incidental to the exercise of the powers of performance of the duties of the Governor.[49] Thus, the position in law is clear that the Governor, while taking decisions in his 'sole discretion', enjoys immunity under Article 361 and the discretion exercised by him in the performance of such functions is final in terms of Article 163(2). Here again, the controversy discussed earlier arises as to whether the order of dissolution is one made in the sole discretion of the Governor and this, along with the individual facts and

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45 *State of Punjab* v. *Sodhi Sukhdev Singh* AIR 1961 SC 493 at paras 3, 42; *Birinder Singh Rao* v. *Union of India* AIR 1968 P& H 441 at paras 9, 15; *Vidyasagar Singh* v. *Krishna Ballabha Sahay* AIR 1965 Pat 321.

46 *Supra* note 4 at 494.

47 AIR 1989 Mad. 48.

48 AIR 1973 Mad. 198.

49 *Satwant Singh, K.* v. *State of Punjab* AIR 1960 SC 266.

circumstances of each case, determines the applicability of Article 361.

C. *Section 123 Of The Evidence Act*

In the event that the State seeks to rely upon Section 123 of the *Indian Evidence Act, 1872* for not producing the material on which their advice was based, the following observations of the Supreme Court are directly applicable: "*Section 123*[50] *of the Indian Evidence Act, 1872, in our opinion, is in no manner relevant in ascertaining the meaning and scope of Article 74(2). Its field and purpose is altogether different and distinct.*[51] *... It may happen that while justifying the Government's action in court, the Minister or the official concerned may claim a privilege under Section 123. If and when such privilege is claimed, it will be decided on its own merits in accordance with the provisions of that section. But, Article 74(2) does not and cannot mean that the Government of India need not justify the action taken by the President in the exercise of his functions because of the provision contained therein.*"[52]

In view of the above discussion, it is quite clear that judicial review of the order dissolving the Legislative Assembly is available, but to a very limited extent. The question therefore to be considered now is of the scope and extent of judicial review.

V. The Limited Scope Of Judicial Review

At the very outset, it must be mentioned that the Court cannot look into the correctness of the Governor's decision in the particular facts of each case, as it is well established that the Court, in such cases, cannot simply substitute its view for that of the Governor. In case of unconstitutional acts, it is no doubt true that judicial review is indeed possible. It has been clearly accepted that judicial review of the decision of the Governor in dissolving the Assembly pursuant to the exercise of the powers under Article 174(2) (b) is available. "*The extent and scope of judicial review, according to me, is as follows: Whether the dissolution is contrary to or in breach of any constitutional provisions or whether it is in excess of the powers conferred under Article 174(2)(b)?*"[53]

With regard to the powers of the Governor under Article 174, Durga Das Basu has observed, "*even in the Rajasthan Case*[54]*, it has been acknowledged that the courts*

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50 "123. The Evidence as to affairs of State — No one shall be permitted to give any evidence derived from unpublished official records relating to any affairs of State, except with the permission of the officer at the head of the department concerned, who shall give or withhold such permission as he thinks fit."

51 *Supra* note 13 at para 322.

52 *Supra* note 13 at para 323.

53 *Supra* note 7 (per Hardas, J.).

54 AIR1977 SC 1361.

may possibly interfere with the exercise of the foregoing powers in case of a mala fide views".[55]

It must be borne in mind that in *Minerva Mills* v. *Union Of India*[56], the Court observed : "*It is a cardinal principle of our Constitution that no one howsoever highly placed and no authority however lofty can claim to be the sole judge of its power under the Constitution or whether its action is within the confines of such power laid down by the Constitution.*"

In light of these observations, it must be seen that although there are no express words of limitation in Article 174(2)(b), still the Governor's power will have to be read subject to limitation implied in the scheme of the Constitution keeping in mind that rule of law and responsible and representative parliamentary democracy are essential features of the Constitution. The oath of the Governor (Article 159) and the Preamble to the Constitution, which envisages a democratic republic, indicate further limitations.

Further, the scope of judicial review available under certain other Articles of the Constitution must be looked at, not with the object of making the observations made on those Article binding as far as Article 174 is concerned, but to ascertain the broad constitutional framework in this regard.

To substantiate the fact that certain judicially evolved principles relating to the scope of judicial review within the constitutional scheme do exist, and must be taken into consideration, the following observations in the *Bommai Case* must be carefully read: "*The scope of judicial review would be on the same or similar grounds on which the executive action of the State is challengeable under constitutional or administrative law principles evolved by this Court, namely, non-compliance with the requirements of natural justice, irrational or arbitrary, perverse, irrelevant to the purpose or extraneous grounds weighed with the President, misdirection in law or mala fide or colourable exercise of power, on all or some of the principles.*"[57]

In *State of Rajasthan* v. *Union of India*[58], there was a broad consensus among five of the seven judges that the Court can interfere if it is satisfied that the power under Article 356 has been 'exercised mala fide or on wholly extraneous or irrelevant grounds'. Some learned Judges have stated the rule in narrow terms and some others in a little less narrow terms but 'not a single learned Judge held that the Proclamation is immune from judicial scrutiny'. The importance of this observation must be gauged from the fact that at that time, clause (5) which was then a part of Article 356 barred judicial review of the Proclamation 'and yet the judges said that Court can interfere on the ground of mala fides or where it is based wholly on extraneous or irrelevant grounds'.

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55 Su*pra* note 4 at 734.

56 (1980) 3 SCC 625.

57 *Supra* note 13 at para 158.

58 AIR 1977 SC 1361.

After referring to the above mentioned case, the Hon'ble Court in the *Bommai Case* stated: "*Without trying to be exhaustive, it can be stated that if a Proclamation is found to be mala fide or is found to be based wholly on extraneous and/or irrelevant grounds, it is liable to be struck down, as indicated by a majority of learned Judges in the State of Rajasthan.*"[59]

In the said case, every member of the Nine Judge Bench agreed that the Presidential Proclamation issued under Article 356 of the Constitution is not completely beyond judicial review. All the judges agreed that the *mala fides* provide a ground for judicial interference.

In *A. K. Roy* v. *Union of India*[60], the Court has observed that "*clause (5) has been deleted by the 44th Amendment and, therefore, any observations made in the State of Rajasthan case on the basis of that clause cannot any longer hold good*". These observations imply that after the deletion of clause (5), the judicial review of the Proclamation issued under Article 356(1) 'has become wider' than indicated in the *State of Rajasthan case.*

In *Kehar Singh* v. *Union of India*[61], it was held that the President's power under Article 72[62] of the Constitution falls squarely within the judicial domain and can be examined by the court by way of judicial review. However, the order of the President cannot be subjected to judicial review on its merits except within the strict limitations defined in *Maru Ram* v. *Union of India*[63]. Those limitations are *whether the power is exercised on considerations or actions which are wholly irrelevant, irrational, discriminatory or mala fide.*

In the *Bommai Case*, Sawant J. concluded (for Kuldip Singh, J. and himself) by stating: "*The validity of the Proclamation issued by the President under Article 356(1) is judicially reviewable to the extent of examining whether it was issued on the basis of any material at all or whether the material was relevant or whether the Proclamation was issued in the mala fide exercise of the power. When a prima facie case is made out in the challenge to the Proclamation, the burden is on the Union Government to prove that the relevant material did in fact exist, such material may be either the report of the Governor or other than the report.*"[64]

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59 *Supra* note 13 at para 374 (per Jeevan Reddy, J. for Agrawal, J. and himself).

60 (1982) 1 SCC 271.

61 AIR 1988 SC 1883.

62 Article 72 deals with the grant of pardons, reprieves, respites, remissions of punishments or suspensions, remissions or commutations of sentences of any person convicted of any offence.

63 AIR 1980 SC 2147.

64 *Supra* note 13 at para 153.

The Court further explained in the *Bommai* Case : "*Although, therefore, the sufficiency or otherwise of the material cannot be questioned, the legitimacy of inference drawn from such material is certainly open to judicial review.*"[65]

It is submitted that a glance at the above cases and an understanding of the constitutional scheme makes it clear that when such instances of abuse of power take place, the power of judicial review is certainly available, and in fact, must be exercised at least in the following cases:

- When the action is carried out in the *mala fide* exercise of power. While explaining the scope of the term '*mala fides*', the Hon'ble Supreme Court explained: "*The ground of mala fides takes in inter alia situations where the Proclamation is found to be a clear case of abuse of power, or what is sometimes called fraud on power – cases where this power is invoked for achieving oblique ends. This is indeed merely an elaboration of the said ground.*"[66]
- Where the exercise of the power is based on extraneous and irrelevant grounds.[67]
- Where the exercise of power is irrational or without any nexus.[68]
- Where there is a misdirection in law.[69]

VI. The Illegality Of The Order Of The Governor – Factual Situations

Having examined the limited scope of judicial review, it is worthwhile to look at the various factual situations where the order of the Governor to dissolve the Assembly may be patently illegal and falling in one of the four categories mentioned above. Now, while the correctness of the decision of Governor cannot be gone in to by the Court, the Court can nevertheless go into the question whether there was any material at all placed before the Governor to enable him to exercise his discretion and whether the material, if any, was relevant. For instance, it may happen that in a certain case, no material, relevant or otherwise seems to have been placed before the Governor, nor does it appear that the Governor, in exercise of his discretion, had made any effort to obtain such material for his consideration as stated above. In addition to this, it is well known that instances have occurred in the past where the action of the Chief Minister in dissolving the House suffers from personal *mala fides* and, that the

65 *Supra* note 13 para 74.

66 *Supra* note 13 at para 374 (per Jeevan Reddy, J.for Agrawal, J. and himself).

67 *A. K. Kaul and another* v. *Union Of India* JT 1995 (4) S.C. 1.

68 *Supra* note 13 at para 227.

69 *Supra* note 13 at para 158.

mala fides have in turn affected the decision of the Governor in dissolving the Assembly. It is submitted that in such cases, no real and genuine grounds exist on the basis of which an honest opinion could be formed by the Governor to dissolve the Assembly; and consequently the decision of the Governor is vitiated by *mala fide* advice of the Chief Minister which is based on wholly extraneous considerations of saving his position for various reasons. In the case of *Arun Kumar Rai Chaudhary* v. *Union of India*[70], it was observed that even if the Houses are dissolved, the Council of Ministers continues. In these kinds of cases it is clear that the power to dissolve the Legislative Assembly has been used for a purpose not authorised by law, namely, only to prevent loss of strength in the Legislative Assembly and to cling on to power and derive unfair advantage from their position of power in contesting the elections.

There are many other situations where improper use of power can be inferred. These have been enlisted in paragraph 82 of the *Bommai Case.* Durga Das Basu, while commenting upon Article 174 has opined: "*... it can be stated with an amount of certainty that illustrations given in para 82 of Bommai indicate improper use of the power*".[71] The examples of these situations and comments thereon are given below :

- Where a Ministry resigns or is dismissed on losing its majority support in the Assembly and the Governor recommends, imposition of President's rule without exploring the possibility of installing an alternative Government enjoying such support or ordering fresh elections.
- Where, despite the advice of a duly constituted Ministry which has not been defeated on the floor of the House, the Governor declines to dissolve the Assembly and without giving the Ministry an opportunity to demonstrate its majority support through the 'floor test', recommends its supersession and imposition of President's rule merely on his subjective assessment that the Ministry no longer commands the confidence of the Assembly.
- Where Article 174 is sought to be invoked for superseding the duly constituted Ministry and dissolving the State Legislative Assembly on the sole ground that, in the General Elections to the Lok Sabha, the ruling party in the State, has suffered a massive defeat.
- The use of the power will be improper if, in certain cases, the Governor gives no prior warning or opportunity to the State Government to correct itself. Such a warning can be dispensed with only in cases of extreme urgency where failure to take immediate action will lead to disastrous

70 AIR 1992 Allahbad 1.

71 *Supra* note 4 at 735.

consequences.

- The use of this power to sort out internal differences or intra-party problems of the ruling party would not be constitutionally correct.
- This power cannot be legitimately exercised on the sole ground of stringent financial exigencies of the State.
- This power cannot be invoked merely on the ground that there are serious allegations of corruption against the Ministry.
- The exercise of this power, for a purpose extraneous or irrelevant to the one for which it has been conferred by the Constitution, would be vitiated by legal *mala fides*.

Further, the following important observation was made in the *Bommai Case*: "*Where the Chief Minister himself expresses inability to cope with his majority legislators, recommends to the Governor for dissolution, and dissolution accordingly was made, exercising the power by the President, it would also be a case of highly irrational exercise of the power.*"[72]

The Sarkaria Commission[73] recommended that when the advice to dissolve the Assembly is made by a ministry which has lost 'or appears to have lost majority' in the House, the Governor should adopt the course of action as suggested in paragraphs 4.11.09 to 4.11.13 and 4.11.20 as may be appropriate. Under paragraph 4.11.20, the exigencies of the situations must be such that 'the Governor must necessarily overrule the advice of the ministry if he has to ensure that the relevant constitutional requirements are observed both in letter and in spirit'. The Commission recommended that if the Chief Minister neglects or refuses to summon the Assembly for holding a 'floor test', the Governor should summon the Assembly for the purpose. In Para 4.11.30, a possible situation is that it may be too early to hold fresh election. Frequent elections, one closely following another, tend to distract the attention of the people, disturb the continuity of administration, and involve heavy expenditure.

Further, the Report of the Committee of Governors on the Role of Governors, at page 54, reads thus: "*The Assembly may, however be dissolved earlier by the Governor. An earlier dissolution may become necessary in any one of the following contingencies :*

1. *The Government is defeated in the State Legislative Assembly on an adverse vote*

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72 *Supra* note 13 at para 222.

73 *Supra* note 12.

amounting to an expression of vote of no confidence in the Council of Ministers, and no alternative government can be formed.

2. *The Chief Minister asks for dissolution on the ground that, due to certain changed circumstances, the Government feels that it should seek a fresh mandate from its political sovereign, the people.*"[74]

If there is no change of circumstances warranting dissolution of the House, and the Chief Minister, being aware of the imminent loss of confidence in the House, resorts to subterfuge and persuades the Governor to dissolve the House, it would be an improper use of the power.

Additionally, the Supreme Court in *Shamsher Singh* v. *State of Punjab*[75], while considering dissolution of the House where an appeal to the country was necessitous, has observed thus: "*We do not examine in detail the constitutional properties in these predicaments except to utter the caution that even here the action must be compelled by the peril to democracy and the appeal to the House or to the country must become blatantly obligatory.*"

Based on the aforesaid passage, two limitations are sought to be spelt out : (i) action must be compelled; and (ii) the appeal to the House or to the country must become blatantly obligatory.

Further, while recommending a 'floor test', the Supreme Court states: "*In this connection, it is also necessary to stress that in all cases where the support to the Ministry is claimed to have been withdrawn by some legislators, the proper course for testing the strength of the Ministry is holding the test on the floor of the House. That alone is the constitutionally ordained forum for seeking openly and objectively the claims and counter-claims in that behalf. The assessment of the strength of the Ministry is not a matter of private opinion of any individual, be he the Governor or the President... Such private assessment is an anathema to the democratic principle, apart from being open to serious objections of personal mala fides.*"[76]

It is pertinent to note that both the Sarkaria Commission and the Rajamannar Commission, headed by two distinguished Judges of this land, have also recommended 'floor-test'.

The question of putting a heavy burden on the State Exchequer on the mere whim of the Chief Minister and the Council of Ministers, or of the Governor himself, is something that should also weigh heavily on the Governor while deciding whether or not to dissolve the Assembly.

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74 *Supra* note 11 at 54.

75 *Supra* note 8 at para 154.

76 *Supra* note 13 at para 119.

It is thus a necessity that the Governor in every situation must exercise his discretion to find out whether it is really necessary to go in for a fresh elections, more so if not many months have gone into the life of Assembly. The conscious failure on the part of the Governor to explore the continuation of the Assembly for full term is a failure on the part of the Governor in protecting and upholding the Constitution.

VII. The Relief That Can Be Granted - The Power Of The Courts To Reinstate The Dissolved Legislative Assembly

Any discussion on this subject would be incomplete without considering whether any relief can be granted at all. Fortunately enough, the Supreme Court has already ruled that a dissolved Legislative Assembly can be reinstated. The conclusions of Sawant, J. and Kuldip Singh, J. in the *Bommai Case.* in this regard, which the majority of the judges agree with, are as follows :

"*V. If the Proclamation issued is held invalid, then notwithstanding the fact that it is approved by both Houses of Parliament, it will be open to the court to restore the status quo ante to the issuance of the Proclamation and hence to restore the Legislative Assembly and the Ministry.*

VI. In appropriate cases, the court will have power by an interim injunction, to restrain the holding of fresh elections to the Legislative Assembly pending the final disposal of the challenge to the validity of the Proclamation to avoid the fait accompli and the remedy of judicial review being rendered fruitless. However, the court will not interdict the issuance of the Proclamation or the exercise of any other power under the Proclamation."[77]

In the same judgment, Jeevan Reddy, J. and Agarwal, J., while affirming the above view, state :

"*If the Court strikes down the proclamation, it has the power to restore the dismissed Government to office and revive and reactivate the Legislative Assembly wherever it may have been dissolved or kept under suspension.*"[78]

The reasoning behind this is stated in the following lines: "*Now, coming to the power of the court to restore the Government to office in case it finds the Proclamation to be unconstitutional, it is, in our opinion, beyond question. ... If this power were not conceded to the court, the very power of judicial review would be rendered nugatory and the entire exercise meaningless.*" [79]

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[77] *Supra* note 13 at para 153.

[78] *Supra* note 13 at para 434.

[79] *Supra* note 13 at para 291.

To answer the question as to whether these observations are applicable even in the case of improper dissolution of the Assembly under Article 174, the learned jurist Durga Das Basu has observed: "*The Courts can also restore status quo ante and mould relief suitably. Actions taken by the President can be declared valid by the Court or validated by the appropriate legislature.*"[80]

A precedent for restoration of dissolved Assembly was set up at an unlikely place that is the Supreme Court of Pakistan.

VIII. Concluding Comments And Questions

It is submitted that in view of these observations and keeping in mind the wide jurisdiction of the Supreme Court under Article 142 of the Constitution, in a fit case, the Court has full power to reinstate the dissolved Assembly. However, it must be noted that a writ petition filed after fresh elections have taken place would be of no use. Even in the *Bommai Case*, the Supreme Court did not reinstate the dissolved Assemblies as fresh elections had taken place and the new Assembly was functioning.

A writ petition would rarely be admitted or entertained if the relief had become academic, for instance, where the relief sought in the proceeding had become nugatory owing to the subsequent events. In *Ramesh Kumar* v. *Kesho Ram,* the Court held: "*Wherever subsequent events of fact or law which have a material bearing on the entitlement of the parties to relief or on aspects which bear on the moulding of the relief occur, the court is not precluded from taking a 'cautious cognizance' of the subsequent changes of fact and law to mould the relief.*" [81]

Therefore, any petitioner who seeks to challenge the Governor's Order must do so immediately to prevent his action from becoming a mere academic attempt. Even so, the following questions would yet arise to perplex the minds of any conscientious judge by whom such a matter is heard as also every avid political observer who possesses an unflinching desire to see his country symbolise true democracy:

- Should the Court lean in favour of reinstating the Assembly when it is dissolved very shortly after its commencement?
- Would it actually be in the interest of the State to reinstate a dissolved Assembly if fresh elections are announced and the electorate, after an assessment of the conduct of the political parties, is mentally ready for a new Government?

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[80] *Supra* note 4 at 735.

[81] (1992) Supp. 2 SCC 623.

- If the dissolution of the Assembly seems to be avoidable but not patently unconstitutional, should the Courts bear in mind the cost of a fresh election in a country where most of the states are financially unstable?

- In states where the act of dissolution is patently *mala fide*, should not the Courts unhesitatingly reinstate the Assembly to set an example to be followed and to save the State from the crushing financial burden?

These are just a few of the considerations that would, and indeed, must, weigh on the minds of persons concerned. The individual facts and circumstances of each case would obviously be the determining factor in deciding such matters. How correctly these facts fall for the notice of the judiciary is another question altogether, which cannot be answered except by acknowledging that political influence knows few limits and recognises even fewer principles. One only hopes that authors do not face the day when they too, like the great protector of our Constitution, Mr. Nani Ardeshir Palkhivala, have to begin their books with the following dedication :

"*To My Countrymen,*
Who gave unto themselves the Constitution but not the ability to keep it,
Who inherited a resplendent heritage but not the wisdom to cherish it,
Who suffer and endure in patience without the perception of their potential." [82]

[82] Nani A. Palkhivala, *We, the People* (1st ed. 1984).

WOMEN AND THE CO-PARCENARY LAW - UNSOLVED QUESTIONS[†]

Pinakin Masurekar[*] and *Krunal Gadhia*[*]

"Social justice demands that a woman should be treated equally both in the economic and social sphere. The exclusion of Daughters from participating in Co-parcenary property ownership merely by reason of their sex is unjust."

- Justice B.P. Jeevan Reddy[1]

I. INTRODUCTION

Four states in India have passed the State Amendments to the *Hindu Succession Act, 1956* viz. Andhra Pradesh[2], Tamil Nadu[3], Maharashtra[4] and Karnataka[5]. These amendment Acts were passed to remove the discriminatory features of the right of property "*by birth*" under the Mitakshara Law. The policy of these State Legislatures to confer upon daughters the hitherto denied right in Co-parcenary Property has been lauded widely, yet the provisions of the amendments have been criticised for ambiguity in language and interpretational difficulties. Doubts have also been expressed regarding their constitutionality, particularly vis-à-vis the exclusion of daughters married before each amendment came into force[6]. The object of this article is to analyse the present situation of the Co-parcenary law after the four State Amendments.

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† This article reflects the position of law as on February 9, 2003.

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1 In a letter to Shri Ram Jethmalani (the then Law Minister of India) as reported in 174th Law Commission Report on " *Property Rights of Women: Proposed Reforms under the Hindu Law*".

2 The Hindu Succession (Andhra Pradesh Amendment) Act, 1986 (No.13 of 1986).

3 The Hindu Succession (Tamil Nadu Amendment) Act, 1989 (No.1 of 1990).

4 The Hindu Succession (Maharashtra Amendment) Act, 1994 (No.40 of 1994).

5 The Hindu Succession (Karnataka Amendment) Act, 1994 (No.23 of 1994).

6 G. M. Divekar: "Some Doubts and Queries on Maharashtra Hindu Succession Act, 1994", (1995) 1 Mh.LJ Jour 21; B. Sivaramayya: "Co-parcenary Rights to Daughters, Constitutional and Interpretational Issues", (1997) 3 SCC (Jour) 25; Nilima Bhadbhade: "State Amendments to Hindu Succession Act and Conflict of Laws: Need for Law Reform" (2001) 1 SCC (Jour) 40.

Amending Section 6[7] of the *Hindu Succession Act, 1956,* which deals with the rights and interests of the members of the Joint Hindu Family in a co-parcenary property, these legislations have now conferred these rights by birth on daughters who are unmarried on the date when these Acts came into force.

II. A Brief History

The idea of making women co-parceners was suggested as early as 1945 in written statements submitted to the Hindu Law Committee by a number of individuals and groups; The Hindu Code Bill attempted to convert basic Hindu Law recognised by custom, usage or by *Sastras* and Commentaries into a statutory law with some changes, in other words to codify that law. This idea was ultimately dropped and disappeared along with the provisional Parliament and with the appearance of the Parliament on January 26, 1950 when the Constitution came into force. About five years thereafter, the question of codifying Hindu Law was again taken up by the Parliament and the previous Code Bill was split up into four separate Bills (now Acts) relating to marriage (*Hindu Marriage Act, 1955*), inheritance (*Hindu Succession Act, 1956*), adoption and maintenance (*Hindu Adoption And Maintenance Act, 1956*), minority and guardianship (*Hindu Minority And Guardianship Act, 1956*).

The major changes brought about by these Acts were :

1. Retention of the Mitakshara co-parcenary with only male members as co-parceners;
2. Co-parcener's right to will away his interest in the Joint Family Property[8];

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[7] Section 6: When a male Hindu dies after the commencement of the Act having at the time of its death an interest in a Mitakshara co-parcenary property, his interest in the property shall devolve by survivorship upon the surviving members of the co-parcenary and not in accordance with this Act: Provided that, if the deceased had left him surviving a female relative specified in Class I of the Schedule or a male relative of that class who claims through that relative the interest of the deceased in the Mitakshara co-parcenary property shall devolve by testamentary or intestate succession, as the case may be, under this Act and not by survivorship.

Explanation 1 – For the purposes of this section the interest of the Hindu Mitakshara co-parcenary shall be deemed to be the share in the property that would have been allotted to him if a partition of the property had taken place immediately before his death, irrespective of whether he was entitled to claim partition or not.

Explanation 2 – Nothing contained in the proviso to this section shall be construed as enabling a person who has separated himself from the co-parcenary before the death of the deceased or any of his heirs to claim on intestacy a share in the interest referred to therein.

[8] This provision was unexpectedly introduced by an amendment by the then Law Minister Mr. Pataskar in the final stages of the clause-by-clause debate when the Bill was to be passed in 1956. It was widely perceived and proclaimed, even in the contemporary press, to be a capitulation by government.

3. Removal of exemption of Marumakkattayam and Aliyasantana communities; that is, virtual destruction of the only systems in which women were the equivalent of full co-parceners; and

4. Alteration of original provision that a daughter would get a share equivalent to half the share of a son in self-acquired property of the father who died intestate. The Select Committee decided to make her share full and equal to that of a son.

In 1984, the Government of Andhra Pradesh (AP) made public announcement of its decision to give 'Daughters of the State' equal rights in co-parcenary. This political gimmick led to the passing of the *Hindu Succession (A. P. Amendment) Act, 1986.* Tamil Nadu., Maharashtra and Karnataka soon followed suit.

Before this, in 1975, Kerala had abolished the entire co-parcenary system by *Kerala Joint Hindu Family System (Abolition) Act, 1975.*

Before we delve into the Amending Acts and their effects it is very important to know the concept of Co-parcenary.

III. Co-Parcenary – The Concept

1. When any property belongs to any Hindu family from generation to generation, the property becomes ancestral or co-parcenary property. Co-parcenary is however a body limited to common ancestor (or the propositus) and his three generations namely his son, son's son and son's son's son.

2. In a Joint Hindu Family, the male members are called co-parceners or co-sharers in the property of the Joint Hindu Family. The property of the Joint Hindu Family belongs to the co-parceners as owners and the female members of the family only have a right to maintenance during their lifetime and in case of unmarried daughters-also a claim for their marriage expenses. Co-parcenary is, in other words, an inner cabinet of the Hindu Joint family capable of holding the joint family property for themselves and for the benefit of the other members of the joint family.[9]

[9] *Nandkishor* v. *Sakti Dibya*, AIR 1953 Orissa 240; *Moro Vishwanath* v. *Genesh Vithal*, (1873) 10 Bom. H.C. 444.

3. To be a co-parcener he must fulfill one of the two tests. One, he must be within four degrees from and inclusive of the propositus who is living and secondly, he must have a right to demand partition "*though he may be removed more than four degrees*"[10] of the original owner or acquirer.

4. The interest of each coparcener is a fluctuating interest, the deaths may augment it, births may diminish it. Thus there is a community of interest and unity of possession between all the members of the family and upon the death of any one of them the others will take by survivorship that in which they had during the deceased's lifetime a common interest and common possession.[11]

5. The Mitakshara doctrine is that ownership of property is of the whole joint family and no one member or co-parcener can claim ownership of any interest or share in the property or any part of the property separately until a partition of the property is affected. This is also known as the doctrine of Aggregate Ownership of the family property.[12]

6. In short, co-parcenary is the Joint Hindu Family, which owns some property.

IV. Outline Of The Amendment Acts

The language of the abovementioned four Amendment Acts is identical. The numbering of the sections is also the same, viz., 29-A (equal rights to daughter in Co-parcenary property), 29-B (interest to devolve by survivorship on death) and 29-C (preferential right to acquire property in certain cases) with the exception of Karnataka which numbers them as 6-A, 6-B and 6-C of the Act. The Statement of Objects and Reasons and Preamble of the other State Acts are almost, in substance, identical.

To get an insight into the minds of the legislatures we shall first comprehend the Statement of Objects and Reasons[13] of the first of these amending Acts, i.e.

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10 G. M. Divekar, *Hindu Law* (Ed. 2001) however, Mulla, *Hindu Law* at 318 (17th Edn.Vol I Article 215) confines the partition right to the fourth degree. Maynes, *Hindu Law* at 616 (14th Ed.) conciliates both the views "The rule is not that a partition cannot be demanded by one more than four degrees removed from the acquirer or the original owner of the property sought to be divided but that it cannot be demanded by one more than four degrees removed from the last owner, however , remote he may be from the original owner thereof."

11 *Katama Nachiar* v. *The Raja of Shivganga* (1863) 9 M.I.A. 539.

12 *Bhagwan Dayal* v. *Reoti Devi* AIR 1962 SC 287.

13 Legislative Assembly Bill No. 26 of 1985 published in Andhra Pradesh Gazette, Part IV-A, (E.O.), September 5, 1985-as quoted in G.M.Divekar, "Birth & Death of Hindu Co-parcenary" (1997 Ed.).

Andhra Pradesh Amendment Act – "*The Hindu Succession Act governs the property rights of Hindus and provides for devolution of property. Women are not members of the Co-parcenary under the Hindu Mitakshara law and therefore, they are not entitled to claim partition in co-parcenary property and such exclusion of daughters has led to the creation of socially pernicious dowry system with its attendant social ills. In order to eradicate this ill by positive means which will simultaneously ameliorate the condition of women in Hindu society, it is proposed to confer equal rights upon Hindu women along with the male members, so as to achieve the Constitutional Mandate of equality by suitably amending the said Act.*"

V. Issues Arising Out Of The Amendment Acts

While attempting to bring equality between a son and a daughter in obedience to the Constitutional mandate against inequality only on the ground of sex, whether the Amendment Acts have given birth to three types of inequality namely :

- Discrimination between a married daughter and an unmarried daughter
- Discrimination between females who come into the family "*by birth*" and "*by marriage*"
- Discrimination between a natural born daughter and an adopted daughter

It is also not clear whether a female member of the co-parcenary can be a 'Karta'.

As regard Conflict of laws, the following issues arise:

- Whether the State amendments apply to 'all Hindus' residing in the State irrespective of their original domicile, or only to Hindus domiciled in that State irrespective of residence or location of property?
- The Conflict between Section 6-A/Section 29-A of the respective Amendment Acts and Section 23 of *The Hindu Succession Act, 1956* (Hindu Succession Act).

Let us discuss and examine these issues separately.

A. Investigation Into Three Types of Discriminations

1. Discrimination Between A Married Daughter And An Unmarried Daughter.

While intending to remove the discrimination between man and woman so far

as the right to property of Hindu co-parcenary is concerned, the Amending Acts create[14] discrimination between married woman and unmarried woman.

The Tamil Nadu Amendment Act provides that the Act will not apply to a daughter married before to the Amendment Act came into force i.e. March 25, 1989[15]. Therefore, daughters married prior to the respective dates will not get any right in the co-parcenary property. But a daughter who is married subsequent to the respective dates mentioned above will be entitled to share 'by birth' which means she will be deemed to have got that share from the time she was born whatever may be the length of time since her birth till the cut off date. So a daughter born, say twenty years back, but married on or before June 21, 1994 in Maharashtra will get no interest in co-parcenary property but her sister born 30 years back but married on or after June 22, 1994 will be entitled to a share in the co-parcenary property since her birth.[16]

The two tests as formulated by the Supreme Court of India to decide, whether the classification adopted by legislature between a married and unmarried daughter can be regarded as reasonable or not are:

- The classification must be founded on intelligible differentia, and
- The differentia must have a rational relation to the object sought to be achieved by the law.[17]

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14 Amended Section added by the Hindu Succession (Tamil Nadu Amendment) Act, 1990 (1 of 1990).
Section 29-A provides "Equal rights to daughter in co-parcenary property.
Notwithstanding anything contained in Section 6 of this Act;
(i) In a Joint Hindu Family governed by Mitakshara Law, the daughter of a co-parcener shall by birth become a co-parcener in her own right in the same manner as the son and have the same rights in the Co-parcenary property as she would have had if she had been a son inclusive of the right to claim by survivorship and shall be subject to the same liabilities and disabilities in respect thereto as the son.
(ii) at a partition in such a joint Hindu Family the co-parcenary property shall be so divided as to allot to a daughter the same share as is allottable to a son.
(iii) any property to which a female Hindu becomes entitled by virtue of the provisions of clause (i) shall be held by her with the incidents of co-parcenary ownership and shall be regarded, notwithstanding anything contained in this Act, or any law for the time being in force, as property capable of being disposed off by her by will or other testamentary disposition.
(iv) nothing in this chapter shall apply to a daughter married prior to or to a partition which had been effected before the commencement of the Hindu Succession (Tamil Nadu) Act, 1994.

15 The cut-off date in case of Maharashtra Act is June 22, 1994 and in case of Andhra Pradesh it is July 30, 1986.

16 G. M. Divekar, *Hindu Law* (ed. 2001).

17 *Gopi Chand* v. *Delhi Administration* AIR 1959 SC 609.

A recent Supreme Court decision lends support to this view. In *Savita Samdevi (Ms) And Another* v. *Union Of India And Others*[18], it was held that the distinction between a married and an unmarried daughter may be unconstitutional. The observations made by the Apex court were: "*The circular in fettering the choice of a retiring employee to nominate a married daughter is "wholly unfair, unreasonable and gender biased" and liable to be struck down under Article 14 of the Constitution... The eligibility of a married daughter must be placed on a par with an unmarried daughter (for she too must have been once in that state), so as to claim the benefit....*" The appeal voiced a cry for gender justice and therefore the Special Leave was granted.

(i) Why has this classification between married and unmarried daughters been made?

- According to the principles of Hindu Law, a woman after marriage ceases to be a member of her parental family and becomes a part of her marital family and therefore there tends to be confusion as far as vesting of co-parcenary rights to a married daughter is concerned. Hence only the unmarried daughters may have been given the co-parcenary rights.

  But if this is the case then giving rights to the unmarried daughters is also inconsequential as they will also get married one day and become a part of another family.

- The legislature might have taken into account the sociological fact that dowry was given at the time of marriage in the case of married daughters. Second in some cases property or jewellery might have been given at the time of marriage as gifts to the daughter in the name of dowry, which though not commensurate with the son's share, is often quite substantial. On this ground, the distinction appears to be reasonable and would prevent heart-burning and tension in the family. A daughter who is married after the commencement of the Act will have already become a co-parcener and entitled to her share in the ancestral property so she may not receive any substantial family gifts at the time of her marriage. Hopefully, this will result in the death of the evil dowry system, which is one of the reasons given in the preamble, justifying the passing of these Amendment Acts.

  But the other view is that the objective of the Act is to remove discrimination against daughters inherent in the Mitakshara co-parcenary. The eradication of dowry by positive measures is only a

[18] (1996) 2 SCC 380.

subsidiary or collateral objective and hence it cannot be said that the classification drawn by the Amending Acts bears a rational relationship to the objective sought to be achieved.[19]

- It can also be assumed that the classification could have been made : to avoid double portions, and to avoid multiplicity of proceedings which could arise after the passing of the respective Amendment Acts.

In a very recent case,[20] the question of constitutionality of the Karnataka Amendment Act of 1994 was challenged before the Karnataka High Court. Holding that the classification between married and unmarried daughters is reasonable and that the Amendment Act is not unconstitutional, R.P.Sethi, C. J. and Mohamed Anwar, J observed, "*Keeping in view of the society and with the object of not unsettling the settled matters the provision of clause (d) was incorporated. It is common knowledge that in the absence of a statutory right in the co-parcenary property, the married daughters used to get an extent of their share in the property by way of gift, dowry or settlement at the time of their marriages. It appears that keeping the aforesaid position existing in the Hindu society, the legislature in their wisdom decided to deprive the married daughters prior to the commencement of the Karnataka Act all the rights conferred upon the daughters by virtue of Sec. 6-A of the Karnataka Act...Extending the benefit of the Act to a married daughter even prior to the commencement of the Amendment Act may even affect the third parties who had acquired valid rights and title in the property on the basis of such settled rights or partitions... The alleged discrimination cannot be termed to be either unreasonable or irrational and without basis. The offending portion of clause (d) of Sec. 6-A is intended to achieve an objective. The two types of daughters as contemplated by the offending portion of the section are the well-defined classes in themselves. The principles of equality as guaranteed by Art. 14 of the Constitution does not mean that every law must have universal application for all persons who are not by nature, attainment or circumstances in the same position, as the varying needs of different classes of persons are found to be requiring separate treatment. Classification is permissible for legitimate purposes.*"[21]

But in this case the constitutionality was challenged after three years of the commencement of the Act and no reason explaining delay was given, hence allowing this petition would have resulted in reopening of thousands of cases,

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19 B. Sivaramayya, *Co-parcenary Rights to Daughters:* "Constitutional and Interpretational Issues" (1997) 3 SCC (Jour) 25.

20 *Nanjamma* v *State of Karnataka* 1999 A.I.H.C 3003.

21 1999 A.I.H.C 3003 paras 5, 6, 8 and 9.

the petition was therefore dismissed and the question of constitutionality was not considered in detail.[22] Also this being a Karnataka High Court judgement, it cannot be said to be binding on other High Courts nor can it be said that this is a settled position in law, as only a single case was referred to in the entire proceedings.

There is no other case-law concerning the present Amendment Acts which may give us detailed decision as to the constitutionality of the classification/ discrimination between unmarried and married daughters of the co-parceners. According to some, the classification is not reasonable and do not form any basis. It also has no relevant nexus to the Objects[23] of the respective Acts.

2. Discrimination Between Females Who Come Into The Family 'by birth' And 'by marriage'.

The Amendment Acts makes yet another alleged discrimination between females who are born into the family and females who are married into the family.

Presuming that both, the parental family and the husband's family are Joint Hindu Families and have their respective co-parcenary properties, *the woman cannot enjoy co-parcenary rights in both the families* as then it would be discriminatory to male members as the male co-parceners cannot enjoy co-parcenary rights in the wife's family. Hence the woman would enjoy co-parcenary rights only in her parental family because Section 6-A/29-A, in its very first clause, says that the daughter of a co-parcener gets the right in co-parcenary property 'by birth' as that of a son.

If she ceases to be a member of her parental family where co-parcenary property exists, then how can she continue to enjoy her co-parcenary rights as it should be understood that the respective four Amendment Acts, which vests co-parcenary rights in women, only applies or is only attracted when there is a co-parcenary.

But on the other hand if the Objects[24] of the Acts is to grant equal rights to women in the co-parcenary property, then a woman on her marriage should also be given a right by virtue of her marriage in the co-parcenary property and she should get an equal share along with her husband. It may be argued against this view, that the wife in the husband's family is also a daughter in her

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22 Only a single case (Gopi Chand) was referred to in the entire proceedings. Important cases like *Savita Samdevi (Ms) and Another* v. *Union Of India and Others* were not referred to. In this case it was held that the distinction between a married and an unmarried daughter may be unconstitutional.

23 Refer the heading 'Outline of the Amendment Acts'.

24 "...to confer equal rights on Hindu women along with the male members, so as to achieve the Constitutional Mandate of equality by suitably amending the said Act."

paternal family, where she would get a right by birth in the co-parcenary property of the paternal family. But this is hypothetical, as her paternal family may not have any co-parcenary property.

Can we presume that after marriage the very same woman takes a new birth to enjoy equal co-parcenary rights in her husband's family also?

Uncodified Hindu Law treated all female members equally as no female member had any right to property except the right to Maintenance. Now, only those female members who come into the family 'by birth' are bestowed with all the rights and those female members who leave everything of their original families, to come and join this family, ironically, get no right/interest in their properties.

3. Discrimination Between A Natural Born Daughter And An Adopted Daughter.

As far as the ancestral property is concerned it is the settled position of Hindu law that the right to property accrues from the date of conception in the womb.[25] A *prime facie* reading of Section 6-A[26]/29-A of the Amendment Acts suggests that the words "*by birth*" were intended as a condition precedent. The dictionary meaning of "*by*" is "*through, means or causation of, or owing to*". If the phrase "*by birth*" is omitted, still the legislative intention of conferring on daughters the co-parcenary rights is in no way affected. This suggests that birth is regarded as a prerequisite for a daughter for the acquisition of a co-parcenary right. The wordings of the very first clause of Section 6-A/29-A of the respective Amendment Acts restrict an adopted daughter from enjoying co-parcenary rights. Section 11 lays down conditions by which the daughter can be adopted.[27] By virtue of Section 12, an adopted daughter becomes the daughter of the adoptive father for all purposes as if she was his natural daughter.[28] If that is so, why is an adopted daughter not given a right in the co-parcenary property on adoption which is as good as her birth in an adoptive family? It may be stated

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25 *Shantabai Todkar & other.* v. *S.K.Todkar* 2000 Vol.102 (3) Bom.L.R. 133.

26 Section 6-A (a): In a joint Hindu Family governed by Mitakshara Law, the daughter of a co-parcener shall *by birth* became a co-parcener in her own right in the same manner as the son and have the same rights in the co-parcenary property as she would have had if she had been a son inclusive of the right to claim by survivorship and shall be subject to the same liabilities and disabilities in respect thereto as the son.

27 Section 11(ii) provides that if the adoption is of a daughter, the adoptive father or mother by whom the adoption is made must not have a Hindu daughter or son's daughter (whether by legitimate blood relationship or by adoption) living at the time of adoption.

28 Section 12: An adopted child shall be deemed to be the child of his or her adoptive father or mother for all purposes with effect from the date of the adoption and from such date all the ties of the child in the family of his or her birth shall be deemed to be severed and replaced by those created by the adoption in the adoptive family.

that under the old (uncodified) law, there was no such difference between a natural son and adopted son and the position of the latter in the adoptive family as to rights, liabilities and disabilities in all respects was the same as that of a natural son, he became entitled to become a co-parcener along with his adoptive father's property as a surviving co-parcener. Under *The Hindu Adoption and Maintenance Act, 1956*, he cannot now divest the property vested in any person before adoption; though he could do so prior to the Act. But the question as regards why an adopted daughter should not get a right by virtue of her adoption still remains unanswered. An illustration will prove the discrimination. If the co-parcener has a son and a natural unmarried daughter, both now get interest in the co-parcenary property. Now, suppose a co-parcener has a son, but no daughter and he then adopts a daughter, why should she be denied the right because she is not born in the family though her position is as good as that of a natural daughter? In such a case, would there be no inequality and discrimination between the natural daughter of the co-parcener and the adoptive daughter of the co-parcener?[29]

To the contrary it may be argued on the basis of Section 12 of *The Hindu Adoptions and Maintenance Act, 1956* (which deems adopted child to be the child of adoptive father or mother for all purposes) that an adopted child is entitled to exercise all rights including the co-parcenary rights. But this argument may not hold water as Section 12 makes it clear that an adopted child's rights in the adoptive family will accrue from the date of adoption. Thus, in the case of an adopted daughter, the conferment of co-parcenary rights in the adoptive family will be from the date of adoption and in the natural family she will also have a vested co-parcenary right by birth. This situation must not have been intended by the legislature. Therefore, the better view seems to be that the Amending Acts do not envisage the conferment of co-parcenary right on an adopted daughter.[30]

Is there any ostensible reason for the exclusion of the adopted daughter? While non-application of mind on the part of the legislature cannot be ruled out, one can only speculate the reasons, if any exist. First, adoption of daughters is not common, as yet. Second, the adopted daughter's rights seriously affect the rights of other heirs, especially that of a wife.

The further question is whether the differentiation between a natural-born and an adopted daughter is valid. The conventional perception is that ties of blood are stronger than those of adoption. Under the '*Shastric*' law the rights of an adopted son suffered diminution in the presence of an afterborn natural son. But the policy of *The Hindu Adoptions and Maintenance Act, 1956* is to treat an

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29 *Supra* note 16.

30 *Supra* note 19.

adopted son and an afterborn natural son on an equal footing. The courts may, it is felt, hold the distinction between an adopted and natural-born son as reasonable classification.

B. Whether A Woman Can Be A Karta?

1. Karta–The Concept

Nowhere in the codified Hindu Law has the term 'Karta' has been defined or even referred to. It is the presumption of Hindu Law that ordinarily the *senior most male* member of a Joint Hindu Family is considered as the Karta or Manager of the family[31] provided he is otherwise fit to act as such, i.e. he is not suffering from any physical or mental deficiency; but in such a case the next senior most male member will take over the Kartaship[32]. There cannot be two Kartas in the same family[33] though the properties may be managed by two or more members[34].

The Karta has following powers :

- to manage the co-parcenary property,
- to carry on joint family business, if any,
- to alienate the property by way of sale or mortgage for legal necessity,
- to make a gift of some property in special cases,
- to incur debts for legal necessity or benefit of the family, etc.

2. Legal Position Till Now

The question whether a woman can be a Karta was riddled with controversies as the Nagpur High Court has time and again held that a widow can be a Karta[35] and the exact opposite view was adopted by the Calcutta High Court

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31 *Shreeama* v. *Krishnavenanama* 1957 A.P. 434; *Ram* v. *Khira* 1971 Pat. 286; *Abdulla* v. *Raunny* 1973 K.L.R. 350.

32 Dr. Paras Diwan, *Modern Hindu Law* at 258 (14th ed. 2001).

33 *Union of India* v. *Shree Ram Vohra* AIR 1965 SC 1531 : The Apex Court put an end to the conflict of views of many High Courts in the country by this decision. In *Mudit* v. *Ranglal* (1902) 29 Cal. 797; *Venkatachalan* v. *Venkateswara* (1943) 2 MLJ 610; *Shankar* v. *Shankar* 1943 Bom. 387; *Darshan* v. *Prabhuy* (1946) All. 67 –it was held that there can be two Kartas.

34 *Ibid.*

35 *Pandurang Vithoba* v. *Pandurang Ramchandra* AIR 1947 Nag 178; *CIT, C.P. and Berar* v. *Laxmi Narayan* AIR 1949 Nag 128.

in a few cases[36]. The Supreme Court has upheld a Madras view[37] that, "*co-parcenership is a necessary qualification for the managership of a Joint Hindu Family... It will be revolutionary of all accepted principles of Hindu Law to suppose that the senior most female member of a Joint Hindu Family, even though she has adult sons who are entitled as co-parceners to the absolute ownership of the property, could be the manager of the family...She would be the Guardian of her minor sons till the eldest of them attains majority but she would not be the manager of the joint family for she is not a co-parcener.*"

3. Legal Position After The Amendment Acts

The new Amendment Acts to the Hindu Succession Act considerably alter the concepts of Mitakshara joint family and co-parcenary. *Once a daughter becomes co-parcener she will continue to be member* of the *natal joint family* even after marriage into the *marital joint family* – a unique feature hitherto unknown in matrilineal and patrilineal joint families in India. Since in the above decisions the courts have cited disability of women in becoming the Karta, *as they are not the co-parceners*, it is obvious that after removal of this disability by virtue of these amending Acts women can act as the Karta.

4. Legal Issues Arising Out Of The Amending Acts

Now the questions are :

- Whether an unmarried daughter - who is the senior most member of the Joint Hindu Family and hence the Karta - remains the Karta even after her marriage?
- And if so, whether she can - as a Karta - alienate the property of her natal family after her marriage in favour of her husband?
- Under the pressure or influence of her marital family, can she partition the dwelling place and thereby enter in her natal home through a different family?

All these questions give rise to another question whether a married daughter

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[36] *Sushila Devi Rampuria* v. *Income Tax Officer* AIR 1959 Cal 697; *Sm. Chmapa Kumari Singhi* v. *Additional Member, Board of Revenue, West Bengal* (1961) 46 ITR 81 (Cal) – referred in AIR 1966 SC 27.

[37] *Radha Ammal* v. *CIT, Madras* AIR 1950 Mad 538.

should become a Karta? The Amendment Acts make her '*subject to the same liabilities and disabilities in respect thereto as the son*'[38] but does it extinguish all her disabilities as a daughter? These questions still remain unanswered.

When a married daughter after her marriage moves out of the state where these amending Acts are applicable which laws should govern her or for that matter the properties?

This question will be dealt with under the heading of "*Conflict Of Laws*".

C. *Conflict Of Laws*

1. Whether the State amendments apply to "*all Hindus*" residing in the State irrespective of their original domicile, or only to Hindus domiciled in that State irrespective of residence or location of property?

a. *The Extent And Applicability Of These State Laws*

None of the Amendment Acts indicate the persons to whom or the properties to which it is applicable.

Although the provisions about co-parcenary property have differed in different areas of India according to schools of law applicable[39], well-established rules and presumptions about migration have solved questions about application of the law. Every Hindu is presumed to be governed by the law of the school that prevails in the locality or territory in which he resides. When one family migrates to another province governed by another law, it carries its own law with it. Thus the migrated Hindu and his descendants are presumed to be governed by the law of the school to which he belonged before migration. Such presumption can be rebutted by proof that the individual or his ancestors have adopted the law, usages, and religious ceremonies of the new place of residence.[40] In the present context, a question arises whether the same principles can be applied, and whether the State amendments apply to "*all Hindus*" residing in the State irrespective of their original domicile, or only to Hindus domiciled in that State

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[38] Section 29-A/(section 6-A of Karnataka Act)-Equal rights to daughter in Co-parcenary property. Notwithstanding anything contained in Section 6 of this Act a) In a joint Hindu Family governed by Mitakshara Law, the daughter of a Co-parcener shall by birth *became a Co-parcener in her own right in the same manner as the son* and have the same rights in the Co-parcenary property as she would have had if she had been a son inclusive of the right to claim by survivorship and shall be subject to the same liabilities and disabilities in respect thereto as the son.

[39] The Dayabhaga School prevailing in Bengal and Assam, the Mitakshara School throughout India; in the Mitakshara school, the Benares school, the Mithila school, the Madras or Dravida school and the Bombay or Maharashtra school. For details, *see* S.V. Gupte, 1981, *Hindu Law*, Vol. I, All India Reporter Limited, Nagpur, Article 7, at 39-41.

[40] *Soorendronath Roy* v. *Heeramonee Burmoneah* (1868) 12 MIA 81 (PC).

irrespective of residence or location of property.

b. *The Legislative Power Of A State*

Under the Constitution, a State may make law on any matter referred to in List II of Schedule VII of the Constitution; and, subject to any law made by Parliament, on any matter referred to in List III of Schedule VII of the Constitution.[41] The Parliament can make law having extraterritorial operation, i.e. having effect on matters or persons or events situated or occurring outside the territory of India.[42] The States have no such power. This power of Parliament is, of course, subject to the well-established principle that Parliament may not pass a law affecting rights to immovable property situated abroad.

Can a State, under this system, make a law to affect property situated or persons outside the territory of that State? The laws made by a State must be for the purposes of the State.[43] In the absence of a 'territorial nexus', laws enacted by State Legislatures cannot have extraterritorial operation[44]. In *Shrikant Bhalchandra Karulkar* v. *State of Gujrat*[45], it was held that mere consideration of some factors that existed outside the State would not make the law extraterritorial. In the above mentioned cases, issues of territorial application arose in the context of legislative power of the State under Article 245 of the Constitution. Issues did not arise between private parties and lead to conflict of laws situation. The question of extraterritorial application of State law arose before the Supreme Court in *Kavalappara Kottarathil Kochuni* v. *States of Madras* & *Kerala*[46]. The facts of the case were that a Madras law provided that "*every sthanam shall be deemed to be and shall be deemed to always have been the property belonging to tarwad*", which meant that members other than the *sthanee* got rights in the property of the sthanam. The question was whether this law governed the properties of the sthanam situated at Cochin (outside Madras State). The Supreme Court held that it did not so apply. The Supreme Court has not however given the reason for the same. But the principle that a State law cannot extend to properties situated outside the State is clear. The same principle can apply by analogy to properties of a Joint Hindu Family.

c. *The Reason For Conflict*

Joint Hindu families or their members may migrate from one State to another, or some of them may reside in more than one State. A single member of a

41 The aspect of succession and joint family fall under Entry 5 of List III, i.e. the Concurrent List in Schedule VII and so both Centre as well the States can legislate in this field.

42 Article 245(2) of the Constitution of India.

43 *State of Bombay* v. *United Motors (India) Ltd.* AIR 1953 SC 252.

44 *R.S.D.V. Finance Co. (P) Ltd.* v. *Shree Vallabh Glass Works Ltd.* (1993) 2 SCC 130.

45 (1994) 5 SCC 1002.

46 AIR 1960 SC 1080.

family may reside in more than one State. Also a family may possess properties, moveable and immovable, in a number of States having different laws relating to co-parcenary property. Such situations raise issues of conflict of laws.

Situations of conflict – some examples:

- The presumptions that a Hindu is subject to the law of the place of residence, and that a migrant family may take its law with it to the new place of migration, may not provide an answer to the problems. If a Hindu son migrates to Maharashtra from Uttar Pradesh having a share in co-parcenary with his father and two brothers who still remain in Uttar Pradesh, will the law of Uttar Pradesh apply to him (by virtue of the above presumption) and thereby deny his daughters a share in the co-parcenary, or will the new law in Maharashtra apply and give his daughters shares in that property? If one of his daughters claims her share in a suit of partition, the court would face the problem of determining the law applicable. This problem would remain, whosoever may have filed the suit for claiming the share.

- The question may also arise in suits between the co-parcenary and third parties. If *K*, a daughter having a share under the Maharashtra law and claiming therefore to be a Karta, alienates property of the joint Hindu family (whether situated in Maharashtra or outside), and in a suit challenging this alienation her authority to alienate is challenged, the court may have to search for the law applicable.

- If the joint family has properties in two States, one which is governed by the Amending Act and the other not so governed, will it result in two Kartas in the same family: one a daughter and the other a son?

- Peculiar is the situation of a daughter who has married after commencement of the four State amendments giving her a share. If she is married into a family settled outside these States, will she be entitled to a share under these amendments? Assuming her share was vested on the date of commencement of the amendments, would her children, particularly her daughters, be entitled to benefit of these amendments? The second question becomes vital if one accepts the view that having married into a family outside the four States, she has acquired a 'domicile' in the State of her husband's residence; in such a case can the arm of a State amendment extend outside the State to confer shares on her daughters?

- Suppose a joint Hindu family with sons and daughters has immovable properties in Uttar Pradesh and Maharashtra. If it belongs to Maharashtra, will the daughters be entitled to a share in the properties

in Uttar Pradesh? If yes, which members will be sharers and what will be their shares? Applying the principle in the *Kochuni Case*[47], the law of each State should apply to properties in that State. The concept of community of ownership and unity of possession would then be effaced, as the body of sharers in different properties of the same family would not be identical.

- Suppose husband and wife are settled in Maharashtra. The wife's father is the Karta of a joint Hindu family located in Uttar Pradesh and having properties *inter alia* in Maharashtra. The husband and the wife break up and the wife claims maintenance from the husband. The property of the wife's family in Maharashtra will have a bearing on the amount of maintenance. Would she have a share in the properties of the joint Hindu family?

If the laws deal with property, the law of the place where the property is situate, i.e., the *lex situs* would vie for importance, especially so if the property is immovable. The general rule is that the *lex situs* is the governing law for all questions that arise in regard to immovable property.[48] The Supreme Court has also recognised this principle in *Kochuni Case*[49]. Each State amendment would then apply to (a) all properties, whether moveable or immovable, within the State; or (b) to immovable properties within the State, leaving issues of moveable property to be decided by the law of the family's domicile.

If the State laws are classified as laws governing personal relations (or succession), the well-established principle that law of domicile governs personal relations would apply in such a situation only when one assumes a 'State domicile' for the purpose.

Whose domicile would determine the application of the law of a State? The domicile of the Karta, or that of all members, or that of majority of coparceners? The domicile of the Karta seems a logical answer, but then who shall be a Karta would be determined according to the law of the State involved. For, under the law applicable in the four States, even a daughter can be a karta. Unless the law applicable (*lex causae*) is identified, the karta cannot be identified; and unless the karta is identified, the *lex causae* cannot be determined. If the *lex causae* is to be determined on the basis of domicile of majority of the coparceners,

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47 *Ibid.*

48 Dicey and Morris, *Conflict of Laws*, at 34 (Sweet and Maxwell 12th ed. 1993).

49 *Supra* note 46.

one again revolves round in circles, for it is the *lex causae* that will provide an answer to the number of coparceners in a joint Hindu family. The domicile of all the coparceners may not always be the same. Members of a Hindu family having properties in different States may want to agree amicably about the division of properties, yet their domicile for the purpose of application of one or the other law of a State may elude them.

Hence to determine the *lex causae*, it is incumbent upon the judiciary to first determine whether the State laws relate to personal relations or to property or to succession?

The amendments to the Hindu Succession Act by Maharashtra, Andhra Pradesh, Tamil Nadu and Karnataka have all been hailed as progressive in their own way. But these can create situations of conflict of laws, since laws in the States in India relating to Mitakshara co-parcenary property differ. Resolution of these situations of conflict and formulation of rules by the courts would take some time.

Hence there is urgent need for:

- Having one law relating to Mitakshara co-parcenary throughout India[50]; or
- A clear definition of applicability of the State laws/amendments.

2. The Conflict Between Section 6-A/Section 29-A Of The Respective Amendment Acts And Section 23 Of The Hindu Succession Act

Section 6-A/29-A of the Amendment Acts states, "*Notwithstanding anything contained in Section 6 of this Act...*" which means it has only attempted to amend provisions of Section 6 of the Hindu Succession Act. It is important to note the impact of Section 6-A of the Karnataka Act and Section 29-A of the other three Acts on Section 23 of the Hindu Succession Act. Section 23 gets nullified. Section 23 of the Hindu Succession Act provides that on the death of a Hindu intestate in case of a dwelling house wholly occupied by members of the joint family, a female heir is not entitled to demand partition unless the male heirs choose to do so; and second it curtails even the right of residence of a daughter by stating that where such female heir is a daughter, she shall be entitled to a right of

[50] This has been attempted and also suggested by the Law Commission in its 174th Report. The Law Commission had attached a draft copy of the Hindu Succession (Amendment) Bill, 2000 dated May 4, 2000.

residence in the dwelling house only if she is unmarried or has been deserted by or has separated from her husband or is a widow. Whether these restrictions will be operative in the case of female coparceners will have to be considered and we must focus on if the interpretation of the words 'Hindu intestate' and 'heirs' exclude coparceners and co-parcenary interests from their scope. Section 6 of the Hindu Succession Act retains the rule of devolution of undivided co-parcenary interest by survivorship in spite of the significant change introduced in it. Under the Act, it should be clarified that female coparcener will have equal rights as males in the matter of asking for partitioning and allotment to them of their share in co-parcenary property. Thus Section 23 of the Hindu Succession Act may need to be deleted altogether.[51] This right is not denied to a son. The main object of the section is said to be the primacy of the rights of the family against that of an individual by imposing a restriction on partition. Why is it that this right of primacy of family is considered only in the case of a female member of the family?[52]

When considering whether these restrictions will be operative in the case of female coparceners, we have to focus on the interpretation of the words "*Hindu intestate*" and "*heirs*" occurring in Section 23. Under Mitakshara law unobstructed heritage (*Apratibandha daya*) devolves by survivorship and obstructed heritage (*sapratibandha daya*) by succession and both the phrases *viz.*, "*Hindu intestate*" and "heirs" exclude co-parceners and co-parcenary interests from their scope. Section 6 of the Hindu Succession Act retains the rule of devolution of undivided co-parcenary interest by survivorship in spite of the significant change introduced in it. There is a second ground that buttresses this view. Section 23 applies to both the male and female intestate and its applicability to the latter indicates that coparceners and co-parcenary interests were outside the scope of Section 23. Thus it is submitted that female co-parceners are not bound by the restrictions contained in the section. The national report on the 'Status of Women in India' recommended that this discrimination in asking for a partition be removed so that a daughter enjoys a right similar to that of a son.[53]

Here also non-application of mind on the part of the legislature cannot be ruled out. The wordings in Section 6-A/29-A should be "*Notwithstanding anything contained in Mitakshara law*" or "*Notwithstanding anything contained in the Hindu Succession Act, 1956*". The above provision would have cleared the

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51 Law Commission of India, 174th Report on "Property Rights of Women: Proposed Reforms under the Hindu Law".

52 *Ibid* at para. 2.9.

53 *Status of Women in India*, A Synopsis of the Report of the National Committee (1971-74) at 53-54.

way for the Amendment Acts and there would have been no conflict between any of the provisions of the Hindu Succession Act and that of the Amendment Acts.

VI. Criticism

The name of the chapter inserted by AP, TN and Maharashtra 'succession by survivorship' is a contradiction in itself, as succession cannot be by survivorship[54]. Also these three Acts have, in clause (v) of Section 29-A, provided that this chapter will not apply to daughters married prior to the commencement of these Acts and hence discriminated amongst the daughter on unreasonable ground of marriage. Karnataka has been kind enough to the married daughters by conferring them other rights but barring them from challenging any partition which has taken place before the commencement of that Act.[55] Also, these Amendments have failed to visualize the legal position of the divorced daughter whose marital status is single but can neither be classified as married nor as unmarried.

It is relevant to note the observations made by Mr. Pataskar while participating in the parliamentary debate at the time the Hindu Succession Bill, 1955 was moved. He said: "*To retain the Mitakshara Joint Family and at the same time put a daughter on the same footing as a son with respect to the right by birth, right of survivorship and the right to claim partition at any time, will be to provide for a joint family unknown to the law and unworkable in practice.*"[56]

VII. Conclusion

In the enthusiasm to grant equal rights to women with men the Legislatures have completely ignored to take notice of the basic concept of co-parcenary system. The state legislatures have also not taken notice of scores of case laws in which the courts have asserted time and again that "*that apparent discrimination between a male and a female in the matter of succession and inheritance under the Hindu law is not violative of the fundamental rights under Articles 14 & 15 of the Constitution*".[57]

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54 In Mayne's, *Hindu Law "he (an undivided member) has an interest in the Co-parcenary and on his death this interest lapses to the Co-parceners; it passes by survivorship to the other Co-parceners. He, therefore, has no power to devise it by will, nor is there any question of succession to it"*-As quoted by B.Sivaramayya.

55 Section 6-A.

56 Lok Sabha Debates pt. at 8014 (1955).

57 *Nalini Ranjan* v. *State* AIR 1977 Pat. 171; *Sonubai* v. *Bala* AIR 1983 Bom 156.

None of these Acts indicate the persons to whom or the properties to which it is applicable.

The effect of these Acts is that now there are four types of Mitakshara co-parcenary laws recognised in India – 1) Dravida school in southern states in which daughters have co-parcenary rights, 2) Bombay school in Maharashtra in which daughters are given co-parcenary rights, 3) Mitakshara law of different schools all throughout India where only sons have co-parcenary rights and 4) Mitakshara law which abolishes the right by birth altogether as in the case of Kerala.

Hence the uniformity of Hindu Law, as intended by the Hindu Code Bill, has ceased to exist. The scarcity of decisions on these Amending Acts make it further confusing. Hence there is an urgent need for certainty in law. Whether it is the duty of the respective State legislatures or of the Courts to clarify these uncertainties is the last of the questions that need some urgent attention.

DATA PROTECTION AND THE INDIAN BPO INDUSTRY†ϕ

*Rukhmini Bobde**

I. INTRODUCTION

In today's competitive world, there is increasing pressure on business enterprises to perform better, faster and cheaper. This means changing the way they manage their business processes. They must do only what they do best. Whatever an enterprise doesn't do well has to be done by someone else.[1] This has led to the growth in Business Process Outsourcing (BPO). Further, enterprises have begun to recognise the advantage of availability of inexpensive, skilled labour in developing countries, which can lead to substantial cutting of costs. This has led to an unprecedented growth in offshore outsourcing of business processes to developing countries like India, China and the Philippines, which has also been made possible because of the rapid advancement in communications and technology.

The increase in businesses' ability to collect, process, store and disseminate personal information has also led to a growing consciousness about the right to privacy of personal data among individuals. These privacy principles temper the free flow of data necessary for various process outsourcings.

This paper is aimed at analysing the conflicting interests of the growing Indian offshore outsourcing industry in free trans-border flow of data, on one hand, and the data protection rights of individuals, which is beginning to gain recognition worldwide, on the other, with a view to suggesting possible measures that could be adopted in India to resolve the same. Part II of this paper contains an overview of the BPO industry worldwide and in India. Part III deals with the subject of personal data protection and analyses the various regulations

† This article reflect the position of law as on February 5, 2003.

ϕ This article was written during the course of a Volintern Training Programme conducted by Nishith Desai Associates (NDA) (a research based law firm with offices in Mumbai, Bangalore and California) for a select group of students of the Government Law College, Mumbai. The factual statements and legal conclusions contained herein are solely those of the author. The contents of this article do not necessarily reflect the position or views of NDA. No reader should act on the basis of any statement contained in this article without seeking professional advice.

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1 Howard Smith and Peter Fingar, "Making Business Processes Manageable", at http://www.fairdene.com/processes/April2002-BPM-4thTier.pdf.

adopted in respect thereof in various parts of the world like the European Union (EU), United States of America (USA), Canada and Australia, where the markets generate enormous personal data for processing.

Part IV contains various relevant aspects of the BPO industry in India with an overview of some of the currently outsourced business processes. Part V analyses the methods available to the outsourcing industry to ensure compliance with the various privacy regulations. Part VI suggests measures that may be adopted in India to fill in the current lacunae of data protection rights.

II. Business Process Outsourcing

A. BPO: An Overview

In the 1980s, process reengineering was at the forefront of corporate agendas as companies attempted to break down traditional hierarchies and restructure around core processes.[2] In the next decade, in order to increase efficiency and reduce costs, the focus shifted to outsourcing of non-core back-office functions in a big way.

The Global Decision-Makers Study on Business Process Outsourcing by Pricewaterhouse Coopers defines BPO as "*the long-term contracting of a company's non-core business processes to an outside service provider*".[3] The Pricewaterhouse Coopers study conducted by Yankelovich Partners among 304 Chief Executive Officers (CEOs), Chief Financial Officers (CFOs), Chief Operating Officers (COOs) and Chief Information Officers (CIOs) at the largest multinational corporations worldwide, found that:

- 63 per cent report outsourcing of one or more business processes.
- On a global basis, outsourcing of Human Resourse (HR) services is most prevalent in Canada (58 per cent) and the United States (57 per cent), followed by Australia (44 per cent), Japan (40 per cent), Europe (21 per cent) and South America (10 per cent).

As per a Mckinsey Quarterly estimate, "*By 2008, global remote service operations may undertake activities accounting for half a trillion dollars around the world and representing every element of the value chain.*"[4] This will include activities accounting for revenue of $585 billion and will represent every element of a business' value chain, including research and design, marketing and sales, accounting

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2 "Managing Growth - Offshore Outsourcing", at http://www.renodis.com/PDFs/Renodis%20MN%20Business.pdf.

3 Available at http://www.pwcglobal.com/extweb/ncpressrelease.nsf/DocID D576B1416753CCA5852567CF00669ACB.

4 *NASSCOM's Handbook: IT Enabled Services*, Fourth Edition, May 2001, at A-1.

and finance, customer contact centres, human resources management and transaction processing.[5]

This tremendous increase in outsourcing is because companies are increasingly beginning to recognise the advantages involved in the outsourcing of back office operations. These are as follows:

- Companies are able to focus on core competencies to increase efficiency and improve shareholder value.
- Companies become more profitable by cutting costs.
- Companies are able to maintain a competitive edge.
- Better service levels than internal service departments can provide.

The range of processes that are outsourced varies from simple mundane tasks such as data entry to high-end, high-value services such as research and development.

1. Offshore BPO

This outsourcing was earlier restricted to the domestic level. However, the beginning of this decade has witnessed a downturn in the global economy that forced corporations to search for novel ways to cut costs and improve efficiencies without sacrificing growth.[6] This has led to the development of offshore outsourcing. Companies in the West have begun outsourcing their back-office business process to developing countries like India and China where inexpensive but skilled labour is available in abundance. This has led to decrease in costs by as much as 60 per cent and in many cases has even led to improvement in quality of service.[7]

2. India: The Preferred Outsourcing Site

In India, the term Information Technology Enabled Services[8] (ITES) is used to refer to the broad range of remote location services being provided in the country. ITES is defined as "*business processes and services performed or provided from a location different to that of their users or beneficiaries and are delivered over communication networks, including Internet*".[9] This may be done by outlocating[10]

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5 *Supra* note 2.

6 *Ibid.*

7 *Ibid.*

8 This term has been coined by National Association of Software and Services Companies (NASSCOM).

9 *Supra* note 4 at A-3.

10 Outlocating: It involves a company setting up a remote subsidiary to procure services from an off-shore site. For example, companies like GE Capital and American Express are heavily into outlocating in India.

or outsourcing[11].

India has emerged as the no. 1 outsourcing site for back-office operations. This is mainly due to the following reasons:

a. *Labour*

India has a large, low-cost, English-speaking talent pool. India's huge pool of English-speaking and computer graduate manpower can continue to cater to the growing demand for professionals for ITES, who are skilled as well as quality conscious. Furthermore, they can be hired for a fraction of the cost of their counterparts in the developed world. As long as a service can be provided remotely, the so-called labor-arbitrage advantage will undeniably exist in India.[12]

b. *Government Support*

The strong support shown by the Indian Government is also largely responsible for the astounding rate of growth of this industry. The Government is liberalising and simplifying policies and procedures of doing business in India. It opened up the tele-communications sector by bringing forward the date of the end of Videsh Sanchar Nigam Limited's (VSNL) monopoly in international telephony from 2004 to April 2002. Also, VSNL itself increased its bandwidth to 1Gbps. The Government is allowing private Internet Service Providers (ISPs) to set up their own international gateways. It has also announced an income tax holiday till 2010 for export of ITES and allowed income tax deductions for almost the entire gamut of ITES.[13] In addition to this, the Government has also set up Software Technology Parks (STP) in various cities. The Government is currently planning roll-out of vocational courses for ITES in several nationwide educational institutes.[14]

Various State Governments (Andhra Pradesh, Maharashtra, Karnataka, Rajasthan, etc.) are also chipping in by announcing attractive policies for Information Technology (IT) Enabled units.[15]

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11. Outsourcing: These are externally contracted services, i.e. services obtained from another organisation (or third party). Services currently outsourced include processing credit cards, claims, payrolls, etc., providing information systems such as data centres, networks, and help desks, etc.
12. *Supra* note 2.
13. *Supra* note 4 at A-15.
14. Accenture analysis, NASSCOM study, 2000-2001.
15. *Supra* note 13.

c. *Geographical Advantage*

There is a virtual twelve hour time difference with USA and other major markets. Thus India is ideally suited for 24 x 7 delivery capability and production support.[16]

d. *Quality*

More than 130 firms have International Organisation for Standardisation 900x certification and at least thirty-seven have achieved Level 3 or better Software Engineering Institute Capability Maturity Model certification for various projects.[17]

According to NASSCOM, the Indian market for BPO services in 2000-01 was approximately US $1 billion and is expected to grow to US $16.4 billion by 2008, accounting for 12 per cent of the global market at that level[18] (US $142 billion).[19] Of this, the major share will be contributed by services like human resources (27 per cent), customer interaction (23 per cent), and data search integration and management. (21 per cent)[20] Based on these estimates, India can gain employment for 1.1 million people in the country by 2008.[21] A large chunk of the Indian BPO market (68 per cent) is offshore work mostly from American and European companies, driven by the urge to cut costs and improve shareholder value.[22]

The key processes outsourced to India, as identified and quantified by NASSCOM, are:

- Back-office operations, accounting, data management accounting for 70 per cent of the BPO market.
- Medical transcription insurance claims processing commanding a significant share at 22 per cent.[23]

Now, as is obvious from the above-mentioned statistics, a large amount of personal data, whether of employees or of the customers of the BPO clients is necessarily flowing across borders from various countries into India. It is therefore pertinent to examine the privacy regulations existing in the countries abroad, which are outsourcing such activities to India, with a view to determining their application on the transfer of data and processing thereof in India.

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16 R. Terdiman, "Analysis of India: Today's Dominant Offshore Outsourcer (Research note), January 16, 2002, at 3.

17 *Ibid.*

18 NASSCOM study 1999-2000 : *Indian IT Strategies.*

19 *Supra* note 4 at A-14.

20 *Supra* note 18.

21 *Supra* note 4 at A-8.

22 *Supra* note 18.

23 *Ibid.*

III. The Flip Side: Data Protection Rights

A. Privacy And Data Protection

The term 'privacy' is sometimes used when referring to the right to personal information. This usage tends to cause confusion. 'Privacy' serves as a catch-all term, protecting a variety of interests ranging from government intrusion into the bedroom to the inviolability of telephone communications.[24] The right to protect personal information is a subset of the right to privacy. It represents a narrower and distinct interest: maintaining the integrity of personal information and fairness to the individuals about whom the data relates.[25] Data Protection specifically applies to the collection, storage, use and disclosure of personal information[26] and is considered one of the most dominant conceptions of privacy.[27]

This right to personal information is a right that has been recognised in communities all over the world, though their ways of interpreting this right and enforcing it tend to differ. The EU community is very conscious of this right to personal information of individuals and regards it as a fundamental right. In 1995, it adopted a comprehensive Directive[28] on processing of personal data. The US, on the other hand, relies on self-regulation and sectoral laws for protection of the personal data of persons. This right also exists in common law, in almost all communities, whereby, for instance, the patient is protected from disclosure of his personal medical information held by his doctor or, for instance, the lawyer's duty not to disclose confidential information of his client or the duty of a banker to maintain confidentiality.

Practically all of us believe that we possess 'an innate right to control personal information'.[29] However, in today's shrinking world, most of us also feel that we 'have lost the ability to control that information'.[30] This is essentially due to two reasons:

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24 Mike Ewing, "The Perfect Storm: The Safe Harbor and the Directive on Data Protection", 24 Hous. J. Int'l L 315, Winter 2002.

25 *Ibid.*

26 *Ibid.*

27 Daniel J. Solove, "Privacy and Power: Computer Databases and Metaphors for Information Privacy", 53 Stan. L. Rev. 1393, July 2001.

28 The EU Directive on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data (95/46/EC), available at www.privacy.org/pi/intl_orgs/ec/final_EU_Data_Protection.html.

29 William J. Fenrich, "Common Law Protection of Individuals' Rights in Personal Information", 65 Fordham L. Rev. 951, December 1996.

30 *Ibid.*

- Technology: Growing advancement in technology has eroded our expectation of respect of our right to privacy. New technologies have made it 'easier and much less expensive'[31] to handle data by way of collection, processing, storage, compiling and transfer of such data.[32]

- Industry: There is a growing interest among companies to acquire and process personal information of individuals. Companies, particularly in the US, create, maintain, buy and sell huge databases especially for purposes like direct marketing. The last couple of decades has seen a very substantial expansion in the business of gathering, processing, and selling information about individuals in the US.[33] People are no longer surprised to receive unsolicited mail by way of catalogues, brochures, e-mails, etc. It is no secret that these firms must have received the names and addresses from some list they purchased from another firm. It is now no different in the Indian market.[34]

As the global market and information technology systems continue to grow, and the number of database users and controllers increases, regulating the storage, transfer and collection of data is becoming increasingly difficult.[35] Companies are constructing gigantic databases of psychological profiles, amassing data about an individual's race, gender, income, hobbies and purchases. It is ever more possible to create an electronic collage that covers much of a person's life.[36]

Customers depend on many private institutions like insurance companies, credit card companies and healthcare industries for various services. These institutions gain a significant control over their personal information not only when customers enter into a relationship with them but also by way of their transactions with these institutions, even if on the surface, interactions with them are as rudimentary and distant as signing up for services, paying bills, and requesting repairs.[37] Thus, businesses' ability to collect, process, store and disseminate personal information is significant.[38] Once this information goes into the hands of companies, an individual rarely has control over the manner

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31 Pamela Samuelson, (Book Review): "A New Kind of Privacy? Regulating Uses of Personal Data in the Global Information Economy", 87 Calif. L. Rev. 751, May 1999.

32 *Supra* note 24.

33 *Supra* note 31.

34 *Ibid.*

35 Jennifer M. Myers, "Creating Data Protection Legislation in the United States: An Examination of Current Legislation in the European Union, Spain, and the United States", 29 Case W. Res. J. Int'l L. 109, Winter 1997.

36 *Supra* note 27.

37 *Ibid.*

38 *Supra* note 29.

in which it is used, and he has to rely on their practised privacy policies for controlling the dissemination of such information. This, needless to say, is not a very comforting thought.

In a detailed study of organisations in the US, such as banks, health and life insurance companies and credit agencies, H. Jeff Smith concluded that all of the organisations "*exhibited a remarkably similar approach: the policy-making process, which occurred over time, was a wandering and reactive one...Most executives wait until an external threat forces them to consider their privacy policies.*"[39] Furthermore, there have been several highly publicised instances where companies violated their own privacy policies.[40]

More insidious than drifting and reactionary privacy policies are irresponsible and careless uses of personal information. For example, in one particular case, Metromail Corporation, a seller of direct marketing information, hired inmates to enter the information into databases. An inmate began sending harassing letters that were sexually explicit and filled with intimate details of people's lives. Also, a television reporter once paid $ 277 to obtain from Metromail a list of over 5000 children living in Pasadena, California. The reporter gave, as the name of the buyer, the name of a well-known child molester and murderer. These cases illustrate the complete lack of care and accountability by the corporations collecting the data.[41]

These considerations have led to a growing awareness among individuals, particularly in the more conscious markets, of their rights to privacy and personal data protection.

B. Existing Relevant Privacy Regulations

Keeping in mind the fact that most of the outsourcing carried on in India is for companies located in USA and Europe,[42] it is important to analyse the data protection scenario in these communities with regard to third party transfers of personal data especially since Indian BPO service providers are usually required to sign BPO agreements that are to be governed by the laws of the respective foreign jurisdictions. The most comprehensive regulation on data protection on the scene today is the *EU Directive on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data*[43] (the EU Directive) adopted in 1995. Following is an analysis of various laws and privacy

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39 H. Jeff Smith, "Managing Privacy: Information Technology and Corporate America", 55 (1994).

40 *Supra* note 27.

41 *Ibid.*

42 *Supra* note 18.

43 *Supra* note 28.

regulations existing in the EU, US, Canada and Australia with an emphasis on their relevance to the outsourcing industry.

C. Developments In Data Protection Prior To The EU Directive

The first document in relation to protection of personal data was adopted in 1980 by the Organization for Economic Cooperation and Development (OECD). The OECD's Guidelines Governing the Protection of Privacy and Trans-Border Flow of Personal Data[44] are a set of non-binding rules for handling electronic data signed by its members, including the US.[45] The Guidelines presented basic data privacy principles and allowed for data to freely pass between nations who adopted the principles.[46]

One year later came the Council of Europe's *Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data*, which took effect in 1985. Both these documents discourage restrictions on the flow of data among member nations, and support restrictions on the trans-border transfer of data if the recipient country does not provide a sufficient level of data protection.[47] The rules support personal data protection at every step, from collection, through storage and dissemination and provides for the right of individuals to access and amend their data.[48] Both documents are to be incorporated into national legislation or form basis of national legislation of member countries.

D. The EU Directive

1. An Overview

The EU Directive came at a time when information explosion had reached unparalleled levels.[49] The objective of this Directive is to protect the fundamental right to privacy of persons with respect to the processing of personal data.[50] It requires the Member States to establish a legal framework for compliance with the Directive within three years of its adoption. [51] This Directive covers both

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44 Available at http://www1.oecd.org/publications/e-book/9302011E.PDF.

45 Barbara Crutchfield George, Patricia Lynch, Susan F. Marsnik; "U.S. Multinational Employers: Navigating Through the "Safe Harbor" Principles to Comply with the EU Data Privacy Directive", 38 Am. Bus. L.J. 735, Summer 2001.

46 David A. Castor, "Treading Water in the Data Privacy Age: An Analysis of Safe Harbor's First Year", 12 Ind. Int'l & Comp. L. Rev. 265, 2002.

47 *Supra* note 45.

48 *Ibid.*

49 John C. O'Quinn, (Book Note): "None of Your Business: World Data Flows, Electronic Commerce, and the European Privacy Directive: By Peter P. Swire & Robert E. Litan", 12 Harv. J. Law & Tec 683, Summer 1999.

50 Article 1, EU Directive, available at http://www.cdt.org/privacy/eudirective/EU_Directive_.html.

51 *Ibid*, Article 32.1.

public and private sectors.

The Directive defines 'personal data' as "*information relating to an identified or identifiable natural person*"[52]. There are three important key person-terms in the Directive – 'data controller', 'data processor' and 'data subject'. A 'controller' is anyone who "*determines the purposes and means of the processing of personal data*"[53], i.e. in the case of outsourcing, the BPO client. A data 'processor' is one who "*processes personal data on behalf of the controller*", i.e. the BPO service provider; and an "*identified or identifiable natural person*" is a 'data subject'[54], i.e. the person whose data is processed – say, the employee or the customer of the BPO client. The Directive has been written from the perspective of the interests of the data subject.[55]

It provides among other things, that personal data shall be collected only for "*specified, explicit and legitimate purposes*" and processed in a way compatible with those purposes.[56] The data needs to be adequate and relevant[57] and it must be accurate and up to date.[58] It also provides for unambiguous consent of data subject to the processing of personal data[59] and the valid cases of processing of such data.[60]

The Directive also provides for greater protection for processing of special categories of data[61], i.e. "*personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, trade-union membership*" and "*data concerning health or sex life*"[62].

The Directive envisages the following rights of data subjects:

- The right to information regarding processing of data irrespective of whether the data was obtained from the data subject[63] or otherwise.[64]
- The right of access to the data.[65]

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52 *Ibid*, Article 2(a).
53 *Ibid*, Article 2(d).
54 *Ibid*, Article 2(a).
55 "European Union Data Privacy Requirements – A U.S. Perspective"; Mayer, Brown, Rowe & Maw, February 2002.
56 Article 6.1(b), EU Directive.
57 *Ibid*, Article 6.1(c).
58 *Ibid*, Article 6.1(d).
59 *Ibid*, Article 7(a).
60 *Ibid*, Article 7(b)-(f).
61 *Ibid*, Article 8.
62 *Ibid*, Article 8.1.
63 *Ibid*, Article 10.
64 *Ibid*, Article 11.
65 *Ibid*, Article 12.

- The right to object to processing of personal data on "*compelling legitimate grounds*"[66] or "*for the purposes of direct marketing*"[67] or to disclosure to third parties.

One distinct and relevant feature of the EU Directive is with relation to transfer of personal data. It depicts a change in focus on the transfer of data between Member Nations and third countries, which have not adopted the Directive.[68] Article 25 allows a transfer of personal data for processing to a non-member country only if "*the third country in question ensures an adequate level of protection*". This adequacy is to be judged in light of various circumstances including:

- the nature of the data;
- the purpose and duration of the proposed processing operations;
- the country of origin and final destination;
- the rules of law, both general and sectoral, in the third country in question; and
- the professional rules and security measures complied with in that country.[69]

This provision has been created essentially to ensure that companies do not evade the protection requirements of the EU Directive by setting up 'data havens' in non-member countries.[70] Furthermore, a perusal of Article 25 of the EU Directive clearly indicates that the provision of the Directive is aimed at countries and not organisations. Thus, it contemplates privacy legislation to be put in place by member countries.

India is on very thin ice in this field due to the complete lack of any sort of privacy or data protection regulation with respect to processing of personal data.

Also, it must be noted from the language of the Directive that the liability for non-compliance with its provisions is on the 'data controller', i.e. in the case of BPO industry, the liability rests on the BPO client to ensure that the BPO service provider also complies with the EU Directive in the handling of personal data of the original customers of the BPO client.

However, Article 26 of the Directive provides for derogations from Article 25. There are essentially two relevant ways in which a corporation may seek to

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66 *Ibid*, Article 14(a).

67 *Ibid*, Article 14(b).

68 *Supra* note 24.

69 *Ibid*.

70 *Supra* note 49.

transfer data to a third country, which does not ensure 'an adequate level of protection' under the Directive.

- Such transfer may take place on the condition that "*the data subject has given his consent unambiguously to the proposed transfer*".[71]
- Also, under Article 26.2, a Member State may authorise such transfer of personal data "*where the controller adduces sufficient guarantees with respect to the protection of the privacy and fundamental rights and freedoms of individuals and as regards the exercise of the corresponding rights*". It specifically allows that such guarantees may result from "*appropriate contractual clauses*".[72] Article 26.4 even enables the Commission to decide that "*certain standard contractual clauses*" shall be deemed to provide "*sufficient guarantees*" required under Article 26.2. The Commission has, in fact, drawn up a set of such clauses[73], which have been discussed later in this paper.

Under Article 25.6, the Commission is empowered to find that a country, "*by reason of its domestic law or of the international commitments it has entered into*" accords adequate protection. The Commission has so far recognised Switzerland[74], Hungary[75] and Canada[76] as providing adequate protection.

2. USA And The EU Directive: 'The Safe Harbor'

While the EU Directive recognises data protection as a fundamental right and contemplates national privacy legislation, the US has always followed a rather passive, self-regulatory approach towards data protection.

Subsequent to the adoption of the EU Directive, intense lobbying between the US Department of Commerce and the European Commission led to the emergence of the Safe Harbor Principles. This is a voluntary program through which a US organisation can receive certification that its data protection standards are adequate within the meaning of the Directive.[77] The Safe Harbor is based on seven Principles[78]:

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71 Article 26.1.1, EU Directive.

72 *Ibid*, Article 26.2.

73 Commission Decision (2002/16/EC), available at http://europa.eu.int/comm/internal_market/en/dataprot/modelcontracts/02-16_en.pdf.

74 By Commission Decision 2000/518/EC of July 26, 2000, available at http://europa.eu.int/comm/internal_market/en/dataprot/adequacy/ch_00-518_en.pdf.

75 By Commission Decision 2000/519/EC of July 26, 2000, available at http://europa.eu.int/comm/internal_market/en/dataprot/adequacy/hu_00-519_en.pdf.

76 By Commission Decision 2002/2/EC of December 20, 2001, available at http://europa.eu.int/comm/internal_market/en/dataprot/adequacy/canadadecisionen.pdf.

77 *Supra* note 24.

78 Available at www.export.gov/safeharbor/sh_overview.html.

a. *Notice*

Notice requires clear and conspicuous disclosure before data collection of the purposes and uses of data collection, contact information, the types of third parties to whom the data is disclosed and the choices offered for limiting use and disclosure.

b. *Choice*

Choice requires the organisation to provide an opportunity to 'opt-out' of data disclosures to third parties or data used for a purpose other that the one it was originally collected for. Sensitive information requires an 'opt-in' choice.

c. *Onward Transfer*

Onward Transfer requires application of the Notice and Choice provisions listed above before transfer to a third party.

d. *Security*

Security requires reasonable precautions against loss and unauthorised access.

e. *Data Integrity*

Data Integrity requires personal data be relevant for the purposes for which it is used.

f. *Access*

Access requires providing access to individuals and the ability to correct, amend or delete inaccurate information.

g. *Enforcement*

Enforcement requires mechanisms for assuring compliance.[79]

An organisation may join the Safe Harbor Principles and it shall then be deemed to have adequate protection for the purposes of the EU Directive.

E. The US Position

The US policy towards data protection has been a hands-off one. Americans prefer a regime of industry self-regulation without significant government intervention.[80] US privacy laws generally deal with concepts of 'invasion'. They stem from what Warren and Brandeis immortalised as 'the right to be let alone'

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[79] *Supra* note 24.

[80] *Supra* note 45.

in their landmark Harvard Law Review article first arguing for the creation of an individual right to privacy.[81] Behind this apparent tautology is the concept that freely available information should be unprotected. Privacy laws function more to define what is not protected than what is.[82]

This attitude of the US is one of appeasement of corporates who have a huge interest in the collection and processing of personal data. The increasing thirst for personal information spawned the creation of a new industry – the database industry. "*The database industry is an information age bazaar where personal data collections are bartered and sold... Over 550 companies comprise the personal information industry, with annual revenues in the billions of dollars. The sale of mailing lists alone (not including the sales generated by the use of the lists) generates three billion dollars a year.*"[83]

As the Working Party under the EU Directive (Article 29) rightly observed in its Fourth Report, "*The underlying rationale for the Safe Harbor Principles is that the United States takes a different view of privacy from that taken by the European Community. The United States uses a sectored approach that relies on a mix of legislation, regulation and self regulation.*"[84]

1. The HEW Code

Ironically enough, the EU Directive has been influenced by the American Fair Information Practices developed in 1973 by the United States Department of Health Education and Welfare (HEW). The HEW Code of Fair Information Practices[85] articulated a number of basic information privacy principles such as the transparency of personal data record-keeping systems, the right of the individual to access her records and to be informed of the uses of her personal information, the right of individuals to correct erroneous personal information in her records, the duty of entities holding records to ensure the reliability and safety of personal data, and the right of the individual to prevent personal information obtained for one purpose from being used for another purpose without her consent.[86]

In the US, the Fair Information Practices have only been selectively incorporated

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81 Samuel Warren and Louis Brandeis, "The Right to Privacy", 4 Harv. L. Rev. 193, at 213 (1890) referred from Sandra Byrd Petersen, "Your Life as an Open Book: Has Technology Rendered Personal Privacy Virtually Obsolete?", 48 Fed. Comm. L.J. 163, December 1995.

82 *Supra* note 24.

83 *Supra* note 27.

84 Article 29 – Data Protection Working Party, Fourth Annual Report on the Situation regarding the Protection of Individuals with regard to the Processing of Personal Data and Privacy in the Community and in Third Countries, adopted on 17.5.2001, available at http://europa.eu.int/comm/internal_market/en/dataprot/wpdocs/wp46en.pdf.

85 Available at http://www.epic.org/privacy/consumer/.

86 *Supra* note 27.

into various statutes in a limited number of fields.[87]

2. Sectoral Laws

Two relevant statutes that may be noted are the *Health Insurance Portability and Accountability Act of 1996* (HIPAA) and the *Gramm-Leach-Bliley Act of 1999* (GLB Act). The former addresses the issue of health privacy and mandates the establishment of standards to protect the privacy and confidentiality of individually identifiable health information[88] and provides for civil as well as criminal penalties for violations. On failure of the Congress to enact comprehensive health privacy regulation, the HIPAA gave the US Department of Health and Human Services (HHS) the authority to create privacy protection by regulation.[89] The HHS issued the final regulation on October 10, 2002.[90]

The final regulation covers health plans, health care clearing houses and health care providers. It protects all medical records and other individually identifiable health information held or disclosed by these entities.[91]

Under it, covered entities must "*adopt written privacy procedures. These must include who has access to protected information, how it will be used within the entity, and when the information would or would not be disclosed to others.*"[92] It also provides for non-disclosure of patient information without consent or authorisation, and in order to ensure that consent is not coerced, it also provides that providers and health plans generally cannot condition treatment on a patient's agreement to disclose health information for non-routine uses.[93]

The GLB Act deals with the issue of privacy in the financial services sector; it prohibits banks, insurers and investment companies from disclosing 'non-public personal information' to a 'non-affiliated third party' without informing the customer of this disclosure and giving him an option to opt-out of such disclosure but it does not allow persons to block sharing of their information with affiliate bodies.[94] However, it does expressly provide for an exception to the rule of

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87 *Ibid.*

88 Jeffrey B. Ritter, Benjamin S. Hayes, Henry L. Judy, "Emerging Trends in International Privacy Law", 15 Emory Int'l L. Rev. 87, Spring 2001.

89 US Department of Health and Human Services, Protecting the Privacy of Patients Health Information, Summary of the Final Regulation, available at http://www.hhs.gov/news/press/2000pres/20001220.html.

90 Available at http://www.hhs.gov/ocr/combinedregtext.pdf.

91 *Supra* note 89.

92 *Ibid.*

93 *Ibid.*

94 Section 6802(b)(2) of the Act states that a financial institution shall not be prevented from "providing nonpublic personal information to nonaffiliated third party to perform services for or functions on behalf of the financial institution", available at http://www.ftc.gov/privacy/glbact/glbsub1.htm.

non-disclosure of personal information to non-affiliates, that the institution must fully disclose this and enter into a contractual agreement with the third party to maintain the confidentiality of such information.[95] Another point to be noted is that the Act applies only to 'nonpublic' information, and much of the information aggregated in databases (such as one's name, address, and the like) is traditionally considered to be public.[96] Though, as is apparent, the GLB Act itself fails to provide any real data protection to individuals, numerous state legislatures have introduced financial privacy legislation that, if enacted, would provide consumers with stronger privacy protections than the GLB Act. Many of these state proposals would among other things:

- Prohibit financial institutions from requiring their customers to disclose any information that is not necessary in connection with the product or service the consumer desires to obtain from the institution.
- Require that consumers opt in before financial institutions could share their personal information with third parties.[97]

One distinct point to be noted about all these US laws is that the regulations tend to focus upon domestic operations and activities in stark contrast to the European architecture, which generally presumes personal data will move across borders. The US laws have been criticised as being particularly insensitive to this dimension of the emerging global economy.[98]

F. Canada

In 1995-96, the Canadian Standards Association developed and issued a standard, billed as 'a model code for the protection of personal information', a voluntary national standard for the protection of personal information that an organisation may adopt.

However, Canada recently enacted the *Personal Information Protection and Electronic Documents Act, 2000.* Under the Act, all the principles embodied in the model code mentioned above have been made mandatory and are contained in Schedule 1 of the Act. It incorporates the principle that "*An organization is responsible for personal information in its possession or custody, including information that has been transferred to a third party for processing. The organization should use contractual or other means to provide a comparable level of protection while the information is being processed by a third party.*"[99] It further provides that: "*The knowledge and consent of*

[95] Available at http://www.ftc.gov/privacy/glbact/glbsub1.htm.

[96] *Supra* note 27.

[97] *Supra* note 88.

[98] *Ibid.*

[99] 4.1.3, Principle 1, Schedule 1 (Section 5), Personal Information Protection and Electronic Documents Act, 2000, available at http://www.parl.gc.ca/36/2/parlbus/chambus/house/bills/government/C-6/C-6_4/sche1E.html.

the individual are required for the collection, use, or disclosure of personal information, except where inappropriate."[100] Some of the other principles that the Act incorporates are Accountability, Accuracy, Safeguards, Openness and Individual Access.[101]

As from January 1, 2004, the Canadian Act will extend to every organisation that collects, uses or discloses personal information in the course of a commercial activity, whether or not the organisation is a federally regulated business.[102]

G. *Australia*

The *Australian Privacy Act, 1988*[103] was recently amended with regard to data protection in the private sector by the *Privacy Amendment (Private Sector) Act ,2000*, providing for ten National Privacy Principles[104] (NPPs), which became operative from December 21, 2001.[105] They comprise several principles like 'Data quality'[106], 'Data security'[107], 'Openness'[108] about policies and 'Access and Correction'[109], among others. Principle 9 deals with 'Transborder data flows'. It provides that "*an organization may transfer personal information about an individual to someone in a foreign country only if*"[110] among other things, "*the organisation reasonably believes that the recipient of the information is subject to a law, binding scheme or contract which effectively upholds principles for fair handling of the information that are substantially similar to the National Privacy Principles*"[111] or "*the individual consents to the transfer*".[112]

It is quite apparent from the above discussion that countries are waking up to the right of data protection of individuals, though their perception of it and measures to ensure it differ.

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100 *Ibid*, 4.3, Principle 3, Schedule 1(Section 5).

101 Schedule1, Personal Information Protection and Electronic Documents Act, 2000, available at http://www.parl.gc.ca/36/2/parlbus/chambus/house/bills/summaries/c6-e.htm#Schedule 1(txt).

102 Commission Decision 2002/2/EC of December 20, 2001, at 2, available at http://europa.eu.int/comm/internal_market/en/dataprot/adequacy/canadadecisionen.pdf.

103 Available at http://www.privacy.gov.au/publications/privacy88.doc.

104 Available at http://www.privacy.gov.au/publications/npps01.html.

105 Available at http://www.privacy.gov.au/act/index.html.

106 3. Transborder data flows, National Privacy Principles (Extracted from the Privacy Amendment (Private Sector) Act 2000), available at http://www.privacy.gov.au/publications/npps01.html.

107 *Ibid*, 4.

108 *Ibid*, 5.

109 *Ibid*, 6.

110 *Ibid*, 9.

111 *Ibid*, 9(a).

112 *Ibid*, 9(b).

IV. Outsourcing In India

A. *Processes Outsourced And More...*

In the outsourcing industry in India, large amounts of personal data of customers as well as employees of BPO clients is outsourced into India.

Following are some of the important outsourced processes that necessitate handling of personal data of individuals:

- Medical Transcription
- Market Research -- data base marketing, customer analysis, etc.
- Benefits Administration
- Recruiting
- Payroll
- Claims Processing
- Accounts payable / receivable
- Check processing, clearing and payment processing
- Credit / debit card services

Following is an examination of some of the processes currently being outsourced to India with special emphasis on the Healthcare and Financial Services industries.

B. *Data Processing*

Almost all kinds of processes that involve data processing are relevant for the purposes of privacy regulation. Essentially, data processing relates to all back office processing of an organisation. The clients for data processing are companies that generate tremendous amount of data like banks, financial institutions, manufacturing companies, insurance companies, etc.[113]

The basic use of data processing is data preservation which is nothing but data entry, i.e. conversion of data in the form of paper into electronic form. This enables long-term preservation of documents and easy data retrieval, storage and dissemination.[114]

Mostly, data is scanned and sent as images or paper to the BPO server where it is entered into an electronic form and sent back to the client. Data migration involves conversion of a mixture of data sources like paper and digital into a

[113] Data Processing, Software : IT enable, India Infoline Sector Reports, at http://www.indiainfoline.com/sect/iten/ch05.html.

[114] *Ibid.*

consolidated database.[115] There are value-added features to this process of data entry that are possible such as report generation, outcome studies, etc.

Data entry operators in the country can input any type of data, develop and update databases and handle a high volume of data at high speeds accurately.[116]

Some of the current popular data entry jobs include[117] paper document conversions to computer ready files for the Internet, Intranet and Extranet, CD-ROM and database, transcription of audio files, mailing lists, creation of new databases and updates to existing databases for banks, airlines, government agencies, direct marketing services and service providers, online completion of surveys and responses of customers for various companies, call centres, hospital records, patient notes and accident reports.

Data processing can be quite helpful to companies as data retrieved from coupons, contests, sweepstakes entries, warranty forms, information request forms, order forms, refund requests, voter registration records, credit card applications and census forms can give useful knowledge to manage customer relations better. Also, data from résumes, insurance forms, tax returns, invoices, and remittance forms, checks and vouchers can help in managing human resources better.[118]

At the same time, most of the data in these processes contain personal information of individuals interacting with the BPO client companies abroad.

1. Financial Services And Health Services

A significant amount of outsourcing to India is from the healthcare industry and the financial industry. These are two industries that, by their very nature, tend to have a large amount of personal, often sensitive data, about their customers. Thus it is important to focus on these two industries and examine the effect of the privacy regulations abroad on the practice of outsourcing to India followed in these industries.

a. *Financial Services*

As an astute European once observed, "*in the final analysis, the financial system is a network of information.*"[119] In essence, information processing is a basic

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[115] *Ibid.*

[116] At http://www.outsource2india.com/services/data_entry.asp.

[117] *Ibid.*

[118] *Ibid.*

[119] C. Goldfinger, La Geofinance 401 (1986) referred from Joel R. Reidenberg, (Colloquium): "The Privacy Obstacle Course: Hurdling Barriers to Transnational Finanacial services", 60 Fordham L. Rev. 137, May 1992.

component of financial services. Financial services depend on personal information and create significant information about individuals.[120] Financial services like banking gain personal information not only through traditional banking functions such as money transmission and credit extension, which require sensitive and detailed information about individuals, but also from the transaction records from these functions, since these records are capable of providing significant information about an individual's life and lifestyle. Similarly, insurance services are information-intensive. Life and health insurance providers must collect and use detailed information about an insured's medical history. Even brokerage services require the processing of personal information and provide details on the lives of individuals[121], among other reasons, due to 'know your client' requirements of various securities laws.

Thus, outsourcing of practically any kind of process by the financial services industry would tend to involve transferring of personal data of individuals. That there is a significant amount of such data currently being transferred is apparent from the number and size of financial services companies currently sourcing services and processes from India – American Express, GE Capital, Merrill Lynch, Visa, ANZ, ABN AMRO, Morgan Stanley and Prudential to name a few.

b. *Insurance Claims Processing*

One such process increasingly gaining importance in the outsourcing industry in India as well as abroad is Insurance Claims Processing. Insurance companies have two basic activities that require internal efforts, i.e. creating and setting up an insurance policy and then processing the large volume of insurance claims and accounting for the insurance claims.[122] "*The entire life cycle of a claim is very costly, and claims origination, processing and maintenance are inefficient. Often the processing is manual.*"[123] Large insurance companies get myriads of claims. With the help of well laid down rules on how they are to be processed, such processing can be done anywhere.[124] In light of these factors, the insurance industry finds outsourcing of claims processing the intelligent choice.

2. Healthcare Industry

Each time a patient sees a doctor, is admitted to a hospital, goes to a pharmacist or sends a claim to a health plan, a record is made of his confidential health

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[120] Joel R. Reidenberg, (Colloquium): "The Privacy Obstacle Course: Hurdling Barriers to Transnational Finanacial services", 60 Fordham L. Rev. 137, May 1992.

[121] *Ibid.*

[122] *Supra* note 4 at A-11.

[123] K. Harris, "Claims Meet the Internet: The Insurance Claims Life Cycle" (Research note), May 14, 2001.

[124] *Supra* note 122.

information. For many years, the confidentiality of those records was maintained by family doctors, who kept records sealed away in file cabinets and refused to reveal them to anyone else.[125] Thus individuals relied on the professionalism of their doctors and the orthodox method of storing records on paper for protection of their health-related personal data. Also, until recently, computerised medical information tended to be in incompatible formats, making cross-correlation and reuse of this information difficult.[126] However, changes in the structure of the health care industry and further improvements in computerised medical information systems have fundamentally transformed the way in which personal medical information is gathered and used.[127]

Moreover, although individuals are usually asked for authorisation to use their medical information, since such authorisations can be directly linked to approval for insurance coverage or medical treatment, patients do not really have a choice.[128]

a. *Processes Outsourced In The Healthcare Industry*

There is admittedly an increasing trend in the healthcare industry in the US, of outsourcing to India. There are mainly two important activities outsourced by the healthcare industry to India – medical transcription and health claims processing.

(i) Medical Transcription

NASSCOM defines medical transcription as "*the process through which one accurately and swiftly transcribes medical records dictated by doctors and other healthcare professionals. It is the method of translating the dictation (that forms the basis of providing healthcare) into a format suitable for inclusion in a medical record (hard copy or electronic).*"[129]

These medical records include patient history, reports, clinical notes, office notes, operation reports, medical recommendations, letters, psychiatric relations, laboratory reports, etc.[130]

What usually happens is that the doctors record their findings through a dictaphone or similar device. These sound tracks are then sent to the overseas BPO server directly through datacom lines. The recordings may also be

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125 *Supra* note 89.

126 *Supra* note 31.

127 *Ibid.*

128 "Protecting Privacy in Computerised Medical Information" Office of Technology Assessment: Digest, available at http://www.ksg.harvard.edu/stp-307/group5/security.htm#Current%20Protections%20to%20Electronic%20Health%20Care%20Privacy.

129 *Supra* note 116.

130 At http://www.indiainfoline.com/sect/iten/ch04.html.

uploaded on to a dedicated server. The transcription unit of the BPO server logs in to that server and downloads the dictation material.[131] The latter employs 'medical transcriptionists' who hear these recordings, transcribe them into reports and send them back electronically.[132]

As per a NASSCOM survey, there are more than 250 companies offering Medical Transcription services in India.[133] Though the Medical Transcription Industry experienced a healthy growth in India through 2000-01[134], the trend of outsourcing in this sector is going down due to improvements in voice recognition technologies that lead to direct digitisation of dictated records.[135]

(ii) Health Claims Processing

Another healthcare process that is currently catching on is health claims processing. In the US, the healthcare industry produces a large amount of health claims in the form of forms under various regulations like the HIPAA. Some of the health claim forms currently being processed by BPO servers in India:

- HCFA - 1500 [136]
- Uniform Billing form 92 (UB-92)
- American Dental Association (ADA)

These forms are scanned and received in the form of images via high-speed link. They are then processed in accordance with the regulations specified and uploaded onto the clients' server.[137]

V. Solutions

The privacy regulations discussed above especially those incorporated in the EU Directive are in stark contrast to India and the practically non-existent privacy regulation in this country. However, enforcement of these regulations is yet another issue. As Swire and Litan have rightly observed, "*the pattern in European data protection law has often been to announce strict rules that appear to prohibit desirable practices but to have considerably more flexibility in practice. The fact that existing regimes have not resulted in draconian enforcement is an indicator of what to expect in the future*".[138] Also, it is very difficult to ascertain if corporations are

[131] Available at http://www.indiainfoline.com/sect/iten/ch04.html.
[132] *Supra* note 116.
[133] *Ibid* at A-12.
[134] *Ibid*.
[135] *Ibid* at B-23.
[136] Available at http://www.vanderbilt.edu/HRS/forms/BCBS%20Claim%20Form.pdf.
[137] At http://www.magellanprovider.com/HdbkAppxG/appg_cleanclaim.pdf.
[138] *Supra* note 49.

in fact complying with the regulations relating to data protection, independent of their claims. It is hardly possible for authorities to verify the actual practice of data processing followed within the company.

Nevertheless, a company that does not comply with the privacy regulations it is subject to does so at its own peril. Data processing contracts are known to be stringent, and in clinching such contracts in the outsourcing industry in India, much hinges on the BPO client's perception of compliance by the Indian BPO service provider.

It would be useful to examine the various ways in which companies may secure compliance. There are, as of now, two methods available to the outsourcing industry to ensure compliance with the various privacy regulations discussed above:

A. Consent

One of the simplest ways of preclusion of liability with respect to transborder personal data flows is to ensure that the transfer and processing of data is done with the consent of the individual. The EU Directive specifically provides unambiguous consent of the data subject as one of the derogations[139] from the rule prohibiting transfer of data to third countries without adequate level of protection.[140]

There are essentially two categories of data transfers in the outsourcing industry that may be identified for the purposes of acquiring consent namely, the personal data of employees of the BPO client and personal data of other data subjects who interact with the BPO client.

1. Employee Data

In order to ensure compliance in the former category of outsourcing, companies need to examine their current employee privacy policies, and new consent forms must be drafted, if necessary, to secure consent with respect to transfer of data into the country of the BPO server. Payroll and Benefits Administration are two examples of outsourced processes that involve handling of personal data of employees of the company outsourcing. Employer data can also tend to overlap with health-related data sharing in view of leave records and internal health reports being processed.

2. Other Personal Data

The other category of data outsourcing includes outsourcing of personal data of other data subjects, namely, customers, potential customers and potential

[139] *Supra* note 71.

[140] *Ibid*, Article 25.

employees. This kind of outsourcing includes outsourcing of processes like medical transcription, insurance claims processing, credit card authorisation, market research, hiring, etc. Consent in such cases must not only be adequate but also effective. For instance, merely informing a customer that his data may be transferred to third parties is not sufficient form of disclosure without informing him as to who it is likely to be transferred to and for what purposes. As has been quite rightly observed by Daniel J. Solove, "*The choices given to people over their information are hardly choices at all. People must relinquish personal data to gain employment, procure insurance, obtain a credit card, or otherwise participate like a normal citizen in today's economy. Consent is virtually meaningless in many contexts. When people give consent, they must often consent to a total surrender of control over their information.*"[141] Even when people seek medical care, among the forms they sign are general consent forms which permit the disclosure of one's medical records to anyone with a need to see them.[142]

B. Privacy Policies

To ascertain whether there is respect for and compliance with data protection rights, it is a company's privacy policy that needs to be examined. "*Although more companies that routinely collect and use personal information are posting privacy policies, these policies hardly amount to a meaningful contract. Rather, privacy policies tend to be self-indulgent, making vague promises such as the fact that a company will be careful with data; that it will respect privacy... These public-relations statements are far from reliable and are often phrased in a vague, self-aggrandizing manner to make the corporation look good. What is not given to consumers is a frank and detailed description of what will and will not be done with their information, of what specific information security measures are being taken...People must rely on the good graces of companies that possess their data to keep it secure and to prevent its abuse. They have no say in how much money and effort will be allocated to security; no say in which employees get access; and no say in what steps are taken to ensure that unscrupulous employees do not steal or misuse their information. Instead, privacy policies only vaguely state that they will treat information securely. Specific measures are not described, and individuals have no control over those measures.*"[143]

It is interesting to note this observation of Daniel J. Solove and then examine the privacy policy of American Express (to cite but an example) posted on their website. Some relevant extracts of that policy are given below:

"*We Collect Only Customer Information That Is Needed, And We Tell Customers How We Use It. We limit the collection of information about our customers to what we need to*

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[141] *Supra* note 27.
[142] *Ibid.*
[143] *Ibid.*

know to administer their accounts, to provide customer services, to offer new products and services, and to satisfy any legal and regulatory requirements...

"*We Ensure Information Quality. We use advanced technology, documented procedures and internal monitoring practices to help ensure that customer information is processed promptly, accurately and completely.*"[144]

Further, the privacy policy goes on to mention that the company will limit access to information systems only to "*those who specifically need it to conduct their business responsibilities, and to meet our customer servicing commitments*"[145].

The privacy policy of this company has been cited since it is one of the major companies that is at present involved in outsourcing of back-office operations into India. Needless to say, an examination of these statements gives no indication whatsoever that personal data in the possession of the company may be transferred to a third country for the purpose of outsourcing.

A privacy policy of this kind would also not provide for 'unambiguous consent' as envisaged in the EU Directive for the transfer of personal data to third countries under Article 26.1.1 of the Directive[146], nor does it satisfy the requirements of disclosure to individuals with regard to transfer to non-affiliate third parties under the GLB Act of the US[147].

Also, some private organisations provide 'opt-out' options to customers (including the abovementioned one) with regard to certain limited disclosures and uses of their personal information. However, an opt-out choice is not really an adequate option as opt-out systems often provide individuals with an 'all-or-nothing choice' which they are likely to take when they are unaware of how information can or might be used in the future.[148] Ideally, for consent to have any real value, persons must be given an 'opt-in choice' to be able to affirmatively decide the ways in which and by whom the information collected about them will be used. For, under a system where individuals opt-in, the default rule is that personal information cannot be collected or used unless the individual provides consent.[149]

C. Contract

Another method of securing compliance with data protection principles is by ensuring through contractual clauses that the BPO service provider located in

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144 Available at http://www10.americanexpress.com/sif/cda/page/0,1641,14275,00.asp?.

145 *Ibid.*

146 Available at www.privacy.org/pi/intl_orgs/ec/final_EU_Data_Protection.html.

147 Section 6802(b)(2). GLB Act, available at http://www.ftc.gov/privacy/glbact/glbsub1.htm.

148 *Supra* note 27.

149 *Ibid.*

India is obliged to follow the privacy principles that the BPO client is subject to while handling the personal data outsourced to it.

The HIPAA regulations provide for adequate contracts with 'business associates' to ensure data protection.[150] The GLB Act also provides for disclosure of non-public personal information to third parties provided there is a contractual agreement to preserve confidentiality.[151]

The EU Directive also allows transfer of personal data to third countries without adequate protection levels if there are 'appropriate contractual clauses' in place.[152] The Commission, by virtue of authority given to it under Article 26.4 of the Directive[153], came out with 'standard contractual clauses for the transfer of personal data to processors established in third countries under the Directive'.[154] They impose the following obligations, among others:

- On the data controller/exporter as well as the data processor/importer that there are technical and organisational security measures as "*are necessary in order to protect personal data against accidental or unlawful destruction or accidental loss, alteration, unauthorized disclosure or access or any other unlawful forms of processing*";[155]
- On the data controller to ensure, in cases of transfers of 'special categories of data', that the data subject is informed of the transfer;[156]
- On the data processor/importer that the data should be processed 'only on behalf of the data exporter' and 'should not be disclosed to a third party unless in accordance with certain conditions'.[157]

Furthermore, the contract should provide that it will be governed by the law of the Member State of the data exporter. Clause 6 imposes liability on the data exporter to pay compensation to a data subject who has suffered damages on account of violation of the provisions of the contract.[158] It also provides for right of action of the latter against the data importer in case of the data controller factually disappearing, ceasing to exist or becoming insolvent[159] and indemnification between the parties[160].

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150 Section 164.504 (e)(1), HIPAA, available at http://www.hhs.gov/ocr/regtext.html.
151 *Supra* note 147.
152 Article 26.2, EU Directive.
153 Available at www.privacy.org/pi/intl_orgs/ec/final_EU_Data_Protection.html.
154 *Supra* note 73.
155 *Ibid*, para 11.
156 *Ibid*, Annex, Clause 4.
157 *Ibid*, para14.
158 *Ibid*, Clause 6.1.
159 *Ibid*, Clause 6.2.
160 *Ibid*, Clause 6.3.

It is imperative that these clauses be incorporated in a contract of outsourcing between any BPO client situated in the EU and an Indian BPO server.

VI. Options For India

In view of the recently emerged but rapidly growing outsourcing industry in our country and the growing consciousness about data protection worldwide, it is imperative that some sort of concrete privacy regulation be adopted in our country as well. This will, apart from sending out a positive signal to the international community, also enable Indian BPO service providers to negotiate their contracts better with the benefit of local legal advice. More importantly, the Indian consumer will also be assured of protection of his personal data. We cannot afford to be caught off guard with regard to the issue of data protection as this might well lead to India's position being seriously hampered in the increasing competition in the outsourcing industry. Following are some of the options that might be considered for incorporating data protection in our country:

A. Self-Regulation

Companies involved in providing outsourcing services along with outlocated wholly-owned subsidiaries of companies may get together and form a set of self-regulatory measures comprising of fair information practices to take care of the demands of the privacy regulations relating to transfers and processing of data to these server companies. NASSCOM is already collaborating with leading Indian ITES services companies to establish quality standards and certifications for this sector.[161] It would prove very beneficial to the growth of the outsourcing industry if NASSCOM would concentrate its efforts over the data protection issues involved in this industry.

This is one option that may be exercised immediately to support the Indian outsourcing industry at least by way of a temporary measure, awaiting more concrete regulation. Even after such regulation has been formed, self-regulation can continue to provide added assurance and enrich the data protection framework in the private sector. An important advantage of self-regulatory measures is that they are made keeping in mind the business needs and practices of the companies rather than the dictates of a Government or Legislature. On the other hand, the disadvantage is that such self-regulatory measures tend to be rather permissive and rarely complete standards of fair information practice.[162]

B. Regulation

This is another option, which would be more effective and better recognised abroad than self-regulation. The Government could, for instance, formulate a

[161] *Supra* note 14.

[162] *Supra* note 120.

set of principles of the kind issued by the US Department of Commerce as 'Safe Harbor' to ensure compliance with the EU Directive. Companies could then commit to adhere to the principles and self-certify, with provision for incurring liability in case of non-compliance or misrepresentation. In fact, after negotiation with the EU Commission, the 'Safe Harbor' principles may be adopted, as they are, as a basis for providing certification to Indian companies, since those principles have already been approved by the EU Commission as providing adequate protection. This way, we would be on safe ground with respect to data transfers from the EU as well as the US.

C. Legislation

However, the most appropriate method of incorporating the principles of informational privacy in India would be by way of a 'comprehensive national legislation'. In light of the emerging database and direct marketing industry in India and the increasing collection and dissemination of personal data of individuals, a statute which would provide adequate personal data protection to all individuals, not just the data subjects of the outsourcing countries, but also to Indian citizens, is what is required.

Such an enactment would provide safeguards against the collection, processing, transfer, storage, etc. of personal information of individuals, by the public and private sector both. It would bestow individuals with the right to information regarding the collection of personal information, the right to opt-in to various types of disclosures of such information, the right to access and correction of such information and the right to be protected against the misuse of such information and redressal in case of such misuse. In addition to this, it would also ensure that such personal data is not transferred to organisations (be they countries, companies or communities) that do not employ similar privacy regulations and, most importantly, such legislation must provide for strict compliance with and enforcement of these principles.

Thus, legislation would undoubtedly prove most effective to secure India's continuing growth in the outsourcing industry. However, from the look of things it also seems to be the most unlikely measure to be adopted in the near future. The Indian Government has not addressed the privacy issue at all. The only legal right to privacy existing in the country at present is the one that has been read in to Article 21 of the Constitution by the Supreme Court and is merely restricted to the right against invasion of privacy by the State.[163] Data protection, sadly, is a complete non-issue in the jurisprudence of this country.

The Andhra Pradesh Government is already planning to develop a Data Protection and Consumer Privacy Act to reassure the ITES companies and their

[163] *Kharak Singh* v. *State of U.P.* AIR 1963 SC 1295.

customers of the safety of their data and indicate the Government of Andhra Pradesh's commitment to, and respect for, consumer privacy.[164] While this will give Andhra Pradesh an edge, such provincial legislations may not be enough to ensure that companies feel secure about outsourcing personal data to India.

VII. Conclusion

India is, at the moment, the leader in offshore outsourcing sites, ahead of China, Ireland, and Philippines etc. The rate at which the outsourcing (ITES) industry is currently growing, it might even overshoot NASSCOM's projection of this industry's ability to generate revenues of US $17 billion and provide employment for 1.1 million people in the country by 2008.[165] This is all thanks to the availability of an abundant supply of inexpensive but skilled labour and the active governmental support that is being given to the outsourcing industry in India. An important issue, however, that the country seems oblivious to is the growing consciousness about data protection rights consciousness across the globe and its potential adverse effects on our growing outsourcing industry. The last couple of years has seen a considerable amount of privacy regulation emerging in various communities all over the world. Though India has been lucky so far due to lax enforcement of these regulations by countries, it is high time India woke up to the reality of complete absence of any kind of data protection in the legal framework of its economy. If India wants to maintain its position as the preferred outsourcing site among companies (especially those in the EU and the US) and nurture the growth of its outsourcing industry, it must seriously start considering the formulation of a strong, comprehensive data protection framework, preferably by way of national legislation. Such legislation will not only help in boosting India's position in the global outsourcing scenario but also enable India to be recognised in the world as a country conscious of the privacy principles and the data protection rights of its citizens.

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[164] Information Technology and Communications Department, Government of Andhra Pradesh, AP Policy on ITES, at 7, Para 3.3.3.

[165] *Supra* note 21.

GOVERNMENTAL SECRECY AND RIGHT TO INFORMATION†

*Venkateshwar Satyanarayan**

I. INTRODUCTION

This article seeks to understand the concept of the various aspects of Governmental secrecy in relation to people's Right to Information. The Indian Government regulates its intelligence communication though *The Official Secrets Act, 1923*. This Act *inter alia* prescribes punishment for obtaining or communicating secret documents of the Government. However, the need for an open Government in recent times has increased. The right balance of secrecy in the context of people's Right to Information would ensure smooth functioning of governance and administration.

II. BACKGROUND AND INTRODUCTION TO THE OFFICIAL SECRETS ACT, 1923

This piece of legislation was designed by the British for protecting their imperial interests and keeping their Indian subjects under subjugation and control. Though secrecy had been an official policy since 1843, the first Indian Official Secrets Act was passed in 1889. Till then secrecy was practised by persuasion. The civil servants were told not to disclose information about the functioning of the government to outsiders, including the press. The Act should have been repealed at once after independence; unfortunately, it is still very much on the statute book. In 1967, the Indian Government made *The Official Secrets Act, 1923*[1] stiffer disregarding the growing public opinion against it among the country's intelligentsia and voluntary sector.

The Official Secrets Act, 1923 consists of fifteen sections, of which Sections 3 and 5 are critically important.

Section 3 provides penalties for spying. Section 5 deals with wrongful communication, etc. of information. Under this section, a person who is in possession of secret information which relates to or is used in a prohibited place or is likely to assist an enemy, prejudice the security of the country or affect adversely relations with a friendly country and passes on the information to unauthorised persons is liable to be imprisoned for three years' or fine or both.

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† This article reflects the position of law as on March 13, 2003.

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1 Amendment in The Official Secrets Act 1923 - Second Amendment.

The Official Secrets Act, 1923 as amended in 1967, provides for penalty for espionage and secondly relates to wilful communication of official information by any person holding office under the Government (including contractors having dealings with Government) to any person other than a person whom he is authorised to communicate.

A. Official Secrets Act 1923 – Why Draconian? Why Misused?

The laws, which have been chararacterised by the critics as an 'anachronism' or 'profanity', are provisions of the Indian *Official Secrets Act, 1923.* Section 5[2] of the *Official Secrets Act, 1923* is an omnibus catch-all provision. It covers even

[2] Section 5. Wrongful communication, etc., of information–

(1) If any person having in his possession or control any secret official code or pass word or any sketch, plan, model, article, note, document or information which relates to or is used in a prohibited place or relates to anything in such a place, or which is likely to assist, directly or indirectly, an enemy or which relates to a matter the disclosure of which is likely to affect the sovereignty and integrity of India, the security of the State or friendly relations with foreign States or which has been made or obtained in contravention of this Act, or which has been entrusted in confidence to him by any person holding office under Government, or which he has obtained or to which he has had access owing to his position as a person who holds or has held office under Government, or as a person who holds or has held a contract made on behalf of the Government, or as a person who is or has been, employed under a person who holds or has held such an office or contract—

(a) wilfully communicates the code or pass word, sketch, plan, model, article, note, document or information to any person other than a person to whom he is authorised to communicate it, or a Court of Justice or a person to whom it is, in the interest of the State, his duty to communicate it; or

(b) uses the information in his possession for the benefit of any foreign power or in any other manner prejudicial to the safety of the State; or

(c) retains the sketch, plan, model, article, note or document in his possession or control when he has no right to retain it, or when it is contrary to his duty to retain it, or wilfully fails to comply with all directions issued by lawful authority with regard to the return or disposal thereof; or

(d) fails to take reasonable care of, or so conducts himself as to endanger the safety of the sketch, plan, model, article, note, document, secret official code or pass word or information, he shall be guilty of an offence under this section.

(2) If any person voluntarily receives any secret official code or pass word or any sketch, plan, model, article, note, document or information knowing or having reasonable ground to believe, at the time when he receives it, that the code, pass word, sketch, plan, model, article, note, document or information is communicated in contravention of this Act, he shall be guilty of an offence under this section.

(3) If any person having in his possession or control any sketch, plan, model, article, note, document or information, which relates to munitions of war, communicates it, directly or indirectly, to any foreign power or in any other manner prejudicial to the safety or interests of the State, he shall be guilty of an offence under this section.

(4) A person guilty of an offence under this section shall be punishable with imprisonment for a term which may extend to three years, or with fine, or with both.

a case where unauthorised disclosure relates to a document or information, which is not a 'classified' one. Section 5 is the main target of public criticism. According to the provisions, it is ultimately within the Government's power to say whether the disclosure has been damaging since it is the party claiming that damage was caused. It has further been argued that the damage disclosure test is not strict enough. A major flaw in this Act is that it does not provide a defence of prior publication i.e. if the information has already been disclosed elsewhere, the charge should fail. A brief review of the provisions of this Act indicates that it deals largely with issues such as espionage, entry into prohibited places, use or control of secret official codes or other acts that result in the communication of information to enemy agents or enemy States. This hardly appears to be the catch-all statute that is brandished as the sole reason for denial of information. However, a closer look at the provisions of the statute indicates that the mischief lies in the manner in which the law has been drafted. In certain provisions explained further, the language used in the statute allows the widest interpretation of provisions, thereby permitting its misuse by Government officials who could use the wide letter of the law to subvert its relatively narrow spirit. Moreover, the Government gets the power to decide as to which is a classified document and which is not and the injury sustained in course of the revelation of the document. Also no court shall take cognizance of any offence unless on the complaint made by the Government or its officers under Clause (3) of Section 13[3]. The Government could then put its police force to 'nail' a person. The statute becomes a tool in the hands of the Government for misuse which shall be elaborated further. This law also seriously affects press freedom. Under this Act, journalists who disclose information, which has been disclosed to them lawfully, will be guilty of an offence. The only defences available are that the journalist did not know and had no reason to believe the information fell within one of the categories of protected information or that the disclosure was not damaging. This in itself would act as a form of prior restraint. So much so, that even Parliament has no ready access to official documents. The information, sensitive or otherwise, which is demanded by the various Standing Committees of the Lok Sabha and the Rajya Sabha[4] is first suitably 'sanitized' by the concerned Ministry or Department.

In the case of *Narendra Narottamdas* v. *Central Bureau of Investigation*[5], it was held that "*The receipt of secret documents is itself an offence. The offence becomes complete immediately on the obtaining of the secret documents.*"

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3 Section 13. Restriction on trial of offences.—Clause 3: "No court shall take cognizance of any offence under this Act unless upon complaint made by order of, or under authority from, the Appropriate Government or some officer empowered by the Appropriate Government in this behalf."

4 *The Indian Express*, December 12, 2002.

5 1981 Bom LR 362.

The mere receipt of secret documents is an offence under Section 5 without regard to the use thereof. Therefore restrictions imposed by Section 5 on the freedom of speech and expression, freedom of press, freedom of information and open Government would not be a reasonable restriction within the meaning of Article 19(2).[6]

In the case of *Buddhikota* v. *State of Maharashtra*[7], the constitutional validity of Section 3 and Section 4 of *The Official Secrets Act, 1923* was challenged on the grounds that since various terms and expressions such as 'enemy', 'secret official code or password', etc are not defined in the Act, no definite meaning could be assigned to them. This would result in vagueness and arbitrariness. However, the Hon'ble Bombay High Court observed, "*It is by now well settled that such words take colour from the context. While interpreting the words of statutory provisions, it becomes necessary to have regard to the subject matter of the statute and the object which is intended to be achieved.*" However the fact remains that the words 'secret' and 'enemy' are not defined in the Act. This could result in vagueness and arbitrariness. In the absence of any definition in the Act, it is left to the Government to decide what material it should treat as 'secret' and what not. The Press Council of India, in its recommendations for amending Section 5, suggested that the definition of the term 'official secret'[8] be included in Section 5. However, this definition has not been included until date. Moreover, the right to information, open Government and freedom of press are implicit in Article 19(1)(a). It is ironical that even the recommendations of the Inter-departmental Study Group set up by the Government in 1977 to look into *The*

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6 Article 19(2): "Nothing in sub-clause (a) of clause (1) shall affect the operation of any existing law, or prevent the State from making any law, in so far as such law imposes reasonable restrictions on the exercise of the right conferred by the said sub-clause in the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality, or in relation to contempt of court, defamation or incitement to an offence."

7 1989 Cr.L.J. 691.

8 For the purpose of this section 'official secret' means – any secret code, password, any sketch, plan, model, article, note, document, including documents regarding proceedings, decisions, minutes of the Union or State Cabinet, or information, which relates to or is used in a prohibited place or relates to anything in such a place, or which relates to any Government department; Provided it is of the nature concerning – (a) defense or security of the nation; (b) foreign relations; (c) monetary policy, foreign exchange policy, economic plans and policies, commercial or financial information, where pre-mature disclosure may harm the national interest or provide opportunities for unfair financial gains to private interest; (d) information which is (i) likely to be helpful in the commission of offences; (ii) likely to be helpful in facilitating an escape from legal custody or to be prejudicial to prison security, or (iii) likely to impede the prevention or detection of offences or the apprehension or prosecution of offenders; (e) private information given to the Government in confidence; (f) trade secrets.

Official Secrets Act, 1923 have been treated as confidential.[9] A reasonable restriction would provide that after the lapse of a prescribed period, the disclosure should not attract any penal consequences. Such disclosure benefits the nation. For example, disclosure of information regarding the India-China conflict of 1962 in any period after 1992 should not attract the punishment. People have a right to know why that conflict occurred and to what extent our national leaders were responsible for it.[10] A plain reading of Section 5(1) and 5(2) reveals a strange absurdity. Section 5(1)(a)[11] exempts a person from prosecution for wrongful communication under Section 5(1) if he willfully communicates secret information to a court of justice or to any person to whom it is in the interest of the State to communicate it. However, these exemptions under Section 5(1)(a) have not been included in Section 5(2) and hence the same person may be prosecuted for receipt of the secret information under Section 5(2) even though he is exempted from prosecution under Section 5(1). One such instance was the use of *The Official Secrets Act, 1923* to prohibit entry of journalists into area surrounding the Sardar Sarovar Project and thereby suppress public debate and dissent by the use of this law. Another drastic instance was when the Government not only refused to make public details of the monetary settlements between the Government and Union Carbide in the Bhopal Gas Tragedy, but several participants at a workshop on the medical aspects of the victims were arrested under the provisions of *The Official Secrets Act, 1923* for taking notes![12] The judiciary has not taken the view that if disclosure is not justified in public interest, no prosecution can be launched against the person concerned. The High Courts of Punjab and Kerala have stated that a budget, before it is presented is also a 'secret document' and its disclosure is an offence.[13] Subjective interpretation of the term 'interest of the state' by the Government as in Section 4(1) gives it an excuse to portray the most trivial matters in the most aggravated form. Courts have offered some respite. The qualifying word 'secret' has been interpreted to include only official code or password and does not apply to any

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9 Home Minister, Shri H. M. Patel, stated that it would not be in public interest to disclose the document. *The Hindu*, July 16, 1979.

10 S. P. Sathe, *Administrative Law*, (Sixth Edition) at 514.

11 *Supra* note 2.

12 Harsh Mander, The Movement for the Right to Information in India, National Centre for Advocacy Studies, Pune, July 1999.

13 (1965)1 CR LJ 393(408); (ILR) 1980 Ker 1085.

sketch, plan, model, article, note or any other document of information under Section 3(1)[14].[15] Mere collection of a document not prejudicial to the state would not constitute an offence unless it is shown it is prejudicial to the State in some manner.[16] The basic ingredient is that the investigation must disclose that the secret document obtained was directed to endanger the State.[17] However *The Official Secrets Act, 1923* is still liable to be misused. This largely depends on the administration invoking the provisions of the Act. If the administration uses it for intelligence purposes in the interest of the people then the statute is necessary, otherwise it becomes a weapon in the hands of the Government against its citizens.

B. Iftikhar Gilani Case

The arrest of Iftikhar Gilani, the New Delhi bureau chief for the Jammu-based newspaper, *Kashmir Times*, a regular contributor to the German broadcaster, Deutsche Welle and Pakistani newspapers - *The Friday Times* and *The Nation,* was a classic example of misuse of *The Official Secrets Act, 1923.* The Delhi Police had accused Gilani of possessing classified documents and arrested him under the provisions of the Act. The only evidence against Gilani cited by the Government was a public document released in 1995 by Pakistan's Foreign Ministry that included information about alleged human rights abuses committed by Indian troops in Kashmir. Iftikhar Gilani was kept in custody for over 180 days, for having in his computer such documents, which were in public domain.

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[14] Section 3: Penalties for spying – (1) If any person for any purpose prejudicial to the safety or interests of the State

(a) approaches, inspects, passes over or is in the vicinity of, or enters, any prohibited place; or

(b) makes any sketch, plan, model, or note which is calculated to be or might be or is intended to be, directly or indirectly, useful to an enemy; or

(c) obtains, collects, records or publishes or communicates to any other person any secret official code or pass word, or any sketch, plan, model, article or note or other document or information which is calculated to be or might be or is intended to be, directly or indirectly, useful to an enemy or which relates to a matter the disclosure of which is likely to affect the sovereignty and integrity of India, the security of the State or friendly relations with foreign States; he shall be punishable with imprisonment for a term which may extend, where the offence is committed in relation to any work of defence, arsenal, naval, military or air force establishment or station, mine, minefield, factory, dockyard, camp , ship or aircraft or otherwise in relation to the naval, military or air force affairs of Government or in relation to any secret official code, to fourteen years and in other cases to three years.

[15] AIR 1996 SC 569.

[16] 1971 Raj 209.

[17] 1992 2 Cri LJ 784.

Even the military intelligence agency admitted this fact. On December 12, 2002, the military intelligence filed a report with the Delhi Commissioner of Police. Retracting its earlier rendered opinion of June 14, 2002, it stated that "*while rendering our previous opinion vide our note under reference, we were not in possession of the second set of documents hence, it led to erroneous over-estimates of the sensitivity of the documents. The opinion rendered by us earlier may kindly be reappraised as given above*".[18] It appeared that the Delhi Police had fabricated the case of violation of *The Official Secrets Act, 1923*, since the opinion clearly stated that "*the information contained in the document was easily available*" and "*the document carried no security classified information and the information seems to have been gathered from open sources*". He had also been charge-sheeted for collecting data on human rights violation in Jammu and Kashmir, though the documents recovered by the police from his computer showed the violation, the Pakistani armed forces as well and that too in Pakistan-occupied Kashmir (PoK).[19]

Iftikhar Gilani's father-in-law is Syed Ali Shah Geelani, a senior separatist leader in Kashmir. There were many political interests and agendas involved in Kashmir of the then National Democratic Alliance Government. The separatist leader was the main critic of the policies of the Central Government in Jammu and Kashmir .The Hurriyat Conference was the separatist party of which Syed Ali Shah Geelani was a member. They had criticised the Central Government's Kashmir peace initiative as anti-national and had boycotted elections in Jammu and Kashmir. The Government therefore got Iftikar Gilini arrested on the same day as his father-in-law although Iftikar Gilini had criticised the Hurriyat Conference in Kashmir. This only fuelled the apprehension in peoples' mind that provisions of *The Official Secrets Act, 1923* could be used to settle political scores and as a tool for political vendetta. Even journalists who followed the case and who wrote against the arrest reported to the Delhi Union of Journalists that they had their telephones bugged.[20] This shows how the statute could be used to subvert voices against the Government. *The Indian Express* conducted a survey[21] and found several cases of persons languishing in jails for long periods for possession of relatively trivial matter or material. The survey exposes the misuse of the Act.

Amendments to the provisions of the Act have been made only twice,[22] which have made the statute more drastic than before. The Act was amended in 1967 to add the grounds 'friendly relations with foreign States' which can be abused

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18 "Iftikar Gilini Arrested", June 15, 2002, Press Trust of India.

19 The Press Council of India.

20 At www.humanrightswatch.com.

21 The Indian Express magazine, March 9, 2003.

22 The First Amendment was carried out in 1951 and the Second Amendment was carried out in 1967.

to prevent disclosures that expose any misdeed by a foreign Government or a scandal in the conduct of foreign policy by our own Government. Moreover, *The Official Secrets Act, 1923* has not been amended as per changes and advancement in information technology and telecommunication. Data can now be obtained easily via the Internet. Information is now freely available in these media, which would otherwise invite provisions of the Act. Legislative wisdom has not considered such changes. The Act, in its definitions, does not consider e-mail passwords in the definition of 'password' stated in Section 2. Due to this, it has been termed as an old and obsolete law needing major review. Nothing should be an offence under the section if it predominantly and substantially subserves public interest, unless the communication or use of the 'official secret' is made for the benefit of any foreign power or in any manner prejudicial to the safety of the State. Unless so amended, in my opinion, the Act is unconstitutional. In Britain, proceedings under the corresponding Act are brought by an independent Director of Public Prosecutions and only with the consent of the Attorney General. In according his consent, the Attorney General acts independently and not as a member of the Government. He applies his judgment to the balance of public interest involved. The decision is his alone. Yet, even this safeguard has not been incorporated. In India, the citizen has no such protection. Without this vital procedural safeguard, the Act ought to be deemed unconstitutional. Cases may still arise where a technical offence appears to have been committed but the matter is not sufficiently blameworthy to warrant prosecution. An oppressive regime could, nonetheless, let loose the police to arrest a man, put him in prison, bring a charge, dub him 'anti-national' and, in the atmosphere so created, put him on trial by the lower judiciary. The possibility of such misuses ought to be minimised by appropriate amendments to the Act.

C. Official Secrets Act 1923 As Opposed To Right To Information

The Official Secrets Act, 1923 is opposed to Right to Information because the push toward secrecy has extended far beyond law enforcement. Under the Act, by restricting access to 'sensitive but unclassified' information, agencies have made it harder for the public to see records that are often used by health and safety advocates and that are sought to be kept secret by the industry. Section 5, as it stands, prevents any information about the affairs of the Government from being disclosed to the public. This has lead to a very ignorant public regarding Governmental affairs.

The scope of Section 2 is enormously wide. Any law, which impinges on the Freedom of Information in a democracy, should be more tightly drawn. In 1971, Justice Caulfield said that Section 2 should be 'pensioned off' because it unduly interfered with the freedom of the press. Section 2 catches all official documents and information. It makes no distinction of any kind or degree.

Mere possession of a document being an offence, the requirement of mens rea – a guilty intent is absent. All these aspects make the Act grossly contrary to the people's Right to Information and to Article 19 of the Constitution. People would be denied information in their interest under this Act, which is otherwise guaranteed by the Right to Information. Any person seeking to obtain information in his individual interest or that of the public at large on matters such as regarding any project in his area would be prevented by the Act mainly because the Government includes every document under the definition of 'Document' mentioned in Section 2. Thus *The Official Secrets Act, 1923* is totally contrary to the Right to Information.

D. Right To Information And The Constitution

At the outset, one would have to determine whether or not the Right to Freedom of Information exists. In so determining, it would be necessary to examine briefly some of the sources of law pertinent to this issue. A brief examination of the provisions of the Constitution of India indicates that it is clearly silent about the Right to Information. While numerous other rights, such as the right of freedom of speech and expression, the right to form associations and unions, the right to move freely throughout the territory of India and the right to practice any profession or carry out any occupation have been clearly enunciated in the Constitution, no explicit mention has been made of the Fundamental Right to Information. There is little doubt that information is not as free as scientists or other common citizens would like it to be. With particular reference to geographical data in *The Atomic Energy Act, 1962*, the general public is denied access to information on areas rich in elements important for atomic plants in the production of atomic energy. Maps of numerous areas are restricted beyond a particular scale and where maps are submitted to the Surveyor General of India for approval, more often than not, these maps are returned with instructions to remove contour details and other essential information such as the latitude and longitude of the section covered by map. With the increasing sophistication of map-making technologies and remote sensing satellite imagery, these restrictions are becoming more and more redundant. In some cases, the information to which the ordinary citizens of the country are being denied access is readily available in other countries of the world via the Internet. In the case of maps, what one is denied access to by governmental agencies is freely available on the internet on many websites.[23] This is done under Section

[23] See for example, at www.nationalgeographic.com/maps and www.atlapedia.com.

18[24] of *The Atomic Energy Act, 1962.* One would be justified in questioning the rationale of such regulations particularly where the rest of the world has access to this information already. The problem is that statutes imposing reasonable restrictions in gathering information have not been changing with time. It appears that there is very little justification for such restrictions now, when the information sought to be protected has already entered the public domain. If one probes into the reasons why access to information is being denied, one is inevitably presented with the argument that the restriction is in the interests of the defence of the country. As it stands, this defence has constitutional support. The provisions of Article 19(2)[25] of the Constitution of India clearly state that the right to freedom of speech and expression may be subjected to reasonable restrictions on certain grounds, one among which is in the interests of the sovereignty and integrity of India and the security of the State. The Government or any department of the Government could, on the basis of this provision, validly deny any citizen right to access information if it is deemed that such disclosure may compromise the security and integrity of the State. No citizen has the power to question why or on what grounds any information that he/she has sought was denied. One would have to be satisfied with the decision of any Government official who claims that the information sought is being denied in the interests of the security of the State. However, the courts do have the power,

[24] Section 18: Restriction on disclosure of information

(1) The Central Government may by order restrict the disclosure of information, whether contained in a document, drawing, photograph, plan, model or in any other form whatsoever, which relates to, represents or illustrates —

(a) an existing or proposed plant used or proposed to be used for the purpose of producing, developing or using atomic energy, or

(b) the purpose or method of operation of any such existing or proposed plant,or

(c) any process operated or proposed to be operated in any such existing or proposed plant.

(2) No person shall —

(a) disclose, or obtain or attempt to obtain any information restricted under sub-section (1), or

(b) disclose, without the authority of the Central Government, any information obtained in the discharge of any functions under this Act or in the performance of his official duties.

(3) Nothing in this section shall apply —

(i) to the disclosure of information with respect to any plant of a type in use for purposes other than the production, development or use of atomic energy, unless the information discloses that plant of that type is used or proposed to be used for the production, development or use of atomic energy or research into any matters connected therewith; or

(ii) where any information has been made available to the general public otherwise than in contravention of this section, to any subsequent disclosure of that information.

[25] *Supra* note 7.

for the limited purpose of determining whether or not the executive has exercised its discretion appropriately, to examine the nature of the information withheld as well as the grounds for so withholding the information. Section 18(3)(ii)[26] of *The Atomic Energy Act 1962* imposes restrictions on utilisation and dissemination of information relating to atomic energy, which is otherwise available to the public at large through other sources.

Indian courts have made the Right to Information as an embodied principle under Article 19 of the Constitution. In the case of *State of U. P.* v. *Raj Narain*[27], the court acknowledged that the right to Freedom of Information was implicit in the right to freedom of speech and expression and stated that the "*people of the country have the right to know every public Act, everything that is done in a public way, by their public functionaries. In a Government of responsibility like ours, where all the agents of the public must be responsible for their conduct, there can be but few secrets. They are entitled to know the particulars of every public transaction in all its bearing.*" In the case of *Life Insurance Company* v. *Manubhai*[28], the respondent published a research study paper "*A fraud on policy holders*". A member of the Corporation published a counter to the study paper in the Corporation published magazine *Yogakshama.* However, the Corporation refused to publish the rejoinder of the Respondent in the magazine. The Supreme Court held that the Corporation being a State instrumentality, its refusal to publish the rejoinder was a denial of the freedom of expression. The community is entitled to be informed whether or not the requirement of law is being satisfied in the functioning of the Corporation. It is widely accepted by the courts that the judges, rather than the ministers or high officials, are in a better position to decide whether any information should be withheld or disclosed and whether public interest will be better served by the disclosure or not. This principle is well established in the case of S. P. Gupta, known as *Judge's Case*, decided by the Supreme Court of India. The Supreme Court of India in the case of *S.P. Gupta* v. *Union of India*[29] has held that the right to know is a facet of the fundamental right to freedom of speech and expression enshrined in Article 19(1) of the Constitution. Prosecutions for an offence under *The Official Secrets Act, 1923* have been few and far between, and an occasion of its abuse for testing its constitutional validity in the Supreme Court, have not arisen. In the case of *Reliance Petrochemicals Ltd.* v. *Proprietors Of Indian Express News-papers*[30], the Supreme Court recognised the right to know as a right under Article 21[31] of the Indian Constitution. This

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[26] *Ibid.*

[27] (1975) 4 SCC 428.

[28] (1992) 3 SCC 637.

[29] AIR 1982 SC 149.

[30] (1988) 4 SCC 592.

[31] Article 21: No person shall be deprived of his life and personal liberty except according to the procedure established by law.

would imply that withholding of information, other than those provided in the class of exceptions, would mean a direct violation of Article 21.The court held the right to know under Article 21 as an essential element of participatory democracy.

E. Right To Information In The Global Scenario

In recent years, many Commonwealth countries like Canada, Australia, and New Zealand have passed laws providing for the right of access to administrative information. USA, France and Scandinavian countries have also passed similar laws. The US *Freedom of Information Act* ensures openness in administration by enabling the public to demand information about issues as varied as deteriorating civic amenities, assets of senators and utilisation of public funds.

It is not only the developed countries that have enacted Freedom of Information legislation. Similar trends are seen in the developing countries as well. The new South African constitution specifically provides the Right to Information in its Bill of Rights thus giving it an explicit Constitutional status. Malaysia operates an on-line data base system known as Civil Services Link, through which a person can access information regarding functioning of public administration. There is thus a global sweep of change towards openness and transparency.

In the US, the First Amendment to the Constitution provided for the freedom of speech and expression. The country had already passed the *Freedom of Information Reform Act, 1986*, which seeks to amend and extend the provisions of previous legislations on the same subject. However, this right is not absolute. The US Supreme Court in 1998-1999 struck down two provisions of the *Communications Decency Act, 1996*, seeking to protect minors from harmful material on the Internet precisely because they abridge the freedom of speech protected by the First Amendment. Moreover, the vagueness in the CDA's language and the ambiguities regarding its scope and difficulties in adult-age verification and make CDA unfeasible in its application to a multifaceted and unlimited form of communications such as the Internet.

Sweden has been enjoying the right to know since 1810. It was replaced in 1949 by a new Act, which enjoyed the sanctity of being a part of the country's Constitution itself. The principle is that every Swedish citizen should have access to virtually all documents kept by the State or Municipal Agencies.

In Australia, the *Freedom of Information Act* was enacted in December 1982. It gave citizens more access to the Federal Government's documents. With this, manuals used for making decisions were also made available. However, in Australia, the right is curtailed where an agency can establish that non-disclosure is necessary for protection of essential public interest and private and business

affairs of a person about whom information is being sought. In Great Britain, the *Official Secrets Act, 1911* and *Official Secrets Act, 1989* are intended to defend national security by rendering inaccessible to the public certain categories of official information. However, the Government recognises that access to information is an essential part of its accountability. More recent legislation governing access to public information include *Local Government (Access to Information) Act, 1985*, the *Environment and Safety Information Act, 1988*, and the *Access to Health Records Act 1990.* On the other hand, *Data Protection Act, 1984*, the *Access to Personal File Act*, the *Access to Medical Reports Act, 1988*, and the *Consumer Credit Act, 1974* all provide some protection for different aspects of personal information.

'Freedom of Expression' as a phrase was coined in the United States, but 'Access to Information' as a phrase was first used in the legislation passed in Sweden in 1766. It was called the *Swedish Freedom of Press Act.* Besides legislation, courts also started acknowledging this right and particular reference may be made to the judgement of Justice Thurgood Marshall of the US Supreme Court pronounced in 1972: "*In a variety of contexts this Court has held that the First Amendment protects the right to receive information and ideas, the freedom to hear as well as the freedom to speak. The reason for this is that the First Amendment protects a process...and the right to speak and hear - including the right to inform others and be informed about public issues -are inextricably parts of that process. The freedom to speak and the freedom to hear are inseparable: they are two sides of the same coin. But the coin itself is the process of thought and discussion.*"[32]

In another US Supreme Court decision, *Alma Lovell* v. *City of Griffin*[33], the earlier position of the US Supreme Court was stated. The appellant, Alma Lovell, was convicted in the Recorders Court in the city of Griffin for distributing pamphlets and magazines without receiving written permission as required by an Ordinance. The validity of the very Ordinance was challenged as being violative of the First Amendment, which reads as: "*Congress shall make no law respecting the establishment of religion, or prohibiting the free exchange thereof, or abridging the freedom of speech or the freedom of the press...*"

The US Supreme Court declared the Ordinance as void observing that, "*Freedom of speech and freedom of the press which are protected by the First Amendment from infringement by Congress are among the fundamental personal rights and liberties...the press in its historic conventional comprehends every sort of publication which affords a vehicle of information and opinion.*"

Mr. Justice Potter Stewart (of the US Supreme Court) said "*without an informed*

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[32] *Kleindienst* v. *Mandel* 408 U.S. 753, 775, (1972).

[33] 82 Lawyers Edition, 1937, US 303.

and free press, there can not be an enlightened people". Thus freedom of the press constitutes one of the pillars of democracy.

Article 19 of *The Universal Declaration Of Human Rights* states that "*Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless of frontiers.*" Similar provisions can be traced in the *The International Covenant on Civil and Political Rights* (ICCPR), in *The European Convention on Human Rights and Fundamental Freedoms* (EHR), and in *The American Convention on Human Rights* (AMR).

Article 58 of the Thai Constitution has also recognised the right to access to public information in possession of Government agencies, State agencies, State enterprises or local administration unless the disclosure of such information adversely affects the secrecy of State public safety or interest of other persons who are protected as provided by law. More recently, Section 32 of the Constitution of South Africa also recognised this right through express provisions in favour of the right to access to information held by the State or any of its organs.

All Freedom of Information statutes provide for right to obtain information subject to the exceptions in regard to certain categories of information and a prescribed channel of redressal of grievances either through Courts (USA) or through departmental channels or through a 'Special Information Commissioner'(Canada). There are considerable national differences only on tangential issues such as time limit for grant of information, permissible costs and channels of appeal, etc.

Disclosure of information should be the rule and secrecy the exception. The exceptions should be clearly defined, and there should be an independent mechanism for adjudication between the citizen and the public authorities.

According to a study of the United Nations, nine exceptions recognised by the American Act are discretionary and in common with Australia and Canada :

- defence, security, and international relations;
- internal discussion and advice;
- law enforcement and legal proceedings;
- effective management and operations of the public service;
- privacy of an individual;
- third party's commercial confidences;
- information given in confidence;
- statutory and other restrictions; and

- research, statistics, analysis; and effective management of the economy and collection of taxes (the last two are common in part).

Australia and Canada, in addition, share publication and pre-maturity in relation to publication as an exemption. Australia has two other exemptions for:

- communications with royal households; and
- unreasonable, and vexatious or voluminous requests which are peculiar to it.

F. Indian Freedom Of Information Act, 2002

The Freedom of Information Bill, 2000 was introduced in the Lok Sabha on July 25, 2000 which resulted in the *Freedom of Information Act, 2002*. This was enacted to meet the needs of effective and responsive Government. It is the most significant milestone in the history of the right to information movement in India. Inspired and encouraged by the exercises taken up by the Press Council of India, Working Group and the Central Government, the State Governments also yielded under popular pressure and started preparing draft legislation on the Right to Information. A number of States introduced Bills on right to information, before the Freedom of Information Bill, 2000 was introduced in the Lok Sabha on July 25, 2000. The defined objective is to enable the citizens to have access to information on a statutory basis. With a view to further this objective, the Act specifies that subject to the provisions of this Act, every citizen shall have the right to freedom of information. Obligation is cast upon every public authority to provide information and to maintain all records consistent with its operational requirements duly catalogued, indexed by the appropriate Government or the competent authority. The Act of 2002 empowers the State Government to make rules to carry out the provisions of the Act. The matters in respect of which such rules may be made are specified therein. These matters relate to, *inter alia*, the fee payable to obtain information from any organisation, the authority to be prescribed before which appeal may be preferred against the decision of the Public Information Officer and any other matter which is required to be prescribed.

In this context, Tamil Nadu was the first State to set an example by introducing the *Right to Information Act* on April 17, 1999.

Notwithstanding the enshrinement of the Right to Information in a statute in Tamil Nadu, it is not clear as to how the Act will apply to Panchayat Unions, Municipalities and Panchayats. The enacted legislation was full of exemptions and inadequacies, so it has failed to evoke much response from the public and devoted NGOs and other concerned activists.

Goa was the second State to enact a Right to Information legislation. The then

Information Minister, Dominic Fernandes, invited the opinion of the Union of journalists as well as several NGOs. Before the bill was introduced in the House for consideration, he also took the other necessary measure to withdraw an earlier unpopular circular, issued in October 1994 by the State Government, that prevented bureaucrats from divulging information to the press.

Despite tall claims made by the State Government regarding transparency and openness to strengthen democracy, the Goa Act also ironically contains several peculiar provisions, which allow the State to withhold information without sustaining reasons for it. The Act needs further clarification on the vague exemptions mentioned in it. It is also not clear as to who would be the competent authority to furnish the information.

It was observed that the Right to Information has considerably reduced black-marketing and corruption in public distribution system as citizens demanded access to accounts and the quota of ration allotted by the Government for them under the Act. Moreover, in polluted areas like Korba, Madhya Pradesh the sharing of information on pollution levels has raised public consciousness. As a result, officials have become careful about monitoring and controlling pollution levels. Chief Minister Digvijay Singh introduced the Right to Information Act, 1998. The Act aimed at providing transparency in the administration. It was passed by the Madhya Pradesh Legislative Assembly on April 30 of the same year.

The grass root movement lead by a service organisation called Mauna Kea Observatories Support Services (MKSS) had compelled the Rajasthan Government to act in the direction to prepare the Right to Information Bill. The Chief Minister assured the State Assembly in 1995 that the Government was willing to grant the Right to Information as a basic right to the citizens and any person could obtain photocopies (on payment of prescribed fee) of any document relating to development works undertaken in the previous five years.

In Karnataka, access to information is governed by the *Karnataka Freedom of Press Act, 1983.* The essential features of the legislation are (i) immunity to a journalist from disclosure of the source of information; (ii) right of access to public documents; and (iii) penalty for causing hurt to a journalist on duty. The storm wind of the Right to Information legislation reached Karnataka also. The State Government's irrigation department took a revolutionary step of making minute details such as tender awarding of a contract, money allocated and expenditure, etc: available to the public. A two-day seminar was jointly organised by the State Government Publicity Information Department and Commonwealth Human Rights Initiative (CHRI) to provide a platform to social activists, politicians and the press to think jointly over the Right to Information. It was at this meeting that the Government agreed to introduce the demanded Bill.

The Maharashtra Government has also passed the *Right to Information Act, 2003*[34] (which is awaiting Presidential sanction). The legislation empowers the citizens with the Right to Information about various Government schemes, their stages of implementation and other details. The Act provides exceptions by which it prevents access to documents, which are prohibited under *The Official Secrets Act, 1923*. This becomes a flaw in the sense that the provisions of *The Official Secrets Act, 1923* are contrary to the Right to Information.

Meanwhile other States like Delhi, Gujarat and Kerala have also decided to introduce the Right to Information Bill in their respective Assemblies.

The various Right to Information laws of states guarantee the following:

- Means of right to access to information;
- Inspection of works, records, taking notes;
- Obtaining certified copies of documents; and
- Taking samples of material.

They provide for the following exceptions:

- The disclosure of contents which prejudicially affect the sovereignty and integrity of India;
- Unwarranted invasion of personal privacy;
- Advice, opinion, recommendations or minutes which may prejudicially affect conduct of Centre-State relations;
- Trade and commercial secrets;
- Anything that is a breach of privilege of Parliament or Legislative Assembly;
- Matters likely to endanger the life or physical safety of any person;
- Minutes/records of advice, opinion, recommendations made during the decision making process prior to formulation of policy; and
- Cabinet papers.

III. Concluding Remarks

While the Right to Information Acts passed by the Union and various State Governments are a welcome step to a more open transparent and informed social order, nonetheless it cannot be overlooked that these statutes still prohibits obtaining documents prohibited under *The Official Secrets Act, 1923*. The

[34] *The Times Of India,* March 10, 2003.

Government is reluctant to make information freely available to the public, especially information that would be helpful in removing corruption in the system. *The Lokpal Bill*, which provides for the establishment of the institution of *Lokpal* (i.e Ombudsman) to inquire into allegations of corruption against public functionaries and for matters connected therewith, is still pending in Parliament. Democracy depends on elections. Elections depend on voters. Voters depend on their right to choose. If voters are uninformed, democracy suffers. Despite widespread poverty and illiteracy, India's electoral democracy has remained vibrant. Unwelcome politicians are voted in and out of power. Yet, thugs are elected to office. Rejecting the Election Commission's order based on a Supreme Court ruling that required candidates to declare their criminal antecedents, if any, and, assets and liabilities, the parties urged the Government to bring a new legislation to supercede it. The political class has once again shown how it seeks to keep the public in the dark by not furnishing information about their criminal record. Prescribing qualifications for contesting elections is the exclusive prerogative of the legislature. The Supreme Court merely decided that the people in a democracy are entitled to know about the candidates who seek to represent them and acquire power on their behalf. This right is derived from Article 19, which is part of the Fundamental Rights enshrined in the Constitution. The Supreme Court's directive is to give effect to the citizen's right to know about the candidates who seek to serve as their representatives, and not to legislate or disqualify a candidate. As the Court observed, this right to know about the candidate is a natural right flowing from the concept of democracy. The citizens are the ultimate sovereigns in a democracy and their right to know full particulars of a candidate, who seeks to represent them in legislature, where laws to bind people's liberty and property are enacted, is absolute and non-negotiable. Nevertheless, the legislature enacted a law, which subverted the Election Commission's order. . The conviction rate in our criminal courts is hardly six per cent. That means there is a 94 per cent chance for every corrupt person to escape. To overcome this, the Law Commission has already suggested enacting an Act called *Corrupt Public Servants (Forfeiture of Property) Act,* which empowers the Central Vigilance Commission (CVC) to confiscate the property of corrupt public servants. This is pending with the Government since February 4, 1999. This clearly shows the major lack of political will to let the people of India know about the political class, which has lead to massive corruption. However the Freedom of Information Act in various states of India have been welcomed immensely. Critics point out that no right to information law can be truly emancipatory unless there is a mechanism to punish delay or refusal to grant information. In some states, the Act has no penalty clause, and without it there is no compelling reason for the official concerned to provide answers. Advances in information and communication technologies have made information access on a large scale a real possibility now more than ever before, but both Governments and Right to Information activists would miss a

fundamental condition that enables this – mass education. Without it , the right is bound to be limited.[35] In some States, information laws do not prescribe punishment for withholding information. In the *Delhi Right to Information Act*, the punishment prescribed in a mere fine of Rupees one thousand. Although the Act states that it will have overriding effect over other Acts it is meaningless, as every legislation contains such a provision. It remains to be seen if it will override *The Official Secrets Act, 1923*. This would hardly act as a deterrent for withholding of information. However, the legislations being only recent, one could expect more in the future.

[35] *The Frontline*, January 15, 2002.

A TEETOTALLER'S TALL CLAIMS†

*Swanand Ganoo**

I. INTRODUCTION

The youth of today are being swept away into a world of controlled alcoholism. Witness a happy gathering of today's youth in Mumbai or any metro and rarely will the sounds and cheers not include those of the opening of a bottle of champagne or a beer brawl. Some may say it's a confluence of the East and the West, others may hold it to be taboo. A few years back, it was more frowned upon while today it receives the acceptance of society. The topic of liquor seems interesting in the land of *madira* and the mystical touch the renowned writers have added to that taste, which may just take the experience beyond the realms of an experience on earth and levitate you. Despite all the views that learned people might have about the topic, one thing which cannot be missed and which rarely attracts attention is that the law governing the magic potion seems to have lost its grip over the citizens, some of whom gladly submit to the water, which may be said to have the colour of the sun. While comparing the prohibition policies across the world, alcohol and its effects on advertising, crime and other addictive goods, one cannot neglect the prohibition laws in Maharashtra.

II. THE BOMBAY PROHIBITION ACT, 1949[1]

Although prohibition has been accorded a place of pride by the framers of the Indian Constitution by incorporating the same as a Directive Principle Of State Policy, every State, in order to meet with the inflating requirements of revenue and the financial crunch and pinch that it feels time and again, has fallen prey to the temptation of collecting excise duty on liquor.

In order to enforce the policy of prohibition more effectively and to overhaul the law relating to intoxicating drugs, the *The Bombay Prohibition Act, 1949* (the Act) was enacted in 1948. The Act was passed *inter alia* to amend and consolidate the law relating to the policy of total prohibition in the State. The Act was adapted and modified by *The Adaptation of Laws Order, 1950.* The Act was to amend and consolidate the law relating to the promotion and enforcement of and carrying into effect of the policy of prohibition and the Abkari Law in the State of Bombay.

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† This article reflects the position of law as on February 14, 2003.

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1 Bombay Act No. XXV of 1949.

The scope of the Act is such that though among other things, the Act permits the consumption, manufacture and sale of liquor, these actions by themselves are prohibited if one does not have a licence to do the same. Thus the prohibitions are actually permissible on securing a licence or a permit.

A. Definitions

The definitions in the Act are necessary not only for interpretation of the main Act but also for the interpretation of other subsidiary pieces of legislation, namely the Rules that have been framed under the law. The terms in the Act are specific to the topic and have a particular scientific and legal meaning. Some important definitions in the Act are important to understand the complex nature of the working of the Act.

1. Common Drinking House

Section 2(7) of the Act defines 'Common Drinking House' as: "*'Common drinking house' means a place where the drinking of liquor or consumption of any intoxicating drug is allowed for the profit or gain of the person owning, occupying, using, keeping or having the care of management or control of such place whether by way of charge for the use of the place or for drinking facilities provided, or otherwise howsoever and includes the premises of a club or any other place which is habitually used for the purpose of drinking liquor or consuming any intoxicating drug by more than one person without licence under this Act.*"

The mere hope of making profit out of the gambling carried out on in the house is sufficient to make it a common drinking house and a person is liable for keeping such a house. The same principle has been laid out in the case of *Emp.* v. *Dattatraya*[2] in respect of common gaming house.

2. Country Liquor[3]

This expression includes all liquor produced or manufactured in India. This expression does not include any foreign liquor, which is defined under Section 2(17) of the Act.

3. Foreign Liquor[4]

Foreign liquor means all liquor produced or manufactured outside India. The State Government has the power to declare any specified description of country

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2 25 Bom.L.R. 1089.

3 Section 2(8), The Bombay Prohibition Act, 1949.

4 Section 2(17), The Bombay Prohibition Act, 1949.

liquor to be deemed as foreign liquor. Foreign liquor is divided into spirits, wines, fermented liquors and mild liquor.[5] 'Indian made Foreign Liquor' is another category of foreign liquor recognised in the *Maharashtra Foreign (Import and Export) Rules, 1963.* It means any country liquor, which is declared to be foreign liquor for the purposes of the Act under the proviso to Section 2(17) of the Act. This does not however include medicinal and toilet preparations.

4. Intoxicant[6]

Intoxicant means any liquor, intoxicating drug, opium or any other substance, which the State Government can, by notification, declare to be an intoxicant. In *Synthetics and Chemicals Ltd.* v. *State of U.P.*[7], the Supreme Court held that industrial liquor would not fall under the expression 'intoxicating liquor'. The expression 'consumption' must be understood in the sense of direct physical intake. It will be incorrect to contend that industrial alcohol is alcoholic liquor for human consumption.

5. Sacramental Wine[8]

Sacramental Wine means wine required for offering the Holy Sacrifice of Mass in a Roman Catholic Church or for use by any person for sacramental purposes and prepared from raisins at a manufactory in accordance with the rules.

6. Spirituous Medicinal Preparation[9]

It means any medicinal preparation in liquid form containing alcohol, which is fit for use as intoxicating liquor.

The words and phrases that are undefined in the Rules are to have the same meaning as in the Act. As the Rules are framed under the Act, they have the same meaning as the words in the Act.

B. The Prohibitions

The Act has set out clear prohibitions under Chapter III. Sections 11 to 59 fall in Chapter III, but the main prohibitions are placed at the outset. Thus Chapter III contains the entire scheme of prohibition enumerating various prohibitions imposed in respect of intoxicants.

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5 Rule 3(6)(1),The Bombay Foreign Liquor Rules, 1953.

6 Section 2(22),The Bombay Prohibition Act, 1949.

7 1990 (1) SCC 109.

8 Rule 2(10),The Bombay Sacramental Wine Manufacturing Rules, 1950.

9 Rule 3(7),The Bombay Spirituous Medicinal Preparations (Sale) Rules, 1954.

1. Prohibition To Manufacture

Section 11 prohibits the import, export, transport, manufacture, bottling, sale, purchase, possession, use or consumption of any intoxicant in any manner which is not in accordance with the provisions of the Act or any rules, regulations or orders made or the terms and conditions of a licence, permit, pass or authorisation. Section 11 lays down that the acts prohibited under the subsequent section are lawful if done in the manner and to the extent provided by the provisions of this Act or any rules, regulations or orders. The Bombay High Court in *C.R.H. Readymoney Ltd.* v. *State of Bombay*[10], held that where the words "*it shall be lawful*" are used in the provision of a statute, they should be taken to convey the meaning that if the law had not been enacted there would have been no authority to do the act.

2. Prohibition Of The Manufacture Of Liquor And The Construction And Working Of Distillery

Section 12 of the Act provides that no person shall (a) manufacture liquor; (b) construct or work any distillery or brewery; (c) import, export, transport, or possess liquor; or (d) or sell or buy liquor. Section 65(6) of the Act provides for the punishment for breach of sub-clauses of Section 12 (a) and (b). Breach of Section 12(c) is punishable under Section 65(a) and Section 66(1)(b) of the Act. Breach of Section 12(d) is punishable under Section 66(c) of the Act. The onus lies on the prosecution to prove the offence. It was held in *State of Bombay* v. *Narandas Mangilal Agarwal* [11] that the State has to prove that the prohibitions contained in Section 12 and Section 13 of the Act were infringed by the accused and that the medicinal preparation seized from the accused is fit for use as intoxicating liquor.

Section 13 of the Act prohibits bottling any liquor for sale, consumption or use. The prohibition extends to use, keeping or having in possession any materials, still, utensils, implements or apparatus whatsoever for manufacture of any liquor and by Section 14 to manufacture of intoxicating drugs.

3. Prohibition Of Sale Of Liquor, Intoxicating Drug And Sweet Toddy

Section 14 of the Act prohibits import, export, transport or possession of any intoxicating drug, cultivation or collection of hemp, sale, consumption of or use and manufacture of any intoxicating drug. Section 16 of the Act prohibits tapping of toddy producing trees and drawing of toddy. Section 17 of the Act prohibits possession, transport, import, export, sale or purchase and use or consumption of opium. Section 18 of the Act prohibits sale to minors. There is an absolute prohibition on sale of any intoxicant to any person who is a

[10] AIR 1956 Bom 304.

[11] AIR 1962 SC 579.

minor, whether for consumption by such person or by any other person.

4. Prohibition On Common Drinking House

Section 22 of the Act states that no person shall open or keep or use any place as a common drinking house or have the care, management or control of, or in any manner assist in conducting such a business.

5. Other Prohibitions

No person except a registered medical practitioner can issue a prescription for intoxicating liquor.[12] There is a prohibition against soliciting the use of an intoxicant or hemp or doing any act calculated to incite or encourage members of the public to commit an offence.[13]

To allow manufacture, sale and consumption of liquor, the State has made provisions for issue of licences and permits.

C. Licences

Section 31 of the Act provides for issuance of licences for *bona fide* medicinal or other purposes. The intoxicant or hemp must be used for medicinal, scientific, industrial or educational purposes only. Any toilet preparation, medicinal preparation, antiseptic preparation or solution, flavouring extract, essence or syrup, all of which contain alcohol unfit for use as an intoxicating liquor, can be manufactured by a licence for purchase, possession or use of any liquor which may be required for manufacturing these articles.[14] A vendor's licence is granted under Section 34; a hotel licence is granted under Section 35. The State Government may grant a licence to shipping companies and to Masters of Ships to sell foreign liquor and to permit the use or consumption of foreign liquor on such a ship under Section 38. Section 39 grants permission to use or consume foreign liquor on warships, troopships and in messes and canteens of armed forces. Such foreign liquor has to be, however, obtained by the authorities in charge of such canteens or mess from vendor's licensee of the Regiment or unit to which such member belongs or where there is no such licence, from the Canteen Stores Department (India), Bombay, holding a vendor's licence.

D. Permits

The State Government can authorise an officer to grant permits for the use or consumption of foreign liquor to persons only on the fulfilment of certain conditions:

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12 Section 22 A, The Bombay Prohibition Act, 1949.
13 Section 23, The Bombay Prohibition Act, 1949.
14 Section 31 A, The Bombay Prohibition Act, 1949.

- The person is not a minor.
- The person was born outside India and brought up or domiciled in any country where such liquor is generally used or consumed.
- The person is on the Register of Foreigners under *The Registration of Foreigners Act, 1939*, and is not domiciled in India.

Section 40 deals with the eligibility of persons for such permits.

'Health Permits' are issued under Section 40A. 'Emergency Permits' are issued under Section 40B. Section 41 grants 'Special Permits to foreign sovereigns'. The State Government grants permits to a Sovereign or Head of a foreign State, an Ambassador, Diplomatic Envoy or Consul, Honorary Consul or Trade, Commerce. A member of the staff is also granted such a permit only if he is a foreign national. 'Visitor's Permit' is granted under Section 46 to a citizen of a foreign country or a citizen of India where consumption has not been prohibited by a law, or has been prohibited but is doing so under a permit. Such a permit is ordinarily granted for a period not exceeding one week at any one time, but may be extended from time to time. A 'Tourist Permit' is granted under Section 46A for a period not exceeding one month. Part VI of the *Bombay Foreign Liquor Rules, 1953* governs grant of the above permits. Part VI-A provides for grant of a permit to purchase, possess, transport, use and consume foreign liquor and country liquor, to any person above the age of twenty-five years residing in any part of the State of Maharashtra. The permit is granted when the person desiring for a permit declares that he requires foreign liquor and country liquor on grounds of health. The certificate of a Registered Medical Practitioner is required for the same. Thus permits are granted under the garb of health. A person is also permitted to consume wine or liquor for Sacramental Purposes under *Bombay Sacramental Wine Rules, 1950.*

The Act also provides for offences and penalties for contravention of the licences and prohibitions.

E. Offences And Penalties

Section 65 to Section 104A in Chapter VII of the Act deal with offences and penalties. The fines imposed by the Act are not severe in nature. A detailed provision is made as regards those who commit the offence more than once.

Section 65 of the Act prescribes a punishment which may extend to three years and also a fine. It has been further provided in the absence of special and adequate reasons to the contrary, for the first offence the punishment shall not be less than six months, and a fine shall not be less than Rupees five hundred; for the second offence the imprisonment shall not be less than nine months, and the fine shall not be less than Rupees one thousand; and for the third and subsequent

offences, imprisonment shall not be less than one year and the fine shall not be less than Rupees one thousand. Section 65 imposes a penalty for illegal import, export, and manufacture of any intoxicant or hemp. It seeks to punish those who construct or work any distillery or brewery, bottle liquor, sell or buy any intoxicant and use or keep in their possession any materials, still, utensils, implements or apparatus for the purpose of manufacturing any intoxicant. Section 66 imposes stricter punishment for illegal cultivation and collection of hemp and other matters. Section 68 provides for imprisonment upto three years for opening a common drinking house. Section 84[15] of the Act provides for the penalty for being found drunk in any drinking house. Whoever is found drunk or drinking in a common drinking house or is found there present for the purpose of drinking will be fined up to Rupees five hundred on conviction. A presumption is drawn against any person found in a common drinking house as to his presence there for the purpose of drinking.

The problem with the enforcement of the law is that the police authorities are lax in raiding the various common drinking houses. Another problem that the enforcement agencies face is that too many common drinking houses crop up too soon. Control over these places seems far from reality. Corruption is also a major cause due to which even those who are nabbed are let off on payment of money. The mushrooming of such common drinking houses leads to a gathering of people, mostly comprising of petty offenders or anti-social elements and this offence is more severe than mere consumption of liquor in contravention of the Act. More severe punishment is thus warranted.

The revenue earned by the State would be less if people are stopped from consuming alcohol. The State has thus adhered to the letter of the Constitution and has provided for prohibition in the State. But what is a law without strict enforcement? The State has made all the right moves by providing a good piece of legislation, but its enforcement at least to the extent of actual prosecutions based on the Act is far too minimal. Probably earning revenue from liquor is more important to the State than securing the future of the young, who time and again have proved to be easily influenced by the West, where having a beverage is a necessity of the climate.

1. Regulatory Piece Of Legislation

A cursory glance at the offences and penalties immediately distinguishes Chapter VII from similar Chapters in other pieces of legislation. The Act can be said to be more of a permissive legislation than a preventive legislation. It permits certain acts like establishment of breweries, distilleries, consumption of alcohol,

[15] Section 84, The Bombay Prohibition Act, 1949.

distribution of alcohol, sale, import and export to name a few. It provides for grant of licences to regulate these activities and gives permits to those desirous of being in possession of liquor. When a person is prosecuted for an offence under the Act, it is enough for the State to prove that the act has been done without a licence or a permit, which is required by the law. The language of the penal sections is drafted in such a way that the provisions prescribing penalties are regulatory in nature. They do not impose complete prohibition on the above-mentioned activities. The prosecution is not required to prove the presence of *mens rea.* It is sufficient if the commission of the act coupled with non-compliance with provisions relating to license/permits is proved. Thus an act which is done with the required license/permit is not illegal but if the same act is done without possessing the required license/permit the said act becomes illegal and the person is liable for prosecution. This is amply clear by use of the phrase 'Whoever in contravention of'.

F. The Rules Under The Act

There are several rules made under the Act. Section 143 confers upon the State Government the power to make rules for the purpose of carrying out the provisions of this Act. There are many intoxicating substances in which people indulge. The Act allows this indulgence by the issuance of permits. This requires that the items of consumption be manufactured, distributed, transported, sold and consumed according to rules, which will regulate the entire process from manufacturing to consuming. As time passed since the establishing of the Act, rules were framed from time to time. Rules were also amended so as to make way for the change in circumstances.

1. Jesters' Paradise

The making of the rules has certainly regulated the law but what has happened is extremely amusing. To initiate the first laugh on the face of readers, it is necessary to look at the provisions of the *Bombay Foreign Liquor Rules, 1953* and *Maharashtra Country Liquor Rules, 1973.*

a. *The Distance*

Rule 24(4)(b) of the *Maharashtra Country Liquor Rules, 1973* and Rule 25 (2)(b) of the *Bombay Foreign Liquor Rules, 1953* state that no licence shall be issued in respect of any shop which is situated fifty metres from any educational or religious institution in 'A' class and 'B' class Municipal Council areas. In other areas this distance is one hundred metres. Rule 45(1C) of the *Bombay Foreign Liquor Rules, 1953* specifies for a Hotel/Restaurant Licence the minimum distance of seventy five metres to be maintained from any educational or religious institution. Further, Rule 45(1C) of the *Bombay Foreign Liquor Rules, 1953* specifies that for a Hotel/Restaurant Licence, a minimum distance of seventy five metres

should be maintained from any bus stand, station or depot of the Maharashtra State Road Transport Corporation (MSRTC) or from boundary of any National or State Highway. Rule 24(4)(c) of *Maharashtra Country Liquor Rules, 1973* requires the shop to be situated one hundred metres from any bus stand, station or depot of the MSRTC. Rule 25(2)(c) of the *Bombay Foreign Liquor Rules, 1953* requires the minimum distance from a bus stand, station or depot of MSRTC to be fifty metres. Rule 24(5) of the *Maharashtra Country Liquor Rules, 1973* seeks to maintain a distance of two hundred metres between two shops. Such a provision is absent in case of foreign liquor.

It is apparent to a keen eye that different distances from important places are sought to be maintained for country liquor and foreign Liquor. The rationale behind these rules apparently needs explanation to the layman. Even after applying one's mind for a considerable period of time, a person cannot come to terms with these rules which try to maintain a distance from important places. The reason behind these erratic rules may be to restrict the entry of liquor in and around these areas.

b. *Vendor's Responsibility*

Rule 17 of *Maharashtra Foreign Liquor (Sale on Cash, Register of Sales etc.) Rules, 1969* prescribes that no vendor is to sell foreign liquor to the following class of persons:

- A Police Officer in uniform,
- A Prohibition and Excise Officer on duty;
- A Railway servant on duty;
- An insane person; or
- A person who is intoxicated.

Rule 39 of *Maharashtra Country Liquor Rules, 1973* provides that a retail licensee shall not sell country liquor to the following categories of persons namely:

- A lunatic or insane person;
- Person who is in an intoxicated State;
- Person known or suspected to be participating in any rioting or disturbance of peace; and
- The Armed Forces of the Union, Member of the Police Force, the Prohibition and the Excise Department, State Transport and Railway Department or driver of a motor vehicle, when on duty or in uniform, or both.

The comparison of these two lists reveals that the categories of persons are

different for country liquor and foreign liquor. The vendor is not allowed to sell country liquor to certain categories of persons, who do not feature in the list of those persons to whom a vendor is not supposed to sell foreign liquor. Do rioters drink only country liquor? Will consumption of foreign liquor by rioters not result in riots? A vendor can sell foreign liquor to the driver of a vehicle but a vendor selling country liquor is prohibited from doing so. Foreign liquor can be sold to a railway servant on duty but not country liquor. All in all, it gives the impression that the rationale behind it is missing.

It is left to the vendor to judge whether the person is a lunatic or an insane person. Sale of liquor to an intoxicated person is prohibited. Unless coupled with apparent loss of control or disorderly behaviour, the vendor cannot find out whether the customer is intoxicated. The Rules thus need to be amended or their rationale explained.

G. The Dry Days In The Year

The Rules in the *Bombay Foreign Liquor Rules, 1953* and *Bombay Country Liquor Rules* specify the days when the liquor shops are to be kept closed under *The Bombay Shops and Establishments Act, 1948.* There are certain days when shops are supposed to remain shut. The occasion must be special from the point of view of the broad considerations of national solemnity, public order, homage to national figures, the likelihood of eruption of inebriated violence on certain days on account of *melas*, festivals or frenzied situations or periods of tension. Gandhiji's birthday, Election Day, hours of procession by rival communities when tensions prevail or festivals where colossal numbers of people gather and outbreak of violence seems to be on the agenda are clear illustrations. Rule 9A of the *Maharashtra Foreign Liquor Rules, 1969* and Rule 26 of *The Maharashtra Country Liquor Rules, 1973* require the following days to be 'dry days':

- January 26 (Republic Day)
- January 30 (Martyr's Day)
- May 1 (Maharashtra Day)
- *Ashadi Ekadashi Shukla Paksha*
- August 15 (Independence Day)
- *Anant Chaturdashi*
- Two days in Prohibition Week, i.e. October 2 and October 8
- *Kartiki Ekadashi*
- The day or days in which poll in relation to any general election or by-election to the House of the People or the Maharashtra Legislative Assembly takes place, two days immediately before such day or poll

- Important days of fairs on publication in the Official Gazette.

India is a secular country. The scheme of these days suggests that days of Hindu importance are days on which liquor shops are to be closed. Are not the special days of other religions as important as to warrant maintenance of peace? The Muslims have days of processions too. Closure of shops does not necessarily achieve the objective of maintaining order on the important days. A common feature observed outside liquor shops is that before the 'dry day' dawns, there are boards put up outside the shop informing consumers that the following day shall be a 'dry day'. At the most consumers cannot buy liquor on that day but consumption cannot be stopped by the State as frequent consumers always have a stock at hand. Only those with a permit are permitted to drink liquor. Illicit liquor is banned. Consumption of liquor without permit is banned. Only those with a permit are allowed to buy liquor, then where is the harm caused if the law is enforced? If the law were to be enforced, then 'dry days' would not be required.

H. The Directive Principles Of State Policy And The Act

The Directive Principle contained in Article 47 of the Constitution of India cast upon the State whereby the fundamental obligation to bring about prohibition of intoxicating drinks in order to maintain public health. Entry 8 of List II of Schedule VII of the Constitution of India reads as follows: "*Intoxicating Liquors that is to say the production, manufacture, possession, transport, purchase and sale of intoxicating liquors*". Thus the State has the competence to pass such legislation, which is in accordance with the Directive Principles of State Policy.

The State has the exclusive right or privilege of manufacturing and selling liquor. The State grants such a right or privilege in the shape of a licence or a lease. The State Legislature is authorised by reason of power contained in Entry 8 of List II of the Constitution of India. In *Nageshwar* v. *State of M. P.*[16], it was held that trade in liquor has historically stood on a different footing from other trades. Restrictions, which are not permissible in other trades, are lawful and reasonable so far as the trade in liquor is concerned. That is why even prohibition of trade in liquor is not only permissible but is also reasonable. The reasons are that public morality and public interest need to be preserved. The State possesses the right of complete control over all aspects of intoxicants viz. manufacturers, collection, sale and consumption. The Supreme Court in the cases of *Cooverje Bharucha* v. *Excise Commr. and Chief Commr., Ajmer*[17] and *State of Orissa* v. *Jaiswal*[18], held that the State has exclusive right "*to sell liquor and to sell the said right*".

[16] AIR 1957 SC 366.
[17] AIR 1954 SC 220.
[18] AIR 1972 SC 816.

1. Constitutional Challenge To The Act

The Supreme Court, in 1951, had to deal with a constitutional challenge to the Act on grounds of violation of Fundamental Rights under Articles 14 and 19. This challenge was made by F. N. Balsara, an accused, convicted of having violated certain provisions of the Act. He prayed for a writ of *mandamus* against the State of Bombay and the Prohibition Commissioner, asking the court to order them to forebear from enforcing against him the provisions of the Act. The Supreme Court in the appeal cited as *State of Bombay* v. *F. N. Balsara*[19] held as follows :

- A provision of law, which provided for permitting certain persons to drink and prohibited certain others from drinking, would not violate Article 14, provided such classification was reasonable.
- Permitting the use or consumption of foreign liquor among members of the Military and Naval Officers does not offend Article 14, as the members of such Force could be regarded as a class by themselves, and such classification was reasonable.
- Restrictions, which are imposed for securing the objects, which are enjoined by the Directive Principles of State Policy in the Constitution, may be regarded as reasonable restrictions within the meaning of clauses (2) and (6) of Article 19 of the Constitution of India.
- When restrictions imposed by a law on the exercise of Fundamental Rights are reasonable in respect of certain items and unreasonable in respect of certain other items, the law as a whole will not be void when the offending provisions are severable; the provisions of the law imposing unreasonable restrictions alone would be void, and those provisions which impose reasonable restrictions will be valid.
- Prohibition of possession, consumption, buying or selling of wines by a law is a reasonable restriction upon the right to "*acquire, hold and dispose of property*" conferred by Article 19(1)(f) having regard to the Directive Principles in Article 47.

2. Right To Carry On Trade In Liquor

The case of *Khoday Distilleries and Ors* v. *State Of Karnataka and Ors*[20] raised an important question – whether there exists a fundamental right to carry on trade in liquor. The Hon'ble Supreme Court held that :

- A citizen is not entitled to carry on trade or business in activities which are immoral and criminal and in articles or goods which are obnoxious

[19] AIR 1951 SC 318.
[20] (1995) 1 SCC 574.

and injurious to health, safety and welfare of the general public, i.e., ***res extra commercium***, (outside commerce). There cannot be business in crime.

- Potable liquor as a beverage is an intoxicating and depressant drink which is dangerous and injurious to health and is, therefore, an article which is *res extra commercium* being inherently harmful. A citizen has, therefore, no fundamental right to do trade or business in liquor. Hence the trade or business in liquor can be completely prohibited.
- The State has the power to completely prohibit the manufacture, sale, possession, distribution and consumption of potable liquor as a beverage, both because it is inherently a dangerous article of consumption and also because of the Directive Principle contained in Article 47, except when it is used and consumed for medicinal purposes.
- The State can create a monopoly either in itself or in the agency created by it for the manufacture, possession, sale and distribution of liquor as a beverage and also sell licences to citizens for the said purpose by charging fees. This can be done under Article 19(6) or even otherwise.
- When the State permits trade or business in potable liquor, the citizen has the right to carry on trade or business subject to the limitations, if any, and the State cannot discriminate between citizens who are qualified to carry on the trade or business.
- The State cannot prohibit trade or business in medicinal and toilet preparations containing liquor or alcohol. The State can, however, under Article 19(6) place reasonable restrictions on the right to trade or business in the same in the interests of general public.

I. Prohibition And Sacramental Practices

In 1949, the Government of Bombay framed the *Bombay Sacramental Wine Manufacturing Rules, 1950* that extended to the entire territory of Maharashtra. 'Sacramental Wine' means wine required for offering the Holy Sacrifice of Mass in a Roman Catholic Church or for use by any person for sacramental purposes and prepared from raisins at a manufactory in accordance with the rules. Rule 3(1) of these Rules mention that any regional head of a religion or religious sect desiring to manufacture and sell such wine is allowed to apply for a licence to the Collector.

The Rules specify one more way of legitimising the sale of such wine. Rule 3 of the *Bombay Sacramental Wine Rules, 1950* allows any person who, according to the religious tenets of the community to which he belongs, is required to use wine or liquor for sacramental purposes and who desires to possess consume or use wine or liquor for sacramental purposes, to make an application for an

authorisation in that behalf. Thus, the Rules mention another way in which a person can consume liquor.

The *Bombay Sacramental Wine Manufacturing Rules, 1950* provide for an entire procedure (recipe) to arrive at the potion. The Sacramental Wine should only be manufactured from raisins without adding sugar, fermenting agent. The licensee must adhere to the recipe and, on demand by the officer-in-charge permit samples to be taken free of cost. The Mass Wine or Sacramental Wine is not allowed without any charges. Excise duty, transport fee, and special fee is payable at 38np./litre of the preparation.

J. Alcohol And Advertising

The promotion of alcohol is an important factor in the increasing popularity of alcohol. The advertising world is full of assignments, which help the increased penetration of alcohol. In States, which have prohibition, there are also prohibitions on the advertising of alcohol.

1. Print Media

The Act calls for prohibition of publication of advertisements relating to intoxicants. This is embodied in Section 24 of the Act. No person shall print or publish in any newspaper, news-sheet, book, leaflet or booklet any advertisement or other matter which solicits the use of or offers any intoxicant or hemp. No advertisement is permitted which is calculated to encourage or incite any individual class or individual or public generally to commit any offence under the Act.

The Act provides for an exception regarding catalogue or price lists, which are approved by the Commissioner. An advertisement or other matter contained in any newspaper, news-sheet, book, leaflet or booklet which is published outside the State for such a purpose is exempted from the application of Section 24. Section 24(3) of the Act, however, permits the Government, by notification in the Official Gazette, to prohibit circulation, distribution or sale of any newspaper printed and published outside the State.

The penalty for contravention of Section 24 is provided in Section 73. The punishment is imprisonment for a term, which may extend to six months and/ or a fine up to Rupees five hundred and in case of publications from outside the State, the fine shall be Rupess one thousand.

2. Advertising On Cable Television

According to Rule 7(2) of the *Cable Television Networks Rules, 1999*, no broadcaster is permitted to show an advertisement, which promotes, directly or indirectly, the sale or consumption of cigarettes, tobacco products, wine, alcohol, liquor or

other intoxicants, infant milk substitution, feeding bottle or infant food.

Alcohol is a State subject under the Constitution. Does the Central Government have the competence to enact a law, which affects the alcohol market, if alcohol is a State subject?

Liquor companies have gone all out to dodge the ban on liquor advertising by plugging a host of other products under their brand names. Most of them are not even available in the market! Moreover, the companies have only replaced the original voice-overs or text in the advertisements with those specifying the surrogate. Music videos, auctions, websites, audio-cassettes, perfumes, sporting equipment, dart kits, awards, soda, juices, playing cards – the list seems almost endless. What seems to bind all these products together is that these are a list of just a few categories, which liquor majors across the country have forayed into over the past years. It is perhaps the most feasible option left for liquor companies in order to dodge the ban on liquor advertising. Liquor companies have made a mockery of the ban by taking advantage of the many loopholes in the current law. Some of the examples are 8PM apple juice (whisky), Aristocrat apple juice (whisky), Bagpiper soda (whisky), Haywards 5000 darting kits (beer), and Gilbey's Green Label water (whisky).

A committee of broadcasters headed by Information and Broadcasting Special Secretary, Mr. R. R. Shah, which was set up by the Government to find out what constitutes surrogate advertisements, has recommended to the Government that socially useful advertisements, sponsored by liquor companies, should be allowed on TV channels.

The Hon'ble Minister for Information and Broadcasting, Smt. Sushma Swaraj, has clarified as to what kind of surrogate advertising will be allowed on television channels. "*Where a product is being manufactured and a brand has been built around it by the liquor company, advertising for that product will not be considered as surrogate advertising and will be permitted, where the product is not being manufactured in substantial quantities, it will be seen as surrogate advertising and will be disallowed.*"

Tackling surrogate advertisements and prohibiting genuine brand extensions will be a tight rope to walk on as advertising is a field that encompasses the world at large, especially with the introduction of modern means of entertainment and communication.

III. Prohibition – A Comparison Of World Laws

The World Health Organization (WHO) has conducted in-depth research in the field of prohibition and has prepared the Global Alcohol Status Report[21].

[21] Available at www.who.int/substance_abuse/PDFfiles/global_alcohol_status_report 8Alcoholcontrolpolicies.pdf.

Few countries have designated a single central agency devoted to alcohol and alcohol problems. In most cases, responsibility for alcohol is diffused throughout national governments and ministries of justice and police. Some countries have centralised planning for the reduction of alcohol and other drug problems in a single joint agency or a commission composed of representatives from several governmental departments.

A. Policies

The European Alcohol Action Plan, developed by the WHO European Regional Office, has provided guidance to a number of countries in developing comprehensive national alcohol plans. Elsewhere, a few countries have developed plans specific to alcohol particularly in cases such as France and Poland, where there is recognition at the national level that prevailing levels and patterns of alcohol use pose a significant threat to health and safety. New Zealand's Liquor Advisory Council undertakes a variety of activities with funding from a levy on alcohol available for consumption, while Switzerland distributes proceeds from the tax on distilled spirits to cantons for prevention and treatment of alcohol and other drug problems. However, this kind of earmarked funding is rare.

B. Regulation Of Physical Availability

There are many ways in which the physical availability of alcohol may be restricted. For example, New Zealand has promoted server training in order to increase the likelihood that when alcohol is served, patrons will be less likely to drink to intoxication or drive away from the premises intoxicated. The most drastic of such restrictions is outright prohibition of the production and sale of alcohol. This is not uncommon in predominantly Islamic countries such as Bangladesh, Maldives and Saudi Arabia. Other countries such as the United States, New Zealand and India permit local or State authorities to render their jurisdictions dry. Pakistan permits alcohol consumption by non-Muslims, but forbids it for the 97 per cent of the population that is Islamic. Far more common than outright prohibition are partial prohibitions, mostly concerning consumption of alcohol in areas considered to be at high risk. These may include workplaces (e.g. Belarus, Belgium, Kyrgyzstan, the Netherlands) as well as areas near workplaces (e.g. Mexico). Italy bans sale of drinks containing more than 20 per cent alcohol at a wide range of public events, including sporting events, amusement parks and open air concerts. Ecuador bans such sales in health or educational institutions, while Egypt permits it only in hotels and tourist establishments. The world has thus followed a varied policy in dealing with this topic.

C. Availability To Young People

At least sixty-seven countries have some kind of minimum age legislation in place. The most common minimum age for legal purchase of alcoholic beverages is eighteen, although at least eight countries require drinkers to wait until the age of twenty-one years, while fifteen permit drinking at the age of sixteen years. Germany and Switzerland permit purchase of fermented beverages at the age of sixteen years, but drinkers must be eighteen years to buy distilled spirits. The United Kingdom bans purchase till the age of eighteen. But it is possible to consume some alcoholic beverages in bars or restaurants at the age of sixteen. The entire world community is thus sensitive to the topic of consumption and young people.

D. Licensing

A more common method of restricting physical availability is through licensing, both of production and sale of alcohol. More than forty countries operate some kind of licensing system. Coupled with such systems are often restrictions on the hours and days when alcohol may be sold.

E. Regulation Of Promotional Activities

Some kind of regulation of alcohol advertising exists in at least thirty-seven countries. Many such regulations seek to protect young people from seeing alcohol advertisements. Mexico, Panama and Paraguay require warning messages on alcohol advertisements. More common strategies for regulating the promotion of alcoholic beverages are the use of voluntary codes and the outright banning of advertising for certain or all alcoholic beverages in some or all media outlets. Twenty-nine countries have implemented bans on alcohol advertising in at least one medium. Most such bans cover a number of beverage categories on at least television and radio. However, in areas such as Belarus with easy access to foreign television channels and relatively little domestic broadcast production, such bans are difficult to enforce. Elsewhere, however, for example in France, enforcement has been strict and effective. An additional ten countries impose partial restrictions on alcohol advertising, most commonly banning advertising during daytime and early evening hours when young people are likely to be in the viewing audience in substantial numbers. Some countries such as Canada prohibit specific content in alcohol advertising, including attempts to influence non-drinkers to drink, associating alcohol consumption with high-risk activities, or implying that alcohol consumption leads to social, athletic or business success. Honduras bans advertising that offends the dignity of women or that ties the use of alcoholic beverages to sports. Mauritius and Norway both ban sponsorship of sporting events by alcoholic beverage companies, while France includes such a prescription in its package of

restrictions on alcohol promotion. Spain prohibits advertising of beverages containing more than twenty per cent alcohol on television and radio and any alcohol advertising in schools, sports centers and health institutions.

At least fourteen countries rely primarily on voluntary codes of good advertising practice to regulate alcohol advertising. Although in developed countries such as Belgium, Ireland and the United Kingdom, these codes are generally observed, elsewhere, as in Zimbabwe or in markets in transition such as the Czech Republic, voluntary codes are less likely to be well-enforced. The prevention of alcohol-related problems requires a comprehensive approach, combining information and awareness programmes and treatment services with preventive policies adopted at national or local levels.

IV. Prohibition Policies In Other Indian States

At present, there are seven states with complete prohibition in force and three with bans on production and consumption of arrack. There are three main types of prohibition policy: complete prohibition of production and consumption; partial prohibition where one or more type of liquor (usually arrack) is prohibited; and dry days where consumption is prohibited for certain days of the week or month. It is interesting to note that Gujarat – the birthplace of Mahatma Gandhi – is also the only State to have had complete prohibition since independence. In the last two decades, complete prohibition policies have been concentrated in the North Eastern states where there is a high incidence of alcohol and substance abuse and strong anti-liquor lobby groups. Partial prohibition (of arrack) has been the main policy choice of the Southern states of Tamil Nadu, Kerala and Andhra Pradesh where much country liquor is distilled. It is also important that prohibition not only affects alcohol but also has effects on the consumption of other addictive goods.

V. Alcohol Prohibition And Effect On Other Addictive Goods In India

In the urban sector, prohibition reduces cigarette and *bidi* consumption, although the effect is minimal. However, in the rural sector, prohibition significantly increases tobacco budget-shares particularly for cigarettes. Partial prohibition also decreases cigarette consumption in the urban sector but significantly increases it in the rural sector. Its effect on the budget-share of *bidis* is negative and similar for both sectors. This suggests that the relationship between alcohol and tobacco items is different across the sectors and by tobacco type. For urban households, alcohol and both tobacco items appear to be economic

complements. In the rural sector, on the other hand, cigarettes and alcohol are substitutes. The results for *bidis* are mixed in that they appear to be complements during periods of partial prohibition and substitutes during periods of complete prohibition. Complete and partial prohibition affects *paan* consumption negatively in the rural sector. The former has an insignificant effect, and the latter a strong negative effect, on urban households. This suggests that *paan* is an economic complement to alcohol in the rural sector and possibly to arrack in the urban sector. The estimates of the prohibition dummies on purchased hot drinks suggest that alcohol prohibition, both complete and partial, significantly decreased consumption of cups of tea and coffee in the urban sector. Complete prohibition significantly decreased consumption in the rural sector but partial prohibition significantly increased it.[22] Thus prohibition has a significant effect on the consumption of other addictive goods. The people who consume none of the above are certainly in the minority.

VI. Conclusion

Abraham Lincoln, with conviction and felicity, said that the use of alcoholic beverages had many defenders but no defence and intoned, "*Whereas the use of intoxicating liquor as a beverage is productive of pauperism, degradation and crime, and believing it is our duty to discourage that which produces more evil than good, we, therefore, pledge ourselves to abstain from the use of intoxicating liquor as a beverage.*" In his famous Washington's birthday address, he said, "*Whether or not the world would be vastly benefited by a total and final banishment from it of all intoxicating drinks seems to me now not an open question. Three-fourths of mankind confess the affirmative with their lips, and I believe all the rest acknowledge it in their hearts.*" I am in complete agreement with what the great George Bernard Shaw, a provocative teetotaller, said using tart words of trite wisdom, "*Alcohol robs you of that last inch of efficiency that makes the difference between first-rate and second-rate. Only teetotallers can produce the best and sanest of which they are capable.*" The Government must take a serious note of enforcing a piece of legislation, which is otherwise well-drafted besides the minute idiosyncrasies.

22 Lupin Rahman, *Alcohol Prohibition and Addictive Consumption in India*, at www.eudn.org/Member/workshop10-2002/rahman.pdf.

THE SARBANES OXLEY ACT 2002: IMPLICATIONS FOR INDIA†

*Juthika D. Choksi**

I. INTRODUCTION

Globally, the unearthing of scams has had a debilitating effect on investor confidence, which has in turn triggered a great deal of introspection in the corporate world. Greater transparency and investor protection seems to be the new found mantra. Enron, WorldCom, Conseco, Global Crossing, Adelphia, United Airlines' parent company UAL, AOL and Xerox would, to a layman, sound like a dream list of Fortune 500 companies. But in these very companies scams amounting to $125 billion were discovered.[1] A major fallout of these scams was the public loss of faith in corporate reported and audited financials and the role of the auditor. The Enron disaster also resulted in the fall of Arthur Andersen, which was at that time the world's largest accounting firm. As a result and in an attempt to establish a new order in corporate governance, the US President[2] signed the *Sarbanes Oxley Act 2002* (also known as *The Corporate Reform Act*)(Act) on July 30, 2002, to ensure 'stricter' auditing, financial reporting and corporate disclosure compared to any other previous law in US history

Named after its architects Senator Paul Sarbanes and Representative Michael Oxley[3], the Act primarily seeks to protect investors by improving the accuracy and reliability of corporate disclosures. It strengthens accounting and auditor independence, oversight and regulation. It provides for mechanisms for greater corporate accountability, principally through requiring the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) to take responsibility for financial reports by certifications of the accuracy of financial statements; and lays down tougher penalties for non-compliance.

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† This article reflects the position of law as on February 18, 2003.

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1 The break-up of the individual scams in $ billion:Enron-63.4, WorldCom-103.9, Adelphia-24.4, Global Crossing-25.5 *Business Standard,* "The math on Corporate Disaster", September 10, 2002.

2 George W. Bush.

3 Mr. Sarbanes was the principal architect of the act while Mr. Oxley was the chairman of the House Committee with jurisdiction over the subject matter. He went along with the recommendations of the Senate Bill.

Following the international scams and the fall of Arthur Andersen, India, though fortunate in not having huge corporate disasters (other than Unit Ttrust of India), was faced with the issue of the need for increased investor protection and the need to improve corporate governance standards. The answer was the setting up of a High Level Committee to analyse various corporate governance issues. Therefore, on August 21, 2002 the Department of Company Affairs (DCA), under the Ministry of Finance, set up the Naresh Chandra Committee[4] to suggest, analyse and recommend changes in diverse areas such as:

- the statutory auditor-company relationship;
- the rotation of statutory audit firms or partners;
- the procedure for the appointment of audit partners and the determination of audit fees, the independence of audit functions;
- a transparent system of scrutiny of audited accounts;
- the advantages and need of having a regulator similar to the one prescribed under the Act; and
- the role of independent directors.

II. Applicability Of The Act

The stated goals of the Act, to be achieved by improving quality and transparency in financial reporting, are to:

- increase corporate responsibility;
- provide for enhanced penalties for accounting and auditing improprieties relating to publicly traded companies; and
- protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities' laws.

A. Broad Applicability

The Act is meant to apply to all 'issuers'. The term 'issuer' is defined under

[4] The High Level Committee set up by the Department of Company Affairs comprises of Mr. Naresh Chandra – Chairman, Mr. Ashok Chandak, Mr. Aditya Vikram Lodha, Mr. R. Krishnan, Mr. M. K. Sharma, Ms. Kalpana Morparia, Mr. Mahesh Vyas, Dr Omkar Goswami, Mr. Rajiv Mehrishi and Mr. S. B. Mathur. The terms of reference of the committee are to examine the entire gamut of issues pertaining to the Auditor-Company relationship with a view to ensuring its professional nature.

Section 3[5] of the *US Securities Exchange Act of 1934* (Securities Exchange Act).

B. Foreign Issuers

The provisions of the Act apply to any foreign issuer who is required to file reports with the Securities Exchange Commission (SEC) pursuant to Section 13(a)[6] or 15(d)[7] of the Securities Exchange Act, including all companies filing

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[5] The definition of the term 'issuer' under Section 3 of the Securities Exchange Act, 1934 is: "any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is, or is to be, used." The term 'security' means "any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

[6] "Every issuer of a security registered pursuant to Section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security–

1. Such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to Section 12, except that the Commission may not require the filing of any material contract wholly executed before July 1, 1962.
2. Such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

Every issuer of a security registered on a national securities exchange shall also file a duplicate original of such information, documents, and reports with the exchange."

[7] Each issuer who has filed a registration statement containing an undertaking which is or becomes operative under this subsection as in effect prior to the date of enactment of the Securities Acts Amendments of 1964, and each issuer which shall after such date file a registration statement which has become effective pursuant to the Securities Act of 1933, as amended, shall file with the Commission, in accordance with such rules and

form 20 - F.[8]

C. Foreign Private Investors

The scope of the Act also extends to non-US issuers that fall within the definition of a 'foreign private investor'. A foreign private investor is:

- a company that is incorporated outside the US and in which US residents do not hold a majority of the shares, or
- if US residents hold a majority of the shares :
  - a majority of its directors and officers are not US citizens or residents;
  - its business is administered from outside the US; and
  - a majority of its assets are located outside the US.[9]

D. Exception

Issuers with Level I ADR[10] programmes in the US, furnishing information to

regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, such supplementary and periodic information, documents, and reports as may be required pursuant to Section 13 of this title in respect of a security registered pursuant to Section 12 of this title. The duty to file under this subsection shall be automatically suspended if and so long as any issue of securities of such issuer is registered pursuant to Section 12 of this title. The duty to file under this subsection shall also be automatically suspended as to any fiscal year, other than the fiscal year within which such registration statement became effective, if, at the beginning of such fiscal year, the securities of each class to which the registration statement relates are held of record by less than three hundred persons. For the purposes of this subsection, the term "class" shall be construed to include all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges. The Commission may, for the purpose of this subsection, define by rules and regulations the term "held of record" as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection. Nothing in this subsection shall apply to securities issued by a foreign government or political subdivision thereof.

8 Form 20-F is the annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act, 1934.

9 Thacher Proffit, Corporate and Financial Institutions Bulletin, August 2002.

10 Level One ADRs are American Depositary Receipts that trade in the over-the-counter (OTC) market. A foreign issuer, however, cannot raise capital through the Level I program. A Level I ADR issuer is required to register the ADR shares under the Securities Act of 1933 by filing a Form F-6 with the SEC. A Level I issuer whose ADRs trade on the pink sheets also will obtain an exemption from the registration and reporting requirements pursuant to Rule 12g3-2(b) of the Securities Exchange Act of 1934. The Level I ADR issuer agrees to provide the SEC with certain information that it provides to the regulators in its home market. If the Level I ADR issuer is quoted on the OTCBB, then the issuer must comply with the requirements of the OTCCB Eligibility Rule. Available at http://sec.broaddaylight.com/sec/FAQ_20_8698.shtm.

the SEC pursuant to Rule 12g3-2(b)[11] of the Securities Exchange Act, will not have to comply with the Act.

E. Unsettled Questions

While the Act has become effective from its date of enactment, except for a few provisions that will come into effect at a later date (up to 270 days from the enactment date i.e. 270 days from July 30, 2002 which would approximately be April 2003), it is still unclear as to how the provisions of the Act will affect foreign issuers.

F. Impact On Corporate Governance In India

The possible implications of the Act for foreign issuers are particularly significant, as many of the provisions of the Act are likely to conflict with local laws and corporate governance practices.

While India will lay down its own laws, keeping in mind the provisions under the Act and prevailing Indian laws, it is likely that some provisions of the Act will be adopted on an 'as is' basis while others may have to be amended to adapt them to suit the Indian legal and judicial system.

III. Corporate Obligations And Accountability

The Act contains two main provisions that create ongoing certification obligations for corporate officers and requires personal certifications of disclosure documents by the CEO and the CFO of issuers.

A. Section 302 - Corporate Responsibility For Financial Reports

1. Form 20 F

Under Section 302 of the Act, the CEOs and the CFOs (officers) of all US and non-US issuers are required to certify the veracity of the financial statements (reports) of their companies. The officers are required to certify in Form 20-F[12] that they have reviewed the reports and that these do not contain any untrue statements of material fact or omit any material fact in respect to the issuers' financial condition and results of operation.

2. Annual And Quarterly Reports

In addition, the officers are also required to certify in each Annual and Quarterly

[11] Available at http://www.us.gov.

[12] *Supra* note 8.

report, that they have evaluated the internal controls relating to the circulation of material information regarding the issuer and must also state the results of that evaluation. Lastly, the officers are also required to state in the report whether there were significant changes that could significantly affect the internal controls. The Act prescribes criminal penalties for false certification.

3. The Indian Position

The Naresh Chandra Committee (NCC) examined Section 302 of the Act and concluded that it would constitute a good corporate governance practice. Recommendation 2.10 of the NCC is similar to Section 302 of the Act. The NCC has recommended that the financial statements of all listed as well as public companies, whose paid up capital and free reserves exceed Rupees ten crore or has a turnover that exceeds Rupees fifty crore should be certified by the CEO, the Managing Director or the Executive Chairman of the company. However, the NCC is not in agreement with instituting criminal proceedings.[13] It stated that enhanced penalties would act as a credible deterrent.[14] The NCC's recommendations, once implemented, would definitely ensure a large amount of transparency and discipline which would deter mis-statements.

4. Analysis

While the Act prescribes severe penalties as discussed in Part V of this Article, one also needs to examine whether similar penalties need to be prescribed in the Indian context. While the Shardul Shroff Committee is currently examining the issue of enhanced penalties for non-compliance, it may be relevant to consider whether penalties for non-compliance and misstatements should be imposed on the individual and/or the company as a more credible deterrent.

B. Section 906 – Consequences For Filing A False Certification

Section 906 of the Act requires that each periodic report filed with the SEC must be accompanied with a written statement by the CEO and the CFO of the issuer stating that the report complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act and that all the information "*fairly presents, in all material respects, the financial condition and results of operations of the issuer*".[15] The Section prescribes a fine of up to $1,000,000 (approximately Rupees Five Crore) or imprisonment for ten years or both for certifying the report, knowing that it does not conform to the requirements of the Act and a fine of upto

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[13] The Naresh Chandra Committee, available at www.finmin.nic.in.

[14] A Committee headed by Mr. Shardul S. Shroff is examining the issue of enhanced penalties for non-compliance.

[15] Section 906 of the Act.

$5,000,000 (approximately Rs. 25 Crore) or imprisonment for twenty years or both for *wilfully* certifying the report, knowing that it does not conform to the requirements of the Act. The aforementioned are the criminal penalties for filing statements that are known to be untrue. This provision came into effect from July 30, 2002, which means that every report coming within its terms filed after that date must comply with Section 906.[16]

C. *Section 301 - Establishment Of Audit Committees*

1. Definition

Section 301 of the Act requires the establishment of an audit committee. An audit committee is defined as: "*A committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and if no such committee exists with respect to an issuer, the entire board of directors of the issuer.*" [17]

2. Independence

The section lays down that every listed company would be required to have an audit committee and outlines the responsibilities of and independence requirements for an issuers' audit committee. All committee members must be 'independent'. The term 'independent' is defined as "*not receiving, other than for the service of the board, any consulting, advisory or other compensatory fee from the issuer*" and as not being an affiliated person of the issuer, or any subsidiary thereof.[18] This means that members of an audit committee may not be involved with the company other than in their capacity as a member of the Committee, the Board of Directors, or any other board committee, and that they may not accept any consulting, advisory, or other compensatory fee from the issuer or may not be an affiliated person of the issuer or any subsidiary thereof.

3. Responsibilities

Each audit committee is supposed to establish a procedure for the receipt of complaints and confidential submissions regarding accounting and auditing matters. The audit committee would be directly responsible for the appointment, compensation and oversight of the auditor and would establish 'whistle blowing'[19] and complaint procedures.

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16 Thelen Reid and Priest LLP, Articles and Legal Updates, August 2002.

17 Defined under Section 2(a)(3) of the Act.

18 Annexure 3, The Naresh Chandra Committee Report, "Summary of the Sarbanes-Oxley Act 2002", at 6.

19 Whistle blowers are those employees who provide information or assist in the investigations of securities law violations.

4. Financial Expertise

It is likely that the SEC will adopt rules requiring the issuer to disclose whether its audit committee includes amongst its members at least one 'financial expert'. Under the provisions of the Act, the SEC would have to consider whether the person, for the purposes of qualifying as a financial expert either through education or experience has:

- an understanding of GAAP[20] and financial statements;
- the experience in preparing financial statements of similar issues and in the use of estimates, accruals and reserves;
- experience with internal accounting controls; and
- an understanding of audit.

5. Delisting

Non-compliance with audit committee provisions would result in the delisting of the company's securities. In the US Exchange, these requirements go beyond existing US listing requirements and provide no exemption for non-US issuers.

6. The Indian Perspective

a. *General Sufficiency Of India's Audit Committee Requirements*

Audit committees are mandatory for public companies under Section 292A of *The Companies Act, 1956* (Companies Act) as well as for listed companies under Clause 49[21] of the Listing Agreement. Clause 49 of the Listing Agreement sets out the role, functions and the powers of such a committee. As these provisions have proved sufficient and are a testimonial to the Securities Exchange Board of India (SEBI) and the DCA's commitment to corporate governance, the NCC found no reason to better the law.

b. *Complete Audit Committee Independence*

The NCC found only one area that would need some legislative change. Clause 49 of the Listing Agreement states that audit committees of listed companies must consist exclusively of non-executive directors, of whom the majority must be independent. The committee suggested that this needed some improvement and tightening. Although doubts were expressed on the advisability of excluding nominee directors of financial institutions from audit committees, the NCC

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[20] Generally Accepted Accounting Practices.

[21] Clause 49 (II) of the BSE Listing agreement states that:
Audit Committee. A. The company agrees that a qualified and independent audit committee shall be set up and that: a. The audit committee shall have minimum three members, all being non-executive directors, with the majority of them being independent, and with at least one director having financial and accounting knowledge; b. The chairman of the committee shall be an independent director; c. The chairman shall be

preferred to be consistent in not considering directors with a certain mandate to be really independent.[22]

present at Annual General Meeting to answer shareholder queries; d. The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee; e The Company Secretary shall act as the secretary to the committee. B. The audit committee shall meet at least thrice a year. One meeting shall be held before finalisation of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors. C. The audit committee shall have powers which should include the following: a. to investigate any activity within its terms of reference. b. to seek information from any employee. c. to obtain outside legal or other professional advice. d. to secure attendance of outsiders with relevant expertise, if it considers necessary. D. The company agrees that the role of the audit committee shall include the following: a. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible. b. Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services. c. Reviewing with management the annual financial statements before submission to the board, focusing primarily on; Any changes in accounting policies and practices. Major accounting entries based on exercise of judgement by management. Qualifications in draft audit report. Significant adjustments arising out of audit. The going concern assumption. Compliance with accounting standards. Compliance with stock exchange and legal requirements concerning financial statements Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large. d. Reviewing with the management, external and internal auditors, the adequacy of internal control systems. e. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit. f. Discussion with internal auditors any significant findings and follow up there on. g. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board. h. Discussion with external auditors before the audit commences nature and scope of audit as well as have post-audit discussion to ascertain any area of concern. i. Reviewing the company's financial and risk management policies. j. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors. E. If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

[22] The Naresh Chandra Committee Report, Chapter 4, at 9.

7. Similarities And Differences

The rules for audit committees under Indian law differ in one significant respect from the guidelines under the Act: a majority of the members of an Indian audit committee must be independent, whereas under the Act, all members must be independent. A brief comparative analysis is set out hereinbelow:

- Indian Audit committees are required under Section 292A of the Companies Act and by stock exchange listing agreements. In the US, the audit committee must be set up as independent under Section 301 of the Act.
- An Indian audit committee consists of a minimum of three members, all non-executive directors, with the 'majority' of them being independent, with at least one director with financial and accounting knowledge. All members of the US audit committees have to be independent with at least one of them having financial and accounting knowledge.
- The Chairman of an Indian audit committee may or may not be an independent director while the Chairman of a US committee necessarily must be an independent director.
- The Indian accounting standards lay down the rule that the Chairman shall be present at the annual general meeting to answer any questions put forth by the shareholders. The US law has no such equivalent rule as yet.
- Both the Indian and the US audit committees have the power to investigate any activity within their terms of reference, to seek information from any employee, to obtain outside legal or other professional advice and authority to secure the attendance of outsiders with relevant expertise, if they consider it necessary.

D. Implications For Directors And Officers

The Act introduced several changes that can be traced directly to remedying some of the worst abuses found in Enron.

1. Section 304 – Forfeiture Of Certain Bonuses And Profits

The section lays down that in the event an issuer is required to restate its financial statements because of misconduct that causes material non-compliance with reporting requirements, the CEO and the CFO must forfeit any bonuses, incentive or equity-based compensation, and profits from the sale of the issuer's securities that they received during the twelve months following the first release of the non-complying financial statements. The SEC is given the authority to exempt any person from these requirements. However, it is not known at this time whether the SEC would provide an exemption for officers of non-US

issuers.[23]

2. Section 306 – Insider Trades During Pension Funds Blackout Periods

a. *Parallel Treatment Of Insiders And Pension Fund Holders*

Directors and executive officers of issuers are prohibited from buying or selling equity securities of the issuer acquired in connection with their service or employment during blackout periods in which the issuer's employees are not allowed to trade in those securities under their individual pension account plans.

b. *Blackout Period*

A 'blackout period' is a temporary (for more than three consecutive business days) suspension by the issuer or by a fiduciary of a pension plan that invests in the issuer's equity securities, of the ability of 50 per cent or more of the participants or beneficiaries of the pension plan to purchase, sell, or otherwise acquire or transfer any interest in an equity security of such issuer held in an individual account plan.[24]

c. *Advance Notifications Requirements*

If a director or an executive officer is subject to the requirements in connection with a blackout period, the issuer, in a timely manner must notify such director or officer and the SEC of such blackout period. In addition, and subject to certain exceptions, the plan administrator of a pension plan subject to the *US Employee Retirement Income Security Act of 1974* (ERISA) must notify plan participants and beneficiaries at least thirty days in advance of the commencement of any period in which their ability to direct the assets in their account is suspended for a period of more than three consecutive business days, and must notify the issuer of any employer securities subject to such period.

3. Section 402 – Loans To Directors And Officers

An issuer is prohibited from extending or maintaining credit in the form of personal loans to any of its directors or executive officers unless they are made on arms-length terms and in the ordinary course of the issuer's lending business. It would be unlawful for the issuer to extend credit to any director or executive officer. Consumer credit companies could make consumer credit loans and issue credit to its directors and executive officers if it is done in the ordinary course of business on the same terms and conditions made to the general public.

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[23] Jones, Day, Reavis & Pogue, Implications for Foreign Private Issuers, at 2 .

[24] Thacher Proffit, Corporate and Financial Institutions Bulletin, August 2002.

4. The Indian Position

The closest Indian parallel to Section 304 of the Act is Section 274(1)(f)[25] of the Companies Act which prescribes a disqualification for directors in defaulting companies. However, the disqualification is limited to certain types of defaults only. It does not include non-compliance with securities laws.

The 'nearest' similarity to the 'blackout periods' is the Indian concept of bar on trading during a closed trading window under the *SEBI – (Prohibition of Insider Trading) Regulations, 1992.*[26]

The Indian parallel to Section 402 of the Act is Section 295[27] of the Companies Act.

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25 Section 274(1)(f) of the Companies Act, 1956 states that: "A person shall not be capable of being appointed director of a company, if an order disqualifying him for appointment as director has been passed by a Court in pursuance of Section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section."

26 Clause 3.2.1 under Schedule I under regulation 12(1) of the Securities And Exchange Board Of India (Prohibition Of Insider Trading) Regulations, 1992, states : "The company shall specify a trading period, to be called "Trading Window", for trading in the company's securities. The trading window shall be closed during the time the information referred to in para 3.2.3 is un-published. 3.2.2 When the trading window is closed, the employees / directors shall not trade in the company's securities in such period. 3.2.3 The trading window shall be, inter alia, closed at the time of:- (a) Declaration of Financial results (quarterly, half-yearly and annual) (b) Declaration of dividends (interim and final) (c) Issue of securities by way of public/ rights/bonus etc. (d) Any major expansion plans or execution of new projects (e) Amalgamation, mergers, takeovers and buy-back (f) Disposal of whole or substantially whole of the undertaking (g) Any changes in policies, plans or operations of the company 3.2.3A The time for commencement of closing of trading window shall be decided by the company.3.2.4 The trading window shall be opened 24 hours after the information referred to in para 3.2.3 is made public."

27 Section 295 of the Companies Act, 1956 states that: "(1) Save as otherwise provided in sub-section (2), no company (hereinafter in this section referred to as "the lending company") without obtaining the previous approval of the Central Government in that behalf shall, directly or indirectly, make any loan to, or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by, (a) any director of the lending company or of a company which is its holding company or any partner or relative of any such director; (b) any firm in which any such director or relative is a partner; (c) any private company of which any such director is a director or member;(d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors together; or (e) any body corporate, the Board of directors, managing director, or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company. (2) Sub-section (1) shall not apply to (a) any loan made, guarantee given or security provided (i) by a private company

IV. Effect On Accounting And Audit Firms

A. *Accounting Firms*

It seems very plausible that the impact of the Act on accounting firms in the US would also have an impact on Indian accounting firms. The establishment of an Oversight Board in the US would help in monitoring the firms and the fulfilment of the mandatory requirements set out under the provisions of the Act. The Act would restrict firms from providing clients non-audit services[28] currently provided by accounting firms and ensure audit partner rotation. These provisions under the US as well as the Indian law are discussed hereinbelow.

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unless it is a subsidiary of a public company, or (ii) by a banking company; (b) any loan made by a holding company to its subsidiary company; (c) any guarantee given or security provided by a holding company in respect of a loan made to its subsidiary company; (3) Where any loan made, guarantee given or security provided by a lending company and outstanding at the commencement of this Act could not have been made, given or provided, without the previous approval of the Central Government, if this section had then been in force, the lending company shall, within six months from the commencement of this Act or such further time not exceeding six months as the Central Government may grant for that purpose, either obtain the approval of the Central Government to the transaction or enforce the repayment of the loan made, or in connection with which the guarantee was given or the security was provided, notwithstanding any agreement to the contrary. (4) Every person who is knowingly a party to any contravention of sub-section (1) or (3), including in particular any person to whom the loan is made or who has taken the loan in respect of which the guarantee is given or the security is provided, shall be punishable either with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months: Provided that where any such loan, or any loan in connection with which any such guarantee or security has been given or provided by the lending company, has been repaid in full, no punishment by way of imprisonment shall be imposed under this sub-section; and where the loan has been repaid in part, the maximum punishment which may be imposed under this sub-section by way of imprisonment shall be proportionately reduced. (5) All persons who are knowingly parties to any contravention of sub-section (1) or (3) shall be liable, jointly and severally, to the lending company for the repayment of the loan or for making good the sum which the lending company may have been called upon to pay in virtue of the guarantee given or the security provided by such company. (6) No officer of the lending company or of the borrowing body corporate shall be punishable under sub-section (4) or shall incur the liability referred to in sub-section (5) in respect of any loan made, guarantee given or security provided after the 1st day of April, 1956 in contravention of clause (d) or (e) of sub-section (1), unless at the time when the loan was made, the guarantee was given or the security was provided by the lending company, he knew or had express notice that that clause was being contravened thereby."

28 The ICAI has prescribed non- audit services that firms may be allowed to continue. The NCC has in recommendation 2.2 set out a list of prohibited non-audit services that include accounting and book keeping services, financial information systems design, actuarial services, investment banking services, outsourced financial services, appraisal or valuation services, fairness opinions and management functions including the provision of temporary staff to audit clients: *The Chartered Accountant*, March 2002, at 1168 – Notification No. CA (7\60\2002).

1. The US Position

Section 101 of the Act authorises the Public Company Accounting Oversight Board (Board), an independent, non-federal body with all the powers conferred upon a non-profit organisation. Its objective is to oversee the audit of public companies that are subject to securities laws and to register and monitor the public accounting firms that perform such audits in order to protect investors and public interest in matters relating to the preparation of audited financial statements. It will be responsible for establishing auditing quality control, ethics, independence and other standards relating to the preparation of audit reports. It will have the power to sue, be sued, complain, defend, conduct its operations, maintain its offices and all other powers authorised by the Act, appoint employees, accountants, attorneys and others, define their duties and fix their composition and allocate, assess and collect support fees from registered accounting firms. Subject to the oversight and enforcement of the SEC, the Board will be funded by issuers who will be subject to an annual fee based on their market capitalisations.

2. The Indian Position

The NCC expressed two opinions as to whether an Accounting Oversight Board similar to that under the Act should be established in India. While one school of thought found the need for a similar kind of board, the other, mostly chartered accountants, felt otherwise. Those who saw the need for such a board based their arguments on the functions of the Institute of Chartered Accountants of India (ICAI). They strongly believed that because the mechanisms of the ICAI were slow, it was not in a position to discipline its members. They saw a need to establish an independent body to carry out such functions.

On the other hand, accountants and spokespersons for the ICAI felt otherwise. They believed that the ICAI should conduct all the necessary disciplinary functions. However, they agreed that it Institute could incorporate some of the suggested changes, which would strengthen the disciplinary mechanism within the Institute.

The NCC therefore concluded that the need of the hour was to reform auditing oversight functions. It rejected the idea of setting up a regulatory oversight board. Absent such a board, the NCC suggested two major steps – first, legislative and organisational support for the setting up of an independent Quality Review Board (QRB) to strengthen and reform the peer review system within the ICAI and second, enhanced disciplinary action within the framework of *The Chartered Accountants Act, 1949* to bring errant auditors to book. Recommendation 3.1 of the NCC suggests that there should be established, with appropriate legislative support, three independent QRBs – one for the

ICAI, one for the Institute of Company Secretaries of India (ICSI) and one for the Institute of Cost and Works Accounts of India (ICWAI).

B. Auditor Regulation And Independence

1. Section 201 – Limitations On Non-Audit Services

a. *The US Position*

Section 201 of the Act prohibits registered public accounting firms from providing non-audit services.[29] Other prohibited services include providing management functions or human resources, broker or dealer services, investment advisor or investment banking services, legal services and expert services unrelated to the audit and any other services determined by the Board.

Other non-audit services including tax services may be permitted only in cases of certain exceptions and if such services are approved in advance by the client's audit committee. Any such approval by the audit committee must be disclosed to investors in periodic reports. The SEC and the Oversight Board also are permitted to exempt any person, issuer, public accounting firm or transaction from the independence rules, on a case-by-case basis, if the Board deems the exemption to be in the public interest.

Public accounting firms are also required to report to the issuers' audit committee:

- all critical accounting policies,
- all alternative accounting treatments of financial information that have been discussed with the management of the issuer including the ramifications and the treatment preferred by the firm, and
- other material written communications between the firm and the management of the issuer.

The Act also contains stricter auditor independence standards and guidelines regarding any conflicts of interest between a public accounting firm and officers of an issuer.[30]

b. *The Indian Position*

Recommendation 2.2 of the NCC has listed prohibited non-audit services including accounting and bookkeeping services, internal audit services, financial information systems, actuarial services, broker, dealer, investment adviser or investment banker services, outsourced financial services, management functions, and form of staff recruitment and valuation services.

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29 Thatcher Profitt, *Corporate and Financial Institutions Bulletin,* August 2002.

30 *Ibid.*

Further, there are certain sections under the Act that pertain to auditor independence and regulations stated and explained hereinbelow:

2. Section 203 – Audit Partner Rotation

a. *The US Position*

The lead audit and the lead reviewing partners may not perform audit services for the same issuer for more than five consecutive years.

b. *The Indian Position*

Recommendation 2.4 of the NCC sets out that, while there is no need to legislate in favour of compulsory rotation of audit firms, the partners and 50 per cent of those responsible for the audit of a listed company whose paid up capital and free reserves exceed Rupees ten crore or a turn over that exceeds Rupees fifty crore should be rotated every five years.

c. *Analysis*

The purpose of Recommendation 2.4 of the NCC is to protect the best interest of the company as well as that of the firm. The auditing partner as well as the staff working on the audit of a particular company would have to be rotated at the end of the five-year tenure. From a distance, it does seem likely that the 'Big Four'[31] would be adversely affected by this provision. What eventually happens with accountants lobbying from both sides remains to be seen.

3. Section 204 – Audit Reports To Audit Committees

Each auditor is required to provide a timely report to the issuer's audit committee on matters related to the accounting practices and policies to be used in the issuer's audit.[32]

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[31] America's largest accounting firms - The Big Eight - which at one time generated 94 per cent of all sales profits and paid 90 per cent of all income taxes in the United States, were Price Waterhouse, Arthur Young, Deloitte, Haskins and Sells Peat, Marwick and Mitchell, Arthur Andersen, Coopers and Lybrand, Ernst and Whinney and Touche Ross. Subsequently, the Big Eight became the Big Six when Ernst and Whinney and Arthur Young merged to become Ernst and Young, and Deloitte, Haskins and Sells merged with Touche Ross to become Deloitte & Touche. Further, Peat, Marwick and Mitchell merged with a Dutch firm KMG to become KPMG as it stands today. The Big Six were now KPMG, Price Waterhouse, Arthur Andersen, Coopers and Lybrand, Deloitte & Touche and Ernst and Young. Subsequently, the Big Six became the Big Five when Price Waterhouse and Coopers and Lybrand merged to become Pricewaterhouse Coopers. After the Enron disaster, Arthur Andersen had to shut down and their Indian arm merged with Ernst and Young. The Big Four as of today are KPMG, Deloitte & Touche, Pricewaterhouse Coopers and Ernst and Young. Stevens Mark "The Big Eight" Introduction.

[32] Jones, Day, Reavis and Pogue, "Sarbanes Oxley Act 2002", Implications for foreign private issue, at 5.

4. Section 206 – Conflicts Of Interest

a. *The US Position*

It would be unlawful for a registered public accounting firm to provide any audit service to an issuer, if the issuer's CEO, CFO or Chief Accounting Officer (CAO) or controller was previously employed by the auditor and participated in any capacity in the audit of the issuer during the one-year period preceding the date of the initiation of the audit.

b. *The Indian Position*

The provisions laid down in respect to auditors' independence are similar to the Indian regulations prescribed by the ICAI to the extent that the ICAI has declared that non-audit work cannot be carried on by audit firms or their associates if the fees from the non-audit work are in excess of those of the audit work.

c. *Analysis*

The provisions of Section 206 raise several questions. Among those issues are:

- How will the requirements of Section 206 affect accounting practice in India?
- Will the Indian arm of a global branch be treated as a separate entity under the Act?
- Would an Indian branch of the same firm be allowed to perform non-audit services if the US branch does the audit?
- Are any of the provisions contrary to existing Indian legal provisions?

V. PENALTIES

The Act has laid down provisions making failure to certify financial reports, obstruction of justice, retaliation against informants, document alteration and securities fraud punishable offences. The penalties for the same are explained and listed hereinbelow.

A. Section 906 – Failure To Certify Financial Reports

Each periodic report containing financial statements filed by an issuer with the SEC, pursuant to Section 13(a) and 15(d) of the Securities Exchange Act, shall have to be accompanied by a written statement by the CEO or the CFO of the issuer. In the event of non-compliance by the CEO or the CFO, he would be liable for imprisonment upto ten years for making a statement knowing that the

reports do not meet the requirements and for a period of twenty years for wilfully making such a statement knowing that the requirements are not complied with, in addition to specified financial penalties discussed hereinabove.[33]

B. Section 807 – Securities Fraud

The Act states that it would be unlawful to defraud a person in connection with any security of an issuer with a class of securities issued under Section 12 of the Securities Exchange Act or that is required to file reports under Section 15(d) of the Securities Exchange Act, or to obtain money or property by false or fraudulent pretences in connection with the purchase or sale of such security. A violation of the rule could result in a fine or a term of imprisonment of upto twenty-five years or both.

C. Section 805 – Obstruction Of Justice

Section 805 of the Act makes the offence of obstruction of justice punishable by imprisonment of upto ten years if the person knowingly and wilfully destroys corporate audit records and punishable by a term of twenty years if the person knowingly alters, destroys or conceals records or documents with the intention to impede, obstruct or influence a federal investigation or a case filed for bankruptcy.

D. Section 1107 – Retaliation Against Informants

Section 1107 of the Act states that the act of retaliation against informants, with the intention to retaliate, to take harmful action against a person for providing a law enforcement officer any truthful information relating to the possible commission of a federal crime would be punishable with imprisonment for a period of ten months.

E. Section 802 – Document Alteration Or Destruction

Section 802 of the Act states that a person who knowingly alters, destroys, falsifies, mutilates, conceals, covers up, or makes a false entry in any record, document or tangible object with the intent to impede, obstruct or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the US or any case filed under Title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, or imprisoned for not more than twenty years or both.

F. The Indian Position

While the NCC has not spelled out specific penalties for offences, it recognises

[33] See Part III of the article.

the need to have faith that regulators will quickly investigate frauds and punish the guilty. They (the NCC) therefore see the need to establish an office along the lines of the Serious Fraud Office (SFO) in the UK.[34] The Corporate Serious Fraud Office (CSFO), to be set up by the DCA, is proposed to consist of several multi- disciplinary investigators. The proposal envisions that the investigators should be inducted on the basis of transfer, deputation and on special term contracts. The aims of the CSFO would be to quickly detect a scam or a fraud, recover the maximum gains from the fraud and restore such moneys to their owners, and to identify the weaknesses in the law and the monitoring and reporting systems that have allowed a fraud to take place to enable the Government to take corrective action.[35]

The establishment of CSFO seems, at this time, to be an adequate measure to detect, deter and punish scams and corporate disasters. Whether it will prove to be as effective as it seems on paper, only time will tell.

VI. Necessary Changes In Indian Law

The NCC has identified various sections that would need to be amended, five of which are discussed hereinbelow. The implementation of these amendments would provide for stringent action and penalties having a deterrent effect.

- Section 77 of the Companies Act places restrictions on the purchase by a company of its own shares or those of its holding company. Companies tend to indulge in such practices to increase their volume and drive up their share prices. This amounts to misleading the various shareholders, a case of fraud, the penalty for the same which is only Rs. 10,000/-. The NCC recommended that the amount of the penalty should be linked to the amount of ill-gotten gains as a percentage of that amount.

- Section 372A of the Companies Act has been misused to indirectly transfer huge sums of money into the stock market through small private limited companies or partnership firms. The liberalisation of the section was made keeping in mind that greater freedom would mean greater accountability and not freedom to the management to lose company money. According to the NCC, a violation of Section 372A should be penalised severely with the offender facing imprisonment.

- Section 274(1) of the Companies Act provides for the disqualification of

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[34] The Naresh Chandra Committee Report, Chapter 5, at 5: The Serious Fraud Office is a government department and is part of the UK criminal justice system. Its aim is to investigate and prosecute serious and complex frauds and so deter fraud and maintain confidence in the probity of business and financial services in UK.

[35] Recommendation 5.3, The Naresh Chandra Committee Report, at 17.

directors in certain circumstances. The NCC recommends that the scope of the section should be widened so as to include repayment of debentures or interest or serious offences as covered under Sections 77 and 372A of the Companies Act. The NCC therefore recommends an amendment to Section 274(1)(g) so that the disqualification will also apply to directors of companies who indulge in what is considered as a serious offence and a betrayal of fiduciary responsibilities.

- The NCC also observed that large amounts of money were transferred by listed companies, disguised as 'trade advances' or advances for the purchase of particular shares. They seemed to be in fact moneys for the company to purchase its own shares. The NCC felt that it should be mandatory for such companies to make a disclosure of such transfers to a prescribed authority and recommended that a company should not be able to borrow more than a proportion/multiple of its paid-up capital and free reserves. This is also justified on the grounds that companies need to maintain a rational debt to equity ratio.

- The NCC also envisages the need to increase the strength of personnel in the prosecuting wing of organisations such as SEBI and the DCA and supplement it with good advocates. This is required to ensure the implementation of the sentences, a concept unheard of for the past five decades. The NCC also recommended that the DCA should examine the possibility of shorter procedures and proceedings along the lines of the recent amendments to the *Code of Civil Procedure, 1908.* (recording evidence through commissioners).[36]

VII. Conclusion

The primary purposes of the Act are to ensure better regulation of auditors, limit conflict of interest by restricting their scope of work, improve financial disclosure, increase accountability through enhanced penalties, etc. While the structure of the Act is considered good, US accountants and their lawyers took advantage of the rule-making processes to lobby to water down some of the provisions of the Act. Auditors have also won the argument that they should be allowed to provide tax services to audit clients.

In India, any far-reaching implications that the Act may have still remains to be seen. Aspects such as the extra territorial application of the Act, the principles

[36] *Ibid.*

of International Law that would be applicable and the impact of the extradition treaty[37] between the US and India are still grey areas that have to be explored.

The Act already had led to the appointment of the NCC and its thoughtful examination of the Indian corporate governance and oversight of the Indian accounting profession. The immediate want of the hour now appears to be the need to amend the Companies Act to provide for stringent penalties, including imprisonment, for both wilful and non-wilful offences in respect of corporate reporting. The Companies Act also needs to be amended to deal sternly with violations of the Listing Agreements. SEBI also should also be well armed to implement the above provisions. From the outside, there is an urgent need to implement the recommendations of the NCC to aid the ICAI and SEBI in implementing good corporate governance norms in India and to protect investor interests in an efficient manner.

[37] The Governments of India and the United States have signed the Extradition Treaty on July 21, 1999. The treaty has come into force from the date of signing itself. The treaty is an important step in India-US law enforcement cooperation and cooperation in the area of counter-terrorism. This exchange constitutes yet another milestone in the continuing cooperation between the two democracies to promote the continued growth of contacts and exchanges in different areas on the basis of mutual benefit and goodwill.

THE ARBITRATION AND CONCILIATION ACT, 1996: IN SEARCH OF A COMPLETE CODE†

*Ashish Aggarwal**

I. INTRODUCTION

There is no mystery involved in the assertion that we have outgrown our judicial system. As anticipated, commercial law has occupied the ground zero of the onslaught of globalization. The exponential growth of this field of law is underpinned by an expansive drive of arbitration and other forms of Alternative Dispute Resolution(ADR). The object of arbitration is the finer disposition, in a speedy and inexpensive way, of the matters involved so that they may not become the subject of future litigation between the parties.[1] The complexities and inadequacies of the court redressal mechanism have given rise to an irrepressible zeal for arbitration, which manifests itself into arbitration clauses in commercial agreements. To keep pace, the Law of Arbitration has undergone unprecedented changes ever since it was first introduced in 1772.

This paper explores the history-shaping trajectory of this emerging field of law. It examines the extent to which the present law succeeds in bridging the lacunae which are responsible for the enactment of legislation. The article seeks to identify certain loopholes and proposes some changes to bring about reform in these grey areas. In this attempt, it also analyses the *176th Law Commission Report on Arbitration and Conciliation (Amendment) Bill, 2001* and the *Consultation Paper on Review of Working of the Arbitration and Conciliation Act, 1996* in India.

II. EVOLUTION OF THE LAW OF ARBITRATION

A mechanism of arbitration existed in India even in the ancient times albeit in a rudimentary form. Under this system, disputes were settled by *panchayats* that were presided over by a *sarpanch*. The *panchayat* was a body consisting of the wealthy, influential and elderly men of the community. The *panchas* were entrusted with the power of management of religious and social functions, and could also ostracise or excommunicate for disobedience to their decisions.[2]

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† This article reflects the position of law as on March 3, 2003.

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1 *Champsey Bhara and Co.* v. *Jivraj Balloo Spinning and Weaving Co.* (1923) 50 IA 324 (330-1): 47. B 578 : 28 CWN 397 : 73 IC 436 = 44 ML J 706 (PC).

2 *Chanbasappa Gurusantappa* v. *Baslingayya Gotturnaya Hiremath* AIR 1927 Bom 565.

After the advent of the British in India, the judicial system was governed by English law. Provisions for arbitration were embodied in the *Bengal Regulation of 1772.* These provisions were retained in the subsequent Bengal and Madras Regulations. *The Code of Civil Procedure, 1859,* in Sections 312 to 317, dealt with arbitration in suits. However, the Code did not apply to the Supreme Court, or the Presidency Small Causes Courts or non-regulation Provinces. *The Arbitration Act, 1899* incorporated various sections of the English Act. For the first time it allowed future disputes, along with existing ones to be referred to arbitration. These provisions were later engrafted into *The Code of Civil Procedure, 1908* (CPC), as the Second Schedule. *The Arbitration Act, 1940* repealed *The Arbitration Act, 1899* Sections 89 and 104(1), clauses (a) to (f) and the Second Schedule of the CPC. *The Arbitration (Protocol and Convention) Act, 1937* and *The Foreign Awards (Recognition and Enforcement) Act, 1961* were also passed.

The year 1991-92 saw a series of economic reforms, which ushered in an era of liberalisation. India witnessed the advent of huge foreign investments and collaborations. The Law of Arbitration, as contained in the above named three Acts, proved to be inadequate to provide settlement of international commercial disputes. Several representative bodies of trade and industry and experts in the field of arbitration, including the Law Commission, proposed amendments to make the law more responsive to contemporary requirements.[3] As the Parliament was not in session, the President of India promulgated the *Arbitration and Conciliation Ordinance 1996.* The Ordinance was largely inspired by the *United Nations Commission on International Trade Law Model Law on International Commercial Arbitration, 1985* (UNCITRAL Model Law). It repealed the earlier existing Acts and *inter-alia* included provisions on conciliation.

The Ordinance was later passed by the Parliament as the *Arbitration and Conciliation Act, 1996,* and received the assent of the President on August 16, 1996. It is interesting to note that although the Act came into force on August 22, 1996, for all practical and legal purposes, it shall be deemed to have been effective from February 25, 1996. This is particularly so, since the provisions of the Ordinance and the Act are similar and there is nothing in the Act to the contrary so as to make the Ordinance ineffective as to either its coming into force on January 25, 1996 or its continuation until August 22, 1996.[4]

The Arbitration and Conciliation Act, 1996 is a historic watershed in the field of Alternative Dispute Resolution. It is a bold and pragmatic initiative taken by the government with a view to integrate the Indian economy to the global financial systems.[5] It is pertinent to point out that though the 1996 Act has

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3 Statement of Objects and Reasons, The Arbitration and Conciliation Act, 1996.

4 *M/s Fuerst Day Lawson Ltd.* v. *Jindal Exports* 2001 (3) SCALE 708.

5 V. Gopalan, *New Law of Arbitration and Conciliation: Recent elucidation and interpretation by the Supreme Court,* (2002) Comp. LJ 220.

instilled the much-required confidence in the minds of foreign investors, it is also not free from ambiguities and shortcomings. In the ensuing paragraphs, an attempt is made to throw light upon some of these incongruities, and at the same time certain measures are suggested to alleviate the same.

III. Scope Of The Arbitration And Conciliation Act, 1996

The provisions in *The Arbitration and Conciliation Act 1996,* dealing with arbitration are mainly divided into two parts. Part I enlists general provisions relating to arbitration while Part II deals with enforcement of certain foreign awards. By virtue of Section 85 of the new Act, the old *Arbitration Act, 1940,* (relating to domestic arbitration) and also the *Arbitration (Protocol and Convention) Act, 1937* and the *Foreign Award (Recognition and Enforcement) Act, 1961,* (relating to international arbitration) were repealed, thus enabling the Act of 1996 to govern both domestic and international arbitration.[6]

A. International Commercial Arbitration Vis-à-Vis Domestic Arbitration.

One of the shortcomings of the *Arbitration Act, 1940* and the other cognate laws that gave rise to the need for a new Act was their inadequacy in governing international commercial arbitrations. Significantly, the *Arbitration And Conciliation Act, 1996* introduced and defined international commercial arbitration in Section 2(1)(f) as that "*relating to a dispute arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is –*

(i) an individual who is a national of, or habitually resident in, any country other than India; or

(ii) a body corporate which is incorporated in any country other than India; or

(iii) a company or an association or body of individuals whose central management and control is exercised in any country other than India; or

(iv) the government of a foreign country;"

The definition of international commercial arbitration in Section 2(1)(f) has two elements, one physical and the other conceptual.[7] The physical element is that one party should be a foreigner, namely either a foreign national or resident, or a foreign body corporate, or a company, an association or body of individuals whose central management or control is in foreign hands or a government of some foreign country. The conceptual element is that the legal relationship between the parties, contractual or otherwise must be such as is considered 'commercial' under the laws.[8]

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6 *Supra* note 3.

7 *Boeing Co.* v. *R.M. Investments Trading* AIR 1994 SC 1136.

8 R. S. Bachawat, '*Law of Arbitration and Conciliation*'(Wadhwa & Co. 1999 ed.).

Though largely based on the UNCITRAL Model Law, Section 2(1)(f) made a deviation from the corresponding provisions therein.[9] Article 1(3) of the UNCITRAL Model Law lays emphasis on three factors, namely, nationality of parties, place of arbitration and the subject matter of dispute. In contrast, the 1996 Act merely lays down the condition of residence and nationality of parties.

The existence of a foreign element is a characteristic feature of international arbitration agreements, and once it established in the commercial relationship, the contract becomes an 'international contract' under Section 2(1)(f), and the arbitration thereunder will be an 'international arbitration'[10]. This will be so, notwithstanding the factum that such contracts are concluded in India, and are to be performed completely within the territory of India. On the contrary, a contract between Indian nationals will never be 'international' notwithstanding the factum that it has to be performed outside India.[11] This goes against the fundamental tenet of Private International Law, that a contract becomes 'international' when the performance thereunder spills over national boundaries.

B. Applicability Of The Arbitration And Conciliation Act, 1996 To International Commercial Arbitrations

International commercial arbitrations, as described above, may be classified on the basis of the venue of the arbitration. Cases where arbitrations are stipulated to take place in India fall within the broad purview of the term 'domestic arbitration'. Such arbitrations are squarely covered by Section 2(2), which delineates the scope of Part I of the Act. Section 2(2) states "*this Part shall apply where the place of arbitration is in India*". This provision is in conformity with the fundamental principle of the Law of Arbitration that it is governed by the law of the country where it is held, namely, the 'seat', or 'forum' or '*laws arbitri*' of the arbitration.[12]

In the case of international commercial arbitrations, anomalies arise where the seat of arbitration is outside the territorial jurisdiction of India. Doubts have often been raised as to the applicability of Part I to the above in light of Section 2(2) of the Act. The question becomes contentious when recourse to Indian courts is required under Sections 8, 9, 11, 27, 35 or 36 of the *Arbitration and Conciliation Act, 1990.* Section 8 invests the courts with the power to refer parties

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9 Article 1(3), UNCITRAL Model Law on International Commercial Arbitration.

10 *Himmatlal* v. *State of Maharashtra* AIR 1977 SC 1825.

11 P. C. Markanda, *Law Relating to Arbitration and Conciliation* (Wadhwa Publishers 4th ed. 2001).

12 Article 5 of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958; Article 2 of the Geneva Protocol on Arbitration Clauses, 1923.

to arbitration on account of the existence of an arbitration agreement. Section 9 empowers the court to pass an interim order in aid of arbitration. Section 11 authorises the court to appoint an arbitrator on the request of the parties. Section 27 contemplates the courts' assistance to the arbitral tribunal in taking evidence. Section 35 deals with the finality of awards while Section 36 envisages the execution of foreign awards. Such reliefs are invariably opposed on the ground of non-applicability of Part I.

In 1997, a Single Judge of the Delhi High Court was seized with the matter pertaining to the said issue.[13] The learned Judge held that though the arbitration was to take place in London and was to be conducted by the Paris International Chambers of Commerce (ICC), Part I was applicable and the Chief Justice of the Delhi High Court could be approached. His Lordship observed that sub-section (2) contains an inclusive definition and "*does not exclude the applicability of Part I to those arbitration which are not being held in India*". Hence the Court allowed the application to refer the dispute to arbitration. This decision was also followed in subsequent cases of the Delhi High Court[14].

However, these cases were later overruled by a Division Bench of the Delhi High Court[15]. In that case the court disallowed an application under Section 9 as the place of arbitration was Kuala Lumpur in Malaysia. Each and every point, which persuaded the court in the *Dominent Case*[16], was discussed and dismissed. This view was affirmed by the Calcutta High Court[17], which held that the provision of Part I would not apply where the place of arbitration is not in India.

The controversy was finally sought to be settled by a Three Judge Bench of the Apex Court in the case of *Bhatia International* v. *Bulk Trading SA* [18]. It was a case of an agreement between an Indian concern and a foreign organisation and the agreement provided for arbitration under ICC Rules to be held in Paris. The Indian party, however, sought interim reliefs from Indian courts by filing an application under Section 9. This application was resisted by the other party contending that Section 2(2) made it clear that the provisions of Part I of the Act would not apply when the place of arbitration is not in India. It was argued that sub-sections (3), (4) and (5) of Section 2 would necessarily apply to arbitration, which takes place in India. Where arbitrations take place outside India, they

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13 *Dominent Offset P. Ltd.* v. *Adamovske Strajirny* AS (1997) 68 DLT 157.

14 *Suzuki Motors Corporations* v. *Union of India* 1997 (2) Abr. L.R. 477 (Del); *Olex Frocas Ltd.* v. *Skoda Export Co. Ltd.* AIR 2000 Delhi 161.

15 *Marriott int'l* v. *Ansal Hotels* 2002 (2) Raj 134.

16 *Supra* note 13.

17 *East Coast Shipping* v. *M. J. Scrap* 1997(1) CNal H 444; *Keventer Agro* v. *Seagram,* (unreported CS 502/7 decided on January 27, 1998).

18 (2002) 2 Comp LJ 361 (SC): JT 2002 (3) SC 150.

would be governed by the rules of the country under whose jurisdiction the proceedings are being conducted. It was, thus, contended that Section 9 would not be applicable to arbitrations, which take place outside India. Rejecting these contentions, the Court held that the Act applies to arbitrations, which are held in India between Indian nationals and also to international commercial arbitrations, whether held in India or outside India. The Act nowhere provides that its provisions are not to apply to international commercial arbitrations that take place in a Non-Convention country. Arbitration is defined under Section 2(a) and includes one that is not administrated by a permanent arbitral institution. It recognises that the arbitration could be under a body like the Indian Chambers of Commerce or the International Chamber of Commerce. For the purpose of this part, the definition of 'international commercial arbitration', thus, makes no distinction between international commercial arbitrations which take place within India and those which take place outside it. In addition, the definition of the term 'court' under the 1996 Act does not provide that the courts in India will not have jurisdiction if an international commercial arbitration takes place outside India. It was observed that an ouster of jurisdiction cannot be implied, and has to be express. Section 2 does not provide that Part I of the Act shall not apply where the place of arbitration is not in India. The language of Section 2 makes it clear that the intention of the legislature was to make the provisions of Part I compulsorily applicable to an arbitration including an international commercial arbitration held in India. Parties cannot, by agreement, override or exclude the non-derogable provisions of Part I in such arbitrations. The Court concluded that by omitting to provide that Part I will not apply to international commercial arbitrations that take place outside India, the effect is that Part I applies to them, though not specifically mentioned.

Their Lordships observed that if the provisions are given the interpretation as was argued on behalf of *Bhatia International,* the following consequences would follow:

- It would amount to holding that the legislature had left lacunae in the Act - neither Part I or Part II would apply to arbitration held in a country which is not a signatory to any of the two conventions. It would mean there is no law in India governing such arbitrations.
- It would lead to an anomaly that Part I would apply in Jammu and Kashmir to all international commercial arbitrations but not to the rest of India, if arbitration takes place outside India.
- It would lead to a conflict between sub-section (2) on one hand and sub-section (4) and (5) of Section 2 on the other. Further sub-section (2) would also be in conflict with Section 1(2), which provides that the Act extends to the whole of India.
- It would leave a party without a remedy as it would not be able to apply

for interim relief in India where the place of arbitration is outside India, though the properties and assets are in India.

In my humble view, the judgment strictly speaking is erroneous though it adopts a pragmatic approach. With due respect, their Lordships seem to have overlooked the cardinal rule of interpretation of statutes - *expresso unius est exclusio alterius* or *expressum facit cessare tacticum* which means 'the express mention of one thing implies the exclusion of another'. Section 2(2) is plain and unambiguous in defining the scope of applicability of Part I. The intention of Indian legislature is patently manifested by its deliberately not making the exceptions as made in the UNCITRAL Model Law. By categorically stating that Part I applies where the place of arbitration is in India, it rules out its application elsewhere.

However, it cannot be denied that the Hon'ble Supreme Court has taken a realistic view of the problem. As the Apex Court has lamented, "*the Act does not appear to be a well-drafted legislation*". The void created by the ill-drafting of the Act defeats one of its very objectives, namely to govern and regulate commercial arbitrations where the place of arbitration is outside India.

It leaves an aggrieved party without a remedy and causes undue suffering to him. By virtue of the non-applicability of Part I, interim measures cannot be granted under Section 9 to an Indian national against the property of a foreign party. By the time the Indian party takes steps to move the court in the country in which the seat of arbitration is located, the property may have been removed or transferred. If a legal proceeding is initiated under Section 8 where one of the parties is not an Indian national, the opposite party will be unable to plead an arbitration clause where the place of arbitration is outside India.[19] Courts are disabled from appointing an arbitrator under Section 11 or in assisting the taking of evidence under Section 27. Awards made in Non-Convention countries would be unenforceable in India. Therefore the non-applicability of Part I to international commercial arbitration taking place abroad thwarts the accomplishment of the objectives of the Act. The provisions, therefore, are in grave need of reform. Other countries have corresponding provisions applicable to international arbitrations held outside their territories. Hence, it is suggested that Sections 8, 9, 27, 35 and 36 should be made applicable to international arbitrations held abroad.

C. Extent Of Judicial Intervention

The second salutary objective sought to be achieved by *The Arbitration and Conciliation Act, 1996* was to minimise the supervisory role of courts in the arbitral process.[20] Referring to the 1940 Act, Justice P. B. Mukherjee made a

[19] *Applied Electronics Ltd.* v. *MTNL* (1996) 2 Arb LR 306 (Delhi).

[20] *Supra* note 3.

pertinent remark,"*as for the legislation the statute of arbitration is a jerry built structure suffering from divided loyalties, precariously balanced between sympathy with private courts of litigant's choice and nostalgia for public courts, which are expected to exercise a kind of paternal control over them.*

"This four-fold curse has effectively laid its stronghold to make the law of arbitration a cripple, which walks permanently on the crutches of legal precedents. It is no exaggeration to say that almost every controversial arbitration of any importance always waits for a second bout of legal fight in the public courts proving the truth of the old cynical statement that only fools go to arbitration because they pay two sets of costs one before the arbitrators, and the other before the courts where they came home to roost."[21]

The Hon'ble Supreme Court also decried the Act for its "*unending prolixity, at every stage providing a legal trap to the unwary*".[22] It observed that "*the way in which the proceedings under the Act are conducted and without an exception challenged in courts, has made lawyers laugh and legal philosophers weep*".[23]

In order to eliminate the vices of unnecessary litigation, the framers of the 1996 Act incorporated Section 5 that defines the role of judicial authority in respect of arbitration matters. Section 5 states "*notwithstanding anything contained in any other law for the time being in force, in matters governed by this Part, no judicial authority shall intervene except where so provided in this Part*". This provision is adopted from Article 5[24] of the UNCITRAL Model Law, which is in turn derived from the suggestions made by its Working Group.[25] Similar provisions also exist in the arbitration laws of other countries.[26]

Hitherto, frequent resort to intervention of the court has been used as a delaying tactic and is more often a source of abuse of the arbitral proceeding than protection against the abuse. The purpose of Section 5 is to achieve certainty as to the maximum extent of judicial intervention.[27] The scope of interference is restricted by Part I to the following grounds :

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21 *Saha & Co.* v. *Ishar Singh,* AIR 1956 Cal 321 at 341.

22 *Guru Nanak Foundation* v. *Rattan Singh* AIR 1981 SC 2075.

23 *Ibid.*

24 Article 5 states: "In matters governed by this law,no court shall intervene except where so provided in this law."

25 A less categorical wording was suggested at the Seventh session of the Working Group but was not adapted : "In matters governed by this law concerning the arbitral proceedings or the composition of the arbitral tribunal, courts may exercise supervisory or assisting jurisdiction only if so provided in this Law"(A/CN.9/246,paras 183-184).

26 Section 5 of the Canadian Commercial Arbitration Act, 1985;
Section 5 of the German Arbitration Act, 1998;
Section 6 of the Korean Commercial Arbitration Rules, 1999;
Section 5 of the Irish Arbitration Act, 1998; and
Section 5 of the Zimbabwe Arbitration Act, 1999;

27 UNCITRAL Report on Adoption of Model Law.

- reference of parties to arbitration when there is an arbitration agreement (Section 8);
- issuance of interim orders as "*measures of protection*" (Section 9);
- appointment of arbitrators (Section 11);
- termination of the mandate of arbitrators (Section 14 (2));
- providing evidence to arbitral tribunals (Section 27);
- setting aside or remission of the award (Section 34);
- power to hear appeals (Section 37);
- power to order delivery of awards on payment of cost to the court (Section 38 (2));
- power to make order on cost of arbitration where no sufficient provision is made in the award (Section 39 (4));
- power to direct determination of any question in connection with insolvency proceedings by arbitration under certain circumstances (Section 41(2));
- power to extend time for reference to arbitration to time-barred future disputes (Section 43 (3)).

The purpose of Section 5 is to keep court intervention restricted to the situation expressly indicated in the Act and to exclude all other remedies.[28] The exclusion is neither confined to the stages after the arbitral tribunal is appointed nor the period during the pendency of the arbitration proceeding alone. The remedies excluded are those that may be otherwise available, right from the stage of interim measures under Section 9 before the commencement of the arbitration and also at the stage of reference to arbitration under Section 11 applications.[29]

When orders under Section 9 relating to interim measures are passed by the civil court as defined in Section 2(1)(e), the remedies under Section 115 of CPC or under Letters Patents or the High Court Acts are excluded. If in a matter filed before a judicial authority, an application for reference under Section 8 is allowed or dismissed by the said authority all remedies to challenge the same under Section 115 of CPC or under Letters Patents or the High Court Acts or by resort to special remedies under the statute applicable to the judicial authority are excluded. Similarly, under Section 11 of the Act, if arbitrators are appointed by the High Court or not appointed, such orders will not be amenable to Letters Patents or the High Court Acts, if they are passed by any Single Judge of the High Court.

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[28] *J. D. Singh* v. *Calcutta Port Trust* AIR 1994 Cal 148.

[29] *Bright* v. *Gibson* (1916) 32 TLR 533.

D. Judicial Intervention In Domestic Vis-à-Vis Foreign Awards

Though the Act subscribes to the theorem of minimum judicial intervention, the extent of interference varies depending on whether it is a domestic or a foreign arbitration. As discussed earlier, Part I governs arbitration that takes place in India[30], while Part II regulates the enforcement of awards passed in countries that are signatories to the New York[31] or Geneva[32] Conventions. Section 5 of the Act limits interference to the specific grounds enlisted in Part I of the Act. It acts as a watchdog and safeguard against excessive interference by the court. It is an established principle that every party should be prepared to accept the decision of the arbitral tribunal even if it is wrong, so long as the correct procedures are observed. If a court is allowed to review this decision on the law or on the merits, the speed and above all, the finality of the arbitral process is lost.[33]

However, it is worthy to note that there is no corresponding provision in Part II of the Act. Curiously enough, the legislature seems to have omitted the inclusion of any clause that could place checks on the intervention of the court. The consequence is that the residuary powers of the courts, whose operations have been excluded in Part I, continue to have effect. It gives a wide leeway to any party aggrieved by the award to challenge it on merits by invoking these enabling provisions as set out in the Act. As there is no bar to interference by the court, its residual powers remain operative. For instance, a court may entertain an application under Section 115 of the CPC, the Letters Patents, the High Court Acts or by resorting to special remedies under the statute applicable to the judicial authority.

Such a practice can lead to abuse by using dilatory tactics to cause hardship or harassment to other parties. This relates back to the position that existed prior to the enactment by nullifying any favourable effect that the Act may have achieved.[34] Besides, by providing differential treatment to foreign arbitrations from the domestic ones, it also nullifies the attempt of the 1996 Act to place the two on an equal platform.

In my opinion, similar provisions should be introduced in Part II so that the power of the court to interfere in matters which are covered by a valid and binding agreement to refer disputes to arbitration in which agreements are

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30 Section 2(2) of the Arbitration and Conciliation Act, 1996.

31 Section 44 of the Arbitration and Conciliation Act, 1996.

32 Section 53 of the Arbitration and Conciliation Act, 1996.

33 *Bachha Lal* v. *Munni Lal* AIR 1937 Oudh 507.

34 *Patto Kumari* v. *Upendra Nath Ghosh* 4 Pat LJ 265.

covered by the New York Convention or the Geneva Convention are clearly excluded, except for the limited purpose set out in the Act. Lesser control must be exercised over foreign arbitrations as against domestic arbitrations. This proposition finds support in the treatise[35] on international commercial arbitration which states, "*amongst states which have a developed arbitration law, it is generally recognised that more freedom may be allowed in an international arbitration than is commonly allowed in a domestic arbitration, The reason is evident. Domestic arbitration usually takes place between citizens of the same states as an alternative to proceedings before the courts of that state. It is natural that a state may exercise firmer control over such arbitrations involving its own citizens than international arbitrations merely on the ground of geographical convenience.*" The UNCITRAL Model Law also takes a similar stand.[36]

It is imperative to elicit another significant distinction drawn between domestic and international arbitrations by the mandate of the 1996 Act. Section 8 of the Act makes it obligatory for the court to refer parties to a domestic dispute to arbitration in case of existence of an arbitration agreement.[37] It precludes the court from hearing the matter on merits on any ground whatsoever, including invalidity of the arbitration agreement.[38] Challenge to arbitration on the ground that the arbitration agreement is null and void can be made only after the tribunal makes the award.[39] Therefore the court is bound to refer and transmit the dispute to the determination of the tribunal as soon as it is established that an arbitration agreement exists.[40]

On the other hand, in case of an arbitration agreement falling under Part II of the Act, it shall be referred under Section 45 or Section 54 depending on whether it is governed by the New York Convention[41] or the Geneva Convention, respectively. Both these provisions entail application of a judicial mind and a determination of the validity of the agreement. As a condition precedent, an

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35 Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, (Butterworth 1999 ed.).

36 *Supra* note 26 at para 63.

37 *Joharimal* v. *Fatehchand* AIR 1960 Raj 67; *State of U.P.* v. *Janki Saran Kailash Chandra* AIR 1973 SC 2071.

38 *K.P. Jethanal Biharilal* v. *The State of Jammu and Kashmir* AIR 1964 J&K 10; *Anderson Wright Ltd.* v. *Moran & Co.* AIR 1955 SC 53.

39 An application to set aside the award may be made under Section 34 of the Arbitration and Conciliation Act, 1996.

40 It departs from the corresponding provision in Article 8 of the UNCITRAL Model Law, which stipulates the pre-requisites of the agreement being valid, operative and capable of being performed.

41 Section 45 is based on Article II(3) of the New York Convention. It corresponds to Section 3 of the Foreign Exchange Regulation Act, 1961 except that Section 45 mandates the judicial authority to refer parties to arbitration.

agreement must be valid, operative and capable of being performed.[42] Any finding of the court as to these questions would necessarily require a hearing of the matter, with regard to the validity of the agreement, on its merits.[43] Such a decision will essentially and indispensably involve a consideration of the salient features of the agreement against the yardstick of basic contractual principles.[44] In effect, the parties are compelled to go through duplicate legal proceedings thereby adding to their burden of litigation.

In my view, this distinction, instead of alleviating, only perpetuates and perpetrates the unjust disparities between the two modes of dispute settlement. It remains oblivious to distressed appeals from the judiciary as well as eminent experts on the subject for a simplified and singular round of litigation. It is suggested that the law relating to the two kinds of arbitration should be made more equitable and must be brought on the same footing. It is further recommended that the decision as to validity, operation and capability of performance of international agreements may be left to the arbitrators, as is done in the case of domestic arbitrations.

E. Appointment Of The Arbitrators: Judicial, Administrative Or As 'Persona Designata'

Ever since the 1996 Act came into force, the issue of appointment of arbitrators has remained a vexing and contentious one. The moot point involved is the extent of judicial review of the decision of the Chief Justice to appoint arbitrators; in other words, the controversy as to whether such an order is a judicial or an administrative one. In addition, the status of the functionaries as '*persona designata*' has been a subject matter of debate.

The procedure for the appointment of the arbitrator is regulated by Section 11 of the 1996 Act.[45] The same provision empowers the parties to constitute an arbitral tribunal.[46] In case the parties fail to agree on a procedure for appointment of the arbitrator, a party may obtain the assistance of the court by invoking sub-sections (4), (5) or (6) of Section 11. Under these clauses, the Chief Justice or any person or institution designated by him shall appoint an arbitrator for the settlement of the dispute. This power of appointment of an arbitrator has often been subjected to scrutiny in order to ascertain the extent to which it permits challenge.

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42 Sections 45 and 54 of the Arbitration and Conciliation Act, 1996.

43 *Renusager Power Co. Ltd.* v. *General Electronic Co.* AIR 1985 SC 1156, at 1182.

44 *Gas Authority of India Ltd.* v. *SPIE CAPAG SA* AIR 1994 Delhi 75.

45 Section 11 is based on Article 11 of the UNCITRAL Model Law.

46 It replaces section 8 of The Arbitration Act, 1940.

In case of *Sundaram Finance Ltd* v. *NEPC India Ltd.*[47], Justice B. N. Kirpal observed that an order under Section 11 is not a judicial one. However, the aforesaid observation may be said to be *obiter dictum* because the question before the Hon'ble Supreme Court related to Section 9 and not Section 11.[48] In the case of *Ador Samia* v. *Prekay Holdings*[49], a Division Bench of the Supreme Court held that an order under Section 11 is an administrative one, against which no appeal for special leave could be filed under Article 136 of the Constitution. This view was affirmed by a Three Judge Bench of the Supreme Court in *Konkan Railway Co.* v. *Mehul Construction Co*[50].

In the subsequent case of *Konkan Railway Co.* v. *Rani Construction Ltd.*[51], the question as to whether a preliminary issue could be decided at the stage of Section 11 was referred to a larger Bench. The Constitutional Bench[52], after hearing both parties, held that orders under Section 11 are administrative in nature.

In the case of *Datar Switchgears Ltd.* v. *Tata Finance Ltd.*[53], the applicants' request to the opposite side under Section 11(6) for the appointment of an arbitrator was not honoured and the opposite party appointed an arbitrator after considerable delay. Thereafter, the applicant filed a petition under Section 11 seeking appointment by the Court contending that as the opposite party did not appoint an arbitrator within reasonable time, the said appointment was invalid and therefore the court could appoint an arbitrator under Section 11. The opposite party contended that there was no time limit in Section 11(6) to take action upon a request for appointment of an arbitrator and the periods fixed under Sections 11(4) and 11(5) were not applicable to Section 11(6), and even otherwise not mandatory. It was held that in cases arising under Section 11(6), if the opposite party has not made an appointment within thirty days of the demand, the right to make an appointment is not forfeited but continues. However the appointment has to be made before the former files an application under Section 11 seeking appointment of an arbitrator. In other words, the decision under Section 11 was construed as an administrative order.

The judicial exposition has been firmly of the view that such a power of appointing arbitrators is administrative and not judicial. The direct consequence of such a view is that an exercise of such an order lies beyond the purview of challenge under Article 136 of the Constitution. However, these orders may

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47 (1999) 3 Comp LJ 205 (SC).

48 P. M. Bakshi, *Power of the Chief Justice - Administrative or Judicial?*, (2001) 31 SCL 159.

49 (1999) 4 Comp LJ 37 (SC).

50 (2000) 4 Comp LJ 273 (SC).

51 (2001) 1 Comp LJ 1016 (SC).

52 2001 (4) SCALE 225.

53 (2000) 5 Comp LJ 205 (SC).

still be subjected to judicial review under Article 226, by seeking a writ of *mandamus*. The rounds of challenge will differ depending on whether the arbitration is domestic or international. In cases of domestic arbitration, if the order is on the administrative side it can be challenged under Article.226 before a Single Judge, then a Division Bench, and eventually the Supreme Court under Article 136 of the Constitution.

The situation is different and, it is submitted, more advantageous subsequent to the *Bhatia Judgment*[54], if the order under Section 11 is construed as a judicial order. The underlying reason is that even if a Single Judge passes the order, there will be no appeal to a Division Bench because of Section 5 which excludes interference with judicial orders. Therefore, there would be only one appeal possible under Article 136.

In the case of a foreign arbitration, a petition under Article 226 will not lie against the order of the Chief Justice of India. Being an administrative order, even a special leave petition under Article 136 cannot be entertained against it. As a result, all the stages of appeal are excluded and there cannot be any interference with such an order under Section 11(6). Keeping in mind the overarching goal of minimising judicial interruption, in my view, the interpretation of an order under Section 11 as judicial, is more suitable.

Such a construction would allow the operation of the peremptory rule contained in Section 5 which would prohibit any interference, whether by way of appeal or revision. The same can also be inferred from the use of the word "*court*" in Article 11 of the UNCITRAL Model Law, which supposedly, formed the basis of Section 11. However, our drafters chose to depart from this suggestion and, instead, employed the term 'Chief Justice' which connotes an administrative character. It is suggested that suitable amendments be carried out to bring the law on par with that of other countries.[55]

To strengthen this contention, the Law Commission places reliance on the Irish law. It states, "*in the view of the Commission the recent Irish Act, 1996 gives us correct guidance. The Irish Act which enables the President of the High Court or his nominee to decide these and other applications, says that the applications are to be made to the 'High Court' and it defines 'High Court' to mean the President of the Court or his nominee. It is clear that the applications are only on the judicial side*".[56]

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[54] *Supra*, note 15.

[55] Most countries use the term 'Courts' in their domestic arbitration statues. See for example Article 11 of the Canadian Commercial Arbitration Act 1985; Article 11 of the Korean Commercial Arbitration Rules,1999; Article 14 of the Swedish Arbitration Act, 1999; Article 11 of Schedule I of the New Zealand Arbitration Act, 1996.

[56] 176th Report of the Law Commission on the Arbitration and Conciliation (Amendment) Bill, 2001.

The use of the terms 'Chief Justice of India' and 'Chief Justice of the High Court' have raised doubts that these functionaries are acting as *persona designata.* A *persona designata* has been defined by the Supreme Court[57] as "*a person who is pointed out or described as an individual as opposed to a person ascertained as a member of a class, or as filling a particular character.*"[58] In the words of Schwabe C.J., *persona designatae* are "*persons selected to act in their private capacity as judges*"[59]. It has been increasingly felt that powers under Section 11 are as *persona designata*, and therefore there is no scope of court intervention even under Article 226.[60]

It is submitted that the above view does not represent the correct position of law. In the case of *Parthasaradhi Naidu* v. *Koteswara Rao*[61], the District Judge was clothed with certain powers as an Election Commissioner. The Full Bench of the Madras High Court held that the District Judge was not acting as *persona designata.*[62] In a later case[63] the Court made a deeming provision in its Election Rules that a District Judge acts as a *persona designata* and not in his official capacity. The Division Bench of the Madras High Court held that he still was acting in a judicial capacity, notwithstanding the provision to the contrary. Further, even if it is assumed that under Section 11, the Chief Justice acts as *persona designata*, there is nothing to preclude him from being subjected to judicial review.[64]

To sum up, the judicial view has been in favour of holding that an order under Section 11 is administrative in nature. However, it is suggested that in the interest of minimising court interference, suitable amendments should be carried out to hold these orders as judicial.

F. Removal Of A Biased Arbitrator

In order to secure a fair and effective settlement of the dispute, an arbitrator must be independent and impartial. One of the avowed purposes of the new Act in India, namely, *The Arbitration and Conciliation Act, 1996* has been to make the Arbitration Law more progressive and more acceptable by international standards. The necessity was particularly felt in the changing economic scenario

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57 *General Talkies Ltd* v. *Dwarka Prasad* AIR 1961 SC 606.

58 Derived from *Osborne's Concise Law Dictionary*, (Penguin UK 4th ed., at 2530).

59 *P. Naidu* v. *K. Rao,* ILR 47 Mad 369.

60 Inferred from the response to the Consultation Paper on Review of Working of Arbitration and Conciliation Act, 1996.

61 AIR 1924 Mad 369.

62 Affirmed by the Supreme Court in the case of *General Talkies Ltd* v. *Dwarka Prasad* AIR 1961 SC 606.

63 *Mahabaleswarappa* v. *Gopalaswami Mudaliar* AIR 1935 Mad 673.

64 In *Konkan Railway Co.* v. *Mehul Construction Co.* (2000) 4 Comp LJ 273 (SC), it was held that a writ petition under Article 226 lies against the acts of *persona designata.*

to reassure and attract the foreign businessman and investor toward India. The international businessman's point of view on the importance of an effective mechanism for ensuring a fair and impartial arbitration has been succinctly stated in *Russel on Arbitration*[65] as "*international arbitration institutions try to meet the expectations of the international business community for independent and neutral tribunals. The party would never agree to arbitration in the first place unless they had confidence that the arbitration system concerned would take every reasonable measure to ensure the independence and the neutrality of the arbitration tribunal.*"

Therefore, the emphasis is laid not only on a fair and unbiased 'award in the future', but also a just and impartial '*arbitration procedure (trial) at present*'.[66] The rule of arbitration and the cannon of judicial ethics rest on the premise that any tribunal permitted by law to try cases and controversies not only must be unbiased but also must avoid even the appearance of bias. This end is best served by establishing an atmosphere of frankness at the outset through disclosure by the arbitrator of any financial transactions or negotiations, which he has had with either of the parties. It is far better that all relationships, business or personal, are disclosed at the outset, when the parties are free to reject the arbitrator or accept him with the knowledge of the relationship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award. Therefore, the arbitrator is duty bound to provide the parties with his complete and unexpurgated business biography. In pursuance of this objective, Section 12 of the 1996 Act has made it obligatory for the arbitrator to disclose at the earliest 'any circumstances likely to give rise to justifiable doubts as to his independence or impartiality'. It confers a right upon the party aggrieved by the non-performance of such duty to challenge the authority of the defaulting arbitrator. By virtue of this provision, the Act endeavours to conform to the hallmark set by the UNCITRAL Model Law.[67]

The degree of accountability of arbitrators may be understood with reference to the opinion of Justice Black of the U.S. Supreme Court who stated "*it is true that the arbitrators cannot sever all their ties with the business world since they are not expected to get all their incomes from their work of deciding cases. But we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have the complete free rein to decide the law as well as the facts and are not subject to appellate review*".[68]

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65 Stevens & Sons 1997ed.

66 Sunil Gupta, *No power to remove a biased arbitrator under the new Arbitration Act of India,* (2000) 3 SCC 1.

67 Section 12 is almost a verbatim reproduction of Article 12 of the UNCITRAL Model Law.

68 *Commonwealth Coating Corp.* v. *Continental Casualty Co.* 393 US 145.

The procedure to challenge the impartiality of the arbitrator is laid down in Section 13 of the Act. Section 13(1) gives the parties the liberty to decide the procedure of such challenge, and in the absence of such an agreement it provides for the objection to be raised before the arbitral tribunal. When the tribunal does not accede to the challenge, it is permitted to continue the proceedings and make an award. The party so aggrieved can challenge the same in accordance with Section 34 only after the award is made. In the landmark case of *Kitiku Imports* v. *Savithri Metals*[69], the Bombay High Court held that the only remedy where the plea of bias is rejected is to wait till the award is passed and then challenge the award. It further held that the spirit and scheme of the Act does not permit immediate intervention by the court where it would result in stay of proceedings.

In my humble opinion, this provision causes excessive hardship to the aggrieved party in so far as it requires the party to pointlessly wait till the award is made in order to challenge the arbitrator on the ground of his lacking competence. The said procedure is not fair as it is highly time consuming and expensive, the prevention of which itself is the objective of the framing of the Act. In my view, Section 13 must be brought in conformity with the UNCITRAL Model Law such that if a plea of bias or disqualification of arbitrators is raised it should be decided as a preliminary issue by the arbitrator and if the plea is not accepted, there should be an immediate right of appeal.

It is also suggested that in order to reduce the risk of dilatory tactics, it must be provided that the arbitral tribunal has the discretion to proceed with the arbitration during the pendency of the determination of the challenge to his authority before the court. In consonance with the laws of other countries[70], there ought to be an equitable balance between the desire of avoiding unnecessary waste of money and time, on one hand, and the need of preventing obstruction, on the other.

IV. Conclusion

The Indian law under the new Act, while eschewing the judicial remedy, steers clear of even the institutional safeguards. In the process, it exposes the remedy of arbitration in India to serious flaws and aberrations. It must be conceded that the enactment of *The Arbitration and Conciliation Act, 1996* is a very laudable

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69 1999 (2) Arb. L.R. 405.

70 Similar provisions exist in Section 1037(3) of the German Arbitration Act, 1997; Section 13(2) of Schedule II to the Australian International Arbitration Act,1974, Article 13(3) of the Canadian Commercial And Arbitration Act, 1985, Article 13(3) of the Schedule to the Irish Arbitration Act, 1998, Article 1393 of Schedule I of the New Zealand Arbitration Act, 1996.

effort. However, the anomalies created by the scheme of the Act must be remedied so as to ensure the law does not lag behind the needs of time. The endeavour of the UNCITRAL Model Law has been the harmonization of national laws. Though India has largely adopted the UNCITRAL Model Law, there remain certain incongruities, which ought to be rectified in order to bring the legislation in tune with other national laws. The mending and amending of the law is a *sine qua non* to the accomplishment of its basic purposes of speed, economy, and real as well as substantial justice.

BASMATI, TURMERIC AND NEEM - PATENTING AND RELATED ISSUES - CASE STUDIES†

*Hariharan G.**

I. INTRODUCTION

The utility of the system of Intellectual Property Rights (IPR) with regard to the protection offered to traditional knowledge and biodiversity came under intense scrutiny in light of the grant of patents to Basmati, Turmeric and Neem. While the controversy surrounding the actual patents in question has ended, the larger issues remain unaddressed. The three cases in question are by no means the only instances where traditional knowledge of the Third World has been the subject matter of intellectual property protection claims in the West. For instance, an American company, POD-NERS L.L.C., initiated infringement proceedings against two Mexican companies in respect of a patented yellow beans variety which originated from beans purchased by the President of POD-NERS in Mexico.[1] Similarly, in 1994, two researchers from the University of Colorado received a US patent number which gave them exclusive monopoly control of male sterile plants of the traditional Bolivian 'Apelawa' quinoa variety.[2]

II. PATENT REGIME UNDER THE TRIPS AGREEMENT

The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs Agreement), administered by the World Trade Organization (WTO), deals with seven forms of IPR[3], but the maximum implications for developing countries arise in respect of patents. First, the scope of patentability, traditionally provided for by most developing countries, is being expanded significantly. Second, the rights of the patentees have been considerably strengthened. This dimension of the patent regime could have major implications for developing countries especially in respect of biotechnology as the biotechnology industry in the developed countries expands, utlising the biogenetic resources of the former.

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† This article reflects the position of law as on February 5, 2003.

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1 Mexican Bean Biopiracy, available at http://www.panna.org/resources/gpc/gpc_200004.10.1.11.dv.html.

2 Patenting, Piracy and Perverted Promises, available at http://www.grain.org/publications/piracy-en.cfm.

3 Patents, Copyrights, Trademarks, Designs, Trade Secrets, Geographical Indicators and Integrated Circuits.

Ensuring access to and transfer of technologies to developing countries based on their genetic resources, identified by the *Convention on Biological Diversity*[4] (CBD) as a key issue, could therefore become a major area of contention.

There are two contentious issues that the TRIPs Agreement raises. The first concerns the subject matter that the patent system should encompass. The second is related to the future status of a process patent regime that many countries like India have adopted. The first issue is pertinent to the present study and warrants a closer look.

III. Extending Of Fields Of Activity Under The Patent Cover

The TRIPs Agreement proposes an almost all-encompassing coverage under the patent system. Article 27(1) of the TRIPs Agreement, in relevant part, provides that "*.... patents shall be available for inventions, whether products or processes, in all fields of technology...*" The coverage so defined is aimed at extending the fields of activity under patents to cover selected forms of life which were hitherto not considered patentable by most countries. As regards plant varieties, Article 27.3(b) of the TRIPs Agreement provides that protection has to be provided "*either by patents or by an effective sui generis system or any combination thereof.*"

The implications of extending patent protection over the plant kingdom could be felt over several fronts, now that the patent system has been strengthened in favour of the patentees. Biotechnology has progressed much in the same way as earlier technologies, and there remains a huge imbalance in the generation of technologies between the developed and developing countries. The process patent regime, which was being used by most developing countries including India to address this imbalance, is now frowned upon under the TRIPs regime.

Although Article 27.3(b) provides an exclusion from patentability of plants and animals other than micro-organisms and essentially biological processes for the production of plants or animals, it provides that Members shall provide for the protection of plant varieties through patents or by an effective *sui generis* – 'of its own kind' – system or by any combination thereof. There is no agreement within the WTO on what an 'effective sui generis system' means. Industrialised nations are interpreting it as the model provided by the *Union for the Protection of New Varieties of Plants*[5] (UPOV). The UPOV is

[4] The *Convention on Biological Diversity* was signed at Rio de Janeiro on June 5, 1992 with the objective of conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of the benefits arising out of the utilisation of genetic resources. Currently, 187 countries are party to this Convention.

[5] *Union pour la Protection des Obtentitous Vegetales*. The Convention was adopted in Paris in 1961 and it was revised in 1972, 1978 and 1991. The objective of the Convention is the protection of new varieties of plants by means of an intellectual property right. India is not a member of this Convention, though it has recently evinced interest in participation.

a narrowly defined agreement which provides limited rights to farmers and accepts the concept of patenting of plant varieties. But this view is not shared by most developing countries who are in the process of developing their own *sui generis* legislation, which is WTO-compatible and suits their country's requirements and protects farmers' rights.

IV. Multinational Aspects Of Patents

Patents are granted under national patent laws and have territorial application only. The TRIPs Agreement provides minimum standards of protection for IPR including patents, while WTO members are free to grant a higher level of protection under their national laws. Under Article 27.3(b), India is free to deny patents on life forms, except on micro-organisms and microbiological and non-biological processes, as per the provisions of the TRIPs Agreement. At the same time if, for example, a foreign country chooses to grant patents on plants or other life forms, India does not have a right to object. Nevertheless, such patents will have force only in such country and cannot be enforced in India.

While IPRs such as copyrights, patents, and trademarks are centuries old, the extension of IPRs to living beings and knowledge/technologies related to them is a relatively recent development. In 1930, the *U.S. Plant Patent Act*[6] was passed, which gave IPRs to asexually reproduced plant varieties. Several other countries subsequently extended such or other forms of protection to plant varieties, until in 1961, the UPOV was signed. However most signatories to UPOV were industrialised countries.[7]

Plant varieties or breeders' rights (PVRs/PBRs) give the right-holder limited regulatory powers over the marketing of 'their' varieties. Till recently, most countries allowed farmers and other breeders to be exempted from the provisions of such rights, as long as they did not indulge in branded commercial transactions of the varieties. Now, however, after an amendment in 1991, the UPOV has tightened the monopolistic nature of PVRs/PBRs by facilitating the removal of exemptions to farmers and breeders.

V. Compatibility Between Conventions

There are several interrelated international agreements which have implications on IPR linked to living species and propagation of living species. Mutual compatibility between these Conventions continues to be a subject of intense international debate. The main Conventions at play here are:

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6 35 U.S.C. § 161-164.

7 A list of State Parties to UPOV is available at www.upov.int.

- TRIPs Agreement which (as far as our study is concerned) outlines minimum conditions for patentability of inventions;
- UPOV which is designed to promote inventions in plant breeding;
- CBD which outlines measures for conservation of biodiversity; and
- Farmers' Rights, initiated by the Food and Agricultural Organisation of the United Nations, which seeks recognition for farmers for their continued efforts in developing and maintaining genetic diversity.

Each of the above Conventions deals with a different aspect, although there are some common threads running through them.

As a general rule, only inventions are considered eligible for patents, while discoveries are not. This rule does not hold good in all countries. For instance, in the USA, an isolated and purified form of a natural product is patentable if it is found in nature in a non-purified form. Similarly, in the European Union (EU), a patent can be granted when a substance found in nature can be characterised by its structure or by any other criteria, if it is new in the sense that it was not available to the public in that form. Such provisions have been used to patent gene sequences and other isolates of DNA. Interestingly, there is nothing in the TRIPs Agreement which mandates Member States to follow such an expansive approach towards patenting of substances already existing in nature.

Article 8 of the TRIPs Agreement[8] allows for legal measures to protect public health/nutrition and public interest; though environmental protection is not explicitly built into this, it could be justified as being in 'public interest'. Unfortunately, this clause is required to be consistent with other provisions of the TRIPs Agreement, which leaves wide open the interpretation of its applicability.

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[8] Article 8 of the TRIPs Agreement reads as under: "Principles:

1. Members may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that such measures are consistent with the provisions of this Agreement.
2. Appropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology."

Article 22 of the TRIPs Agreement[9] allows for the protection of 'geographical indications' as defined therein. This could help protect products which are known by the specific locations in which they have originated (as has been done, for instance, with Champagne). It is debatable whether, for instance, Basmati rice could have been protected in this manner (the name does not derive from any location, but the variety is known to come from a particular geographical area). Countries like India are already considering domestic legislation on this.

Both Article 16(5) and Article 22 of the CBD provide countries with some manoeuverability with regard to IPRs. If indeed a country can establish that IPRs run counter to conservation, sustainable use, and/or equitable benefit-sharing, it would be justified in excluding such IPRs. However, the caveat 'subject to national legislation and International Law' may well make this difficult, since the TRIPs Agreement is also 'International Law'. This leads us to the question - Between the TRIPs Agreement and the CBD, which holds legal priority? Legal opinion would perhaps be that TRIPs, being the later treaty, would supersede CBD in case of a conflict. However, given that CBD deals much more with the protection of public interest and morality, which the TRIPs Agreement acknowledges as valid grounds for any measures that countries want to take, it could also be argued that CBD's provisions should supercede those of TRIPs. This question has not yet been tested in any active case in the international arena.

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[9] Article 22 of the TRIPs Agreement reads as under: "Protection of Geographical Indications:

1. Geographical indications are, for the purposes of this Agreement, indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.
2. In respect of geographical indications, Members shall provide the legal means for interested parties to prevent:
   (a) the use of any means in the designation or presentation of a good that indicates or suggests that the good in question originates in a geographical area other than the true place of origin in a manner which misleads the public as to the geographical origin of the good;
   (b) any use which constitutes an act of unfair competition within the meaning of Article 10*bis* of the Paris Convention (1967).
3. A Member shall, *ex officio* if its legislation so permits or at the request of an interested party, refuse or invalidate the registration of a trademark which contains or consists of a geographical indication with respect to goods not originating in the territory indicated, if use of the indication in the trademark for such goods in that Member is of such a nature as to mislead the public as to the true place of origin.
4. The protection under paragraphs 1, 2 and 3 shall be applicable against a geographical indication which, although literally true as to the territory, region or locality in which the goods originate, falsely represents to the public that the goods originate in another territory."

VI. Case Studies

A. The Basmati Case

1. Brief Facts

On September 2, 1997, the United States Patent and Trademarks Office (USPTO) granted Patent No. 5,663,484 on 'basmati rice lines and grains' to the Texas-based company, RiceTec Inc. This patent application No. 272353 was filed on July 8, 1994. This patent gave the company several rights, including exclusive use of the term 'Basmati', a monopoly on breeding farmer-bred Basmati varieties with any other varieties, as well as proprietary rights on the seeds and grains from any crosses. The patent application also covered the process of breeding RiceTec's alleged novel rice lines and the alleged novel means to determine the cooking properties and starch content of the rice grains and its use in identifying desirable rice lines.

2. Implications Of The Grant Of The Patent

With the grant of the patent, RiceTec would be able to label its aromatic rice as 'Basmati', in the 45,000 tonne US market.[10] Basmati rice has been one of the fastest growing export items from India in recent years. India exports more than half a million tonnes of Basmati to the Gulf, Saudi Arabia, Europe and the USA. With the grant of the patent, RiceTec Inc. would be in a position to sell its rice under the brand name 'Basmati' which would significantly cut into India's global market share, especially as the rice grown in the USA could be sold cheaper than the Indian and Pakistani varieties.

3. The Case For RiceTec

RiceTec had stated in its patent application that their 'invention' was based on its surprising discovery that certain Basmati plant and grain characteristics and aspects of the growing environment for traditional Basmati rice lines are not critical to perceived Basmati product quality by consumers. It had said that the 'limited success' in growing Basmati in other parts of the world "*supports the belief in consumer, trade and scientific circles that authentic Basmati rice can only be obtained from the northern regions of India and Pakistan due to the unique and complex combination of environment, soil, climate, sowing practices and the genetics of the Basmati varieties.*" RiceTec also acknowledged that "*good quality Basmati rice traditionally come from northern India and Pakistan...Indeed in some countries the term can be applied to only the Basmati rice grown in India and Pakistan.*" However, the company then went on to claim that it had invented certain 'novel' Basmati lines and grains "*which make*

[10] Amit Sengupta, "Victory on Basmati", available at http://www.delhiscienceforum.org/prop2.html.

possible the production of high quality, higher yielding Basmati rice worldwide".[11]

RiceTec maintained that its only aim was to stop other US food companies from copying its product.[12]

RiceTec also denied that it took germplasm (the genetic material) from India or Pakistan or that it used biotechnology or genetic transformation to produce the patented new basmati lines. It contended that the germplasm "*came partly from the World Collection of Germplasm in Aberdeen, Idaho, which is operated by the Agricultural Research Service of the US Department of Agriculture*". RiceTec added that it used "*traditional, classical*" breeding techniques over a period of ten years. It also said that its production of high quality products and the new breeding methods it had developed would "*help feed a hungry world and reduce land requirements*".[13]

4. The Case For India

The Agricultural and Processed Foods Export Development Agency (APEDA), on behalf of the Indian Government, filed voluminous scientific evidence before the USPTO, insisting that most high quality Basmati varieties already possess the characteristics claimed in the patent application. Of RiceTec's twenty claims before the USPTO, three (Nos. 15 to 17) were considered critical by the Indian side because if these had been upheld, RiceTec would have been granted patents for characteristics that were considered unique to Basmati varieties grown in India and Pakistan.[14]

It was also contended that RiceTec's claims for its invention encroached upon the use and definition of the term 'Basmati', a term traditionally associated with India and Pakistan. Literally translated, 'Basmati' means 'queen of fragrance' or 'fragrant earth'. It is slender, long-grained, aromatic rice that grows best in the region of the Punjab, which spans both India and Pakistan. It was contended that while RiceTec could sell rice virtually identical in aroma and taste worldwide, it could not use the traditional Indian name 'Basmati' because it is employed for a very specific variety of rice grown in a specific geographic area. In other words, the Indian Government claimed similar special status for Basmati Rice as that granted to Champagne, Cognac and Scotch whisky vide Article 23 of the TRIPs Agreement.

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11 *Ibid.*

12 "Basmati battle boils on", May 1, 2001, available at http://news.bbc.co.uk/1/hi/business/1306267.stm.

13 "Trade and Development Case Studies – Country Studies: India – Part 6: Local species — turmeric, neem and basmati", available at http://www.itd.org/issues/india6.htm.

14 *Supra* note 10.

Further, the US National Agricultural Statistics Service, in its Rice Year book 1997, released in January 1998, stated that almost 75 per cent of the rice imports of USA were the Jasmine rice from Thailand and most of the remainder were from India and Pakistan – "*varieties that cannot be grown in the US*" [15]. This was also used by the Indian Government to challenge RiceTec's claim.

It was also contended that RiceTec's actions constituted biopiracy because they violated the provisions of the CBD, giving States sovereignty over their genetic resources. The RiceTec claim ignored the contributions of local communities in the production of Basmati and it did not intend to share the benefits accruing from the use of their genetic resources. In other words, the contributions of farmers who have been growing basmati for hundreds of years in India and Pakistan as well as the more formal scientific breeding work that has been done by rice research institutes to evolve better varieties of Basmati have been ignored.

5. How It All Ended

RiceTec, in September 2000, unilaterally withdrew four of its claims (Nos. 4, 15, 16 and 17) contested by India, Claim No. 4 being largely grain-related. If the four claims had not been withdrawn, RiceTec may have obtained a monopoly in the world market over the marketing of the rice grains possessing the said 'novel' traits in the US. Theoretically, this would have adversely affected the country's exports of basmati rice to the US as well as to other countries as commercial sale of grains with similar attributes would have infringed RiceTec's patent.

Unlike the four withdrawn 'grain specific' claims, the remaining sixteen claims were plant or 'lines-specific'. That is, the claims of RiceTec having developed 'novel rice lines' could produce grains having characteristics 'similar to those of good quality Basmati rice'. Further, these plants possessed the high-yielding, disease resistance and photoperiod-intensive trait as found in modern semi-dwarf rice varieties. These also included the claims that the 'novel' lines could be cultivated in 'North, Central or South America, or Caribbean Islands'.

In May 2001, however, RiceTec withdrew eleven other claims (Nos. 1, 2, 3, 5, 6, 7, 10, 14, 18, 19 and 20). The remaining claims essentially relate to the three 'novel rice lines', namely Bas867, RT1117, and Rt1121, that are capable of producing grains similar or superior to Basmati rice. However, these are considered relatively harmless claims pertaining to RiceTec's specific plant

[15] "TED Case Studies – Basmati", available at http://www.american.edu/projects/mandala/TED/basmati.htm.

variety breeding efforts and not open-ended claims *per se.*

However, it is considered that the most significant victory for India has been that the USPTO Patent Examiner has officially changed the title of the RiceTec's patent from the original 'Basmati lines and grains' to 'Rice lines Bas867, RT1117, and RT1121'.[16] This implies that RiceTec now cannot claim the unique qualities of Basmati nor the unique name 'Basmati'.

B. The Turmeric Case

1. Brief Facts

Turmeric (*Curcuma longa*) is a plant of the ginger family yielding saffron-coloured rhizomes used as a spice for flavouring Indian cooking. Its unique properties also make it an effective ingredient in medicines, cosmetics and as a colour dye. As a medicine, it is traditionally used to heal wounds and rashes.[17]

On March 28, 1995, two US based Indians, K. Das and Harihar P. Chohly, were granted a US patent (No. 5,401,504) on 'Use of Turmeric in Wound Healing', which was assigned to the University of Mississippi Medical Centre. The invention claimed under the patent was the use of turmeric at the site of an injury and/or its oral intake to promote the healing of a wound.[18]

The claim related to the use of turmeric to augment the healing process of chronic and acute wounds. The basic process in regard to angiogenesis as it relates to wound healing deals with the capillaries, which consist of endothelial cells and pericytes. These cells do not divide readily but undergo rapid proliferation during spurts of angiogenesis in wound healing. The inventors claimed to have generated experimental evidence showing that turmeric causes endothelial cells to proliferate, indicating that this molecule can be used to augment wound healing.[19]

It is to be noted that according to the US Patent Statute, the second medical use of a known substance is patentable provided it satisfies the patentability criteria.[20] In India, such inventions are not patentable under Section 3 of *The Patents Act, 1970.*

2. Implications Of The Grant Of The Patent

Turmeric has been traditionally used in India for its wound-healing properties.

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16 Dr. P. K. Vasudeva, "India has actually won Basmati Patent Battle", available at http://members.tripod.com/israindia/isr/sept12/vasu.html.

17 *Supra* note 13.

18 Patent Application No. 174363 dated December 28, 1993, available at http://patft.uspto.gov/netacgi/nph.

19 *Ibid.*

20 35 U.S.C. § 100.

For instance, it is used as a blood purifier, in treating the common cold, and as an anti-parasitic for many skin infections. It is also used as an essential ingredient in cooking many Indian dishes. The media coverage of the patent generated debate and discussion on the issue and the Centre for Scientific and Industrial Research (CSIR), an autonomous institution under the Department of Science and Technology, Government of India, decided to file for re-examination of the patent at the USPTO.

Unlike the Basmati case, the grant of the patent did not have too many economic implications in as much as there were no export markets at stake. Still, the grant of the patent aroused considerable interest as it highlighted the darker side of the patent regime in the US, especially since it had the potential for grant of patent rights on traditional Indian knowledge.

Another disturbing implication of this patent arose from the fact that this was not a product patent: there was no claim that the wound healing agent (that is, the turmeric powder) was any different from the one used traditionally by Indians. Therefore, Indians in the US who used turmeric to treat their or their children's wounds would technically be infringing the patent. If the University of Mississippi were to apply for and be awarded a similar patent in India – unlikely as this may be given the anger this case has aroused in India – the number of patent infringers could soon reach the order of millions of people.[21]

3. The Case For The Inventors

The inventors claimed that the invention provided a method of promoting healing of a wound in a patient, which comprises administering a wound-healing effective amount of turmeric to the patient.

They further postulated that turmeric may have significant antineoplastic, antioxidant, antibacterial and anti-inflammatory properties when given orally or applied topically. In view of these facts and the availability of turmeric, they claimed to have studied the wound healing properties of turmeric to provide a simple and economical solution to the problem of chronic ulcers.[22]

After trials on rats, the inventors concluded that, turmeric offered an alternative to conventional therapy for full-thickness wounds. Considering that turmeric is readily available and economical, this could be of particular importance to the indigent population, which suffers significant morbidity from complex wounds.

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21 Graham Dutfield, "Is novelty still required for patents in the United States? The case of turmeric", available at http://users.ox.ac.uk/~wgtrr/turmeric4.htm.

22 *Supra* note 18.

4. The Case For CSIR[23]

According to the provisions of the US Patent Statute, an interested person can institute re-examination proceedings based on prior art to prove lack of novelty of the invention patented.[24] Depending on the evidence, the patent could be completely cancelled or the scope of protection reduced.[25] In other words, it was necessary to find adequate evidence in the form of printed and published information that would establish that the manner of use of turmeric as in the claimed invention was known before the patent was claimed and, therefore, the patent was invalid. Despite the fact that the use of turmeric was known to every Indian household for ages, finding published information on the use of turmeric powder through oral as well as topical route for wound healing proved to be a difficult task. These publications had to be in the public domain before December 28, 1992 (one year before the date of filing of the application, given the one year grace period available in the USA[26]), disclosing the use of turmeric in the form of powder for healing of wounds.

It was also necessary that the document(s) relied upon should disclose the complete information clearly without any ambiguity. Thirty-two such documents were found and formed the backbone of the re-examination proceedings.[27]

It was found that the USPTO had given careful and detailed consideration to the prior art details given in the patent and arrived at the decision to grant the patent only after giving the benefit of doubt to the applicants. In other words it could be inferred that the USPTO was not fully convinced about the novelty/non-obviousness – the two important and essential criteria for the grant of a patent – of the invention disclosed.

5. How It All Ended

The formal request for re-examination of the patent was filled by CSIR at USPTO on October 28, 1996.

In its first office action in the re-examination proceedings, the USPTO, on March 28, 1997, rejected all the six claims based on the references submitted by CSIR as being 'anticipated references' and therefore considered invalid.

After receiving the first action, the University of Mississippi Medical Centre, to

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23 CSIR initiated the re-examination proceedings on behalf of the Indian Government.

24 35 U.S.C. § 302.

25 35 U.S.C. § 305.

26 35 U.S.C. § 119.

27 N.R. Subbaram, "US patent no. 5401504 based on Turmeric, its Revocation & the lessons to be learnt therefrom", available at http://www.patentmatics.com/pub2002/pub72.htm.

whom the turmeric patent was assigned, decided not to pursue the case and transferred the rights to the inventors, who decided to file a response. The inventors argued that the powder and paste had different physical properties, with respect to bio-availability and absorbability, and therefore, one skilled in the art would not expect with any reasonable degree of certainty that a powdered material would be useful in the same application as a paste of the same material. The inventors further mentioned that oral administration was available only with honey and honey itself was considered to have wound healing properties.[28]

The USPTO observed that the documents which were relevant to the subject and which were also in public domain prior to the date of filing of the application for patent had been brought to their notice. It therefore rejected all the claims and made its action final. It made it clear that the paste and the powder forms were 'equivalent' for healing wounds in view of the cited art.[29]

6. Summing Up

The turmeric case is a landmark case since this was the first time that a patent based on the 'traditional knowledge' of a developing country was challenged successfully and USPTO revoked the patent. It also shows the strength of the United States Patent System so far as transparency is concerned. The case also emphasises the importance of documentation and public availability of scientific information, which can be utilised as evidence. In this case, it was possible for the CSIR to establish that the patent claim was not 'new'. However, it may not be possible to establish this in each of the examples mentioned without the assistance of well documented traditional knowledge databases. The creation of Traditional Knowledge Digital Library, Traditional Knowledge Resource Clarification, and finally the inclusion of Traditional Knowledge in the International Patent Clarification System has now been taken up on a war footing in India after this case.

C. The Neem Case

1. Brief Facts

On December 12, 1990, the multinational agribusiness corporation, W.R. Grace of New York, and the United States Department of Agriculture, Washington DC, filed a European Patent application with the European Patent Office (EPO) on the basis of a US priority application of December 26, 1989, covering a method for controlling fungi on plants with the aid of a hydrophobic extracted neem oil. After a very difficult and highly controversial examination procedure,

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[28] R.A. Mashelkar, "Intellectual property rights and the Third World", *Current Science* 81 (8): 960. available at http://stp.unipune.ernet.in/ipr/articl2.htm.

[29] *Supra* note 25.

the grant of a European patent for this application was published on September 14, 1994, the main claim having been restricted by the EPO to "*a method for controlling fungi on plants comprising contacting the fungi with a neem oil formulation containing 0.1 to 10% of a hydrophobic extracted neem oil which is substantially free of azadirachtin, 0.005 to 5.0% of emulsifying surfactant, and 0 to 99% water.*"[30]

In June 1995, a legal opposition against the grant of this patent was filed by Magda Aelvoet, a Member of the European Parliament, on behalf of the Green Group in the European Parliament, Brussels, Dr. Vandana Shiva, on behalf of the Research Foundation for Science, Technology, and Natural Resource Policy, New Delhi, and the International Federation of Organic Agriculture Movements, based in Germany (the Coalition).[31]

2. Implications Of The Grant Of The Patent

Although the opposition was made primarily on legal grounds, the underlying concerns of the Coalition were the following:

- biological resources are common heritage and should not be patented;
- the patent will restrict the availability of living material to local people, whose ancestors have spent centuries developing the material;
- the patent may block economic growth in developing countries.

However, it was clear that the patent will not have any consequences for Indian farmers in terms of royalty payments since Grace did not hold a patent in India.

3. The Case For W. R. Grace

W. R. Grace did not have a patent on the tree itself, but rather on the process of making the emulsion. It should be noted that none of the neem patents involved a genetically engineered product; neither had the tree itself been patented, nor any of its parts. W.R. Grace believed that this process was a discovery because it entails manipulation yielding greater and better results.

In April 1993, a Congressional Research Service (CRS) report to the US Congress set out some of the arguments used to justify patenting: "*Azadirachtin itself is a natural product found in the seeds of the neem tree and it is the significant active component. There is no patent on it, perhaps because everyone recognises it as a product of nature. But ... a synthetic form of a naturally occurring compound may be patentable, because the synthetic form is not technically a product of nature, and the*

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[30] "Background Paper to the Neem Challenge", available at http://www.platformgentechnologie.nl/patents/euro_pat_office/parents/neem_final_backgrounder_nl.shtml.

[31] *Ibid.*

process by which the compound is synthesised may be patentable."[32]

W. R. Grace's justification for patents, therefore, was based on the claim that these modernised extraction processes constituted a genuine innovation.

4. The Case For The Coalition

Evidence was presented to the EPO to the effect that the fungicidal effect of hydrophobic extracts of neem seeds was known and used for centuries on a broad scale in India, both in Ayurvedic medicine to cure dermatological diseases and in traditional Indian agricultural practice to protect crops from being destroyed by fungal infections. Since this traditional Indian knowledge was in public use for centuries, it would seem that the patent application in question lacked two basic statutory requirements for the grant of a European patent, namely novelty and inventive step[33] (non-obviousness in the USA).

In addition, the Coalition argued that the fungicidal method claimed in the patent was based on one single plant variety (*Azadirachta indica*) and hence resulted in at least partially monopolising this single plant variety.

Further, the Coalition claimed that the process patented was not new and novel from a domestic point of view. In their request, they presented many scientific publications to prove that the knowledge of the use of protic solvents in stabilising organic material was publicly accessible. They also presented letters from US based scientists stating that "*no new novel chemistry was discovered*" and that the process patented makes "*only trivial changes to known products and processes*".[34]

5. How It All Ended

In the first preliminary statement of September 30, 1997, the Opposition Board of EPO held that in summary, it appeared that the present patent could not be maintained in view of the evidence supplied by the Coalition for lack of novelty and inventive step. In a second preliminary statement of June 15, 1999, the Opposition Board of EPO held that according to evidence supplied by the Opponents it appeared that all features of the present claim (of the patent) have been disclosed to the public prior to the patent application during field trials in the two Indian districts Pune and Sangli of Maharashtra, Western India, in summer 1985 and 1986.[35] Furthermore, the Opposition Board held that on the

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[32] Vandana Shiva, "The Neem Tree- a Case Study in Biopiracy", available at http://www.physics.uc.edu/~manash/neem.html.

[33] *Supra* note 30.

[34] Joris Kocken and Gerda van Roozendaa, "The Neem Tree Debate- I", *Biotechnology and Development Monitor* No. 30, March 1997, available at http://www.biotech-monitor.nl/3004.htm.

[35] *Supra* note 30.

basis of other evidence supplied by the Opponents, it appeared to be mere routine work for a skilled person to add an emulsifier in an appropriate amount and that therefore the present subject-matter was considered not to involve an inventive step. The patent was accordingly revoked.[36]

VII. A Common Trend Or Isolated Instances?

The three cases studied above involve patenting of plants/plant products that have traditionally been used in India for medicinal or agricultural purposes. The outcry that followed the grant of the patents in the above cases was primarily based on three underlying concerns:

- that farmers will no longer be able to use these products without paying royalties;
- that consumers will be deprived of cheap medicines; and
- that local communities should receive a share of the commercial gains.

Additionally, it was realised that patents and other forms of IPRs were increasingly being used by companies to expand their market share, to prevent competitors from becoming active in particular countries, or as a bargaining tool to negotiate favourable local agreements.

At the same time, it became apparent that the situation was not as hopeless as it seemed. Though the prophets of doom had a field day, all three cases highlight the fact that patent legislations of majority of the countries in the world provide certain built-in provisions such as oppositions, re-examination, revocation under public interest, etc. to guard against erroneous grant of patents. These proceedings can be fruitfully utilised for either getting the patent completely cancelled or to restrict the scope of protection secured. The final result would depend upon the strength of the evidence produced before the patent authorities. Further, the rights in the patents can be enforced only in the country which grants it and nowhere else. In other words, the grant of a patent is not the end.

A look at the success in getting the US patent on turmeric completely cancelled suggests that if patent cases are fought based on well argued and aptly supported technical and legal grounds, there is nothing to fear about the grant of patents for inventions based on traditional knowledge. The success also confirms the fact that India has the required expertise and capabilities to contest the complex technical and legal disputes relating to IPR successfully.

At the same time, this cannot lead to complacency. Notwithstanding the varied

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36 Chakravarthy Raghavan, "Neem Patent revoked by European Patent Office", available at http://www.twnside.org.sg/title/revoked.htm.

degree of success achieved in these three cases, these cases serve to illustrate the inadequacy and inequities of existing intellectual property systems in protecting the rights of farmers and indigenous peoples over their knowledge and biodiversity. The current systems do not protect the interests of community innovators, and ultimately threaten conservation and improvement of biodiversity worldwide.

Also, it is not as if Basmati, Turmeric and Neem are isolated instances of greed transcending national borders. They are merely prominent cases among a host of others such as:

- Composition of *jamun*, bitter-gourd, *gur-mar* and eggplant for treatment in diabetes.
- Various products obtained from the neem tree.
- Composition of *methi* as a tonic to bring down blood glucose levels.
- Compositions comprising of *kala jeera* or *kalonji* for increasing immune functions, and in the treatment of diabetes, hepatitis, and asthma.[37]

This takes us to the next issue – the reasons for such obvious biopiracy. The primary reason from the legal perspective is the difference in the patent regime. Patent regimes in the Third World are radically different from those in the West. Patents on transgenic plants, animals and microorganisms are being construed as inventions and patentable in the US. In the EU, patents are being granted for the process, and therefore, only given if the process can be used in general in other organisms. In the Third World, cultural and social factors have led to such substances not being patentable. This is true in India, where plant varieties and other life forms are not patentable. Until recently, the regime even frowned upon patents in pharmaceutical products, and it was only pressure from the WTO that has led to the amendment to *The Patents Act, 1970* permitting patents on such products.

There has traditionally been no legal protection for plant varieties in India. Seeds were exchanged among farmers on the basis of the principle that the means of enhancement of food security should not fall into the domain of commercial interests. This free sharing of knowledge has in no way hampered the development of new plant varieties or agricultural research. Indeed, the

[37] R. V. Anuradha, "Biopiracy and Traditional Knowledge", *Earthscapes*, May 20, 2001, available at http://www.hinduonnet.com/folio/fo0105/01050380.htm.

development of hybrid varieties in the course of the Green Revolution bears testimonial to this fact. They were developed entirely on the basis of free access to and free sharing of knowledge pertaining to biological resources.

In Europe and in North America, the principle of free access to information has been progressively restricted following pressure from the private sector for the establishment of a system of private property rights. This is to some extent connected to the decline of agriculture as a subsistence activity and the overall commercialisation of the primary sector. In India, socio-economic conditions differ dramatically from those obtaining in the countries that are part of the Organisation for Economic Cooperation and Development (OECD). The primary sector still constitutes more than a quarter of the gross domestic product (GDP) and employs about two-thirds of the working population.[38] Further, agriculture is still mainly a subsistence activity. The current Patents Law in India reflects both the traditional practices of free exchange and the socio-economic conditions of the country. It provides, for instance, that methods of agriculture or horticulture cannot be patented.[39] Further, in the case of substances intended for use as food, it restricts patentability to the process and provides for a shorter duration of the rights.[40]

Yet, studies indicate that by altering their patent regimes to bring it along the lines of those followed in the West, developing countries may stand to gain financially. Biological products and processes account for 45 per cent of the world economy. All twenty of the staple agricultural crops (that provide 90 per cent of humanity's calorie requirements) originate in developing countries, as do nearly two-thirds of the world's plant species. And the commercial value of organically derived drugs in the 1990s alone is estimated at US $500 billion. But developing countries have shared little in these profits, and may need to be more assertive in staking their claims.[41]

Another reason for the unauthorised use of traditional knowledge is the non-recognition of the technology innovation that takes place in an informal system of innovation, be it by artisans, farmers, indigenous peoples or other grassroots innovators. In fact, many societies in the Third World have nurtured and refined systems of knowledge of their own, relating to such diverse areas such as geology, ecology, botany, agriculture, physiology and health. These systems

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38 Table 6, 32, *Statistical Outline of India 2002-03*, at 14 (Tata Services Ltd. 29th ed. 2002).

39 Section 3(h) of The Patents Act, 1970.

40 Philippe Culled, "For an alternative patents regime", *Frontline*, Volume 16 - Issue 21, October 09 - 22, 1999.

41 Payal Sampas, "The Worldwatch Report: Judgment protects indigenous knowledge", The Worldwatch Institute (Distributed by The Los Angeles Times Syndicate).

have, therefore, generated a rich store of traditional knowledge which is easily susceptible to biopiracy unless urgent action is taken to protect these knowledge systems through national policies and international understanding linked to IPR, while providing for its development and proper use for the benefit of its holders. Steps have already been taken in this direction through the creation of a Traditional Knowledge Digital Library (TKDL) on traditional medicinal plants and systems, which will also lead to a Traditional Knowledge Resource Classification (TKRC). This will eliminate the problem of the grant of wrong patents since the Indian rights to that knowledge will be known to patent examiners worldwide.

A comprehensive initiative was spearheaded by the Department of Indian Systems of Medicine and Homeopathy (ISMH). It set up an inter-disciplinary task force, known as TKDL task Force, by drawing experts from Central Council of Research of Ayurveda and Siddha, Banaras Hindu University, National Informatics Centre, Council of Scientific and Industrial Research and Controller General of Patents and Trade Marks. The Task Force evolved a scientific classification approach known as TKRC, which would enable retrieval of information on traditional knowledge in a scientific and rational manner. The structure of TKRC would be similar to that commonly used for classifying modern innovations, which enable an easy linkage with the International Patent Classification (IPC).[42] The CBD grants States sovereign rights over their biological resources.[43] However, this provision has never been exploited to its full potential as such rights are to be exercised primarily through the medium of domestic legislation. Such legislation is lacking in India and most of the Third World countries.

The TRIPs Agreement gives Member-States the liberty to adopt plant variety protection regimes which are not based on patents.[44] Given the current socio-economic conditions in India, this possibility could have been fully utilised to strengthen the position of all innovators in the field of agricultural management.

VIII. Lessons Learnt And Problem Areas

The lessons learnt and problem areas can be summarised thus:

- There is a wide gap in the availability of information in countries like the USA for patent examination purposes pertaining to traditional knowledge base from biodiversity-rich countries. Further, their insistence on written published information, as opposed to oral knowledge, could make challenges to such patents difficult. This was

42 *Supra* note 28.

43 Article 3, CBD.

44 Article 27(3)(b), TRIPs Agreement.

evident in the turmeric case, where obtaining published information relating to the use of turmeric as a wound-healing agent proved to be a difficult task despite it being common knowledge. As regards developed countries, the need for greater scrutiny of patent applications pertaining to biological resources, and the need to consult the source of the biological resource and knowledge pertaining to the same prior to the grant of the patent is, therefore, imperative. As regards the developing world, steps towards documenting peoples' knowledge in Biodiversity Registers and other modes could help to establish 'prior use' of a particular resource/product derived from it.

- Although remedies are available in the laws of developed countries for challenging the grant of such patents, the financial, technical and legal costs for initiating such proceedings are exorbitantly high. As pointed out by India in one of its papers to the WTO[45], it would be more cost-effective to establish an internationally accepted solution to prevent biopiracy than to divert national resources to expensive judicial processes for the revocation of patents.

- Currently, there is no requirement under patent laws of most countries requiring the holder of the patent to share the benefits with those who had collected, preserved or initially identified the biological material as potentially worthy of investigation. Even the TRIPs Agreement that seeks to harmonise the Intellectual Property laws of various countries does not mandate benefit sharing of this kind either.

- The report of the United Nations Committee on Traditional Knowledge noted that while indigenous and local communities could contribute many useful technologies for the conservation and sustainable use of biodiversity, the field is rich for scientific and technological collaboration for the management of biodiversity. However, where indigenous and local community knowledge or technologies were involved, their IPR must be protected. Because current regimes require further strengthening, consideration must be given to a range of additional options, such as alternative legal means, the adaptation of existing systems and the development of *sui generis* systems based on such concepts as traditional resource rights, WIPO's Model Provisions, the Principles and Guidelines for the Protection of the Heritage of Indigenous People, or the rights regimes proposed by a number of international agencies as well as non-governmental organisations. For *sui generis* systems to be

[45] "Protection of Biodiversity and Traditional Knowledge – The Indian Experience: India's submission to the Committee on Trade and Environment Council for Trade-Related Aspects of Intellectual Property Rights", available at http://www.twnside.org.sg/title/cteindia.htm.

successful, they should also take account of indigenous and local community customary law systems.[46]

- Another idea worth pursuing is a regime of 'defensive' rights. Such a regime would not allow the right holder to monopolise knowledge or its use, but would guarantee him/her the ability to stop others from appropriating or misusing their knowledge or resources. In other words, no one would be able to monopolise any resource or knowledge over which such a right has been granted. A country could pass legislation stating that its resources were accessible to all, provided they signed a legally binding agreement that they would not in any way apply restrictive IPRs on these resources, or allow such applications by third parties. In addition, appropriate benefit-sharing arrangements could also be worked out in Material or Information Transfer Agreements. Of course, for a country to unilaterally introduce such a system on its own would not make much sense; such a scheme would have to have the sanction of the international regime.

India has enacted two laws to follow up TRIPs and CBD: *The Plant Varieties and Farmers' Rights Act, 2001* (PVFRA) and *The Biological Diversity Act* (BDA) (passed in December 2002) respectively. The PVFRA is India's *sui generis* plant variety protection regime (as per Article 27(3)b of TRIPs Agreement). A few points in this regard may be noted:

- The BDA provides for the protection of local community rights in a broad sense, while the PVFRA contains only a narrow definition of farmers' rights (the right to reuse, exchange, and sell (except as branded product) protected plant varieties; it does not provide for the protection of farmers' own varieties (which are unlikely to pass the stringent tests of novelty, distinctiveness, etc.) but rather focuses on organised sector plant breeders.

- The BDA provides for benefit-sharing measures with local communities; the PVRFA has no such provision.

- The BDA attempts to include local community representatives at various levels of decision-making, the PVRFA almost completely excludes them, giving decision-making powers largely to bureaucrats.

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46 "Traditional Knowledge And Biological Diversity- Report of the United Nations Committee", Advance Unedited Copy UNEP/CBD/TKBD/1/2, dated October 18, 1997, available at http://www.biodiv.org/doc/meetings/tk/wstkbd-01/official/wstkbd-01-02-en.pdf.

IX. Conclusion

A study of the international legal framework and its effects, as manifested in these three cases, indicates that Intellectual Property laws have become tools of corporate expansion: they assert a new marketing tactic of technological superiority and legal exclusivity rather than protecting the rights of the creator of the invention. However, India will have to work within the framework of the regime to protect its interests, and at the same time, try and shore up support for meaningful changes at the international level. The first step in this direction has been taken with the setting up of the TKDL and the passing of the BDA.

The TRIPs Agreement is undoubtedly a big step in the direction of harmonisation of patent law worldwide, yet it is apparent that the inherent inequality of the international economic system has been ignored.

Another problem in this area is the absurd attitude prevalent in countries like India that natural resources should not be the subject matter of patents. Such a view in the era of multilateral agreements can offer no protection to Indian farmers. It is best if such mindset is changed and efforts are taken to protect and preserve India's biodiversity within the framework of International Laws and agreements like the TRIPs Agreement.

SECURITISATION: BANKRUPTCY REMOTENESS AND OTHER ISSUES†

*Gauri N. Walawalkar**

I. Introduction To The Concept Of Securitisation

Almost every new concept emerging in modern society necessitates a new body of law. Till the law crystallises into well defined principles, society has to progress by a method of trial and error. The passing of an Act is just the first manifestation of the process of crystallisation. Though every Act tries to contemplate and provide for all probable controversies, it is hardly possible for a human brain to cover them all. The flesh and blood gets infused in an Act only after years of judicial interpretation. The position is not very different with the law relating to securitisation in India. The present paper deals with issues regarding securitisation with special reference to the concept of bankruptcy remoteness, taking into consideration the main trends in various other countries. Though the law in such countries on bankruptcy remoteness is in its infancy, if we were to look closely at the issues involved, we may be able to save at least some of the initial victims of unsettled legal principles.

Securitisation is a comparatively new concept in the financial markets in India. The concept emerged in the United States in the early 1970s, as a means to convert the loans granted to various borrowers into present cash flows. The concept came to be used in India in the early 1990s. Till recently, there was no integrated set of rules for regulating the bodies involved in securitisation, their transactions and other related issues, when the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance was promulgated by the President in 2002 which was subsequently, passed by Parliament (the Act).

When a lender advances loans to various borrowers, he advances it generally against a mortgage or hypothecation of assets. The charges are enforced only in the case of default by the borrower after the loan becomes payable. If the loan is paid according to the terms and conditions of the contract, the assets are

† This article reflects the position of law as on February 20, 2003.

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released. The outstanding loan amount along with interest thereon is called receivables. Traditionally, if the lender who has advanced credit facilities, is in need of immediate liquid cash, it would have raised loans for its own use, without disturbing the receivables. Securitisation is thus a method of raising funds by way of selling the receivables for present cash.

In any securitisation transaction, the assets underlying the loans (the Security Interest) granted by the lender to various borrowers are transferred along with the receivables to another entity, the Special Purpose Vehicle (SPV). The consideration paid will be at a discounted value of future cash flows (i.e. receivables). The SPV is created mainly to formally take the assets off the accounts of the transferor (Originator) and for issuing securities in the market, so that in the event of the bankruptcy of the Originator, the assets so transferred, do not get affected and will not be payable to the creditors of the Originator as a part of his property. But the receivables in most cases are still paid to the Originator and the debtors (Obligors) (Obligor means a person liable to the Originator, whether under a contract or otherwise, to pay a financial asset or to discharge any obligation in respect of a financial asset, whether existing, future, conditional and includes the borrower) are generally not informed of their direct liability to the transferee. In these cases, the Originator acts as an agent of the SPV and is called as an Administrator, Servicer or a Receiving and Paying Agent. The SPV sells the securities in the market, and the buyers (investors) have undivided interest in the assets underlying the securities.

The benefits of securitisation cannot be understated. Securitisation allows a financial intermediary to sell its right to receive the future payments from the borrowers to a third party and receive consideration for the same upfront, the proceeds of which may be further redeployed in business or used to liquidate existing obligations. This cycle could be repeated several times leading to efficient usage of capital.[1] Securitisation being normally though not necessarily, an off balance sheet funding alternative, it generates cash for the Originator without any addition to borrowings (without increasing the debt to equity ratio). Companies that have capital adequacy pressures can undertake securitisation to raise funds.[2] The future receivables like airline ticket receivables, export receivables, which involve future performance by the Originator can, also be sold. The credit rating of the PTCs can be and is invariably, much higher than that of the Originator, the extent depending upon the risks involved. The SPV is thus in a position to issue PTCs at a lower cost than the Originator is borrowing. The PTCs also have the flexibility to suit the needs of the various investors in the market. The securities can be designed with different combinations of liquidity, returns and risks. Thus, the securitised instrument

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1 CRISIL, "Special Report: CRISIL", *Business Standard*, July 1, 2002.

2 *Ibid.*

may be totally different from the original loans issued by the Originator.

II. The Concept Of Bankruptcy Remoteness

A very vital question that arises in securitisation transactions is whether the transfer of assets amounts to a 'true sale' or whether it is merely a collateralised loan. The main difference between a securitisation transaction and a collateralised loan is that, in a securitisation transaction, the receivables are transferred to the SPV along with the substantial risks involved and the SPV relies on the assets in case of the default by the borrowers, rather than on the Originator. But the collateralised loan means that the borrower raises the loan against some assets and is directly and fully liable for the payment of the debt. It is pertinent to note that, if a court finds that substantially the risks in event of default of the Obligor, have been retained by the transferor, and thus, the true nature of the transaction is merely a financing structure, it may proceed to consolidate the assets of the Originator and that of the SPV in the event of the bankruptcy of the Originator. The court can, in that case declare the receivables to be still payable to the transferor. This would defeat the entire exercise of securitisation, and the security holders of the SPV will suffer the loss.

Care is therefore usually taken to ensure that even in the case of bankruptcy of the Originator, the receivables transferred by the Originator will not be held to be still receivable by the transferor and be a part of his property. The bankruptcy of the Originator should not affect the status of the SPV, as also the bankruptcy of the SPV should not affect the rights of the security holders. Thus, bankruptcy remoteness means firstly, that the rights and interests of the SPV and the security holders in the transferred receivables and assets remain intact, even in the event of bankruptcy of the Originator, without them being taken to be a part of the property of the Originator, and secondly, that even if the SPV goes bankrupt, the rights and interests of the security holders remain intact. For this reason, the assets should be taken to be irrevocably transferred, though there are some exceptions (like 'clean up option').

Thus, bankruptcy remoteness is a key concern in securitisation transactions to ensure that the transfer of assets of the Originator to the investors' representative or SPV is not affected by bankruptcy or distress of the Originator. This necessitates certain legal precautions in structuring the assignment of receivables, as also so constituting the SPV that it can neither be taken to liquidation by the shareholders of the Originator, nor by those of the SPV itself. Further, the structure should also ensure that the SPV would not be treated as the subset of the Originator by substantive consolidation.[3]

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[3] Vinod Kothari, *Securitisation,* at 30-31, (Academy of Financial Services, Y2K ed. November, 1999).

A clean up, buy back or call option is an option with the Originator where the Originator can buy back the outstanding securitised instruments when the original principal has been substantially amortised, leaving a small uneconomical amount to be serviced. Normally, clean up call is exercised when the outstanding principal falls below 10 per cent of the original.[4] Martin Rosenblatt, a leading expert on securitisation accounting, comments: "Issuers who have abandoned 'gain on sale' accounting by increasing the optional call from a 10 per cent cleanup call to a 20 per cent call will have to go back to the drawing board."[5] As provided for in the ABS Guidelines, Originators may retain a first right of refusal option, which serves as a 'clean-up-option' of the remaining assets, once the securitisation transaction becomes uneconomical to carry on upon maturity of the securitisation transaction. In addition, the Originator may also be obliged to repurchase the assets from the SPV if the Originator breaches any conditions, representations and warranties in respect of the securitisation transaction.[6] Clean-up calls must represent a relatively small percentage of the overall securities backed by the asset pool[7] otherwise; it may be taken to be recourse.

Most securitisation agreements provide for normal warranties of the originator – these pertain to the enforceability, legal validity, creditworthiness etc. of the receivables at the inception of the agreement. Such a covenant would not disqualify the securitisation from a sale treatment. However, if the Originator, assumes any liability for any subsequent deterioration in the quality of the receivables, a de-recognition or a sale treatment would not be appropriate.[8]

It is interesting to note that securitisation being a recent concept, though the generally applied criteria for deciding the bankruptcy remoteness of the SPV from the Originator can be listed; the extent of weightage to be given to each of them is not well settled. Courts in certain jurisdictions consider these criteria in deciding bankruptcy remoteness of the SPV, but the importance given to each of these may change depending upon the facts of the case and the surrounding circumstances.

The Criteria used in deciding the bankruptcy remoteness of an SPV:

A. Fair Market Price

The price at which the SPV buys the receivables from the Originator should

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4 Available at http://www.vinodkothari.com/glossary/cleanup.htm.

5 "FASB issues implementation guide to FAS 140", available at http://www.vinodkothari.com/secnews8.htm#fasb%20implementation%20guide.

6 Available at http://www.sc.com.my/html/resources/guidelines/FAQs.

7 Available at http://www.securitization.net/knowledge/legal/basel_0212.asp.

8 *Supra* note 3 at 398.

be a fair market price (FMP). In the bankruptcy proceedings, the court may consolidate the assets of the Originator and those of the SPV on the ground that the price paid was not a fair market price.

B. Recourse

Recourse refers to the risk of loss which the Originator retains in the transaction. It may consist of guarantees against market losses, warranties as to the collectibility, obligations to repurchase the underperforming receivables[9] or in any other form. Higher the level of recourse, higher is the possibility that the court will characterise the deal as a collateralised loan. This is because, one of the main reasons underlying securitisation is alienating the risk from the Originator. Though, recourse to the Originator to some extent is allowed, in many jurisdictions, the limits to which it is allowed have not been defined yet.

C. Separation

An SPV is created to ensure a legally valid assignment of the receivables to an entity, which is separate from the Originator, so as to show, that, as the receivables are transferred to a distinct juristic person, they no more form part of the Originator's property. The court will consider whether the affairs of the Originator and the SPV are "*excessively entangled*"[10].

Standard and Poor's legal criteria of separateness stipulates various factors that the entity should agree to abide by. These include:

- To maintain books and records separate from any other person or entity;
- To maintain its accounts separate from those of any other person or entity;
- Not to commingle assets with those of any other entity;
- To conduct its own business in its own name;
- To maintain separate financial statements;
- To pay its own liabilities out of its own funds;
- To observe all corporate, partnership, or LLC formalities and other formalities required by the organic documents;
- Not to guarantee or become obliged for the debts of any other entity or hold out its credit as being available to satisfy the obligations of others;
- Not to pledge its assets for the benefit of any other entity or make any loans or advances to any entity;

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9 Jeffery E. Bjork, "Seeking Predictability In Bankruptcy: An Alternative to Judicial Recharacterization in Structured Financing", available at http://www.law.emory.edu/BDJ/volumes/fall97/bjork.html.

10 *Ibid.*

- To hold itself out as a separate entity; [11]

D. Intention Of The Parties - Form Versus Substance

The actual structure of the transaction and all the terms and conditions of the contract, would be considered by a court ignoring the terminology given by the parties to the transaction, in the documents evidencing the contract (*Major's Furniture Mart* v. *Castle Credit Corp.*)[12]. In cases, the court may give more importance to the intention of the parties as expressed in the document than the actual terms and conditions (*Cohen* v. *Army Moral Support Fund*)[13]. The main concern of the courts is to see the intention of the parties, but the importance given by different courts to the two methods of ascertaining intent may differ.

E. True Sale

A securitisation transaction needs to be deemed as a 'true sale' for the SPV to be bankruptcy remote. In a 'true sale', the Originator transfers both the legal and the beneficial interest in the assets to the SPV. There are some questions related to whether sale of future receivables is legal, valid and binding and cannot be disrupted by a liquidator of the Originator on its bankruptcy. In many jurisdictions securitisation of future receivables will show up on the balance sheet of the Originator and, on its bankruptcy may not be enforceable. However, many jurisdictions, such as Mexico, Brazil and Turkey recognise a 'true sale' of future receivables.[14]

For a sale to be considered a 'true sale', the assets should be actually removed from the balance sheet of the Originator. This should be done as soon as all the significant risks and benefits in the securitised assets get transferred to the SPV and when the Originator surrenders control over the assets. An issue arises as to which criteria should be adopted to decide whether significant risks and benefits have been transferred.[15]

III. Other Issues Related To Securitisation

Having considered the criteria of bankruptcy remoteness of the receivables from the bankruptcy of the Originator, let us examine certain other related issues:

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[11] Vinod Kothari, *Securitisation, Asset Reconstruction & Enforcement of Security Interests*, at 376-377, (Academy of Financial Services, 2003 ed. January, 2003).

[12] 602 F. 2d 538 (3d Cir. 1979).

[13] 67 B.R. 557 (Bankr. D.N.J. 1986).

[14] Report of the In-house Working Group on Asset Securitisation, Press Release: 1999/2000/841, available at http://www.rbi.org.in/.

[15] *Ibid.*

A. *Features Of An SPV For It Being Bankruptcy Remote*

- An SPV should undertake the activity of asset securitisation only, and none other. This is to ensure that the SPV's internal risk of insolvency is reduced, as there will be no claims created by other activities. It should not even assume other debts for the same reason.
- An SPV should have directors independent of the Originator for better governance of the SPV and the protection of the rights of the security holders.
- An SPV must have a status, 'separate' from that of the Originator. Care needs to be taken for protecting the separate status of the SPV from the Originator. If it is found by the court that there is excessive entanglement between the two entities, it may pierce the corporate veil and consolidate the assets of the two entities in case of the bankruptcy proceedings.
- While the rated securities are outstanding, the bankruptcy remoteness of the SPV should not be undermined by any merger or consolidation with a non-SPV or any reorganisation, dissolution, liquidation, or asset sale.[16] Any change in the structure of the SPV should not increase the liability of the SPV and should ensure that it does not thereby make it more susceptible to bankruptcy proceedings.

B. *Computation Of The Fair Market Price*

As mentioned above, one of the important criteria on the basis of which the assets of the SPV are consolidated with that of the Originator is the actual price paid for the receivables being lower than the fair market price. Hence, the computation of the price is of great importance. Some of the ways in which the FMP is sought to be arrived at, are discussed below:

1. Aicher And Fellerhoff

Aicher and Fellerhoff suggest that if the effective price paid, accounting for all the recourse provided in the transaction, reasonably approximates what a willing buyer would pay a willing seller, it should be taken to be the FMP. They do not state what level of recourse is to be permitted for the transaction to satisfy the status of a true sale. They suggest that if the FMP takes into consideration the level of recourse available to the buyer, the courts should not characterise the transaction as a loan. They further take the view that, any interest being retained by the seller in the event of surplus collection (that is, any collection exceeding the expected returns) also should not be considered inconsistent with the idea of a 'true sale'.[17]

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16 *Ibid.*

17 *Supra* note 4.

2. Jeffrey E. Bjork

Mr. Bjork gives another way of computing the FMP. Taking the view that, as the courts have not yet defined the limits to which the recourse is allowed, it is better not to have any recourse at all. He gives a formula for computing the FMP.

3. Book Building

Book building is yet another way of estimating the FMP. In this method, bids are invited from prospective buyers and the price is decided taking into consideration the prospective investors' expected yield, which is further used as a basis to appropriately discount the price.

C. Abuse Of Asset Securitisation

Enron is an example of the potential abuse of asset securitisation. Enron created over 3000 'off balance sheet' SPVs. Enron's motivation in creating these SPVs was to minimise the losses stated on its financial statements, artificially inflate the value of assets, accelerate profiles, and avoid adding debt to its balance sheet. Specifically, Enron used SPVs and derivatives to manipulate its financial assets in three ways. First, it concealed the losses that it suffered. Second, it concealed huge debts incurred in financing unprofitable new business ventures. Third, it inflated the value of its assets.[18]

D. Waiver Of The Right To File Bankruptcy Petition

The most direct way of protecting investors of an SPV from the risk of voluntary bankruptcy would be to require the SPV to completely waive the right to file a voluntary bankruptcy petition. The Bankruptcy Code does not expressly prohibit a waiver of the right to file proceedings for bankruptcy protection. However, legislative history indicates that while some courts have held pre-petition waivers to be enforceable, others have held them to be unenforceable.[19]

E. Accounting Standards For The Purpose Of Securitisation

The major guides to accounting principles for securitisation are the following:

- The US Financial Accounting Statement Board (FASB) 140
- International Accounting Standard (IAS) 32/39
- (UK) FRS 5[20]

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[18] Kenneth N. Klee & Brendt C. Butter, "Asset Backed Securitisation, Special Purpose Vehicles and other Securitisation Issues", UCC Law Journal Vol. 35, No. 2, available at http://eres.lawlib.ucla.edu/tempfiles/tmp5321/publishedarticle.pdf.

[19] *Ibid.*

[20] *Supra* note 3 at 386.

The FAS 140 requirements mainly deal with:

- The conditions to be met for the SPV being demonstrably distinct from the Originator;
- Limits on the permitted activities of the SPV;
- Limits on the assets and instruments that the SPV can hold; and
- The conditions under which the SPV can sell or otherwise dispose of non-cash financial assets.[21]

F. Waivers And Contractual Prohibition Of Claims

The SPV's Constitutional documents may also require the SPV to obtain agreements from its creditors:

- Not to file an involuntary petition against the SPV (The no-petition agreement) and,
- That their claims shall not constitute claims for the purposes of bankruptcy laws for so long as the debt securities are outstanding (The no-claim agreement). These provisions are not effective in dealing with involuntary creditors like tort claimants.[22]

G. Bankruptcy Remoteness And Bankruptcy Proof

In one case, LTV Steel Company Inc., challenged its pre-bankruptcy securitisation facilities, arguing that the transfers to the SPVs were not true sales and therefore, LTV should be able to use the collections of receivables as 'cash collateral' by giving adequate protection under bankruptcy law. LTV's rationale was that, without such use, it might have to cease its operations, thereby jeopardising employee jobs and retiree benefits and adversely affecting the local economy. The bankruptcy court permitted LTV to use these collections pending resolution of the true sale issue. To some extent this shook the confidence of the financial markets in securitisation.[23] At first glance, it seems that the proceedings did nothing more than provide a wake-up call to the market to the fact that certain securitisation structures may be bankruptcy remote, but as Alex Dill puts it, "*not necessarily bankruptcy proof*".[24]

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21 *Supra* note 7 at 366.

22 *Supra* note 14.

23 Steven L. Schwarcz, "The Impact of Bankruptcy Reform on "True Sale" Determination in Securitization Transaction", available at http://www.vinodkothari.com securitization_safe_harbour.doc.

24 'Testing the waters of US ABS', Corporate Finance July 2001.

H. Securitisation Of Future Receivables In India And Bankruptcy Remoteness

In India, the position as to how secure the sale of future receivables will be treated was not clear before the passing of the Act. The unclear conditions as to whether future receivables will be treated as future property under the *Transfer of Property Act, 1882*, had put the bankruptcy remoteness of securitisation of future receivables at stake. The Report of the In-house Working Group (of RBI) had observed, "The implication of the provision in the Transfer of Property Act is that, in case of bankruptcy of the Originator, the contract can be treated by the Liquidator as being an executory contract, which can be therefore terminated by him. The monies that are paid as consideration by the investors for the purchase of the receivables, while recoverable, would be as unsecured creditors of the Originator. This is a significant impediment in perfecting security interest in future receivables."[25] The relevant portion of the Act may be produced as follows:

The definition of "financial asset" includes: "*any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent.*"

Whereas, Section 5(1) of the Act states: "*Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution.....*"

Section 5(2) of the Act states: "*If the Bank or financial institution is a lender in relation to any financial assets acquired under sub-section 5(1) by the securitisation company or the reconstruction company, such securitisation company or reconstruction company shall on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.*"

Thus, it may be said that the Act distinguishes the term 'future interest' from the term 'future property'. Under Section 5 of the *Transfer of Property Act*, the conveyance of future property, or property not existing today is a contract to be performed in future, that is, an executory contract, which is specifically enforceable as soon as the property comes into existence. (*Jugalkishore* v. *Raw Cotton Company*)[26].

But the Act, by having distinguished 'future interest' from 'future property' has afforded a stronger basis to the securitisation of future receivables in India. The words, 'Notwithstanding anything contained in any agreement or any other

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25 *Supra* note 9.

26 AIR 1955 SC 376.

law for the time being in force' at the beginning of the Section 5(1) read along with the words, "*shall vest*" in 5(2) and the holistic reading of the section sufficiently clarifies this intent of Parliament and it seems, that by the words, "*shall vest*", the bankruptcy of the Originator will not reduce the status of the security holders to that of unsecured creditors. Besides, Section 35 of the Act provides that the provisions of the Act shall have an overriding effect over any other law, in case of any inconsistency and thus reiterates that future receivables can be securitised in India.

I. SPV Under The Companies Act, 1956 And Bankruptcy Remoteness

Under Section 434 of the *Companies Act, 1956* (the Companies Act), a company shall be deemed to have been unable to pay its debts if the creditor to whom the company is indebted has served a notice for payment of the sum and the company does not pay the sum within three weeks from receipt of such notice or secure the debt or compound the same to the satisfaction of the creditor, and shall be liable for winding up proceedings under Section 433 of the Companies Act. Thus, if an SPV is formed as a Company under the Companies Act, it will leave itself open to a winding petition for non-payment of even a nominal sum as per Sections 433 and 434 of the Companies Act, if it issues a debt instrument or raises any kind of a debt. To ensure that the company is bankruptcy proof, the instrument issued by it should not impose an unconditional liability on it to repay the debt irrespective of the realisations from the underlying assets i.e., it should be without recourse to the issuer.[27] This means that the nature of the securities issued by the company should be such that the liability of the company is limited by the realisation from the underlying assets. The company will then not be open to winding up proceedings by security holders, if it pays them in proportion to their share in the underlying assets, after the assets are realised.

Of course, really, the monies held in trust by the company are outside the scope of winding up. They do not form part of the company's assets in the hands of the liquidator and they are payable in priority to the claims of the creditors. Property or monies which can be identified as belonging to or held in trust for other persons may be followed and recovered from the liquidator and a trust can be express or implied.[28]

IV. Looking Forward

The Act does not expressly state whether securitisation can be done outside the scope of the Act. But the following provisions of the Act show that the Act does

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[27] *Supra* note 9.

[28] V. S. Datey, "Law Relating to Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest", *Taxmann Allied Services Pvt. Ltd.*, Para 6.6, December, 2002.

not deal with all the securitisation transactions. The heading to Chapter II reads as follows 'Regulation Of Securitisation And Reconstruction Of Financial Assests Of Banks And Financial Institutions' and Section 3(1) states, 'No securitisation or reconstruction *company* shall commence and carry on business of securitisation or reconstruction without....' and lays down the conditions. The definition of securitisation also contemplates an SPV in the form of securitisation or reconstruction *company* and thereby shows that, the Act deals with securitisation involving banks or financial institutions as Originators and an SPV in the company form. Thus, where the Originator is not a bank or a financial institution, the transaction will not fall within the ambit of the Act. Most of the Originators would like to avoid the minimum capitalisation clause, as incorporating a shell company with meager capital will be more profitable to the Originator. Thus, where a manufacturing company is an Originator, or where the SPV is in the form of a trust or an entity (not being a company), the securitisation transaction may be done without complying with the provisions of the Act. In such cases, the universally accepted rules about securitisation could be the guiding principles.

The question that comes up for consideration is what will happen in case the court comes across a price, which is much lower than the FMP or a very high level of recourse? Will it be able to consolidate the assets of the two entities in spite of the words, "*shall vest*"? Or will the court take it to fall in its discretionary power? What are the principles guiding the securitisation transactions, which do not fall within the ambit of the Act? Only the coming years of securitisation will be able to answer these questions.

THE ILLEGAL PROLIFERATION OF SMALL ARMS – A GLOBAL DILEMMA†

*Shibani A. Rao**

I. INTRODUCTION

"...Indeed, there is probably no single tool of conflict so widespread, so easily available and so difficult to restrict as small arms..."[1]

- Kofi Annan, Secretary General of the United Nations

Small arms have caused big tragedies. The proliferation of small arms, ammunition and explosives has also aggravated the violence associated with terrorism and organised crime. As the Secretary General of the United Nations (UN) has rightly perceived that even in societies not beset by civil war, the easy availability of small arms has in many cases contributed to violence and political instability, which, in turn, has damaged development prospects and imperilled human security in every way. The unchecked spread of these weapons has exacerbated inter and intra-state conflicts, contributed to human rights violations, undermined political and economic development, destabilised communities, and devastated the lives of millions of people.[2]

It is surprising to note that although considerable efforts are continually being made worldwide towards the control of conventional weapons of war and mass destruction such as nuclear bombs, tanks and missiles, it is in reality, small-arms and light weaponry that savagely violate human rights the world over, by causing immeasurable losses of innocent civilian lives, especially those of women and children. Amidst all of the debate about controlling the proliferation and misuse of small arms, there is a glaring, fundamental omission – the human face.[3] Research and policy tends to focus on supply-related issues such as

† This article reflects the position of law as on February 19, 2003.

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1 Statement made at the ministerial meeting of the Security Council on the question of small arms on September 24, 1999; The United Nations Press Kit, Fact Sheet 16, available at http://disarmament.un.org/cab/smallarms/presskit/sheet16.htm

2 The Small Arms Survey 2002, The Graduate Institute of International Studies, Geneva, Switzerland, available at http://www.smallarmssurvey.org/

3 *Ibid.* "*Caught in the Crossfire: The Humanitarian Impacts of Small Arms*", Chapter 4 of the Small Arms Survey 2002, at 155.

production and the mismanagement of stockpiles, inter-state transfers and the illicit trade, technical aspects of weapons tracing, marking, collection and destruction, and on legal or normative regimes designed to stop the flow of weapons.[4] But missing from all of this is the human dimension – consideration of how people are affected daily by the presence of these weapons – particularly in regions of armed conflict.[5]

This article is a humble attempt to unravel various issues underlying this global dilemma, examining from diverse perspectives, the nature and consequences of its existence, principally focussing on legal dimensions. The latter part includes a brief discussion on initiatives being undertaken by organisations and nations individually as well as on an international scale, with a few suggestions incorporated on reform measures that can be undertaken to successfully tackle and reduce its austere impact.

II. Small Arms – An Insight

In the hands of irregular troops operating with scant respect for international and humanitarian law, small arms and light weapons have taken a heavy toll on human lives, with women and children accounting for a high proportion of the casualties.[6] They have driven people from their homes, undermined development, led to increases in crime and social violence and thwarted the prospect for investments.[7] The scale of human suffering caused by small arms is immense, in so far as not only does it result in hundreds of thousands of deaths and more than a million injuries each year, but also permanent physical and psychological damage, destruction of families, lost productivity, and diversion of resources from basic health services. The illicit manufacture, transfer and circulation of small arms and light weapons and their excessive accumulation and uncontrolled spread in many regions of the world, which have a wide range of humanitarian and socio-economic consequences and pose a serious threat to peace, reconciliation, safety, security, stability and sustainable development at the individual, local, national, regional and international levels are grave global issues of concern that need to be addressed and tackled effectively.[8]

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4 *Ibid.*

5 *Supra* note 3.

6 United Nations Press Release SG/SM/7078 AFR/160, available at www.un.org/News/Press/docs/1999/19990726.SGSM7078.html.

7 *Ibid.*

8 Report of the United Nations Conference on the Illicit Trade in Small Arms and Light Weapons in All Its Aspects New York, 9-20 July 2001.

At present, there is no universally accepted definition of small arms and light weapons, but there exist a wide variety of definitions, which are basically directed at the 'person-portability' factor. Small arms and light weapons have unique characteristics[9] that make them a significant threat to civilians and therefore a particular concern for organisations that assist in development or humanitarian relief:

- These weapons do not require extensive logistical capabilities and thus allow highly mobile operations. An individual can carry small arms for personal use while light weapons can be handled and transported by two or more people serving as a crew, by a pack animal or a light vehicle.
- Their relatively low cost in comparison to other conventional arms make them affordable to many actors beyond the State. They are easy to transport and to conceal and this makes them easy to smuggle into areas of conflict.
- Due to the high firepower of light weapons like mortars, rocket and grenade launchers or mounted anti-aircraft guns, single individuals or small-armed groups can cause heavy casualties among the civilian population when using such weapons indiscriminately.
- Since many small arms require little, if any, maintenance, they can essentially last forever. They are also easy to operate and even young children can use them with minimal training.

According to the definitions[10] drafted by the UN Panel of Experts on Small Arms and approved by the United Nations General Assembly in 1997, the following weapons are included in the categories of small arms and light weapons:

1. Small Arms

Revolvers and self-loading pistols, Rifles and carbines, Sub-machine guns, Assault rifles and Light machine guns.

2. Light Weapons

Heavy machine-guns, Hand-held under-barrel and mounted grenade launchers, Portable anti-aircraft guns, Portable anti-tank guns and recoilless rifles, Portable launchers of anti-tank missile and rocket systems, Portable launchers of anti-aircraft missile systems and Mortars of calibres of less than a 100 mm.

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[9] "*Definition of Small Arms and Light Weapons*", The Bonn International Center for Conversion (BICC). Available at official website: http://www.bicc.de/.

[10] *Ibid.*

3. Ammunition And Explosives

Cartridges (rounds) for small arms, Shells and missiles for light weapons, Anti-personnel and anti-tank grenades, Landmines, Mobile containers with missiles or shells for single action anti-aircraft and anti-tank systems and Explosives.

Limitless and unrestricted small arms and conventional weapons, have lead to the death of more people and the squandering of more money than nuclear, chemical, and biological weapons combined, and continue to have a much greater impact upon human population and world politics.[11] The rudimentary reason for rise in circulation of small arms may be differentiated into political, economic, criminal or anti-social and survival-related causes. Factors such as incomplete disarmament of warring parties on termination of war; distribution of arms between communities with a view to encourage political unrest (usually supported by a neighbouring region); intentional illegal trafficking (analogous to the narcotics trade); the absence of adequate security measures provided by the State (which gives impetus to the want and acquisition of small arms for individual security); and finally, the purchase of small-arms as a source of power, wealth and security between minority groups have played a pivotal role in providing a major boost to the illegal arms trade. As a direct result, this has lead to a sudden spurt in the levels of growth of the illicit arms trafficking trade in recent times.

Why and how does this industry thrive? The answer lies in the fact that nobody would ever know the exact number of small-arms in existence in the world at any point of time since firstly, 'small' arms being small in size are easy to conceal and transport, without being detected; secondly, they have greater levels of endurance (most of the small-arms currently in circulation have been used since World War II[12]); finally, small arms sell at alarmingly cheap prices, such as the Russian-style AK-47, which, in certain parts of the world, can even be traded for a goat or a bag of clothes or even a chicken![13]

Shown below is a chart compiled by the Small Arms Survey 2002[14] that provides an exemplary evidence of black market rates at which an AK-47 (one of the more popular of its cohort) can be purchased in various countries worldwide.

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[11] The University of California at Berkeley Mini Conference, Fall 1999, available at http://www.ocf.berkeley.edu/~ucbmun/materials/disecFall99.doc.

[12] Eric David Newsom, "Small Arms Use and Proliferation: Strategies for a Global Dilemma", from the USIA electronic journal "*U.S. Foreign Policy Agenda*" (1340), available at http://www.iansa.org/documents/gov/sept_99/newsom.htm.

[13] Armed Conflict and War in Africa, available at http://www.rebirth.co.za/armed_conflict_and_war_in_africa.htm.

[14] *Supra* note 4, Table 2.1, Press Kit – Chapter 2, at 2.

Price (in U.S.$)	Location	Year
10	Afghanistan	2001
12	Angola-Namibia border	1998
15	Mozambique	1999
25	Honduras	1997
40	Phnom Penh, Cambodia	2001
86	Uganda-Sudan border	2001
100	Nicaragua	2001
100	Warri, Nigeria	2001
120	Somalia	2000
250	Sakhkot, Pakistan	2001
400	Siberia, Russia	1998
800	Colombia	2001
1,200	Bangladesh	2000
2,400	Kashmir, India	2000
3,000	Colombia	2000
3,000	West Bank, Palestinian territories	1999
3,800	Bihar, India	2001

III. The Global Scenario

Various countries the world over, have been facing the brunt of illicitly acquired small arms since time immemorial. However, the September 11 attacks on New York and Washington, D.C., were successful in highlighting the gravity and seriousness of the issue of small arms and their illegal proliferation on a global level. The US Government could no longer hew to a strict unilateralist line and was suddenly faced with the need to build a broad international coalition to respond to the attacks.[15] However, in the middle of November 2001, it remained unclear as to whether this would bring a renewed US commitment to multilateral treaties, and moreover, one victim of the new US preoccupation with its self-proclaimed fight against terrorism was the effort to curb the proliferation of small arms and small weapons.[16] The need to restrain illegal trafficking in small arms has always remained an issue of pressing concern for those that have suffered directly from the impact of the spread of small arms, especially those living in zones of armed conflict in Africa, and certain parts of

[15] Human Rights Watch – Arms (Small arms and Light weapons), available at http://www.hrw.org/arms/.

[16] *Ibid.*

Asia. Figures released by the UN assert the existence of 500 million illicit small arms and light weapons in circulation around the world, in other words one for every twelve people.[17] The dark shadow of this industry has been gradually spreading like *virii* even to regions that it is least expected to be found in.

A. Africa

Since the post-1980s era of conflict in this continent, Africa has been the hardest hit by the illegal arms trafficking trade. While more than five million small-arms and light weapons are known to be circulating in the East African region, approximately two million deaths have been reported to have occurred in West Africa alone over the last decade, according to statistics provided by the UN.[18] In 1999, the Red Cross estimated that in the Somali capital of Mogadishu alone, the city's 1.3 million residents possessed over a million guns. In fact, small arms are filling African graves in ever-increasing numbers – from the killing fields of Burundi and the Democratic Republic of Congo to the streets of Lagos and Johannesburg; and while the international community anxiously anticipates for agreement on the regulation of the global trade in small arms, a growing number of African countries, UN agencies and non-governmental organisations are grappling with the human and developmental consequences of gun violence and seeking to reduce both the supply and the demand for what Secretary General Kofi Annan has called "*the weapons of choice for the killers of our time*"[19].

The proliferation of small arms in Africa has demonstrated another alarming outcome – the generation of child soldiers[20]. Although mere access to automatic rifles does not create child soldiers,[21] the use of small arms does change the role

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[17] *Supra* note 8.

[18] Robert Muggah and Eric Berman, "Humanitarianism Under Threat: The Humanitarian Impacts of Small Arms and Light Weapons", A Study Commissioned by the Reference Group on Small Arms of the UN Inter-Agency Standing Committee, available at http://www.undp.org/erd/smallarms/docs/hum_impact.pdf.

[19] *Supra* note 6.

[20] A child soldier is any child or youth under the age of 15 (an age dictated by the UN Geneva Conventions as of November 2001) or under the age of eighteen with optional protocol involved in any military action of a group or country.
These are children taken from their homes and families being forced to kill, be killed, over-work themselves, and be the sex slaves of the older soldiers in the front lines. War affects every part of a country, not least of all its children. We cannot even begin to imagine the brutalities children are forced to face in other countries. If a child in this situation is lucky, he will die; thousands of others are not so lucky and live this horror everyday. Ignorance is not a solution as it only makes the situation worse. Learning about how countries ignore the use of child soldiers, the ways children are forced to serve, the experiences of former child soldiers, their reintegration into society does help.

[21] As perceived by the UNICEF's small arms project officer (Africa), Ms. Lieke van de Wiel.

played by children.[22] Small arms being small and easy to handle, any child undergoes a transformation into a professional and effective killer in no time, enabled due to powerful modern firearms, as opposed to earlier conflicts, where children would, at the most, be entrusted with carrying supplies or placed in forward positions to draw enemy fire away from other soldiers.

The outlook for human rights in Africa at the close of 2002, however, was more hopeful than it had been for several years, according to the World Report 2003[23], published by the Human Rights Watch, which also states that African leaders made significant commitments to transparent and accountable governance and respect for human rights with the creation of the African Union (AU), and its adoption of the New Partnership for Africa's Development (NEPAD), a comprehensive economic and political reform program.

Reducing the availability and use of small arms in places where fighting has ceased, has become increasingly important to Africa's development as the number of conflicts has increased over the past decade, the widespread abuse of weapons diverting scarce Government resources from health and education to public security, discouraging investment and economic growth, and depriving developing countries of the skills and talents of the victims of small arms.[24]

B. Asia

Post September 11 2001, American politicians and commentators repeatedly declared that "*everything had changed*". This contention came as a matter of surprise to the people of Asia. While incidents of violence against civilians on such a large scale (specifically ones that resulted from the usage of illegally obtained small arms) was a relatively new phenomenon in the United States, in most parts of Asia, common people have lived and coped through the years with the devastating, destabilising and debilitating effects of state and non-state terrorism (read: the disastrous effects of the usage of small arms). Asians have had to come to terms with the harsh realities of the immediate consequences of such small arms related violence – death and injury to family and friends – time and again, while being subjected to the sort of closing of political space that often follows: arbitrary targeting of political opposition supporters to instil fear, martial law, states of emergency, and the suspension of civil liberties.[25] After the carnage caused, for instance, by the forced labour policies of the Khmer Rouge in the 1970s, the shelling of populated areas by resistance forces in Afghanistan in the

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[22] Michael Fleshman, "Counting the cost of gun violence", Africa Recovery, Vol. 15#4, December 2001, at 1.

[23] Available at http://www.hrw.org/wr2k3/.

[24] *Supra* note 8.

[25] *Supra* note 23.

early 1990s, or the military sweeps in Aceh in the late 1990s, victims received no compensation, and camps in places like Bangladesh and Sri Lanka remained full of refugees and internally displaced persons, for whom seemingly random violence meant an end to a stable and predictable life and its essentials, such as access to education, clean water, and health care.[26] Nevertheless, Asia and its people did not fail to show their deep sympathy for the victims or outrage at the devastation caused by the September 11 attacks and although condemnation was widespread, many understood the use of small arms and light weaponry as part of a continuum, albeit more catastrophic, that included the kinds of atrocities so often experienced in a Kashmir, a Karachi or a Colombo.

The massive proliferation of small arms and light weapons in South Asia is directly linked to the Soviet invasion of Afghanistan in 1979, and the subsequent creation by the US of a system, commonly known as the Afghan pipeline, to funnel weapons covertly to the Afghan resistance, which enabled the transfer of tens of thousands of tons of weaponry to the *mujahidin*[27]. Statistics provided by the UN show Afghanistan to be the current 'world-leader' for unaccounted weapons, with an alarming ten million and a growing number of small arms in circulation at this very moment. Enormous quantities of siphoned-off pipeline weapons have been found in the arms bazaars in Pakistan's Northwest Frontier Province – available to any purchaser with sufficient capital.[28] Large numbers of pipeline weapons have made their way into the hands of Sikh and Kashmiri militants and evidence suggests that the militants obtain the weapons in several ways, directly from members of Pakistan's intelligence and military establishment, particularly the ISI[29], from the arms bazaars in Pakistan's Northwest Frontier Province and from former Afghan fighters.[30] There is compelling evidence that elements of the Pakistani government have sponsored a significant flow of arms to Kashmiri militants, as well as an extensive training

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26 *Ibid.*

27 The Harakat-ul-Mujahidin (HUM), a terrorist organisation based in Pakistan that operates primarily in Kashmir; Urdu for 'The Holy Warriors' or 'The Soldiers of God'.

28 Human Rights Watch Campaigns – Kashmir, available at http://www.hrw.org.

29 The Directorate for Inter-services Intelligence; founded in 1948 by a British army officer, Major General R. Cawthome, then Deputy Chief of Staff in Pakistan Army. Field Marshal Ayub Khan, the President of Pakistan in the 1950s, expanded the role of ISI in safeguarding Pakistan's interests, monitoring opposition politicians, and sustaining military rule in Pakistan.

The ISI is tasked with collection of foreign and domestic intelligence; co-ordination of intelligence functions of the three military services; surveillance over its cadre, foreigners, the media, politically active segments of Pakistani society, diplomats of other countries accredited to Pakistan and Pakistani diplomats serving outside the country; the interception and monitoring of communications; and the conduct of covert offensive operations. For information see http://www.fas.org/irp/world/pakistan/isi/.

30 *Supra* note 28.

program and also substantial evidence that Sikh militants in Indian Punjab have had ready access to Pakistan's arms stockpiles.[31]

A report compiled by the Human Rights Watch on Kashmir bears evidence to the fact that in recent years, militants in both Kashmir and Punjab have committed numerous, serious violations of humanitarian law, including direct attacks on unarmed civilians, indiscriminate attacks, summary executions, hostage-taking, rape, threats to commit bodily harm, and the use of religious sites for military purposes. The extreme gravity of the abuses committed by militant groups in Punjab and Kashmir is in part a direct consequence of the diffusion of advanced light weapons and small arms and the evident failure of those assisting the militants to pressure them to respect human rights and abide by the rules of war.[32] Pakistani support for the militants – direct support in the form of arms shipments and training, and indirect support in the form of a green light to purchase arms originally destined for Afghanistan – has greatly facilitated abuses.[33] It cannot escape mention that various incidents of havoc also caused by illegal small arms and light weaponry have been experienced by the people in Sri Lanka and occasionally South India as a result of the activities of the Liberation Tigers of Tamil Eelam (LTTE), a terrorist organisation that operates from Sri Lanka.

In Asia, sweeping national security and anti-terrorism laws, often inherited as part of the colonial legacy, have traditionally been used to suppress pro-democracy movements and human rights activists.

1. Of Small Arms And Human Rights Violations – The Legal Scenario In India

Among all the countries in Asia, India has borne a considerably critical brunt of small arms related deaths since its post-independence era. There have been continual accounts of human rights abuse as a direct outcome of the usage of small arms, notwithstanding extensive constitutional and statutory safeguards that are prevalent here, widespread terrorism being the most significant of them all, principally involving the misuse of illegally obtained small arms and light weapons, these ordinarily being smuggled across the border and distributed amongst anti-social terrorist and militant organisations operating in various areas ranging from Kashmir in the north right upto Tamil Nadu in the south.

It has commonly been seen in most cases that small arms related deaths are generated by intense communal tensions (for example, the 1993 riots and more

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31 *Ibid.*

32 *Supra* note 28.

33 *Ibid.*

recently, the Godhra carnage in Gujarat to name a few) as well as violent secessionist movements with the authorities' attempts to repress them. The concerted campaign of execution-style killings of civilians by Kashmiri militant groups that grew in dimension during the 90s continued and included several killings of political leaders and party workers: Apart from these, hundreds of people are killed in election and politics-related violence throughout the country from time to time – these again being instances of small arms related crime.

As far as the law and policy in India relating to the rights of an individual are concerned, Article 21 of the *Constitution of India* confers Right to Life and Personal Liberty and remedy can be sought against acts violative of Article 21 by moving the High Court[34] at the state level or the Supreme Court of India[35] at a national level. There also exists comprehensive codification as far as the safeguard of human rights in particular is concerned as evidenced by the *Protection of Human Rights Act, 1993.* This Act has made adequate provision for the institution of Human Rights Commissions at the state as well as on a national level, but how far this act has proved beneficial in the implementation or alternatively, successful in protection of human rights in practicality in India, is a question debatable in nature.

On the subject of arms and their trade, the *Arms Act, 1959* provides for comprehensive legal norms regarding the acquisition, possession, manufacture, sale, import, export and transport of arms and ammunition. It specifically states that no person shall acquire, have in his possession, or carry any firearm or ammunition unless he holds a license for it.[36] In fact, the Act entirely covers the subject of firearms and their procurement and distribution in all details, accounts for punishments and fines in case of non-compliance. But yet again it is the issue of non-enforcement that questions the very existence of these extremely well formulated laws in India. Moreover terrorist organisations being intrinsically rebellious in nature set out implementing nefarious activities based on the belief that no common law is applicable to them.

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[34] Under Article 226 of the Constitution of India, the High Court of a State has power in relation to its territorial jurisdiction to issue directions, orders and writs including writs in the nature of Habeas Corpus, Mandamus, Prohibition, Quo Warranto and Certiorari for enforcement of the fundamental rights conferred by Part III of the Constitution of India or for any other purpose.

[35] Article 32 of the Constitution of India states that the right to move the Supreme Court by appropriate proceedings for the enforcement of the fundamental rights, is guaranteed. The Supreme Court has power to issue directions or orders or writs including writs in the nature of Habeas Corpus, Mandamus, Prohibition, Quo Warranto and Certiorari, whichever may be appropriate for the enforcement of any of the Fundamental Rights. The right guaranteed by Article 32 cannot be suspended except as otherwise provided for by the Constitution of India.

[36] Section 3 of the Arms Act, 1959.

Calls by USA for a "*global campaign against terrorism*" following the September 11 attacks provided a context for several initiatives by the Indian Government to tighten security legislation in the country. The *Terrorist and Disruptive Activities (Prevention) Act, 1987* (TADA) having lapsed[37] at the time, successive attempts by different State governments and the recommendation of the Law Commission to freshly enact versions of the TADA at the Centre were shelved due to public outcry. The "*Prevention of Terrorism Ordinance*" (POTO) was promulgated in October 2001 and further enacted as the *Prevention of Terrorism Act, 2002* (POTA) in March 2002. Human rights organizations were concerned that some of its provisions were not consistent with the rights to freedom of expression and association set out in international human rights standards.[38] The *Foreign Contribution (Management and Control) Bill 2001* was drafted in November 2001, which was intended to replace the *Foreign Contributions (Regulation) Act, 1976* and to curb the flow of foreign funds to both 'terrorist' groups and non-governmental organizations. Again, this Bill was highly debated upon and opposed, it being considered as draconian in nature as the POTA.

The newly appointed Chairman of the National Human Rights Commission, retired Chief Justice of the Supreme Court of India Mr. Justice A. S. Anand, after assuming charge in New Delhi on February 17, 2003 contended that the POTA in fact, did have provisions for safeguard against its misuse, but the existing provisions were inadequate.[39] He further stated that no civilized country could allow 'terrorism to flourish', but the existence of differentiation between a criminal and a terrorist would be essential, since the fact that all terrorists are criminals would not necessarily mean that all criminals are terrorists.[40]

Looking at the main provisions of POTA, one is struck by the mechanisms the law establishes to interfere with political opposition.[41] Terrorism as defined under the Act, includes acts committed with any lethal weapon.[42] Offences under the POTA include the invitation of support for a terrorist organization[43], addressing a gathering of terrorist sympathizers and assisting in arranging a meeting where support is expressed for a terrorist organization or its activities[44]. It also consists of provisions for seizure of property belonging to terrorist organizations and

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37 The Act lapsed in 1995.

38 The Amnesty International Report, 2002, available at http://web.amnesty.org/web/ar2002.nsf/asa/india.

39 Press Trust of India, "POTA has provisions to safeguard against its misuse: Anand", *The Hindustan Times*, New Delhi, February 17, 2003.

40 *Ibid.*

41 Alok, "POTA–The Latest Black Law", available at http://www.geocities.com/aipsg/charcha/May2002/alok_pota.htm.

42 Section 3(1)(a).

43 Section 21(1).

44 Section 21(2).

their sympathisers.[45] Additionally, confessions made to a police officer under certain conditions have been made admissible under the POTA.[46]

Certain 'safeguards' formulated under the provisions of the POTA include:

- Investigation of an accused can be done only by a Deputy Superintendent of Police or higher,[47]
- Confessions made to the police must be recorded within 48 hours before a magistrate, who will send the accused for a medical examination if there is complaint of torture,[48]
- Police officers can be prosecuted for abusing their authority and compensation can be paid to the victims.[49]

On a concluding note, India has no dearth of intelligent and well-formulated laws to curb the proliferation and misuse of small arms. But it is the enforcement aspect that needs to be worked upon to a great extent. Hence it is not the law that requires amendment, but there is undoubtedly a dire need for the stepping up of enforcement agencies to work in compliance with norms and obey judicial decisions, working hand-in-hand with the Government, the judiciary and more importantly the people, to ensure impeccable safeguard of human dignity.

2. China

The People's Republic of China (PRC) is also a major source of small arms production and proliferation in Southeast Asia. Chinese arms manufacturers are known to be involved in illegal production, having produced small arms in quantities beyond the mandated criteria as determined by China's central government, the surplus arms being sold for profit.[50] It is a proven observation that laws are not successful in solving the problem per se, as China has in the past, enacted strong laws to curb this illegal activity, which to some extent was successful in limiting small scale production of small arms and light weapons. These laws, however, do little to make an impact on well-connected large state manufacturers. Prevalent corruption added to this exceedingly complex situation, worsens the scope for control.

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45 Section 7 and Section 8.
46 Section 32.
47 Section 51.
48 *Supra* note 46.
49 Section 58.
50 *Ibid.*

C. *Russia And The Russian Far East*[51]

The end of the Cold War has had a direct effect on the phenomenon of small arms proliferation in Asia and elsewhere. The arms build-up in the Soviet Union was both in nuclear and conventional weapons, and with the end of communism, the rationale for the heavy armaments declined precipitously. Moreover, the demoralisation and impoverishment of Russian society and the Red Army has weakened government control over weaponry, which has become a commodity of trade in many cases. The so-called Russian Mafia, which had existed throughout the Soviet period, was lured by the illicit arms trade to facilitate the export of weapons. Many of the small arms that have been intercepted and confiscated point to Russia as another major source of supply, some of which were left over from past conflicts in Indo-China (Cambodia and Vietnam).[52] However, there are signs that new Russian small arms are also currently in circulation.[53]

IV. Fighting The Menace – A Continuing Battle

The illegal proliferation of small arms is a complex and increasingly international issue. The problems caused by small arms are primarily regional, sub-regional and internal (i.e. within a State) in nature. As a result, while constructive steps may be taken on a global level, a primary focus for practical solutions would appear to be in regional, sub-regional and internal action, which is why it is important to develop a body of relevant case studies of the impact of small arms proliferation in particular regions as a basis for policy action.

Necessary, first and foremost, is an identification of the areas that further need to be worked upon, to get to the root of the problem. Human and humanitarian dimensions bear crucial importance in this case and equally so, the implications that poverty and underdevelopment may have for the illicit proliferation or trade in small arms and light weaponry. Higher aims of nations must be directed toward the eradication of this disease so as to reduce, if not wipe out completely, the magnitude of human suffering all over the globe. Nations must endeavour to enhance respect for life and the dignity of the human person through the promotion of a culture of peace and tranquillity, by averting consequences of its lethal sting on children, women as well as the elderly, mainly by stressing upon the urgency of international efforts and cooperation aimed at combating

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[51] Robert E. Bedeski, Andrew Andersen and Santo Darmosumarto, "Small Arms Trade and Proliferation in East Asia: Southeast Asia and the Russian Far East", Working Paper no. 24, Institute of International Relations, University of British Columbia.

[52] *Ibid.*

[53] *Supra* note 51.

this trade simultaneously from both a supply and demand perspective, thereby reaffirming the respect of the entire global community for and commitment to International Law.

Tracking down small arms individually is a totally impossible as well as impractical approach. Also, no immediate solution can be arrived at for a problem that has emerged over an extensive period of time. Hence, a pragmatic approach would be adopting a steady pace and working on various levels. A comprehensive set of guidelines are put forth hereinbelow that could be adopted by nations individually to ensure the beginning of an end of the illegal trade, transfer and proliferation of small arms and light weapons.

A. On A National Level – Laws, Regulations, Policies And Procedures

In case of absence of laws or enactments related to the illegal trade in small arms and its consequences, the State must strive to formulate adequate laws, regulations and administrative procedures to exercise effective control over the production of small arms and light weapons within their areas of jurisdiction and over the export, import, transit or retransfer of such weapons, in order to prevent illegal manufacture of and illicit trafficking in small arms and light weapons, or their diversion to unauthorised recipients.[54] Next, the States must adopt relevant measures to establish offences under prevalent law (or in cases where no specific law is applicable, institute laws that do so) the illegal manufacture, possession, stockpiling and trade of small arms and light weapons within their areas of jurisdiction, as criminal offences, in order to ensure that those engaged in such activities can be prosecuted under appropriate national penal codes.[55] To ensure successful enforcement and implementation of the aforementioned laws, agencies and infrastructure must be established that would be responsible for research and surveillance, policy making or alternatively, providing guidance for policy making, ultimately for the benefit of the war against the illicit arms trade in all efforts to uproot it completely.

In a country like India, it would be especially beneficial if a constant communication medium were created between individual states and the Centre so as to ensure that the entire nation is working in consonance. Additionally, each firearm manufacturer in the country should be mandated to formulate some kind of a marking system for each legitimately produced firearm. If imported from another country, a track must be kept on each and every piece of small arms that make their way into the country. Ideally, the country of manufacture and such information that would enable the appropriate authorities to identify the manufacturer apart from a serial number that could assist the

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[54] *Supra* note 8.

[55] *Ibid.*

said authorities to track down and identify the weapons. Again, the role played by law would be crucial in this case, as related laws would lay down guidelines for the same and also take the necessary measures to prevent the manufacture, stockpiling, transfer and possession of any unmarked or inadequately marked small arms and light weapons. A well organised, updated and maintained system of records is essential as that would enable the authorities to access such records at any given point of time, as and when required. Additionally, stringently regulated imports and exports are an absolute must.

Brokering of small arms and light weapons is another area for which appropriate legislation needs to be developed that would include registration of brokers, licensing or authorisation of brokering transactions as well as appropriate penalties for all illicit brokering activities performed within the State's jurisdiction and control.[56] Another crucial dimension is the question of violation. Norms must be set forth to award penalty and/or punishment to those who indulge in any activity that violates the law of the land and accordingly, strict measures of enforcement and appointment of relevant authority to control the same would be necessitated.

Next in the order of importance is the destruction of weapons collected or seized by the authorities and marked as illegal. The executive body of the state must ensure that all the accumulated confiscated weapons are totally destroyed according to procedures established by the law. Simultaneously, the national governments must from time to time organise surveys and censuses to record figures related to small arms, which would ensure an expeditious check on the trade, influx and efflux.

Most important of all is the need to develop and implement, including in conflict and post-conflict situations, public awareness and confidence-building programmes on the problems and consequences of the illicit trade in small arms and light weapons in all its aspects, including, where appropriate, the public destruction of surplus weapons and the voluntary surrender of small arms and light weapons, if possible, in cooperation with civil society and non-governmental organisations, with a view to eradicating the illicit trade in small arms and light weapons.[57] A propagation of this dilemma and its consequences at a grass-root level using political and social organisations as media is an initiative every nation must individually adopt. The establishment of a large network of people throughout the country will not only enable tracing of small arms over a period of time, but also bring about considerable degrees of interaction among the masses. On a political level, leaders must strive to achieve intra-national as well as international harmony, by avoidance of internal and

[56] *Supra* note 8.
[57] *Ibid.*

external conflict and politically instigated unrest. Stepping up the judicial system to act in accordance would be an added benefit.

Another feasible proposition would be the development and implementation, where possible, of effective disarmament, demobilisation and reintegration programmes, including the effective collection, control, storage and destruction of small arms and light weapons, particularly in post-conflict situations, unless another form of disposition or use has been duly authorised and such weapons have been marked and the alternate form of disposition or use has been recorded, and to include, where applicable, specific provisions for these programmes in peace agreements.[58]

Since armed conflicts have, time and again, had a direct impact on children, the needs of affected children (which could well include child soldiers), especially issues such as their reunification with their families, reintegration into civil society, and their appropriate rehabilitation would be in the best interest of child victims as well as their families.

B. Regional And Sub-Regional Levels – A Three Pronged Strategy

The three-step-action plan elaborated below, if incorporated in the regular working of regions within a nation, would prove to be extremely beneficial in ousting the illegal arms trade and its effects at a grass-root level.

1. Awareness

Especially applicable to a country like India, it is crucially important that awareness be created among the masses, for example, by instituting awareness programmes in every village, town and district, advising the populace against indulging in the illegal procurement, use or trade of small arms and light weapons, furnishing to them information regarding the dire consequences and violations that their use presents to humanity.

2. Network

Creation of a network of civil society among people and law enforcement authorities (such as the police of the designated area, for example) wherein people could act as ideal media by providing vital information that would assist authorities to curb trade or use of small arms and light weapons.

3. Synchronisation

Whatever be the strategy, it is ultimately essential that it operate in synchronisation with law, norms and policies and works to assist the higher

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[58] *Supra* note 8.

ideals of the nation. Harmony between the sub-regional, regional and the national levels is an absolute essence for the effective functioning of methods to curb and control the illegal proliferation of small arms.

C. *On The International Plane*

At a global level the key to effective implementation of the aims to curb illegal arms trade is cooperation : international cooperation, cooperation by nations with international organisations, principally the UN and its allied bodies, among others, cooperation with the International Criminal Police Organization (Interpol), cooperation with the World Customs Organization, as well as other relevant organisations, to enhance to identify those groups and individuals engaged in the illicit trade in small arms and light weapons in all its aspects in order to allow national authorities to proceed against them in accordance with their national laws collectively providing support and assistance to nations in post conflict situations, collective disarmament and demobilisation of ex-combatants and their subsequent reintegration into civilian life, including providing support for the effective disposition of collected small arms and light weapons, encouraging the relevant international and regional organisations and States to facilitate the appropriate cooperation of civil society, including non-governmental organisations, in activities related to the prevention, combat and eradication of the illicit trade in small arms and light weapons in all its aspects, in view of the important role that civil society plays in this area and finally, to promote dialogue and a culture of peace by encouraging, as appropriate, education and public awareness programmes on the problems of the illicit trade in small arms and light weapons in all its aspects, involving all sectors of society.

D. *Role Of The Media In Peace-Building*

The Media plays an extremely vital role in spreading awareness – newspapers, television, radio, cinema, and more recently, the Internet – what could be a more effective technique to spread awareness among the masses of the ills of illicit propagation of small arms? The media can be a powerful instrument of conflict resolution, when the information it presents is reliable, respects human rights, and represents diverse views, upholds accountability and exposes malfeasance, enables a society to make well-informed choices, thereby reducing conflict and fostering global human security. The Media, in some form or the other, has pervaded every aspect of human life in some way or the other. Hence its utilisation as an influential instrument for the purposes of meticulous planning, implementation and evaluation of initiatives so as to avoid risk and misapplication of resources would ensure the message to get conveyed across the globe in the right spirit.

V. Conclusion

Summing up, it ultimately boils down to us civilians to work collectively as one, in concordance with law enforcement agencies to achieve and propagate peace and harmony by saying no to illegally obtainable arms, largely endeavouring to safeguard human rights in all magnanimity.

DEFENCE MECHANISMS UNDER THE TAKEOVER CODE†♦

*Kruti Desai**

I. Introduction To The Takeover Code

As it has been rightly said in the Report of the blue-ribbon Securities and Exchange Commission (SEC) Committee on Takeovers,[1] *"The purpose of the Securities and Exchange Commission's regulatory scheme should be neither to promote or deter takeovers; such transactions and related activities are a valid method of capital allocation, so long as they are conducted in accordance with the laws deemed necessary to protect the interest of shareholders and the integrity and efficacy of capital markets. Takeovers should be allowed to take place, for this reason, the committee does not encourage or discourage, or evaluate the merits of, takeovers."*

Takeovers of listed companies in India are presently governed by the *Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations*[2] (Takeover Code).

The Takeover Code is a set of regulations under the Securities and Exchange Board of India Act, which determines whether or not an acquisition of shares in a company amounts to a takeover. The Takeover Code is triggered when 15 per cent or more shares are acquired or there is a change in control.[3] At this

† This article reflects the position of law as on February 16, 2003.

♦ © Nishith Desai Associates, 2003. This article was written during the course of a Volintern Training Programme conducted by Nishith Desai Associates (NDA) (a research based law firm with offices in Mumbai, Bangalore and California) for a select group of students of the Government Law College, Mumbai. The factual statements and legal conclusions contained herein are solely those of the author. The contents of this article do not necessarily reflect the position or views of NDA. No reader should act on the basis of any statement contained in this article without seeking professional advice.

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1 Report of the blue-ribbon SEC Committee on Takeovers comprising 17 Wall Street takeover experts, submitted in 1983, during the early days of the wild corporate raids in the US, referred from, Krishnan Thiagarajan, *Fending off hostile raiders - Whining corporates may stiffle the takeover market,* Business Line's Investment World, The Hindu group of publications, at, http://www.blonnet.com/iw/2000/11/26/stories/0826h011.htm.

2 *Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, (1997).*

3 *Ibid*, Regulation 10.

point of time, an acquirer has to make an open offer for at least 20 per cent of equity of the company.[4] It provides for detailed procedures for making a public announcement in the case of an acquisition or an agreement to acquire shares, voting rights or control of a nature that would trigger.[5]

Control of a company includes the right to appoint the majority of the directors, to control the management or policy decisions that can be exercised by a person or persons acting individually or in concert. This can be either directly or indirectly, by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.[6]

For individuals holding over a 15per cent stake and less than a 75 per cent stake in a company, the Takeover Code allows a creeping acquisition of 5 per cent in any financial year ending 31st March. If this limit is exceeded, the acquirer has to make a public announcement to acquire the shares of the company.[7]

Any person, who acquires 5 per cent, 10 per cent or 14 per cent of the equity or that many voting rights of a company in any manner, has to report this at every stage to the company and the stock exchanges within two working days.[8] Further, after the acquirer has a 15 per cent holding in a company, he has to disclose the acquisition or sale of every additional 2 per cent of shares or voting rights acquired to the target company, and to the stock exchanges where the company is listed, within two days.[9] These periodic disclosures will bring about transparency, and also alert the existing management of the target company in case of any hostile bid.[10]

When an acquirer wants to takeover a company without the tacit approval of the existing management or promoters, it is considered an unsolicited or hostile bid. The Takeover Code, however, does not differentiate between a friendly or hostile bid. It only recognises an acquirer.[11] However, a hostile takeover means an unsolicited takeover not supported by the management and board of directors of the target company.

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4 *Ibid*, Regulation 21.

5 *Ibid*, Regulations 14 to 19.

6 *Ibid*, Regulation 2 (c).

7 *Ibid*, Regulation 11.

8 *Ibid*, Regulation 7 (1).

9 *Ibid*, Regulation 7 (1A) and 7 (2).

10 Centre for Monitoring Indian Economy Pvt. Ltd., *Mergers & Acquisitions,* (October 2002), at 139.

11 Saurabh M. Shah, "*Econometric Modeling for Predicting Hostile Takeover for the Competition*",at www.quimpro.com/knowledgepark/projects\Nirma%20INSTITUTE/Nirma%20Institute.htm.

This article will first explain the various defence mechanisms available to a target company. It will then show why is it important to defend the company during a takeover bid. The next part will deal with the takeover laws of other countries (European Union, Germany, England and Wales, United States, Italy), relating to application of defences. Lastly the article will analyse the Indian laws relating to takeover and whether they are adequate for applying the various takeover defences available to a target company.

II. Types Of Defence Mechanisms

Takeover defences are of two types namely, Pre-Emptive Defences and Post Facto Defences. Pre-Emptive Defences are put in place prior to the takeover bid and Post Facto Defences are applied after a takeover bid has been announced.

Sanjay Dhir, in his article '*Takeover Defences in India*'[12] has stated that, "*A misconception that Indian companies have about takeover defence is that it is relevant only after a takeover bid has been announced. However, planning a takeover Defence is essential to successfully mounting one, should the need arise. Also, takeover defence is not only about successfully defending a takeover bid when announced, but equally relevant if it prevents a bid. Prevention is always better than cure... takeover defence is also misunderstood as being limited only to defeating a takeover bid. While this is the primary objective and would undeniably constitute a successful defence, the need for a target to eventually make the acquirer pay the maximum and a full price for its shares should also be the central objective. Promoter controlled Boards often get distracted with protecting incumbent Promoter's position at any cost. However, their fiduciary responsibility remains to get the best deal for all shareholders.*"[13]

Takeover defences take a wide variety of forms. They might involve acquiring, as a subsidiary, a corporation that would cause antitrust problems for an acquiring corporation. They might involve entering into a contract with another company which provides that if a majority of the corporation's stock is acquired in a hostile tender offer, the corporation will sell its most desirable assets under the terms specified in the contract. They might involve filing of lawsuits against an acquiring corporation in an attempt either to stop a tender offer on legal grounds or to cause enough delay that the acquiring corporation gives up. When courts examine defensive tactics, the focus of their attention is not on legal questions relating to the basic actions themselves, but rather on whether the directors properly discharged their fiduciary duties in adopting or approving the actions.[14]

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12 Sanjay Dhir, "Takeover Defences in India," *Mergers and Takeovers – a Compendium*, Bombay Chartered Accountants' Society, at 61, (1999). The author Sanjay Dhir is the Assistant Director – M & A Jardine & Flemming.

13 *Ibid.*

14 Practising Law Institute, "Judicial Response to Tender Offer Defenses," *Corporate Law and Practice* (Second Edition 1999) § 13:5.1.

A. White Knight

A White Knight is a company solicited by the target company to make a friendly offer to outbid the raider and avoid a hostile takeover. The White Knight then takes control of the target company.[15]

A target company that is trying to avoid being taken over by a hostile bidder may try to be acquired by another company, the White Knight. The White Knight must be able and willing to acquire the target company on more favourable terms than those of the original bidder. The White Knight will usually demand protection in the form of a lock-up agreement of purchase and sale eventually signed with the target company. The agreement may give the White Knight options to buy stock in the target that has not yet been issued at a fixed price or to acquire at a fair price assets of the target that are viewed as strategic by the White Knight. These lock-up agreements usually make the target less attractive to the original bidder. If this does not work, and a bidding war ensues, the Knight can exercise the stock options and sell the shares at a profit to the acquiring company.

White Knight defence is thus seeking a friendly acquirer. White Knights are third parties who are friendly incumbent management or Promoters and are introduced into the fray as competing offerors (in India within 21 days of the first bid[16]). White Knights could include friendly non-competing business houses, technology partners, joint venture partners, pre-selected multinational corporations and key customers. A White Knight can be inducted into the target through preferential allotment, although this needs relevant shareholder approval which may not be achievable in a short time frame and during a bid. Ideally, potential White Knights should be identified beforehand and could be given a strategic stake to discourage potential predators. Advisors play a vital role in locating and securing such White Knights.[17]

To give an example, Mahindra and Mahindra has acted as a White Knight to rescue Great Eastern Shipping Co. Ltd. (Gesco) from being acquired in the recent takeover bid for the company by Renaissance Estates.[18]

B. Competitive Bid

A Competitive Bid is very similar to a White Knight defence. Here also, another company or person makes an open offer to acquire the shares of the target

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15 *Takeover Defensive Techniques*, at, http://emgt.ku.edu/emgt806/Handouts/takeover_defensive_techniques.htm.

16 *Supra* note 2, Regulation 25(2).

17 *Supra* note 12.

18 *Supra* note 11.

company. In this way, the shareholders will sell the shares to the competitive bidder and the acquirer is prevented from taking over the target company. However, in this case the company which makes a competitive bid is called a 'Grey Knight'[19].

Under the Takeover Code,[20] as per the latest amendments,[21] shareholders now have the option to withdraw their applications for shares tendered up to three working days prior to the date of closure of the offer. The withdrawal of shares once tendered was not permitted under the Takeover Regulations, earlier. Shareholders, therefore, often found themselves at a disadvantage, especially in a situation when a counter-offer was made at a higher price. If they had already tendered their shares under the earlier offer, they could not withdraw them and tender them under the counter-offer instead.

Such a case was witnessed with great regard to the offer and counter-offer made for VST Industries. The Damani brothers, through Bright Star Investments, made a hostile takeover bid for this third largest cigarette manufacturer, originally at Rs.112 per share. ITC's wholly-owned subsidiary, Russell Credit, made a counter bid for the company at Rs. 115 per share. There were a host of revisions in both the open offer and counter-offer prices. The final prices for the original (hostile offer) were Rs.151 per share, while the counter-offer price was Rs.125 per share. Many shareholders had subscribed to the Russell Credit counter-offer which opened earlier (due to regulatory delay regarding the Bright Star bid). These were unable to later switch to the open offer by Bright Star Investments, even thought it was at a substantially higher price.[22]

C. *Legal Or Political*

Under certain circumstances, the target company files a suit against the bidder company claiming that the intentions of takeover are malicious and not synergistic. This helps the company to buy time and contemplate some other move. At times, the target company raises doubts over the financing arrangements of the bidder company to make the bid futile.[23] This technique is also called the 'Show Stopper', which would remove the raider with one sudden blow.[24]

Legal actions can buy valuable time for a target to organise itself for a more robust defence. In India, this can take the form of standstill agreements, court injunctions, suspension of timetable by Securities and Exchange Board of India

19 *Supra* note 15.

20 *Supra* note 2, Regulation 22(5A).

21 *Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2002* dated September 9, 2002.

22 *Supra* note 10.

23 *Supra* note 11.

24 *Supra* note 15.

(SEBI) on technical grounds and any other form of investigation, shareholders/ employee action and antitrust actions.[25]

Targets should carefully study the circumstances and mechanism of the bid to determine whether all rules have been followed. Targets could look to appeal to the Company Law Board and Courts to temporarily stall the takeover timetable or discredit the acquirer. It is not easy for the Board of Directors to block transfer of shares any more, although the threat of it on technical grounds can still be used as an effective tactic.

Another tactic is to lobby SEBI, relevant ministries and other pressure groups to support the target and put pressure on the acquirer. This may include mobilisation of employees/unions against the potential acquirer.[26]

D. Poison Pill

A Poison Pill is a provision of a corporate charter or of shareholder rights that comes into effect in the event of a takeover which will be detrimental to the acquiring company.[27] It mainly includes implementing rights plan that entitle existing shareholders to large amounts of stock, debt securities, or cash, if a hostile bidder gains control.

Poison pills are specific actions triggered by the launch of a bid, which potentially reduce the value of the target in the hands of the acquirer. It could take the form of change of control clauses in joint venture agreements, rights issues at deep discounts, preferential allotments, issue of securities that convert at a discount or issued on the launch of a bid, licences, wage and other agreements that lapse on change of control.[28]

It is a 'shareholder rights' contract between a company and its shareholders that is triggered by an event such as another person gaining a control block of the company's stock. The contract allows shareholders to purchase new shares or debt securities of the corporation at a discount, thereby raising the corporation's debt or diluting the value of its stock and making an unfriendly takeover difficult.[29] The poison is a massive dilution of the bidder's shareholdings due to the issue of the target's stock to shareholders other than the bidder at a 50 per cent discount to the market price.[30]

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25 *Supra* note 12.

26 *Ibid.*

27 *Supra* note 15.

28 *Supra* note 12.

29 Christian Kirchner and Richard W. Painter, "Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for Reform," 50 Am. J. Comp. L. 451, fn. 1.

30 Richard A. Shaw, Q.C., "Hostile Takeover Bids: Defensive Strategies", 38 Alberta L. Rev. 111.

"In the corporate world, companies to avert a hostile takeover create a "poison pill" that the raider will not want to swallow." [31]

"It takes a number of forms, but the common elements, such as imposition of some costs on the bidding firm, for example, by forcing to dilute its equity holdings (by issuing new shares to shareholders other than the raider), revoking or diluting its voting rights (through a predetermined change in voting powers triggered by the raiders arrival) or forcing it to assume unwanted financial obligations."[32]

A 'Shareholders Rights Plan' is designed primarily to make it difficult, time-consuming and expensive for a hostile acquirer to consummate offers that may not offer fair value to all shareholders. It is usually an issue of convertible preferred stock distributed as a dividend to current stockholders. The preferred stock is convertible into common shares equal to or greater than the number of shares outstanding. The takeover attempt becomes its own poison because it vastly increases the price to be paid for a company.[33]

Upon the occurrence of certain takeover events, the company's shareholders (other than the acquirer) can exercise rights or warrants. On exercising this option, the shareholders can buy additional equity securities in the company or of the acquirer at a substantial discount. The risk of dilution, combined with the authority of a target's board of directors to redeem the rights prior to a triggering event, compels the potential acquirer to negotiate with the target's board of directors, rather than proceeding unilaterally.[34]

A target may also create a new class of securities with rights and obligations linked to a takeover succeeding. For example, a target could give its shareholders securities that can be converted to cash if a takeover succeeds. This strategy, because of its various permutations and combinations, has also been called the 'Doomsday Conspiracy'.[35]

E. Golden Parachutes

These are large separation payments offered to managers to reduce their opposition against a takeover bid.[36] A golden parachute is a guarantee of a fairly large sum to be paid to senior executives whose services may be

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31 '*Poison Pills: Keeping Predators At Bay*,' at, http://www.themanagementor.com/kuniverse/kmailers_universe/finance_kmailers/mgr/takeovers1.htm. See also *Supra* note 12.

32 *Supra* note 11.

33 *Supra* note 30. See also *Supra* note 12.

34 *Ibid.*

35 *Supra* note 12.

36 *Supra* note 31.

terminated as a result of a takeover of their employer. A similar defence ploy is to have non-compete arrangements with key employees that lapse on change of control, thus weakening the competitive position of the target post acquisition.[37]

It means a clause in an executive employment contract that provides the executives with a lucrative severance package in the event of their termination and may include a continuation of salary, bonus and/or certain benefits and perquisites, as well as accelerated vesting of stock options.[38] In short, Golden Parachute is "*a substantial compensation package given to corporate executives in the event of a takeover*".[39]

F. Pacman Defence

The Pacman Defence is the launching of a bid for the bidder itself. It is "*a takeover defence in which the target company attempts to turn the tables and takeover the company that initiated the hostile takeover*".[40]

It is a rarely used but highly aggressive defence by which the target makes a hostile tender offer for the bidder. Such a defence is only effective if the target company has the financial resources to make a legitimate bid for the bidder. Such a scenario may be mutually destructive, as both companies may be left highly leveraged in the wake of their attempts to implement hostile tenders for each other. The advantages for the target companies are that it can send a message that it will defend itself at all costs. The disadvantages for the target companies are that it requires funds for such a strategy and secondly, it may emasculate both the target and the bidder.[41]

The target may, by itself or by joining hands with a White Knight, make a counter offer for the acquirer as a form of defence. Such parties, also called 'Grey Knights', purchase shares of the acquirer in the market thereby keeping him busy with defending his own company. Such a strategy, known as the Pacman Defence, is similar to the popular video game by the same name, whereby each company tries to gobble up the other first, creating a maze of inter-company holdings for Chartered Accountants to sort out subsequently.[42]

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37 *Supra* note 34.

38 Corporate Governance Glossary available at http://www.corp-gov.org glossary.php3?glossary_id=62.

39 *Supra* note 15.

40 *Ibid.*

41 At http://www.uark.edu/depts/acctinfo/course/5413/G6HostileTakeoverDef.doc.

42 *Supra* note 31.

G. Greenmail

Greenmail means paying off the hostile bidder in return for it agreeing to go away. It is "*the repurchase by a corporation of the raider's stockholdings through an above-market offer not made to any other stockholders. In exchange, the raider agrees to stop all takeover activities.*"[43]

Greenmail is the "*practice of paying a potential acquirer to leave you alone*". Specifically, the target company buys back the target company's stock from the potential acquiring company, and in return the potential acquiring company agrees to not undertake a hostile takeover of the target company. The agreement that the acquiring company signs is called a 'standstill agreement', and it contains all the provisions the acquiring company must adhere to – amount of the target's stock (if any) the acquire company can own, and the circumstances under which the acquiring company can sell the target company's stock, etc. Most courts view Greenmail as appropriate as long as it is done for valid business purposes, although some courts have described Greenmail to be a "*breach of fiduciary responsibility to shareholders*". The use of Greenmail has diminished since the 1980s because 1) there was abuse in its use – companies who tried to use it as a takeover defence found themselves being threatened to be taken over by many companies (where the potential acquirers had no true intention of taking over the target but just wanted the Greenmail payment), and 2) in the 1987 tax reform, the change in tax law regarding Greenmail said that any gain from a Greenmail transaction would result in a 50 per cent tax on the gain.[44]

This Greenmail defence was applied in India in the Gesco takeover battle, which was well summarised by C.R.L.Narsimhan in the *The Hindu*.[45] The battle for the real estate-rich Mumbai company Gesco with a market price for its scrip that did not reflect either its book value or any other inherent strength, began on October 19, 2000 with the AH Dalmia group of Delhi making a hostile bid for a 45 per cent stake at Rs. 27 a share.

This price was even less than half the book-value of the company (Rs. 54.50).

Interestingly, the offer and the counter offer pushed up the bidding cost and in the end the predator, the AH Dalmia group sold out its 10.5 per cent stake at Rs. 54 per share for a consideration of Rs. 16.35 crores. That holding - consisting of 30 lakh Gesco shares - was acquired earlier at an average cost of Rs. 24 per share (for a consideration of Rs. 7.20 crores).

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43 *Supra* note 38.

44 *Supra* note 41.

45 C. R. L. Narasimhan, "Greenmail, losers and winners – the Gesco takeover battle", *The Hindu*, Wednesday, January 10 2001, available at http://www.hinduonnet.com/thehindu/2001/01/10/stories/0610000a.htm.

The obvious winner therefore was the Dalmia group that pocketed a quick Rs. 8 crore and odd. Maybe that was not how the script should have read. Earlier, the group seemed intent on taking full control of the company and thereafter exploit its rich real estate. In the end, it turned out to be a transaction for swift profit and almost akin to a 'Greenmail'. This term refers to an act of an investor who buys a large block of stock with the intention of selling it to a corporate raider at a premium or selling it back to the company at a higher premium to keep it out of the reach of the corporate raider. The Gesco affair comes as close as anything can in India to a Greenmail.[46]

H. Sale Of Crown Jewels

'Crown Jewels' are the most valuable divisions or assets of a company.[47] They are very profitable or highly desirable businesses owned by the target that are especially sought after by the acquirer. Thus, 'Sale of Crown Jewels' means selling a corporation's most valuable assets. With these being sold off, the target becomes unattractive to the acquirer. It could also be called the 'Scorched Earth' defence, in which the defending corporation not only sells off its most desirable assets, but could also include, encumbering itself with liability, or otherwise rendering itself unattractive as a takeover candidate by leaving nothing but 'scorched earth'.[48]

Regulation 23[49] of the Takeover Code prohibits the Board of Directors from selling, transferring, or disposing of assets of the company without the approval of the shareholders, unless it is done in the ordinary course of the business.

I. Buy-Back Of Shares

A target company may buy-back its shares to prevent a hostile bid. It is the purchase of stock in a corporation by the corporation, diminishing the number of shares outstanding.[50] The buy back of shares will result in increasing the holding of the promoters, thus preventing a change in the control. This defence is not very highly recommended as it turns out to be quite expensive and it may not prove to be effective. This view has also been expressed by Sanjay Dhir,[51] in the following words: "*The target can use surplus/borrowed funds to buyback and extinguish shares from the market, reducing the market float available to a potential acquirer and increasing the Promoter's stake by default. Using Buyback to support the*

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46 *Ibid.*

47 *Supra* note 15.

48 *Ibid.*

49 *Supra* note 2, Regulation 23(1). See *Infra* note 117.

50 *Ibid.*

51 *Supra* note 12.

share price through treasury operations may also be a temporary defence tactic. However, such a tactic will be expensive and unlikely to have enduring benefits unless accompanied by genuine action to improve shareholder value."

Note: It is to be kept in mind that most of these defence mechanisms can be applied only after obtaining the shareholders' approval, after the takeover bid has been announced. For calling a general meeting, minimum 21 days' notice is required to be given to the shareholders, and the implementation takes time even after obtaining the shareholders' approval. Hence these defences need to be applied as soon as possible to comply with the time limitations. Further, these defences may only make it difficult for the acquirer to successfully acquire the target company. It does not mean that the acquirer will stop his attempts to acquire the target company.

III. Importance Of Defence Mechanisms

Why is it necessary to defend the company during a hostile takeover?

- The management of the acquirer may not be good enough to manage the target company.
- The directors of the target company should be able to protect the shareholders from bids that offer an inadequate price to its shareholders.
- To prevent a hostile bidder from gaining effective control in circumstances where minority shareholders may remain vulnerable to oppression because the mandatory bid rule would not apply.[52]
- To protect the shareholders from bids that are coercive.
- Defensive measures sometimes increase the price paid for a target company (perhaps an explanation for the fact that premiums paid in tender offers are generally higher in the US than in the UK).[53] Defensive measures also increase a target company's ability to negotiate a higher premium. The higher premiums paid for US companies than for their European counterparts support this observation and suggest that the modified business judgment rule in American corporate law may be more effective at raising premiums than the strict neutrality rule in London's City Code.[54] Proponents of

[52] This could occur, for example, if the bidder acquires less than a control block for purposes of the mandatory bid rule, but either alone or in conjunction with another large shareholder is in a position to effectively control the company and oppress minority shareholders. See *Supra* note 29.

[53] *Supra* note 29.

[54] Kirchner and Painter, "A European Modified Business Judgment Rule for Takeover Law," 2 *European Business Organization Law Review* 353-400, at 380-81 (Asser Institute - Max Planck Institute) (2000), (discussing statistical data and possible explanations for higher premiums paid in the U.S.). Referred from *Supra* note 29.

the strict neutrality rule dismiss these concerns because diversified shareholders who own both bidder and target company stock should be indifferent to price bias favouring bidders over targets.[55]

- Because the directors do not want to lose their position. But this cannot be said to be the right approach since it is in the interest of the directors not in the interest of the shareholders.

However, takeover defences should not be allowed to be applied too easily either. This is because of the risk that excessive implementation of takeover defences could discourage bids and ultimately disadvantage shareholders (an observation borne out by the fact that while premiums paid in merger transactions in the US are higher than in the UK, the number of hostile bids in the US, relative to the size of the US economy, is lower). For these and other reasons, the best probable approach could be an American style modified business judgment rule allowing takeover defences coupled with a shareholder's right to veto those defences.[56]

IV. Defence Mechanisms In Other Countries

A. *European Union (EU) Takeover Directive*[57]

In July 2001, after twelve years of negotiation, the proposed Takeover Directive failed to get the necessary majority in the final vote in the European Parliament, there were 273 votes in favour, 273 against and 22 abstentions. It would have been approved but for Germany, which changed its mind at the last minute and withdrew its support. The reason being that by restricting defensive action companies could take, the Takeover Directive would make German companies easier takeover targets.[58] They pointed out that the prospect of different rules

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55 *Supra* note 29.

56 *Ibid.*

57 Attempts to harmonise Takeover Law in Europe started in 1974 with a first draft - proposal for a Takeover Directive of the Commission, based on the so-called Pennington - Report. In 1989, the Commission presented a proposal for a takeover directive (the already mentioned Thirteenth Directive on Company Law), and on September 10, 1990 the Commission adopted an amended version of that proposal, which took account of the opinions of the Economics and Social Committee and of the European Parliament. In 1995, a new revision led to a proposal of a so-called framework directive, which then was presented in a revised version in 1997. This then led to a Common Position of the Council of June 19, 2000, which was accepted by the Commission on July 26, 2000. This version of the Thirteenth Directive then became the subject of a bitter struggle between Parliament, Council and Commission for over a year. Referred from *Supra* note 29.

58 Freshfields Bruckhaus Deringer - Anthony Salz and Julian Francis, "European Overview - Second time lucky for draft Takeover Directive?" *Mergers & Acquisitions 2002,* Law Business Research, Ch. 2, at 5.

on different sides of the Atlantic was troubling, and that extending the London City Code rule to all of Europe raised the prospect that American companies could take over their European counterparts more easily, and pay less for doing so, than vice versa. The strong value of the US dollar against the Euro made this threat even more apparent.[59]

The provisions of the draft of the proposed Takeover Directive with respect to the defence action to frustrate bids were laid down as follows :

Article 8 of the proposed Thirteenth Directive shares a crucial feature with London's City Code[60] (the City Code): the strict 'neutrality rule' in Principle 7 of the City Code, which forbids, on the part of the target's board, "*any action, which could effectively result in any bona fide offer being frustrated or in the shareholders of the offeree company being denied the opportunity to decide on its merits*". The proposed Thirteenth Directive likewise prohibits a target company's directors from implementing almost all defensive measures - such as raising new capital, making significant acquisitions or selling significant assets - unless such measures are authorised by a general shareholders' meeting that takes place during the period of the takeover bid. This approval process is, in most cases, impossible to use because the notice and preparation period for a general shareholders' meeting is too long. This rule is of course very different from the rule in the US, in which not a single state imposes a strict neutrality rule on target company's directors and courts in many states are quite lenient in reviewing defensive measures that are challenged by shareholders. It is this shareholder approval rule that has been the linchpin of German opposition to the Thirteenth Directive in the European Parliament.[61]

However, Member States may allow the board of the offeree company to increase its share capital during the period for acceptance of the bid, if prior authorisation has been received at a general meeting of shareholders not earlier than 18 months before the beginning of the period of acceptance, provided that shareholders' pre-emption rights are observed in relation to the share issue. This exception provides a significant loophole that allows offeree companies to take frustrating action without getting the authorisation of the shareholders during the course of a bid, particularly as the provision is silent on such matters as the pricing and underwriting of the new shares, the rights attaching to the new shares and the transferability of the pre-emption rights.[62]

The proposed Thirteenth Directive, like the City Code, not only restricts the

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59 *Supra* note 29.

60 The City Code on Takeovers and Mergers, (London).

61 *Ibid.* See *Supra* note 54.

62 *Supra* note 58.

Board of the target company but also restricts the conduct of the bidding corporation in order to protect the target company's shareholders against partial bids (bids for less than 100 per cent of a company's shares) which threaten to leave minority shareholders at the mercy of the bidder once the bidder has acquired control. Article 5 of the proposed Thirteenth Directive thus requires member states to adopt rules that protect minority shareholders, including a 'mandatory bid' rule requiring an offeror that acquires a control block of a company's stock to offer an 'equitable price' in cash or liquid securities for all of the shares of the company. This rule stands in marked contrast to the law in the US, where a bidder making a partial bid for a control block is not required to buy out minority shareholders.[63]

The Commission was very disappointed by the defeat of the Takeover Directive, and immediately took steps to revive it. In September 2001, the Commission set up the High Level Group of Company Law Experts to help resolve the problematic issues and report to the Commission by the end of 2001.[64]

The recommendations of the Group's report with regard to the defence action or the frustration action were :

Frustration action- only if shareholders approve after announcement: The board of the target company should be allowed to take frustrating action to defeat a bid if they get shareholder approval after the bid is announced. No frustrating action approved before the announcement should be allowed.[65]

According to Anthony Salz and Julian Francis,[66] the recommendation was proving controversial. In relation to the old draft, the German government and some Members of the Parliament (MEPs) were keen to give target companies more flexibility to take action to frustrate bids in the EU. The recommendation would require the German government to change the recently-introduced *Takeover Act 2002*, which allows shareholders or the supervisory board to approve frustrating action before the bid is announced (although there are some signs that these provisions are not popular in the German market and will not be used – so far, no German company has sought approval from its shareholders to put takeover defences in place).

The EU Takeover Directive has been launched once again. The European Commission has published its new proposals for a Takeover Directive following last year's rejection of the previous directive by the European Parliament.[67]

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63 *Supra* note 29. See *Supra* note 54.

64 *Supra* note 60.

65 *Supra* note 58.

66 *Ibid.*

67 *EU takeover directive launched again,* dated October, 2002, at, http://www.manifest.co.uk/manifest_i/2002/0210Oct/021007takeover.htm.

B. *Germany*

In 2000, the German government began to draft a new Takeover Code. The government, in its cabinet sitting of July 11, 2001, decided to propose a takeover law (the German Takeover Code) markedly different from the proposal of the Thirteenth Directive that had failed in the European Parliament on July 4, 2001. In December 2001, the German Takeover Code was adopted by both Chambers of German Parliament, the Bundestag and the Bundesrat, and became law effective from January 1, 2002.[68]

In November 2001, the German government's public finance committee had introduced another option for the authorisation of defensive measures in Section 33. According to the new and now adopted version of Section 33, it is sufficient for the supervisory council of the target company to consent to the defensive measures.[69]

The German Takeover Code in essence adopts the American approach of granting wide discretion to directors of target companies to implement defensive measures, without the protection, however ineffective in some instances, that Delaware courts give to shareholders who complain that takeover defences are being abused.[70] Nowhere does the German Takeover Code limit the authority of the supervisory council to approve a defensive measure that breaks up the target company simply in order to keep it away from the hostile bidder (the Revlon mode[71] in which takeover defences are subject to strict scrutiny under Delaware law). Nowhere does the German Takeover Code even require that the takeover defence be reasonable in relation to the threat posed by the takeover bid (the proportionality rule at least purported to be applicable in Delaware under Unocal[72]).[73]

C. *England And Wales*

Under the laws of England, particularly the City Code on Takeovers and Mergers, the offeror must acquire 50 per cent of the voting rights of the company. No offer which, if accepted in full, would give the offeror more than half the offeree's voting rights can become unconditional unless the offeror has agreed to acquire 50 per cent of the voting rights. The availability of finance would not normally be permitted to be a condition to a cash offer.[74]

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68 *Supra* note 29.

69 *Ibid.*

70 See *Infra* under United States.

71 *Infra* note 96.

72 *Infra* note 92.

73 *Ibid.*

74 Slaughter and May - Simon Robinson, "England and Wales," *Mergers & Acquisitions 2002*, Law Business Research, Ch13, at 67.

Further, an offeror who acquires not less than nine-tenths of the relevant shares to which the offer relates may purchase the remainder on giving notice to the holders. In such circumstances, minority shareholders can also require the offeror to acquire their shares.[75]

The City Code requires any person who acquires 30 per cent of the voting stock of a company to make a cash offer for the entire company, conditioned upon the bidder receiving at least 50 per cent of the voting securities of the company.[76] Only after the bidder receives 50 per cent of the company's voting securities, can the bidder make the offer unconditional.[77] If the offer lapses without becoming unconditional, the bidder is precluded for twelve months from making a further bid for the company without permission from the Panel on Takeovers and Mergers.[78] After the bidder acquires 90 per cent of the company's voting shares, it can force the remaining ten percent to tender their shares on the same terms.[79] Partial offers are permitted in a narrow range of circumstances. An offer that would result in an acquirer having 30 per cent or more of a target company's voting rights must be approved by shareholders holding over 50 per cent of the voting rights not held by the acquirer or persons acting in concert with the acquirer, a requirement that may occasionally be waived if over 50 per cent of the voting rights in the company are held by a single shareholder.[80]

D. United States

Federal regulation of tender offers began in 1968 when Congress passed the *Williams Act.*[81] That same year, state legislatures began passing their own statutes, most of which were designed to thwart tender offers either by substantive regulation or procedural roadblocks. By the 1980s, over two-thirds of the states had passed such statutes.[82]

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75 *Ibid.*

76 *City Code of Takeovers and Mergers*, Rule 5.1, cited and discussed in Karmel, Transnational *Takeover* Talk-Regulations Relating to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia, 66 U. Cin. L. Rev. 1133, 1138 (1998), referred from *Supra* note 29.

77 *Ibid*, Rule 10.

78 *Ibid*, Rules 9.1-9.3, 10.

79 *Ibid*, Rule 9.3.

80 *Ibid.*

81 Practising Law Institute, "State Legislation Regulating Tender Offers," *Corporate Law and Practice,* Second Edition Copyright 1999, § 13:5.2, referring to the Williams Act which added Securities Exchange Act of 1934, §§ 13(d), (e), 14(d), (e), (f).

82 *Ibid.*

In 1982, the Supreme Court of US ruled on the constitutionality of the Illinois statute, which was similar to many others, in the case of *Edgar* v. *MITE Corp.*[83] Here is how the Court summarised the Illinois statute: "*Under the Illinois Act any takeover for the shares of a target company must be registered with the Secretary of State. An offer becomes registered 20 days after a registration statement is filed with the Secretary unless the Secretary calls a hearing. The Secretary may call a hearing at any time during the 20-day waiting period to adjudicate the substantive fairness of the offer if he believes it is necessary to protect the shareholders of the target company, and a hearing must be held if requested by a majority of a target company's outside directors or by Illinois shareholders who own 10 percent of the class of securities subject to the offer. If the Secretary does hold a hearing, he is directed by the statute to deny registration to a tender offer if he finds that it 'fails to provide full and fair disclosure to the offerees of all material information concerning the take-over offer, or that the take-over offer is inequitable or would work or tend to work a fraud or deceit upon the offerees'.*"

Hostile transactions in the US generally consist of one or both of the following elements: (i) an attempt to purchase all or a majority of the voting stock of a target company by way of a tender or exchange offer and (ii) an attempt to replace the directors of the target's board with individuals nominated by the acquirer. In attempting to consummate a hostile transaction, an acquirer is faced with numerous obstacles. First, many states have enacted takeover statutes which impose supermajority voting and other requirements, making it difficult to consummate a takeover without the consent of the target's board.[84] Secondly, the prevalence of stockholder rights plans and staggered boards (and the willingness of courts to uphold the use of these devices) means that it can take up to two years for a potential acquirer to consummate a pure hostile transaction.[85]

In addition, many other forms of deal protection are also available in US transactions, including stock options, no-shop provisions, 'poison pills' and limited termination rights. In overly broad terms, the standard applied to deal protection techniques is that they must be reasonable and they must not be preclusive with respect to a potential third-party bidder. It is also important to note that because these and other deal protection techniques are frequently the subject of comment by both judges and practitioners (and are typically heavily negotiated by parties engaged in business combinations), their form and use are constantly evolving.[86]

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83 *Edgar* v. *MITE Corp.*, 457 U.S. 624 (1982), referred from *Supra* note 81.

84 Simpson Thatcher & Bartlett - Casey Cogut, Alan Klein and Sean Rodgers, "United States," *Mergers & Acquisitions 2002*, Law Business Research, Ch. 30, at 161.

85 *Ibid.*

86 *Supra* note 84.

In the case of *Moran* v. *House International Inc.*[87], the company adopted the 'poison pill' as a pre-emptive defence against takeovers. Household International Inc. adopted a Preferred Share Purchase Rights Plan, which provides that Household common shareholders are entitled to the issuance of one Right per common share under certain triggering conditions. There were two triggering conditions namely, the announcement of a tender offer for 30 per cent of Household's share, and the acquisition of 20 per cent of Household's shares by any single entity or group. If an announcement of a tender offer for 30 per cent of Household's shares is made the Rights are issued and are immediately exercisable to purchase 1/100 share of new preferred stock for $100 and are redeemable by the Board for $ 50 per Right. If 20 per cent of Household's shares are acquired by anyone, the Rights are issued and become non-redeemable and are exercisable to purchase 1/100 of a share of preferred. If the Rights is not exercised for preferred, and thereafter, a merger or consolidation occurs, the Rights holder can exercise each Right to purchase $200 of the common stock of the tender offeror for $100.[88] Shortly afterwards one of its directors and his corporation, which was a major shareholder of Household and which had suggested the possibility of acquiring the Household, joined in a suit challenging the adoption of the plan. The Delaware Supreme Court found that the Household directors did have the benefit of the 'business judgement rule'.[89] It found further that the directors had not breached their fiduciary duty, in that they had passed the rights plan "*in the good faith belief that it was necessary to protect Household from coercive acquisition techniques*",[90] such as two-tiered tender offers, in which, after the acquiring corporation has amassed enough stock to secure voting control, it forces the other shareholders out of the corporation in a freeze-out merger on terms dictated by it.

Most courts deciding cases involving defences to tender offers have shown the same unwillingness to fault directors for those manoeuvres, as did the Delaware Supreme Court in *Moran*.[91]

The US courts, while deciding whether a takeover defence is valid or not, apply the 'business judgement rule'.

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87 *Moran* v. *House International Inc.*, 500 A.2d 1346 (Del. 1985), referred from *Supra* note 14.

88 *Ibid*, at 1349.

89 The business judgment rule is a "*presumption that in making a business decision the directors of a corporation acted on an informed basis.*" *Aronson* v. *Lewis*, Del. Supr., 473 A. 2d 805, 812 (1984), referred from *Supra* note 14.

90 *Ibid*, at 1356.

91 *Supra* note 14.

The business judgment rule is a "*presumption that in making a business decision the directors of a corporation acted on an informed basis*".[92] The "*directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. They satisfy that burden by showing good faith and reasonable investigation* ..."[93] In addition, the directors must show that the defensive mechanism was "*reasonable in relation to the threat posed*".[94]

Professors Bebchuk and Ferrell argue that Delaware courts allow directors to get away with a wide array of takeover defences - particularly poison pills - that defend their 'fortress' corporations against hostile bidders to the detriment of shareholders.[95] Professors Bebchuk and Ferrell suggest that, at a minimum, federal law ought to give shareholders the option of choosing a regime less tolerant of defensive measures.[96]

However, there is one exception to the court's typical reluctance to interfere with the action of directors in fighting tender offers, so long as the directors meet the requirements discussed above (the business judgement rule). This is when a corporation enters the so-called '*Revlon mode*'. This concept comes from *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*[97] According to this case, a company enters the '*Revlon mode*' when it becomes apparent that a sale or break-up of the company is inevitable. According to the Delaware Supreme Court, once that has happened, the duty of the directors shifts to that of actioneers whose duty is to stop any defensive measures and get the best price for the shareholders.[98]

The judicial response has been applauded by those who believe that the large number of corporate takeovers that US has seen is bad for its economic life, largely because takeovers divert the energy of corporations and their managers away from the efficient provision of goods and services and into wasteful power struggles for control. The defence-oriented judicial response has not been appreciated, of course, by those who believe in the purported societal benefits of tender offers, benefits that arguably flow from a Darwinian 'survival of the fittest' in which poorly managed corporations are swallowed up by better managed ones. This judicial response often has not been appreciated by shareholders either, especially when defensive manoeuvring has prevented them

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92 *Aronson* v. *Lewis*, Del. Supr., 473 A.2d 805, 812 (1984). Referred from *Supra* note 29.

93 *Unocal Corp.* v. *Mesa Petroleum Co.*, 493 A.2d 946 at 955 (Del. 1985). Referred from *Supra* note 29.

94 *Ibid.*

95 See Bebchuk and Ferrell, "Federalism and Corporate Law: The Race to Protect Managers from Takeovers," 99 Columbia Law Review (1999). Referred from *Supra* note 29.

96 *Ibid.* Referred from *Supra* note 29.

97 *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, 506 A. 2d 173 (Del 1986).

98 *Supra* note 14.

from selling their shares at a premium in response to a tender offer."[99]

1. Comparing The EU And The US

"*A conclusion that defensive measures should be prohibited is too simplistic. The matter is complicated because defensive measures also increase a target company's ability to negotiate a higher premium.*"[100] The higher premiums paid for US companies than for their European counterparts support this observation and suggest that the modified 'business judgement rule' in American corporate law may be more effective at raising premiums than the strict 'neutrality rule' in London's City Code.[101]

As noted by Christian Kirchner and Richard W. Painter, the US is very lenient on adopting takeover defences whereas, the EU Directive, which is based on the London City Code, adopts the strict neutrality rule where no defences can be adopted by the directors of the target company unless approved by the shareholders, which is not quite applicable due to the time limitations. But the authors of the article also noted that in spite of this, the US is more developed with respect to takeovers.

The approval of the shareholder is not required for applying a defence mechanism during a takeover bid, whereas in the UK, the shareholders' approval is required.

The proposed EU Directive, like the London City Code, required a mandatory bid, i.e., a 100 per cent bid, which is not the case in the US where partial bids are allowed for acquisition of a control block.

From the above, it is seen that the US follows a more lenient policy towards defence mechanisms, while UK follows a strict policy, which makes it difficult to apply defences.

2. Takeover Defence Insurance

An interesting aspect in the US is the availability of an insurance policy, which covers the costs of defending a bid for a hostile takeover. It is called Strategic Defence Insurance.

In the article[102] titled "*Strategic Defence Insurance (SDI)*", it was stated that, "*3,000*

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99 *Supra* note 14.

100 Jonathon R. Macey, and Per Samuelsson, "The Regulation of Corporate Acquisitions: A Law and Economics Analysis of European Proposals for Reform", 1995 Columbia Law Review 495. See *Supra* note 29.

101 *Supra* note 29.

102 *Strategic Defence Insurance,* at http://docs.tob-eur-opa.com/jims/defsdi.doc.

US publicly traded companies chose to 'protect' shareholders from coercive unsolicited hostile takeover bids in 2000 by adopting a 'Shareholders Rights Plan'. SDI is a cost effective tool designed to pay for the significant costs of fighting a hostile bid or proxy contest. For a fraction of the full premium US companies can now buy an Option guaranteeing the right to secure the SDI policy in the event of a hostile bid or proxy contest.

"*US companies can now fully prepare and protect shareholders from the financial drain of fighting an unwanted takeover by purchasing an Option. The Option enables a company to exercise a full SDI policy at a pre-determined premium and coverage limit.*

"*The policy reimburses the insured company for direct costs associated with the successful defence of a hostile takeover bid and/or proxy contest.*

"*The policy covers expenses incurred on the successful defence, for example, Investment Bankers, Attorneys, Financial Institutions, Printing/Mail, Public Relations/Advertising, Proxy Solicitation, Corporate Management.*"

Such an Insurance Policy is also issued in the London market. It is called the Professional Liability Insurance and covers the legal costs to defend a corporation from a hostile takeover attempt.[103]

Another interesting point to be noted is the availability of an insurance, which covers the costs of a potential acquirer. The Aborted Bid Costs (ABC) policy[104] reimburses the insured company for direct costs associated with a merger, acquisition, divestiture or transaction that has been terminated for identifiable reasons outside the control of the insured entity.

E. Italy

In the article[105], *"Borsa Italiana releases Deminor Rating's Italian Corporate Governance Survey"* written on August 13, 2002, following the International Corporate Governance Network (ICGN) annual conference in Milan from July 10-12, 2002, Borsa Italiana released a comparative study on the applied corporate governance practices of Italian listed companies. The study, carried out by Deminor Rating, highlights the corporate governance standards across three different segments of the Italian stock exchange compared to a European benchmark. A major conclusion of the analysis is that companies in the Italian market are among the best performers when compared to the European benchmark. One of the reasons for this is due to a range of

[103] *Tender Offer Defense Expense Insurance*, from Rupp's Insurance & Risk Management Glossary, at, http://www.nils.com/rupps/tender-offer-defense-expense-insurance.htm.

[104] *New Insurance Policy*, available at http://docs.tob-eur-opa.com/jims/definsure.doc

[105] *Borsa Italiana releases Deminor Rating's Italian Corporate Governance Survey*, August 13, 2002, available at www.deminorrating.com/servletPublic?what=page&page_id=634.

takeover defences. "*Most Italian companies are insulated against hostile takeovers due to the presence of majority shareholders, the extensive range of structural takeover defences and the Italian legal framework.*"

V. Defence Mechanisms In India

A. *Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997*

Takeover defence is not easy in India due to the legislative and regulatory framework leaving Indian companies with limited defences as compared to the flexibility available to their counterpart targets in the West.[106] The following are the issues under the Takeover Code,[107] which have come up for consideration, that have a relevance to the defences available to the target company.

1. Minimum Number Of Shares To Be Acquired

Regulation 21[108] of the Takeover Code lays down that an acquirer must bid for a minimum of 20 per cent of voting capital of the company. Most international takeover regimes require acquirers to compulsorily bid for the entire company. The 20 per cent rule in India does not allow shareholders who do not have confidence in an acquirer's management to fully exit from the target on reasonable terms.[109]

The 20 per cent provision also creates a potential false market in the shares of the target. Typically, the share price of the target rises steeply during the

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[106] *Supra* note 12.

[107] *Supra* note 2.

[108] *Supra* note 2, Regulation 21 states as follows:

21. Minimum number of shares to be acquired

1. The public offer made by the acquirer to the shareholders of the target company shall be for a minimum twenty per cent of the voting capital of the company.
3. If the public offer results in the public shareholding being reduced to 10% or less of the voting capital of the company, or if the public offer is in respect of a company which has public shareholding of less than 10% of the voting capital of the company, the acquirer shall either,
   a. make an offer to buy the outstanding shares remaining with the shareholders in accordance with the Guidelines specified by the Board in respect of Delisting of Securities; or
   b. undertake to dis-invest through an offer for sale or by a fresh issue of capital to the public, which shall open within a period of 6 months from the date of closure of the public offer, such number of shares so as to satisfy the listing requirements.

[109] *Supra* note 12.

period of the offer. This can be attributed to the premium offered by the acquirer, the results of any competitive bidding and buying in the market by various parties. However, as the acquirer is under no obligation to accept more than 20 per cent and there is no other serious buyer for the stock at the end of the offer, the result is a steep fall in the share price once the offer is closed. This has an adverse effect on all shareholders, dissenting or not.[110]

For an Indian target to mobilise all resources to thwart a 20 per cent bid is a frustrating task. It is more like a semi final, with the acquirer most likely intending Greenmail, disrupting the working of the target by gaining control through the back door. Greenmail normally involves the accumulation of a large block of a target, with the hidden objective of raising the market price of the shares and selling them for a premium. In a 20 per cent offer situation, a target's shareholders end up choosing between incumbent promoters fully in control and an acquirer who wishes to hold 20 per cent, but not yet willing to take control and pay a full price to all shareholders.[111]

When the final draft of the Takeover Code of 1997, had been submitted by the Bhagwati Committee to SEBI, it was stated by Urmik Chhaya in the *Business Standard*,[112] regarding the draft that the condition that an offeror must acquire a minimum of 20 per cent from the public (also called partial offer) after acquiring 15 per cent of the company, seemed to have little logical base. This came as a disappointment because nowhere in the world was a partial offer allowed. France was probably the last country to have a condition of partial offer but the experiment failed. The comments of Munesh Khanna, Associate Partner, Arthur Andersen, were, "*It is a typically bureaucratic figure. Why 20 percent? Why not 30 percent or for that matter 40 percent? There does not seem to be any logical answer to the question. However, even this requirement is a substantial improvement over SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1994.*"

This issue was also considered by Krishnan Thiagarajan in the *Investment World*,[113] where he expressed the opinion that there was a growing demand among sections of Corporate India for an outright acquisition of 100 per cent equity, or at least 51 per cent, when an acquirer crosses the 15 per cent threshold.

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110 *Ibid.*

111 *Ibid.*

112 Urmik Chhaya, "Deflecting the Sharks?", *Business Standard*, February 3, 1997.

113 Krishnan Thiagarajan, *Fending off hostile raiders — Whining corporates may stiffle the takeover market,* Business Line's Investment World, The Hindu group of publications, available at, http://www.blonnet.com/iw/2000/11/26/stories/0826h011.htm.

He went about to discuss the pros and cons of having a mandatory 100 per cent or 51 per cent bid as follows.

The points in favour of the mandatory bid were that it would allow minority shareholders an exit option, or else in the case of 20 per cent bid, if it is a friendly acquisition, only the promoters would sell of their stake leaving the minority shareholders to be satisfied with a proportional acceptance of equity shares by the acquirer. Secondly, frivolous offers would be avoided.

While the points against a mandatory bid were that in a country like India, where financing options from banks or alternate sources are virtually absent, a 100 percent acquisition would make a takeover offer too onerous for an acquirer. So the *London City Code* on Takeovers, which provides for 100 per cent acquisition, or the *Williams Act* of the US may not be viable in India. Making the takeover offers too onerous may end up killing the takeover market in India, leaving it open only to cash-rich Indian and foreign companies. Also, this requirement of 100 per cent acquisition by a bidder in a target company in which a good chunk of equity is with financial institutions (FIs) may prove a non-starter and discourage the growth of the takeover market.

The Bhagwati Committee in the Justice Bhagwati Report[114] had also considered this issue. The Committee was informed that 20 per cent offer size did not provide exit opportunity to all shareholders especially in case of offers where the offer price was at a premium to the then prevailing market price. This had led to complaints and demand for increasing the offer size. The Committee was also apprised that as on December 31, 2000, a majority of the offers (approximately 70 per cent) were of minimum size, i.e. for 20 per cent. Further, 94 per cent of the open offers did not elicit full acceptance. The Committee also noted that the acquirers still had to rely largely upon their own source of funding for acquisitions through public offers, given the absence of institutional/organised source of funding for takeovers. The Committee therefore felt that any increase in the minimum open offer size may adversely affect the number of public offers. Hence under the present conditions, the current minimum offer size of 20 per cent seemed to be adequate. The Committee further noted that the extant Regulations permitted the acquirer to make an offer for a higher percentage of shares, if the acquirer so desires.

[114] J. Bhagwati Report on SEBI, (Substantial Acquisition of Shares and Takeovers) Regulations, (1997), [2002] 37 SCL 42.

Thus the minimum requirement for the current economic situation in India is quite appropriate and need not be increased.

2. Competitive Bid

Regulation 25[115] provides that an offer for a competitive bid should be made within 21 days after the announcement of takeover is made.

In UK, a formal defence can be launched up to day 39 and a White Knight can be brought in up to day 60. This 21-day limit for Indian targets severely limits the time they have available to launch an effective defence and highlights the need to plan beforehand and move fast.[116]

Then again it should be noted that too much time should not be given for launching a competitive bid or else it may lead to frivolous bids not intending to actually acquire the shares of the shareholders but only to increase the price of the shares. Thus, it can be said that once a bid is announced, around 31 days should be given to announce a competitive bid.

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[115] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, (1997), Regulation 25 states:

1. Any person, other than the acquirer who has made the first public announcement, who is desirous of making any offer, shall, within 21 days of the public announcement of the first offer, make a public announcement of his offer for acquisition of the shares of the same target company.

Explanation: An offer made under sub-regulation (1) shall be deemed to be a competitive bid.

2. No public announcement for an offer or competitive bid shall be made after 21 days from the date of public announcement of the first offer.

[116] *Supra* note 12.

[117] Supra note 2, Regulation 23(1) states as follows:

23. General Obligations of the board of directors of the target company

1. Unless the approval of the general body of shareholders is obtained after the date of the public announcement of offer, the board of directors of the target company shall not, during the offer period,
   a. sell, transfer, encumber or otherwise dispose of or enter into an agreement for sale, transfer encumbrance or for disposal of assets otherwise, not being sale or disposal of assets in the ordinary course of business, of the company or its subsidiaries; or
   b. issue or allot any authorised but unissued securities carrying voting rights during the offer period; or
   c. enter into any material contracts.

Explanation : Restriction on issue of securities under clause (b) of sub-regulation (1) shall not affect

i. the rights of the target company to issue or allot shares carrying voting rights upon conversion of debentures already issued or upon exercise of option against warrants, as per pre-determined terms of conversion or exercise of option.

3. Provision For Shareholders' Approval For Certain Defences

For the purpose of applying defences such as 'poison pills' and 'sale of crown jewels', it is important to note Regulation 23(1)[117] of The Takeover Code,[118] which lays down the general obligations of the Board of the target company.

It has been provided that the Board of Directors of the target company can sell, transfer, encumber or otherwise dispose of assets which is not in the ordinary course of business, if the shareholders' approval is obtained after the announcement of the bid. With the shareholders' approval, the target company can also, during the offer period, issue or allot any unissued securities carrying voting rights, which are authorised.

Further, the shareholders' approval is not required to issue or allot shares having voting rights upon conversion of debentures which have already been issued or to issue or allot shares carrying voting rights upon exercise of option against warrants, as per pre-determined terms of conversion or exercise of option. By this clause, a target company can put in place the 'poison pill' defence as an anticipatory measure against the acquirer by issuing debentures, which can be converted when a takeover bid is announced.

By a recent amendment of September 2002, it has been provided that approval of the shareholder is not required to issue or allot shares, pursuant to public or rights issue in respect of which the offer document has already been filed with the Registrar of Companies or Stock Exchanges, as the case may be.

Thus on a perusal of the above provisions, it can be observed that a target company can effectively apply various kinds of defence mechanisms, before a takeover bid is announced as well as after the bid announced.

4. Creeping Acquisition Limit

Regulation 11(1)[119] of the Takeover Code provides for the consolidation of

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ii. issue or allotment of shares pursuant to public or rights issue in respect of which the offer document has already been filed with the Registrar of Companies or Stock Exchanges, as the case may be.

[118] *Supra* note 2.

[119] *Supra* note 2, Regulation 11(1) states :
Consolidation of holdings 11(1) No acquirer who, together with persons acting in concert with him, has acquired, in accordance with the provisions of law, 15 per cent or more but less than 75% of the shares or voting rights in a company, shall acquire, either by himself or through or with persons acting in concert with him, additional shares or voting rights entitling him to exercise more than 5% of the voting rights, in any financial year ending on 31st March, unless such acquirer makes a public announcement to acquire shares in accordance with the Regulations.

holdings, whereby any person who has acquired more than 15 percent but less than 75 percent, of the stake of a company, can acquire additional stake up to 5 percent in any financial year ending 31st March. But if he acquires more than 5 percent then he must make an open offer according to the regulations. This provision can allow a promoter to buy additional shares up to the required limit, and thereby increase his holding over the company. It may not always be used, as the limit is up to only 5 percent, but this can be used along with other defences, to increase the holding of the promoter in the company.

B. Antitrust And Competition Laws

Absent in the Indian takeover framework was good anti trust legislation, similar to the Mergers and Monopolies Commission in the UK, wherein a takeover could be disallowed on public interest and monopoly grounds. This limits the Indian target's ability to apply fairly standard international defence tactics. While there may not be legitimate grounds to disallow a takeover on anti trust grounds, reference to such legislation usually buys a target valuable time.[120]

However, this weakness has been overcome by the Indian Parliament by passing of the *Competition Act, 2002.*[121]

The *Competition Act, 2002*[122] prohibits any person from entering into a combination which is going to cause an adverse effect on competition within the relevant market in India and such a combination shall be void.[123]

Section 5 of the Act lays down that the acquisition of an enterprise by any person or merger or amalgamation of enterprises shall be treated as a combination.

Thus, this defence of filing antitrust cases against the acquirer if it affects competition can be effectively applied in India now.

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[120] *Supra* note 12.

[121] This Bill was introduced in August, 2001, and referred to Standing Committee which made its Report available after examining it over a period of one full year, taken from *Rajya Sabha Synopsis Of Debates* (Proceedings other than Questions and Answers) Friday, December 20, 2002/ Agrahayana 29, 1924 (Saka) available at http://rajyasabha.nic.in/rsdebate/synopsis/197/20122002.htm.

[122] Competition Act, 2002, see also *supra* note 15.

[123] Competition Act, 2002, Section 6 states:
6. (1) No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void."

C. *Companies Act, 1956*

There are many provisions in the *Companies Act, 1956*[124] (Companies Act) which are not specifically enacted for being used as a defence against a takeover, but may be interpreted to effectively be applied to frustrate a takeover bid. An analysis of the relevant provisions is as follows:

1. Buy-Back Of Shares

Section 77,[125] states that a company may buy-back the shares of its own companies out of its free reserves, or securities premium account or the proceeds of any shares or other specified securities, subject to certain conditions. The buy-back should be authorised by its Articles of Association. A special resolution should be passed in a general meeting authorising the buy-back. However, as per a recent amendment,[126] no special resolution is required if the buy-back is for less than 10 per cent of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorised by the Board by means of a resolution passed at its meeting.

However, this method of defence is not highly recommended, as it turn out to be expensive and may not always be effective.

2. Issuing Of Shares At Discount

The Companies Act, under Section 79 and 79A, lays the provisions for the above. Issuing shares at a discount would attract the shareholders to buy its shares and would thus result in the increase in the share capital of the target company. This would make the bid expensive for the acquirer.

The conditions for issuing shares at a discount are that the shares should be of the class already issued. They should be authorised by a resolution passed by the company in a general meeting, and the resolution be sanctioned by the Company Law Board (CLB). However, no sanction is required if the maximum rate of discount in the resolution exceeds 10 per cent.

3. Issuing Of Sweat Equity Shares

The Companies Act, under Section 79A, lays the provisions for the above. Issuing Sweat Equity shares would, would result in the increase in the share capital of the target company. This would make the bid expensive for the acquirer.

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[124] Companies Act, 1956.

[125] *Ibid*, Section 77.

[126] Companies (Amendment) Act, 2001, w.e.f. 23-10-2001.

The expression 'sweat equity shares' means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The conditions for issuing sweat equity shares are that the shares should be of the class already issued. They should be authorised by a resolution passed by the company in a general meeting.

4. Further Issue Of Capital[127]

Section 81 of the Companies Act lays down the provisions regarding further issue of shares. This is a commonly adopted poison pill to thwart the takeover bid, by increasing the share capital of the company and thereby making it expensive for the acquirer to acquire the requisite percentage of shares. Further, shares may be offered if a special resolution to that effect is passed in the general meeting of the company.

5. Power Of Company To Accept Unpaid Share Capital, Although Not Called Up

Section 92 of the Companies Act empowers the company to accept from any member the amount remaining unpaid in case of partly paid up shares, although it is not called up. The company can do this only if it is authorised by its Articles of Association. This will allow the target company to increase its paid up capital and thereby makes the bid expensive for the acquirer.

6. Power Of Company To Alter Its Share Capital

Section 94 of the Companies Act empowers a limited company to alter its share

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[127] Section 81 lays down the provisions for Further Issue of Capital which states in part as follows:

(1A) Notwithstanding anything contained in sub-section (1), the further shares aforesaid may be offered to any persons whether or not those persons include the persons referred to in clause (a) of sub-section (1) in any manner whatsoever-

a. if a special resolution to that effect is passed by the company in general meeting, or
b. where no such special resolution is passed, if the votes cast (whether on a show of hands, or on a poll, as the case may be) in favour of the proposal contained in the resolution moved in that general meeting (including the casting vote, if any, of the chairman) by members who, being entitled so to do, vote in person cast against the proposal by proxy, exceed the votes, if any, cast against the proposal by members so entitled and voting and the Central Government is satisfied, on an application made by the Board of directors in this behalf, that the proposal is most beneficial to the company.

capital provided it is authorised to do so by its Articles of Association. Any such alteration is required to be passed in a general meeting and does not require the sanction of the Court. Hence when a bid is announced, the company may, by obtaining the shareholders approval, alter the share capital of the company in order to defend itself against the bid.

7. Restriction On Acquisition Of Certain Shares

Section 108A of the Companies Act states that no acquisition shall exceed 25 per cent of the paid up equity share capital of the company. Also no transfer of shares shall take place in the above case, except with the approval of the Central Government.

Section 372A of the Companies Act restricts any company from acquiring directly or indirectly, the securities of another body corporate, exceeding 60 per cent of its paid up equity capital or its free reserves or 100 per cent of its free reserves, whichever is more, unless the company passes a resolution of its shareholders in a general meeting.

8. Application To Company Law Board

Sections 397 and 398 of the Companies Act provide for an application that can be made to the CLB in case where the affairs of the company are being conducted in a manner prejudicial to public interest or in cases of oppression and mismanagement. The CLB may in such cases make such order as it think fits. Under Section 399, members holding not less than one-tenth of the issued share capital of the company, or 100 shareholders or one tenth of the total number of shareholders, which ever is less, can appeal to the CLB. Section 403 provides that the CLB can pass an interim order under Sections 397 and 398 of the Companies Act.

VI. Conclusion

From the above it can be said that the Indian laws, are fairly sufficient to apply the defence mechanisms when a takeover bid is announced. A minor change should be made, that is, the increase in the time for a competitive bid should be increased from the present 21 days to preferably around 31 days. Otherwise it is quite in consonance with the laws of UK and US, taking into account the fact, that India is yet a developing country.

THE DAWN OF 'COPYTRUST'†ϕ

*Ashika Visram**

I. INTRODUCTION

Trusts and monopolies are concentrations of wealth in the hands of a few. Such conglomerations of economic resources are thought to be injurious to the public and individuals because such trusts minimise, if not obliterate normal marketplace competition, and yield undesirable price controls.[1] To prevent this from happening, the American Congress passed the *Sherman Antitrust Act* in 1890. In India the development in this field was relatively later, when the *Monopolies and Restrictive Trade Practices Act* was passed in 1969.

Copyright Law means the exclusive right to do or authorise the doing of various acts in respect of a work. This is done to provide incentive to innovate, and for the increase in productivity. The only area Copyright Law and Antitrust Laws appear to clash is in the case of 'Computer Operating Systems' (OS). In this case the copyright grants rights which are monopolistic in nature due to the presence of network effects, thus attracting Antitrust Law. However, while the aims and objectives of Patent Law and Antitrust Laws may seem, at first glance, wholly at odds, the two bodies of law are complementary, as both are aimed at encouraging innovation, industry and competition.[2]

This article thus considers the interplay between Copyright Law and Antitrust Law, in the case of Computer Operating Systems and attempts to offer solutions for the problems that arise due to the insufficiency of Copyright Law in this context.

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† This article reflects the position of law as on January 21, 2003. The term 'COPYTRUST' has been coined by the author to signify the importance of the application of antitrust remedies to the Law of Copyright.

ϕ This article was written during the course of a Volintern Training Programme conducted by Nishith Desai Associates (NDA) (a research based law firm with offices in Mumbai, Bangalore and California) for a select group of students of the Government Law College, Mumbai. The factual statements and legal conclusions contained herein are solely those of the author. The contents of this article do not necessarily reflect the position or views of NDA. No reader should act on the basis of any statement contained in this article without seeking professional advice.

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1 Legal Information Institute, "Antitrust: An overview", at; http://www.law.cornell.edu/topics/antitrust.html.

2 897 F.2d 1572, at 1576, 14 U.S.P.Q.2d (BNA) 1034, at 1037 (Fed. Cir.1990).

In this background, the term 'Copytrust' appears to best explain the applicability of antitrust remedies to the law of copyright. The word copytrust is meant to convey a unique situation where copyright may sometimes result in the formation of trusts, or monopolies, thus attracting antitrust provisions.

Computer programs were the source of great debate for decades. The need for some sort of protection to the writers of computer programs was essential, but what sort of protection was to be given was a subject of controversy. The turn of events was such that the urgency with which protection was required did not allow the formation of any new laws. As a result, lawyers and courts alike turned to the application of old principles in the context of computer programs. Intellectual property lawyers, when confronted with this problem, tended to look toward Copyright, as it appeared to be the best suited for the purpose.

For the purpose of protection by means of copyright, a software program can be divided into two parts, its source code and its object code. The source code is essentially that part of the program that is in a 'Human Readable Form' while the object code is essentially in 'Machine Readable Form'. [3]

It was already settled law in many countries that the 'literary works' protected by the law of copyright were not necessary 'literary' in the popular meaning of the phrase, but rather, any fruit of the authors intellectual effort, which was expressed in the form of letters and numbers. For e.g. in United Kingdom, railway timetables, football fixture lists, telegraph codes and the like had all been given protection. It was, therefore, not too difficult to establish that the source code of a computer program could be protected; it was certainly as intelligible to those who understood it as a telegraph code. If source code were protected, it seemed inconsistent not to protect the object code also.[4]

There remained however an uncertainty which caused the software developers to put pressure on their respective governments, to provide a comprehensive legislation on the subject.[5] Various international conventions formulated certain guidelines and treaties to help unify and integrate the law of copyright. Article 10(1) of the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPS)[6] states that computer programs, whether in source or object code, shall be protected as literary works under *The Berne Convention, 1971.*

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3 Samuel R Baker, Joseph R Caruso, Carol S Osmond, "Computers and Software, Baker and Mc.Kenzie Canada: Protection for Computer Programs", at 80.

4 Harry Small, "The Draft Directive of the council of the European communities on the protection of computer software", *Computers and Software, Baker and Mc.Kenzie* at 155.

5 *Ibid.*

6 Available at http://www.wto.org/english/tratop_e/trips_c/t_agm3_e.htm#1.

In India, the *Copyright Act 1957* (Copyright Act), was amended in June 1994 clearly explaining the rights of copyright holder, position on rentals of software, and the rights of the user to make backup copies and the heavy punishment and fines on infringement of copyright of software. It also included computer programs, tables and compilations including computer data bases in the definition of literary works, under Section 2(o); further defining the term "computer programme" under Section 2(ffc) to mean; *a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result.*

According to Section 14 of the Copyright Act, it is illegal to make or distribute copies of copyrighted software without proper or specific authorisation. The only exception is provided in Section 52 of the Act, which allows a backup copy purely as a temporary protection against loss, destruction or damage to the original copy. The 1994 amendment to the Copyright Act also prohibits the sale or giving on hire, or offer for sale or hire, any copy of the computer program without specific authorisation of the copyright holder.

II. Problems Faced Due To Non-Natural Inclusion Of Copyright

This historical introduction is important because in spite of computer programs now being clearly included within the ambit of Copyright Law, certain problems are bound to arise (and have arisen) by this non-natural inclusion into the law of copyright.

This clash between Copyright Law and Antitrust Law seems inevitable. Antitrust Laws aim to prevent of any kind of monopoly. However, this conflict arises mainly in the later inclusions in Copyright Law such as various technological innovations and computer programs. Traditional copyright subject matter like art, music, and literature rarely raise even colourable claims of market power or monopolisation. At least one commentator has argued that traditional copyrights, by themselves, do not confer market power because there is a large degree of substitutability among literary and artistic works.[7] Perhaps an even stronger reason is that the so-called monopoly in traditional copyright subject matter is self-limiting no matter how popular the work. Few read the same novel or see the same movie over and over again to the exclusion of other novels and movies.[8]

The problem that arises with computer software is that it is frequently used by

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[7] Dennis S. Karjala, "Copyright Protection Of Operating Software, Copyright Misuse, And Antitrust", 9 Cornell J. L. & Pub. Pol'y 161, at 164.

[8] *Ibid.*

a large number of people, and as the number of users increases, the program becomes a standard, upon which further programming is done. This leads to the phenomenon called the bottle-neck effect as a result of which the persons owning the software, which has become the basis of further programming, have an unfair advantage over other programmers, who then have to licence the standard software at exorbitant costs from the monopolist, who may grant such licences according to their whims and fancies. The Copyright Law contains certain safeguards against potential abuse, but such safeguards are more to protect the rights of the owner of the copyright rather than a user thereof.

A. Network Effect

Economists have developed theories of network effects[9] to account for the extent to which consumer value in a product derives not from the intrinsic functionality or quality of the product itself but from the fact that a large number of other persons (i.e., a network) use the same or a compatible product.[10]

Telephones and fax machines are classic examples of actual network goods; owning the only telephone or fax machine in the world would be of little benefit because it could not be used to communicate with anyone. The value of the telephone or fax machine one has already purchased increases with each additional purchaser, so long as all machines operate on the same standards and the network infrastructure is capable of processing all member communications reliably.[11]

For application software, generally such network effects do not occur, since we might have a number of word processors, all performing substantially similar functions, running on the same or on different Operating Systems. The problem arises when one Operating System, usually the first to gain market advantage comes to be widely used, as a result application software programmers desire to write software compatible with it to ensure large number of users, while users in turn, prefer to use that Operating System because of the large number of application programs it can support and also because transfer of data would be simpler between computers supporting the same Operating System. A monopolistic situation thus develops, and becomes subject to the same evils that antitrust laws try to protect. It results in high prices and often involves tying claims as is seen with the Internet Explorer browser and Windows. Unfortunately the Copyright Law, fails to distinguish between application software and Operating Systems, and grants a blanket protection to both.

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9 Mark A. Lemley & David McGowan, "Legal Implications of Network Economic Effects", 86 Calif. L. Rev. 479.

10 *Supra* note 7 at 173.

11 *Supra* note 9.

Perhaps the best examples of standard setting through network effects, is Microsoft in relation to Operating Systems, and Intel in relation to hardware. So long as such a standard owner does not resort to unfair means, Antitrust Laws would not be attracted. However in recent times both Microsoft and Intel have been subjected to large amounts of litigation for unfair trade practices and licensing strategies.

III. Why Copyright Law Is Insufficient

In India, as in most parts of the world, Copyright Law focuses on protection of rights of the person who owns the copyright from infringement by third parties. It does not focus on the misuse of such rights. The only provisions within the Indian Copyright Act that might be invoked to prevent misuse of the rights it confers is Section 31[12] which deals with compulsory licensing and Section 52[13] which allows fair use.

Subject to the above provisions, the Indian Copyright Act contains nothing to limit the rights of the owner of the copyright. Section 52 is limited in its application since it allows the copying of the program only for the purposes for which it was supplied. This would make reverse engineering to find the source by an 'Original Equipment Manufacturer' (OEM) or application software developer unlawful and not covered by this section. Without the source code, the software developer is once again left at the mercy of the monopolist. Section 31 would be of some avail in cases of unilateral refusal to deal, but ineffective in case of restrictive trade practices such as those discussed in the *Microsoft Case.*

IV. Copyright Misuse Doctrine: How Far Applicable

A. Historical Introduction Of The Misuse Doctrine

The Doctrine of Intellectual Property Misuse has its origins in the Patent Misuse Doctrine. Patent misuse is an affirmative defence to a suit for patent infringement

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[12] Section 31 deals with compulsory licences of works already published where the owner of the copyright refuses to republish the work, the Copyright Board may after giving opportunity to be heard, and after inquiry, if satisfied that the grounds of refusal are not reasonable, may order the Registrar to grant a compulsory licence to the complainant, on the payment of such fees as may be prescribed.

[13] Section 52, lays down that in the case of computer programs, the making of copies or adaptation of a computer program by the lawful possessor of a copy of such computer programe from such copy-i) in order to utilise the computer program for the purpose for which it was supplied; or ii) to make back-up copies purely as a temporary protection against loss, destruction, or damage in order only to utilise the computer program for the purpose for which it was supplied.

or for royalties due under a patent licensing agreement.[14] However this doctrine has been extended to copyright cases as well. In *Lasercomb America, Inc.* v. *Reynolds*,[15] the Fourth Circuit Court held that the Patent Misuse Doctrine was equally available to copyright infringement cases. In this case, a some what common clause in the licence agreement prohibiting licences from developing or selling competitive software was found by the Fourth Circuit to be misuse of copyright and the consequence to the licensor of having included this non competition clause in its license agreement was that the licencees were free to make and sell copies of Lasercomb's software, at least until Lasercomb "*purged itself of the misuse.*"[16] Since then, a number of courts in the United States have considered and upheld the misuse defence.

Most courts have declared that the misuse defence does not require proof of an antitrust violation or proof of market power, or competitive injury. The only thing that the defendant in a misuse claim must prove is that the plaintiff extended his property right beyond the patent or copyright.[17]

B. Problem Faced By Application Of The Misuse Doctrine

The question is whether the misuse defence is available in a case of a complete refusal to license a product, i.e. not 'mis-use' but 'no-use'. The misuse doctrine has been limited in its application by the courts to being a defence to an infringement claim. It has been aptly said that the misuse doctrine has only been used as a shield; it has yet to be used as a sword.[18]

If a company were found guilty of misuse, enforceability of its copyright would only temporarily be restricted, until such misuse was rectified. However that company would still continue to hold a monopolistic right in the Operating System. Thus the Misuse Doctrine could help rectify any unfair practice by a company, but is of no help to prevent a monopolistic situation involving a complete refusal to deal with the product. In other words, copyright misuse does not directly deal with the structural problems that arise from the combination of strong network effects and the copyright itself.[19]

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14 Jere M. Webb and Lawrence A. Locke, "Recent Development: Intellectual Property Misuse: Developments In The Misuse Doctrine", 4 Harv. J.Law & Tec 257, at 257, referring to 4 D. CHISUM, PATENTS § 19.04 (1990).

15 911 F.2d 970 (4th Cir. 1990).

16 *Ibid* at 977-78.

17 Maureen A. O'Rourke, "Striking A Delicate Balance: Intellectual Property, Antitrust, Contract, And Standardization In The Computer Industry", at 33-34.

18 *Supra* note 7 at 185.

19 *Supra* note 7.

V. Merger Doctrine

A. *Idea/Expression Dichotomy*

Copyright Law protects only the expression of the idea, and not the idea itself. This is reflected in the TRIPS Agreement, Article 9(2) of which states that Copyright protection shall extend to expressions and not to ideas, procedures, methods of operation or mathematical concepts as such[20] and has also been recognised by the Supreme Court of India in the case of *R.G. Anand* v. *Delux Films*[21] where Justice Fazal Ali, noted that, "*There can be no Copyright in an idea, principle, subject-matter, themes, plots or historical or legendary facts and violation of the Copyright in such cases is confined to the form, manner and arrangement and expression of the idea by the author of the Copyrighted work.*"

This distinction is important as it is essential for the general ideas to remain available in the pubic domain, so as to encourage maximum variety in creativity. In the case of traditional literary works like essays and poems, it is simple to apply this principle and protect only the particular manner in which the idea is expressed. However, in the case of computer programs, the application of this doctrine is not that easy. In *Whelan Associates, Inc.* v. *Jaslow Dental Laboratory, Inc.*[22], the court found that, "*The 'expression of the idea' in a software computer program is the manner in which the program operates, controls and regulates the computer in receiving, assembling, calculating, retaining, correlating, and producing useful information either on a screen, printout or by audio communication.*"

The courts, applying to computer programs the traditional principles long applied to works such as plays, novels, motion pictures and music, have generally held the structure, sequence and organisation (SSO)[23] of computer programs to be protectible on appropriate facts.[24] Thus even if two programs do not contain line-for-line similarity, they can be found to be infringing, if they are substantially similar.

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20 Part 2 Section 1 of the TRIPS Agreement. The TRIPS Agreement is Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, signed in Marrakesh, Morocco on April 15, 1994. Available at http://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm.

21 (1978) 4 SCC 118.

22 609 F. Supp. 1320.

23 "Structure, sequence and organisation" is found in elements such as the plot and sub-plots, sequence of scenes, setting, characterizations, and patterns of dialogue in works of fiction or drama, or the detailed outline and organisation and selection, coordination and arrangement of information in textbooks or other nonfiction works.: Whelan, 797 F.2d at 1234, at 1242-43.

24 Morton David Goldberg and John F. Burleigh, "Copyright Protection For Computer Programs: Is The Sky Falling?" 17 AIPLA Q. J. 294. at 298, (1989).

B. Origin Of The Merger Doctrine

The Merger Doctrine in Copyright Law is rooted in the case of *Baker* v. *Seldon*[25], where the court found that in some cases the particular form of expression is so indispensable with the idea that it can be treated as an integral part of the idea, and is not granted separate protection.

In another interesting case, that of *Rosenthal Jewelry Corp.* v. *Kalpakian*[26], the plaintiffs sought to copyright a jewellery pin in the shape of a bee. The court held that in this case, the number of designs by means of which a jewelled bee could be made were not many, and therefore were not sufficiently distinct from the underlying idea and did not merit protections. A grant of Copyright in this case would in effect be protection of the idea itself. In this case, market factors were wholly irrelevant to the issue of its protection. However, in many recent cases, expressive elements have been treated as merged into the idea of computer software based upon the elements' popularity or standardisation in the market.[27]

Since software both develops and is prone to standardisation at very fast rates, the user may be used to certain features of the standard and will thus search for the same features in any new software. Therefore those seeking to create new software must first seek to integrate all the old features which the users have grown accustomed to. In these cases the expression should be held to have merged with the idea, so as to form an integral part of the idea itself.

In *Lotus Development Corp.* v. *Borland International, Inc.*[28], it was considered whether Lotus had a protectible interest in the menu hierarchy system of its Lotus 1-2-3 program, operated by a series of commands appearing in columns operated by manual key strokes. When Borland sought to introduce its own spreadsheet program, it found that users had become highly accustomed to the user interface in Lotus 1-2-3 and that it therefore would be unable to draw users to its own, more advanced program without making use of that interface.[29] Here the court held that the interface was a method of operation which was comparable to an idea. Moreover, by giving Lotus a monopoly on its menu hierarchy system, the court would be stifling the development of more innovative expressions of the spreadsheet program, since users would be reluctant to switch without all the features of the earlier program. Therefore the court did not grant protection to the user interface of Lotus.

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25 101 U.S. 99 (1879).

26 446 F.2d 738 (9th Cir. 1971).

27 Fred Anthony Rowley, Jr., "Dynamic Copyright Law: Its Problems And A Possible Solution", 11 Harv. J. Law & Tec 481, at 492, (1998).

28 49 F.3d 807 (1st Cir. 1995), affirmed by an equally divided Court, 516 U.S. 233 (1996).

29 *Supra* note 27 at 497.

As it can be seen, the Merger Doctrine has been held to be applicable in the case of user interfaces. It has had no application where the owner of the copyright refuses to license its source code or other information to Independent Software Vendors (ISVs) or Original Equipment Manufactures. (OEMs). Indeed to ask the courts to merge the entire source code of the Operating System with the unprotectable aspects would be a great travesty of justice, and would result in discouraging innovation, quite at odds to the purpose of Intellectual Property Law and Antitrust Law. Further, companies would be provided with an incentive to produce sub-standard programs to prevent the application of this doctrine. One can therefore conclude that while the Merger Doctrine seems to have limited applicability, it is not sufficient to solve the problem existing within Operating Systems.

VI. Liability Rule V. Property Rule

Liability rules are those under which the interest holder cannot prevent others from exploiting the property but receives financial compensation (typically in accordance with some preset rule) from those who do so. Property rules, on the other hand, are those under which the holder of the property interest can prevent others from exploiting the property without his or her consent.[30] The use of liability rules instead of property rules is not entirely a copyright or antitrust concept. But it is discussed under Copyright Law because it proposes a change in Copyright law from property rules to liability rules in the case of Operating Systems. Such changes would be difficult if one proposes to change copyright legislation worldwide, but still has application in judgments of various courts in the context of software.

Intellectual Property is not that much different from tangible property, both kinds of property confer on the owner an absolute right on the property so as to ensure an efficient use of the resources of the property. In the case of Intellectual Property, this right confers on the owner a choice of whether to make the property available to the public or not, but due to the protection conferred by the law, owners of the Intellectual Property usually choose the former. However, it is essential that there exist a proper method of enforcing these rights. Here courts may choose between liability rules or property rules. Dana Wagner, in her article, "*The Keepers of the Gates: Intellectual Property, Antitrust, and the Regulatory Implications of Systems Technology*", has considered in depth the use of liability rules in the case of Systems Technology. She has summarised the meaning of liability rules as well as property rules, and has contemplated the use of liability rules in the case of Systems Technology, as an exception to the general rule of conferring property rights in the case of intellectual property .

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[30] Dana R. Wagner, "The Keepers of the Gates: Intellectual Property, Antitrust, and the Regulatory Implications of Systems Technology", 51 Hastings L.J. 1073, at1080.

A. Application Of Principle By The Courts

The Courts have, on numerous occasions, directed compulsory licencing, in cases where the non-granting of a licence would be contrary to the aims of both Intellectual Property and Antitrust; i.e. to maximise social welfare through the promotion of innovation and competition.[31]

In *Intergraph* v. *Intel*[32], where Intel in the light of a patent infringement suit filed by Intergraph, cut off all access to previously granted information about the Intel microprocessor, which was essential to the functioning of Intergraph, since their production depended on Intel Technology, the court reasoned that since Intergraph had already expended large amounts of money as capital Intel was recognized as an industry standard, Intergraph's ability to compete freely would be impaired. In this case, the District Court struck a compromise between strong property rights and open access. Rather than eliminate Intel's rights altogether, or allow their exercise in restraint of competition, the District Court found a middle ground. It reaffirmed Intel's proprietary rights in its microprocessing technology but established that those rights would be protected only by a liability rule, not by the usual property rule.[33] A similar situation was seen in the *Dell Computers Corporation Case.*[34] Again more recently in the Consent Decree in the *Microsoft Case*, the parties have come to a similar conclusion. This case has been considered in detail later.

It can therefore be seen that courts are in recent times, anxious to solve the apparent conflict between Antitrust and Intellectual Property. Therefore courts usually uphold the Intellectual Property rights of the defendant unless he has

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31 See, e.g., *Image Technical Servs.* v. *Eastman Kodak Co.*, 125 F.3d 1195, 1218 (9th Cir. 1997); *Atari Games Corp.* v. *Nintendo of Am., Inc.*, 897 F.2d 1572, 1576 (Fed. Cir. 1990) "The aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are actually complementary, as both are aimed at encouraging innovation, industry and competition."

32 *Intergraph Corp.* v. *Intel Corp.*, 3 F. Supp. 2d 1255 (N.D. Ala. 1998), vacated and remanded, 195 F.3d 1346 (Fed. Cir. 1999), and on remand, 88 F. Supp. 2d 1288 (N.D. Ala. 2000).

33 *Supra* note 30, at1084.

34 No. 931-0097 (F.T.C. 1996).: In this case, the Video Electronics Standards Association (VESA) had recognised the VL-Bus as an Industry Standard for the bus design. After recognition, Dell asserted that it had a patent in the above design and sought to enforce this patent, also claiming that it had the right to exclude anyone from using the patent. The difference between Dell and Intergraph was that Dell, as a member of VESA, was greatly instrumental in getting the VL-bus recognised as a standard, by certifying that the VL-Bus did not infringe any patent or copyright of Dell. However the decision in this case too was based solely on the ground of Intergraph, and Dell was forced to license the VL-Bus design, and proper compensation would be payable.

engaged in anticompetitive behavior, at the same time limiting the scope of these rights. However Copyright Law, as it now stands, still involves property rules, and the application of liability rules in each case depends on the discretion of the court. What would really be required is a proper standard, or a set of circumstances in which liability rules can be invoked. The Essential Facilities Doctrine, provides such circumstances. This will be discussed in Part VIII.

B. Disadvantages Of Liability Rules

- If Intellectual Property rights provide incentives for innovation, weakening those rights could reduce innovative endeavours. Worse still, firms would be motivated to use methods of exclusion that are not based in the legal system, most notably secrecy and exclusionary engineering. At least one commentator has suggested that if innovators lost the ability to regulate technological access through legal means, they would invest more resources in achieving such regulation through these alternative means. If these efforts succeeded, the outcome would be the same as before–companies seeking access to systems technology would be dependent upon the consent of the innovator–and the cost to society would be greater, as the incremental resources invested in maintaining excludability would effectively be wasted.[35]

- Another objection to liability rules is that they raise valuation difficulties. Because these rules produce nonconsensual transactions, they require an external mechanism for assigning values to property rights. Typically, the external mechanism will be the judicial system, which will assign values based upon prevailing market rates. Where those rates are nonexistent or unreliable, however, another valuation method is necessary.[36]

  Therefore it can easily be said that this doctrine is also not without difficulty to implement, and there is a need to establish a more concrete framework for the settlement of the problem than the one laid down above. However these principles of liability rules are important in as much as they lay the foundation for the application of the Essential Facilities Doctrine.

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[35] *Supra* note 30, at 1113.

[36] *Ibid* at 1115.

VII. ANTITRUST

A. Brief Overview Of US Antitrust Laws

Federal antitrust policy was first announced in 1890 by enactment of the Sherman Act. This law condemned contracts, combinations and conspiracies in restraint of trade, and monopolisation, attempted monopolisation and combinations and conspiracies to monopolise.[37] In 1914, Congress enacted the *Federal Trade Commission (FTC) Act* with its administrative body for policy development and its broad prohibitions against unfair methods of competition. The Sherman Act, said to be a constitutional sweep, aims at arrangements that restrain trade and at monopoly activity, while the FTC Act condemns "*unfair methods of competition*" and "*unfair and deceptive trade practices*". An extremely wide range of activity is embraced in these phrases.[38]

B. Definition Of A Monopoly

Monopoly, literally means 'single seller'. It is a situation in which a single firm or individual produces and sells the entire output of some good or service available within a given market. It is "*the power to control prices or exclude competition*"[39]. This power usually depends on the market share of that company. In any monopolisation claim, it is essential to prove sufficient market share, which differs from case to case.

Both monopolisation and attempted monopolisation require some evidence of wrongful intent. It is well established that a monopolist will not be penalised for obtaining or maintaining monopoly power "*as a consequence of superior product, business accuracy or historic accident.*"[40] Rather, courts require evidence of a general unlawful purpose or intent to exercise that monopoly power.[41] Sometimes, market power may be acquired illegally – for example, through an agreement that unreasonably restrains competition. Moreover, even when market power is legally acquired, it can be illegally maintained.[42] Finally, even when a firm

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37 S.M. Durgar, *Law of Monopolistic Restrictive & Unfair Trade Practices,* at 6, (3rd ed. 1997).

38 *Ibid* at 14.

39 *United States* v. *E.I. du Pont de Nemours & Co.*, 351 U.S. 397, 391 (1956).

40 *United States* v. *Griffith*, 334 U.S. 100, at 107 (1948).

41 Ilene Knable Gotts and Howard W. Fogt, Jr., "Clinton Administration Expresses More Than Intellectual Curiosity In Antitrust Issues Raised By Intellectual Property Licensing", 22 AIPLA Q. J. 1, at 17 (1994).

42 See, e.g., In Re. *Intel Corp.*, No. 9288, PP11-41 (FTC June 8,1998)(complaint), at http://www.ftc.gov/os/1998/9806/intelfin.cmp.htm.

has legally acquired and maintained its market power, conduct by a firm with market power may be unlawful if it unreasonably harms competition.[43]

1. Definition Of A Relevant Market

The determination of the relevant market is very important in antitrust cases, for determining whether the Intellectual Property Right holder has extended his right to another market. In *Brown Shoe Co.* v. *United States*[44], the Court explained that "*the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.*"[45]

Two copyright cases have considered whether denial of access to copyrighted material constituted an antitrust violation.[46] In both cases, the plaintiff alleged that the refusal was tantamount to an exclusionary denial of access to an essential facility. In both cases, however, the facts did not support a finding that the denial prevented the plaintiff from competing in the relevant market.[47]

2. Definition Of A Technology Market

A technology market is similar to the traditional antitrust definition of a product market. This too is characterised by cross-elasticity of demand and the likelihood of demand-side substitution in response to a supra-competitive price increase. A technology market has been defined in a number of patent-pooling cases as well as cases where an antitrust counterclaim was brought in an action for patent infringement.[48] Once the market is determined, it is important to understand that the immunity conferred by Intellectual Property extends only to the particular market in which the patented or copyrighted product exists. In one case in the Supreme Court of the United States[49], the boundaries of immunity were described as: "*the possession of a valid patent or patents does not give the patentee any exemption from the provisions of the Sherman Act beyond the limits of the patent monopoly.*"

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43 Commissioner Sheila F. Anthony, "Antitrust And Intellectual Property Law: From Adversaries To Partners", 28 AIPLA Q. J. 1, at 10,11(2000).

44 370 U.S. 294 (1962).

45 Joshua A. Newberg, "Antitrust for the Economy of Ideas: The Logic of Technology Markets", 14 Harv. J. Law & Tec 83 at 88 (2000).

46 *Supra* note 41 at 18.

47 *Ibid.*

48 *Northlake Mktg. & Supply, Inc.* v. *Glaverbel*, S.A., 861 F.Supp. 653 (N.D. Ill. 1994); *Tapeswitch Corp. of Am.* v. *Recora Co., Inc.*, 196 U.S.P.Q. (BNA) 348 (N.D. Ill. 1977); *Walker Process Equip., Inc.* v. *Food Mach. & Chem. Corp.*, 382 U.S.172, 177 (1965).

49 *United States* v. *Line Material Co.*, 333 U.S. 287, at 308; 76 U.S.P.Q. (BNA) 399, at 408 (1948).

C. Method Of Determining Violation Of Antitrust

1. Per Se Analysis

In the 1970s, the courts narrowed the types of conduct exempt from antitrust scrutiny which culminated with a now-infamous government policy called the 'Nine No-Nos'[50]. The Nine No-Nos[51] were certain types of conduct that the Department always regarded as suspect and likely to unreasonably harm competition. Such conduct was found violative *per se.* It was suspect because courts and agencies still tended to infer market power from the existence of a patent, without weighing the significance of substitutes for the patented technology or product.[52]

However in recent times, antitrust and intellectual property are no longer considered at odds. This view is summarised in the Federal Circuit's 1990 opinion in *Atari Games Corp.* v. *Nintendo of America, Inc.*, in which the Federal Circuit stated: "*The aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are complementary, as both are aimed at encouraging innovation, industry and competition.*"[53]

The 1995 Antitrust Guidelines also consider the licensing of intellectual property to be pro-competitive as it allows firms to combine complementary factors of production and to also help integrate complementary intellectual property. Consumers may benefit from licensing because it can expand access to intellectual property and thus increase the speed and reduce the cost of bringing innovations to market.[54]

2. Rule Of Reason Analysis

The Federal Trade Commission (FTC) and the Department of Justice (DOJ) generally analyse restraints involved in licensing transactions and other

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50 *See* U.S. Dep't Of Justice, Antitrust Enforcement Guidelines For International operations (November 10, 1988) S.5.6 (April 6, 1995).

51 The No-No's were as follows:1)A patentee should not require a licensee to grant back patented improvements to the licensee's original technology; 2) the setting of royalty payments in amounts unrelated to the sales volume of the patented product; 3) tying of unpatented supplies; 4) post-sale restrictions on resale by purchasers of patented products; 5) tie-outs; 6)licensee veto power over the licensor's grant of future licenses; 7) mandatory package licensing; 8) restrictions on sales of unpatented products made by a patented process; and 9) specifying the prices a licensee could charge upon resale of licensed products.

52 *Supra* note 43 at 5.

53 897 F.2d 1572, at 1576, 14 U.S.P.Q.2d (BNA) 1034, at 1037 (Fed. Cir.1990).

54 *Supra* note 52 at 8.

agreements involving intellectual property using what antitrust law calls the 'rule of reason'. The rule of reason analysis involves several steps which include a determination as to whether the license would facilitate exercise of market power, whether the licence would clause network effects, whether the restrains are anti-competitive in nature, and finally, whether the anti-competitive effects are outweighed by the pro-competitive efficiency of the license and the restrictions.

D. *Applicability Of Antitrust Principles In Resolving The Operating System Problem In Copyright*

All the remedies with copyright that have been discussed earlier have their limitations. Also, once an antitrust violation is proved, the court has available to it a wide range of potential remedies, ranging from an injunction against the illegal conduct to compulsory licensing or publication of the program's source code. The court could even order structural relief, such as separating ownership of the Operating System rights from rights in application programs[55] or auctioning off the source code to a number of purchasers who would then compete.[56] However the traditional antitrust remedies may seem too harsh and not in the best interests of the public. One remedy, however, worth some regard is the Essential Facilities Doctrine.

VIII. Essential Facilities Doctrine.

A. *Terminal Railroad*

Perhaps one of the most authoritative writings on the application of the Essential Facilities Doctrine to Computer Operating Systems remains the article written by Teague I. Donahey in 1997, entitled *Terminal Railroad Revisited: Using the Essential Facilities Doctrine to Ensure Accessibility to Internet Software Standards*[57]. In this article he has discussed in great length the case of *United States* v. *Terminal Railroad Ass'n of St. Louis*[58], and has discussed its application to the monopoly created by Operating Systems in the present day.

In the *Terminal Railroad Case*, the courts, for the first time recognised that a monopoly in some situations would not only be desirable but also more

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55 In the Microsoft case, the District Court had ordered a division of Microsoft, into two companies, one consisting of business relating to OSs and the other of Application Software. However this decision was reconsidered at the appellate stage as being too harsh a remedy.

56 *Supra* note 7 at 186.

57 Teague I. Donahey, "Terminal Railroad Revisited: Using The Essential Facilities Doctrine To Ensure Accessibility To Internet Software Standards", 25 AIPLA Q. J. 277(1997).

58 224 U.S. 383 (1912).

beneficial than open competition. Here the Terminal Railroad Association had acquired all the railway lines and bridges in the city, thus having a monopoly on the railways. Contrary to expectation, the court did not order a split in the company, but instead recognised that the previous system had lead to an unnecessary duplication of facilities, further that a number of railroads would lead to the fragmentation of the city and unnecessarily high costs of construction.[59] It would "*preserve to the public [the] system of great public advantage,*" but it would require the Association to provide competing railroad companies with access to its tracks and bridges on "*reasonable terms and regulations*"[60].

B. Microsoft Corporation

Since the 1980s with the advent of Microsoft and its Personal Computer (PC), Microsoft has made great inroads in the market of Operating Systems. With Windows acquiring a large market share, a number of writers have compared this situation with a natural monopoly, similar to the one created in the *Terminal Railroad Case* referred to above. Further the advent of Windows 98, where the web browser formed an integral part of the Operating System, gave rise to a large amount of litigation against Microsoft both by the United States Government and by private parties both within the US and in other countries. While as of now, the litigation initiated by the government has been concluded, some litigations such as those against Java, etc. in the US, and one in Europe, are still pending against Microsoft, though it is expected that they will be decided in line with the consent decree passed in the former case. While the court recognises that Microsoft possessed a monopoly in OS, its decision is much in conformity with the Terminal Railroad case, i.e., compulsory licensing as against effecting a split in the company. It is thus essential to understand fully the application of this doctrine not only in the case of Microsoft, but also in the case of any future Operating System which may become a standard in the market. This doctrine is based on the concept of a 'natural monopoly'.

C. What Is A Natural Monopoly?

While the term 'natural monopoly' has become a term of art in the fields of both law and economics, it will be treated here in a relatively broad sense: a 'natural monopoly,' at root, is a monopoly which is inevitable and/or socially desirable. Typical examples of natural monopolies have included electric utilities, gas pipelines, and wire or cable-based communications systems. *Terminal Railroad Case*, of course, dealt with what has been one of the most classic natural monopoly industries: the railroads.[61]

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[59] *Supra* note 57 at 279-281.

[60] *Supra* note 57 at 281 referring to Terminal R.R., 224 U.S. 383 at 411.

[61] *Ibid* at 284.

There are several barriers to entry of competitors, in the case of natural monopolies.

- The software industry as a whole exhibits substantial economies of scale, and what results is the same type of natural monopolistic market behaviour as has been seen in the railroad industry. Though software companies face substantial fixed costs in the form of an educated workforce, facilities and equipment, and the considerable time required to develop a software program, the marginal costs are relatively minimal; once a software product has been developed and production begins, it costs very little to produce an additional copy. Thus, average cost per unit decreases substantially as sales volume increases.[62]

- Network externalities (or network effects) are another common barrier to entry. This is sometimes coupled with the effect of innovative technology. There are several factors which cause innovative technology markets to be more prone than others to natural monopoly formation. They are (1) competitors may not have the knowledge or expertise to immediately produce a competitive product; (2) competitors may not be able to immediately afford to develop a competitive product; and (3) intellectual property rights may limit a competitor's ability to immediately create a viable alternative. In the sense that new and innovative technology often does not face legitimate competition for a certain time period, any resultant monopoly, while temporary, is essentially inevitable.[63]

  These factors together are sufficient to conclude that a natural monopoly can be said to exist in Operating Systems in the manner that they exist today. The dominance of Microsoft in the Operating System market is as yet unchallenged. The advent of the Linux Operating System poses a challenge to Microsoft; being a freeware program, it has an edge over Microsoft and an incentive for users to switch to Linux, and avoid the high cost of software it otherwise has to incur. In India as in other countries, one can see the effects of the battle. While Microsoft President, Bill Gates, has in the past few months invested large amounts of money on computer education in India, Linux has been hard selling its Operating System, attracting users by the fact that it is free to be used by all, and has persuaded several State Governments to use the Linux Operating System. No doubt, these tactics will continue, until either Microsoft regains its monopoly status, or Linux is able to effectively take its place.

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62 *Supra* note 57 at 293.

63 *Ibid* at 289, referring to Herbert Hovenkamp, "Technology, Politics, and Regulated Monopoly: An American Historical Perspective", 62 Tex L. Rev. 1263, at 1264 (1984).

But whichever way the scales turn, the resulting monopoly will eventually attract the same evils that antitrust law seeks to prevent.

D. Relevance Of The Essential Facilities Doctrine

The Essential Facilities Doctrine is best understood as a unique remedy. In situations where it would be impracticable or undesirable to increase competition in a given primary market, the Essential Facilities Doctrine provides that a court may require a monopolist to provide access of 'essential' resources to firms in complementary markets. This remedy maximises efficiency by leaving the natural monopoly in place while ensuring efficiency and competition in related, complementary markets.[64]

In the past as well, a number of cases have relied on the Essential Facilities Doctrine. In one landmark judgment; *MCI* v. *AT&T*[65]; MCI claimed *inter alia* that it had been denied access to AT&T's essential telephone facility. Four elements were set forth in *MCI Case* as being necessary for liability under the doctrine: (1) control of the essential facility by a monopolist; (2) a competitor's inability, practically or reasonably, to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.[66] Subsequent to this decision, courts have applied this doctrine in other cases of refusal to deal.

A second leading essential facilities case, *Otter Tail Power Co.* v. *United States*[67], was decided under similar circumstances. In *Otter Tail Case*, the Government brought a suit, after Otter Tail, a regional electric utility company, refused to wheel electric power to a number of small municipalities. The Supreme Court, while not explicitly mentioning the Essential Facilities Doctrine, upheld a District Court decree requiring Otter Tail to distribute power, stating that "*each town ... generally can accommodate only one distribution system, making each town a natural monopoly market for the distribution and sale of electric power at retail.*" Compulsory interconnection was therefore required.[68]

The recent Microsoft judgment, discussed in Part X of this article, while not explicitly using this doctrine, allows for the compulsory licensing of the Windows Operating System, and thus uses principles similar to that of this doctrine. The steady trend of case law shows that this doctrine is perhaps the best suited in the context of Operating Systems.

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64 *Ibid* at 311.

65 708 F.2d 1081 (7th Cir.).

66 708 F.2d 1081 (7th Cir.), at 1132-33.

67 410 U.S. 366 (1973).

68 *Supra* note 41 at 309-310.

IX. Indian Law

A. *Introduction To Indian Law Of Antitrust*

The Indian law as regards monopolies, until recently, did not offer as satisfactory an answer as the law in the US. In India we have the *Monopolies and Restrictive Trade Practices Act, 1969* (MRTP Act), concerned with the prevention and formation of monopolies and the restriction of unfair trade practices. However, in December 2002 the Competition Bill which had been pending in Parliament was passed. The *Competition Act, 2002* (Competition Act) revokes the MRTP Act and is much more suited for the needs of the time. The MRTP Act had several provisions for the prevention and control of monopolistic and restrictive trade practices, It also had provisions for the severance of an undertaking, and many of these provisions have been reflected in the Competition Act. This article highlights the changes that have been brought about by the Competition Act.

B. *The Competition Act*

The long awaited Competition Bill was finally passed by Parliament in December 2002. The Act will replace the MRTP Act, which has become obsolete in certain respects in the light of international economic developments relating more particularly to competition laws. The Act shifts the focus from curbing monopolies to promoting competition.[69] Also it will formulate a new regulatory body know as the Competition Commission of India in place of the MRTP Commission. All cases pending with the MRTP Commission except those dealing with unfair trade practices will be transferred to this body. Mr. Arun Jaitley, Justice and Company Affairs Minister, said: "*There are three main ingredients of the bill - checking the abuse of anti- competition agreements and the abuse of a dominant position, and regulating the procedure related to acquisitions and mergers.*"[70]

1. Provisions For Anti-Competitive Agreements

Section 3 of the Act prohibits any agreement which will have an anti-competitive effect in India. It further declares all such anticompetitive agreements to be void. Such agreements include those which: (a) directly or indirectly determine purchase or sale prices; or (b) limit or control production, supply, markets, technical development, investment or provision of services. Subsection 4 of the above Section lays down that (a) tie-in arrangement; (b) exclusive supply agreement; or (c) refusal to deal shall be agreements in contravention of sub-

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69 Statement of Objects and Reasons, Competition Bill, 2001.

70 Angus Donald, "Indian Cabinet Passes Competition Bill: Reform Move Proposals To Be Presented To Parliament Later This Month Despite Strong Protests", *Financial Times*, June 27, 2001.

section (1) if such agreements cause or are likely to cause an appreciable adverse effect on competition. Finally subsection 5 states in part that nothing contained in this section shall apply to copyright under the Copyright Act. This last subsection is similar to the exception mentioned in MRTP Act, except that this Act declares the exception in the case of copyright expressly while in the MRTP Act, such exception is included in the expression "*under any law for the time being in force*". Thus once again we find that it is only the abuse of powers conferred by copyright that can be remedied by this Act.

Subsection 3 of Section 19 lays down that the Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under Section 3, give due regard to several factors[71]. While some of these factors would work to find the agreement adverse to competition, the last three are mitigating factors, in the presence of which the Commission is less likely to find the agreement adverse to competition.

2. Provisions For Abuse Of Dominant Position

Section 4 prohibits the abuse of dominant position[72]. This section thus recognises that in certain cases a monopoly is unavoidable, and therefore takes steps to prevent the abuse of power conferred on such monopoly. This stand is thus similar to the rule of reason analysis followed by the American courts. Subsection 2 lists out the activities that constitute an abuse, including discriminatory pricing or sales conditions, restricted market access and network effects by forced entry into other connected markets.

Subsection 4 of Section 19 lays down that the Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under Section 4, have due regard to several factors, including the market share, size and resources of the enterprise, the size and importance of the competitors, the economic power of the enterprise including its commercial advantages over competitors, and various market entry barriers caused due to copyright or market dependence.

It must be noted that this Act, does not prohibit monopolies or dominant

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71 The factors enumerated are as follows (a) creation of barriers to new entrants in the market; (b) driving existing competitors out of the market; (c) foreclosure of competition by hindering entry into the market; (d) accrual of benefits to consumers; (e) improvements in production or distribution of goods or provision of services; or (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

72 Section 4, Explanation (a) "dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, whether in India or outside India, which enables it to-(i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.

positions, but the abuse of such dominant position. If an Operating System engages in unfair pricing, imposes barriers to entry, and extends its monopoly into other markets, it would be guilty of abuse of power under this section.

3. Enforcement Mechanisms

The Competition Act seeks to ensure fair competition in India by prohibiting trade practices which cause appreciable adverse effect on competition in markets within India, and for this purpose, provides for the establishment of a quasi-judicial body called Competition Commission of India (hereinafter referred to as CCI) which shall also undertake competition advocacy for creating awareness and imparting training on competition issues.[73] Chapter IV of the Competition Act deals with powers and functions of the CCI. Section 18 lays down that it is the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers, and ensure freedom of trade carried by other participants in markets in India. Section 19 enables it to inquire into anti-competitive agreement or abuse of dominant positions either *suo-moto* or on the complaint of any person or under a reference by the government. Subsection 5 of Section 19 states that for determining whether a market constitutes a 'relevant market' for the purposes of this Act, the Commission shall have due regard to the definitions of the terms "*relevant geographic market*" or "*relevant product market*".[74]

Section 28 then allows the Central Government to order the division of the undertaking, in cases of abuse of dominant position. This Section reflects Section 27 of the MRTP Act.

4. Extra-Territorial Reach

Section 32 allows the CCI to take action in the case of any act, which takes place outside India, which has an effect on competition within India. The provisions of this Section thus offer wider relief that that under MRTP Act, by allowing relief inspite of the fact that the party is outside India. This provision would enable Indian Original Equipment Manufacturers (OEMs) to take action against Microsoft or any other company that is based outside India, in cases where it abuses its dominant position in the Indian market.

It has now only been some time since this Bill became an Act.[75] While critics of the Bill were not entirely satisfied with its provisions, this article has mainly highlighted those provisions which would be instrumental in bringing action

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73 Statement of Objects and Reasons, Clause 3, Competition Bill 2001.

74 See Section 19(5), 19(6) and 19(7), Competition Act.

75 The Bill was notified in January 2003.

against a dominant Operating System. The provisions laid down for abuse of dominant position under both Sections 4 and 19 along with Section 32 would enable the Government or an OEM to bring satisfactory action against Microsoft, or any other company to gain an unfair advantage in Operating Systems due to network effects and copyrighted software. If the CCI were to adequately consider the factors mentioned in Section 19, there would be no difficulty in finding a violation under this Act.

C. *Application Of The Essential Facilities Doctrine In India*

Neither the MRTP Act, nor the Competition Act has within its ambit, any application of the Essential Facilities Doctrine. Nor has the Supreme Court recognised the applicability of this doctrine in any judgment. However it cannot be said that this doctrine is completely at odds with Indian Law. Labour Laws have, for a long time, recognised some services to be of essential or of public utility. In such services, there is a prohibition of strikes and lockouts, except if certain conditions are fulfilled. At the time of enactment of the *Essential Services Maintenance Act, 1981*, Shri C.M. Stephen[76] argued the need for the enactment as follows: "*The simple question is the right of an individual or group of individuals vis-à-vis the right of society...Practically this act is only a declaration that the underlying principle, with respect to essential services must be implemented strongly and vigorously in the protection of society.*"[77]

These same principles, i.e., that of individual right *vis-à-vis* right of society is the basis of the Essential Facilities Doctrine. The Indian Legislature has recognised that these principles must be invoked to limit the right to bargain in cases of essential services, and it will only be time before these principles are recognised to compulsorily license software as against division of an undertaking in cases of a copyright. The Copyright Act already has some provisions for compulsory licensing under Section 31, and therefore it is stated that such a doctrine is not at odds with Indian Law.

X. Case Study Of Microsoft

The one case that has generated a lot of interest in recent times causing a lot of speculation as to what the outcome would be, was *United States* v. *Microsoft Corporation.*[78] It is mainly this case that brought out this whole issue of the relation between copyright in Operating Systems and Antitrust Law. The final consent decree between the two parties was accepted by the court on November 1, 2002. It was the culmination of four years of litigation, and the final verdict has not been to the full satisfaction of many.

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76 Union Communications Minister, L.S.D , September 5, 1981, at 329.

77 Satindra K. Upadhyay, *Law of Essential Services in India: A critical study of the Essential Services Maintenance Act, 1981*, at 15.

78 2002 U.S. Dist. LEXIS 21097.

This part of the article examines the judgment, summarising the provisions made to limit Microsoft's powers, cites some opinions that have been recorded in respect of this judgment and finally suggests alternative ways out for those affected and disheartened by this judgment.

A. Matters Discussed

- The appropriate market was defined as "*the licensing of all Intel-compatible PC Operating Systems worldwide*".
- The Court recognised that the Monopoly was lawfully acquired due to a market prone to network effects.

B. Charges Against Microsoft

- Anti-competitive clauses in agreements entered into with Original Equipment Manufactures (OEM) by Microsoft included prohibitions against altering the appearance of the Windows desktop, or making any changes in the Initial Boot Sequence, or displaying third party brands on the Active desktop.
- Integration of Internet Explorer (IE) and Windows in such a manner that an attempt to delete IE would result in crippling the Operating System.
- Agreements with Internet Access Providers (IAPs)[79] to provide easy access to IAPs' services from the Windows desktop in return for the IAPs' agreement to promote IE exclusively and to keep shipments of internet access software using Navigator under a specific percentage, typically 25 per cent.[80]
- Agreements with Internet Content Providers (ICPs), Independent Software Vendors (ISVs) and Apple, offering deals and inducement, which involved grants of free licences to bundle IE with their offerings, and other inducements to promote IE instead of Netscape.
- Conduct with Java and Intel to prevent Java from developing a viable cross platform threat to Microsoft and Intel from aiding Java in such development.

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[79] *Ibid* note 14.
[80] *Ibid* note 31.

C. Consent Decree (Second Revised Proposed Final Judgment)

The Second Revised Proposed Final Judgment (SRPFJ) which the parties seek to have entered as a final judgment in this case sets forth a number of restrictions upon Microsoft's conduct which are intended to remedy the effects of Microsoft's anticompetitive behavior. Section III of the SRPFJ, entitled "*Prohibited Conduct*", contains the substance of these restrictions. Each of these sections restricts Microsoft's ability to utilise its market power as a means, via retaliation and coercion, to protect its monopoly.[81]

D. Prohibited Conduct

- Microsoft is prohibited from retaliating against any OEM, ISV or independent hardware vendors (IHV), especially when it is aware that the OEM is contemplating developing of distributing a non-Microsoft product, or shipping PCs containing more than one OS, or otherwise exercising any rights under this final judgment.[82]
- Licences given to OEMs, by Microsoft must be on uniform terms, and any discount given by Microsoft to OEMs must be according to some verifiable criteria. This simplified the complicated royalty system currently followed by Microsoft.
- Microsoft is prohibited from disallowing a non-Microsoft product to be displayed on the same area of the screen as Microsoft products are displayed. Restrictions on the Initial Boot Sequence have also been removed.
- All programs must be included in the 'Add Remove programs' utility, and the user can prevent the automatic launch of any software, thus remedying the tying of the IE browser with the Windows OS.
- Microsoft is prohibited from entering into any fixed percentage agreements of granting any consideration to an ISV to refrain from developing or using any software that competes with Microsoft software.
- The decree makes provisions for the proper disclosure by Microsoft of Application Programming Interface (API), communications protocols, and other technical information for purposes of ensuring successful interoperation with Microsoft's Windows Operating System.
- The decree also makes provisions for the compulsory licensing of communications protocols, which are designed to run on a Microsoft

[81] *Ibid* at 49-50.

[82] *Ibid* at 50.

server, for the purpose of interoperating between the Windows OS Product. Also it must license any Intellectual Property to the relevant entity, to enable it to exercise any of the rights obtained under this judgment. Further the terms of these licenses must be reasonable and non discriminatory as regards the monetary consideration and amount of royalties payable.

The above restrictions that have been imposed are, however, limited in their application by the decree, and allow Microsoft certain exceptions to the above restrictions so as to allow it to conduct its business in a fair manner.

E. Other Provisions

- Compulsory access to the source code is granted only to the Plaintiffs, at a secured location.
- The decree will be valid for five years, unless the Plaintiffs apply for extension.
- A Technical Committee and a Compliance Officer have been appointed to aid the enforcement of the decree and the settlement of disputes.

F. Evaluation Of The Judgment

The US Justice Department applauded the ruling, saying the settlement would both address Microsoft's unlawful conduct and restore competitive conditions in the software industry. Attorney General, John Ashcroft, said the department was "*strongly committed*" to ensuring that Microsoft complies with the settlement and will continue to closely monitor the company's implementation of its terms. Microsoft was pleased with the decision, which it described as "*tough but fair*". The company said its compliance would be closely watched by the government and its competitors.[83]

Microsoft's rivals said they would seek tighter limits on the world's largest software company after a federal judge approved most of its antitrust settlement with the Justice Department. Critics said the agreement had many loopholes and that enforcement would be difficult. Bob Lande, Professor of Law at the University of Baltimore characterised the settlement as "*either a total victory for*

[83] Reuters, "Judge backs Microsoft antitrust settlement", *The Economic Times*, Sunday, November 03, 2002, available at http://economictimes.indiatimes.com/cms.dll/html/comp/articleshow?artid=27040057&sType=1#top.

Microsoft or close to it."[84] "*Microsoft lost every battle and they won the war,*" said Shane Greenstein, Technology Business Professor at the Kellogg Graduate School of Management at Northwestern University. "*The lesson everyone learned here is just stay out of Microsoft's way.*"[85]

The case against Microsoft is still pending in the European Union; however, a Microsoft representative said that in the interests of trans-Atlantic consistency, the company hopes the US decision will become a reference point. A strong critic of Microsoft said the Brussels case is different and the Commission must act independently.[86]

One of Microsoft's most tenacious rivals, Sun Microsystems, vowed to keep fighting Microsoft with a billion-dollar lawsuit and urged State Attorney Generals to appeal their antitrust case despite a legal setback.[87] "*We will continue to pursue our civil case and to cooperate with the European Commission's case against Microsoft to ensure that the company does not continue to use its monopoly position to become the gatekeeper of the Internet,*" said Sun Special Counsel, Michael Morris. Microsoft also faces private antitrust suits from consumers and from the world's largest Internet media company, AOL Time Warner.[88]

It is felt that while Microsoft's competitors seem disillusioned by the judgment, the judgment is, infact, quite in conformity with antitrust law. After examining the provisions of the judgment granting compulsory licensing, fair terms of licences, and a considerable opportunity granted to OEMs to make adaptations to the Operating System, it is felt that the only place where the judgment could be found to be lacking is in granting compulsory access of the source code to the OEMs.

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84 Reuters, "MS competitors vow to continue court battles", *The Economic Times*, Saturday, November 02, 2002, available at, http://economictimes.indiatimes.com/cms.dll/html/comp/articleshow?artid=27053443&sType=1.

85 *Supra* note 83.

86 Reuters, "Microsoft focus on Brussels after US decision", *The Economic Times*, Monday, November 04, 2002, available at http://economictimes.indiatimes.com/cms.dll/html/comp/articleshow?artid=27170402&sType=1.

87 Santa Clara, California-based Sun filed a suit seeking more than $1 billion in damages and claiming its business was damaged by Microsoft's abusive monopoly, which impeded the use of Sun's Java software platform.

88 Reuters, "Sun to pursue billion-dollar Microsoft suit", *The Economic Times*, Saturday, November 02, 2002, available at http://economictimes.indiatimes.com/cms.dll/html/comp/articleshow?artid=27040671&sType=1.

However, compulsory access to the source code might present some problems itself, the most prominent of these being misuse of source code. This would in turn bring large infringement action and perhaps create more problems than it would solve. In such a case, grant of compulsory access on a case-by-case basis seems the best alternative. The decision of the court to grant compulsory access of the source code, to the plaintiffs, i.e. the State, seems most appropriate.

XI. Conclusion

It has only been two months since the final judgment was declared in the Microsoft case. While many are certain that Microsoft has retained most of its power, others feel that the judgment was fair, and that the restrictions that have been imposed are sufficient to restrain Microsoft's anti-competitive behaviour. However, whatever may be the opinions of people, what remains to be seen is the power of Microsoft after this judgment.

The power of Microsoft, being entirely created by Copyright Law, appears to be unsolved by copyright. Copyright Law appears to have created a monster, which it knows no way of limiting.

The court has recognised that monopoly in Operating Systems is inevitable and has thus proceeded to regulate its anti-competitive behaviour, letting the monopoly remain in place. The courts verdict has been much in conformity with the Essential Facilities Doctrine, ordering compulsory licensing, and thus recognising Microsoft to currently have a Natural Monopoly.

However, the pace of innovation being as it is, it is highly likely that a new company may replace Microsoft in the near future. It is also possible that the entire Windows software become obsolete thus rendering useless the monopoly that Microsoft has. For e.g., since the advent of cellular phones, any company that may have had a monopoly in pagers would have no use for such a monopoly since the very technology is useless.

The technology market thus seems to have a self-regulatory mechanism to prevent long-term monopolies. However, if one monopoly is simply replaced by another, the consumer interests would not be served. The demerits of monopolies would still be looming large; therefore some regulation of these monopolies is essential.

With the help of antitrust principles, to regulate the behaviour of companies as long as they have a monopoly in the software, such monopolies may prove

beneficial to the public. Therefore such regulations should be fair, and not unduly harsh, so as not to result in a detrimental effect on competition. The Microsoft judgment is perhaps the best example in recent times of regulating monopoly with the intention of preserving public interest.

It can therefore be affirmatively concluded that the Essential Facilities Doctrine and compulsory licensing of software are the best remedies to deal with the problem of natural monopoly formations in Operating Systems. The continuous application of such principles to copyright, by the courts, indicates that a new area of law can be said to have developed, which can be termed as 'Copytrust'.

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