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FROM THE PRINCIPAL'S DESK

I write this address for the 6th edition of *The Law Review* with a deep sense of regret and loss at the sad demise of our founder Editor-in-Chief the late Mr. Justice Y. V. Chandrachud, the former Chief Justice of India. His unwavering support and impartial vision were instrumental in giving our fledgling publication the correct guidance. We shall long value and cherish the enthusiasm and support provided by him for all of the six years that *The Law Review* has been in publication. He had been a pillar to our publication and we shall really miss him.

The Law Review has acted as an irreplaceable platform for students to explore the complex maze of law and to contribute to the vast body of legal research in various fields. The fifth edition of *The Law Review* met with great success and was greatly appreciated by the Hon'ble Judges of the Supreme Court and the Bombay High Court as well as all of the reputed law firms of Mumbai. It was well received not only by law schools all over India, but also by eminent institutions overseas.

Continuing the practice from the previous year, The Law Review Committee organized an orientation program for its prospective student authors and newly inducted committee members to facilitate them in developing their legal research and writing skills. The program dealt exhaustively with several aspects right from choosing the subject of the article and researching on it, to specifications and minute details that must be adhered to while publishing it.

In the year 2007, The Law Review Committee received nearly thirty articles, of which eight articles have been chosen for publication on the basis of their content, relevance and coherence in the style of writing. Apart from the editing by the committee, it was ensured that every article was also edited by experts in the area of law dealt with by the article. With this intention, the Committee identified and approached distinguished practitioners of the legal domain, who undertook the challenging task of editing the articles.

The present edition of *The Law Review* carries a rich blend of a variety of legal topics. The articles therein, present not only an analysis of the impact and implications of existing laws but also propose legislation to solve legal quandaries. They further submit detailed academic discussions on current issues pertaining to domestic as well as international law that have interested lawyers and academicians alike.

Over the years, the Government Law College has been fortunate to have received unconditional and wholehearted support in all its endeavours from judges and lawyers, amongst others. I thank the members of the Editorial Board, whose invaluable inputs have made a qualitative contribution to *The Law Review.* This publication would have not been possible without the generous support of some of the most prominent lawyers of the country and I thank the contributors for the same.

It is indeed heartening to see that with every passing year, *The Law Review* has evolved into a fostering ground not only for the student authors but also for its readers. I am sure that in the years to come, *The Law Review* will not only achieve but also sustain its vision to contribute to the development of law and to initiate legal debate and reform.

Mrs. P. R. Rao
Principal, Government Law College

FOREWORD

1. In the Article on "Inventive Step to Innovative Leap: Advocating the Next Big Advance in the Incumbent Patent Regime", the authors say:

   "All avant-garde legislations suffer from a singular yet preponderant pitfall. The contemporariness of such legislation precludes and often curbs further legal innovation. For years, India has walked the tight rope in Intellectual Property Laws, only just meeting its international treaty obligations while balancing the monopoly conferred by these rights within our overall socialist outlook. In amending the law of Patents in the country through three Amending Acts, we successfully fulfilled the TRIPS obligation. However even as these entailed concerted and sometimes unviable concessions, the spurt of expansion of this law unwittingly became the biggest roadblock for further requisite changes that could only have ameliorated and retrieved the situation for our flourishing economy."

2. In the Article on "Globalisation And The Indian Legal Services Sector: Opportunities And Constraints", the author says :

   "Globalisation is the latest exhortation that has come to dominate the world in the past two decades. The frontiers of the global economy have expanded, with increased reliance on the market economy in the fields of labour and cross-boundary professional services. It has been said that a legal services sector of international standards is absolutely essential to support an economy that aims to be world class. India, being one of the fastest growing economies, has already undergone liberalisation in many sectors. Investment and financial flows initiated in the nineties have progressively lowered the barriers to competition and hastened the pace of globalisation."

3. In the Article on "Global Warming And The Alien Tort Claims Act: Desperate Times, Desperate Measures", the author says:

   "The ambivalent attitude of world forces–both political powers and corporate czars, to the scientific link between human activities and climate change has undergone a marked shift over the past decade. From outright scepticism, denial, and even the deliberate concealment

of data, to a full-fledged debate in the United Nations Security Council (UNSC), policy-makers and scientists alike are acutely aware that the adverse impacts of global warming are no longer a remote possibility, but serious consequences to be faced in their own lifetime...

Moreover, unstable conditions exacerbated by climate change in Asian, Latin American and African nations, coupled with refugee populations fleeing from drought and food production, pose a security threat to the US and it fully anticipates being called on to reconstruct and provide aid in such areas. It is in the interests of Congress if corporations share the burden of some of this heavy expenditure entailed. However, it seems unlikely that even judicial creativity can interpret the ATCA as it stands today to recognize global warming claims."

4. In the Article on "Disgorgement : An Introduction Of A New Concept Or A Precedent To Debacle?" the authors say:

"The concept of 'disgorgement' is one of the few concepts which are well established and applied by capital market regulators worldwide. 'Disgorgement is an equitable monetary remedy "designed to deprive a wrongdoer of his unjust enrichment and to deter others" from future violations.' In India, the remedy for a tort or for a breach of contract is damages, penalty or restitution. Disgorgement was never recognised or applied in India as a remedy under Securities law."

5. In the Article on "Jus Cogens: A Rules–Standards Analysis" the author says:

"The term *jus cogens* means the compelling law. In the *jus cogens* discourse, *jus cogens* are seen as norms from which no derogation is permitted. Though the concept as such has become a part of international law doctrine, its content remains a matter of debate. Other issues include identifying a definite institutional actor having the authority to articulate a norm as *jus cogens.*"

6. In the Article on "Beyond A Tudor Approach To Transfer Pricing: Evolving A Model For Effective Use Of Secret Comparables" the author says:

"The introduction of transfer pricing in India since the year 2001 has no doubt witnessed a new era in the taxation of international transactions that is markedly detailed and specific. It has also unfortunately witnessed the almost dystopian practice of use of secret comparables. While some concede that the use of secret comparables may be considered a necessary evil in the light of its significant relevance and necessity, the practice is not without its fair share of detractors."

7. In the Article on "Time to 'Can'– Spam?" the author says:

"Technology poses one of the strongest challenges to conventional legislations, often eviscerating lacunae therein and requiring the conception and recognition of *new* rights. A sterling example of the inadequacy of existing legal paradigms to cope with pace of technological progress is the untrammelled growth of unsolicited commercial e-mail and unsolicited bulk e-mail, commonly referred to as spam. Spamming, once viewed as a mere nuisance, is now posing some alarming problems, with global spam related revenue losses in 2006 alone crossing the 200 billion dollar mark. Besides clogging up inboxes and increasing transaction costs, spam often contains false, fraudulent, or misleading information with children being worst affected."

8. In the Article on "In Defence of Bethlehem" the author says:

"It is an interesting irony that history traces civilisation through warfare. Almost as old as warfare are the laws of war. The Old Testament, for example, states conditions under which enemy cities may be destroyed and people enslaved. Also, much of what is today accepted as the law of warfare has its origins in the 17th century writings of Hugo Grotius."

This article analyses the provisions of international law that allow States to respond to terrorist attacks with force. To lend context to the discussion, the author will use the July War between Israel and Lebanon as a backdrop.

Late Mr. Justice Y. V. Chandrachud
Former Chief Justice of India

INVENTIVE STEP TO INNOVATIVE LEAP: ADVOCATING THE NEXT BIG ADVANCE IN THE INCUMBENT PATENT REGIME†

*Akash-Pierre Rebello** and *Jeet Shroff***

I. INTRODUCTION

'It may be a small step, but it is a step forward, and that is all that is necessary so far as the subject matter is concerned.'

The Privy Council in *Canadian General Electric* v. *Fada Radio*[1]

All avant-garde legislations suffer from a singular yet preponderant pitfall. The contemporariness of such legislation precludes and often curbs further legal innovation. For years, India has walked the tight rope in Intellectual Property Laws, only just meeting its international treaty obligations while balancing the monopoly conferred by these rights within our overall socialist outlook. In amending the law of Patents in the country through three Amending Acts[2], we successfully fulfilled the TRIPS[3] obligation. However even as these entailed concerted and sometimes unviable concessions, the spurt of expansion of this law unwittingly became the biggest roadblock for further requisite changes that could only have ameliorated and retrieved the situation for our flourishing economy.

Modern day Patent law is not restricted merely to path-breaking invention. Its evolution has led to the acceptance of *economic significance* as a patentable attribute. Utility Models refer to those inventions that do not meet the patentable levels for non obviousness and inventiveness but are still innovations that are granted protection, albeit, for a lesser period of

† This Article reflects the position of the law as on 10 August 2007.

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1 AIR 1930 PC 1.

2 *The Patents (Amendment) Act, 1999, The Patents (Amendment) Act, 2003, The Patents (Amendment) Act, 2005.*

3 The Trade Related Intellectual Property Rights Agreement (TRIPS).

time. They represent a form of protection that does not unduly discourage competitors from building on an innovator's contributions while permitting an improver to capture the economic value of his improvement.[4]

The concept of Utility Models has been successfully used in China, Germany, Japan and Italy to propel growth and introduce an element of inventiveness, or at any rate, innovativeness, in predominantly the small scale industry sector as also in other sectors of their industries. An example of this process is that protection for Utility Models has been shown to improve productivity in countries with lagging technologies. In Brazil, Utility Models helped domestic producers gain a significant share of the farm-machinery market by encouraging adaptation of foreign technologies to local conditions.[5] Utility Models in the Philippines encouraged successful adaptive invention of rice threshers.[6]

The spawn of a booming Small Scale Industry in India, has prompted the need to innovate amongst these businesses to meet increasing competition. The advent of Incremental Patents has further hastened the need to protect diminutive innovations, which, while never being inventive enough to be patented, embody patentable-inventions in the making. These inventions are called Utility Models and as stated above, are accorded legal protection for reduced periods in a number of countries. Yet, despite their palpable benefits to India's burgeoning economy, they continue to remain derelict and deserted due to the deluge of legislation, the Patents Act has already attracted.

This article seeks to comprehend the notion of a Utility Model and test its efficacy for India. Further, it seeks to juxtapose Utility Models against the present Indian Patent regime. Lastly, it seeks to observe from the sidelines,

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4 JH Reichman, 'Legal Hybrids Between The Patent And Copyright Paradigms' 94 *Columbia Law Review* 2432.

5 Robert E Evenson & Larry E Westphal, Technological Change and Technology Strategy, in 3A Handbook of Development Economics (Jere Behrman & TN Srinivasan eds. 1995), 2257 (citing S Dahab, Technological Change in the Brazilian Agricultural Implements Industry (1986) (unpublished Ph.D. dissertation, Yale University)).

6 *Ibid*, 2261. Quoting KW Mikkelsen, Inventive Activity in Philippine Industry (1984) (unpublished Ph.D. dissertation, Yale University).

corresponding laws on Utility Models in other Common Law jurisdictions and craft a possible legislation to meet India's peculiar needs.[7]

II. Delineating A Conception: Utility Models Vis-à-Vis Conventional Patents

A. What Is A Utility Model?

The first country to incorporate and legally enforce Utility Models was Germany. Termed 'Gebrauchsmuster', the first legislation on the point came up in 1891.[8] It was conceived as a protection for innovations which require less capital for research and development and has therefore on occasion been defined as 'a creation much simpler than an invention or an invention which need not be the result of the intensive inventive activity that is characteristic of ordinary inventions.'[9]

The traditional German law accentuates the need for Utility Models to bring about some advance by virtue of their conformation, arrangement or device although the improvement may not meet the conventional benchmark of Patentability.

The European Union Green Paper on contemplated community action for Utility Models defines a Utility Model as 'a registered right conferring exclusive protection upon *technical inventions* possessing novelty and involving an inventive step, the thresholds for which are not as great as in the case of Patents.' Further, unlike Patents, Utility Models are granted without *prior search* to establish novelty and inventive step. Hence, they

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7 In Part II, the concept of Utility Models and the present position of the law in India is explained. In Part III, international legislations and agreements are analysed, while in Part IV, an attempt is made to evolve a possible law for India. Finally, the authors conclude with a plea for an unprejudiced consideration of the nuance of this principle and recommend an expeditious incorporation of the same in the prevalent patent regime.

8 Kelsey Martin Mott, 'The Concept of Small Patent in European Legal Systems and Equivalent Protection under United States Law', *Virginia Law Review,* (March, 1963), vol 49 [2], 239.

9 Martian-Achard, 'Y a t il lieu d'étendre la protection légale aux modèles d'utilité ? 53 (1934). Zeitschrift Fur Schweizerisches Recht 221a-22a' reported in Kelsey Martin Mott 'The Concept of Small Patent in European Legal Systems and Equivalent Protection under United States Law' *Virginia Law Review* (March, 1963), vol 49 [2], 232, 239.

are protection rights which can be obtained more swiftly and cheaply but which also confer less legal certainty.[10]

Summarising the differing definitions, we may come to certain common ground that forms the crux of the concept of Utility Models. The essentials of the protection may be categorised as follows:

- Reduced requirement of inventiveness;
- Conferment of exclusive exploitation rights upon the owner;
- Shorter period of protection as compared to traditional patent rights;
- The examination of the application for the aforesaid requirements is precluded, making Utility Models an effective, quick and cheap mechanism of protecting diminutive inventions having an element of novelty but not enough inventiveness to qualify for a successful patent grant.

B. Where Does It Stand In The International Legal Scenario?

Modern day jurisdictions have been more than liberal in embracing Utility Models. Variously described as 'innovation patent' in Australia, 'utility innovation' in Malaysia, 'utility certificate' in France, and 'short term patent' in Belgium, as many as seventy five countries provide utility model protection in some form or the other.[11] Strikingly however, USA, UK and Canada still do not allow or accept the notion. India, which predominantly follows the British Patent system, is another notable naysayer.

Utility Models are covered within the ambit of the Paris Convention by virtue of Article 1(2)[12] which includes Utility Models within the meaning of the term 'Industrial Property'. However, while it does not define Utility Models *in specie,* it significantly goes on to apply the principle of National

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10 EU Green Paper on Utility Models to evaluate the need for community action.

11 Uma Suthersanen, 'Utility Models And Innovation In Developing Countries', Feb 2006 UNCTAD-ICTSD Project on IPR and Sustainable Development 3.

12 *Ibid.*

Treatment to Utility Models as a natural corollary of the application of National Treatment to 'Industrial Property'. Utility Models are also covered by the Patent Cooperation Treaty within Article 1(2).

The TRIPS Agreement– the ruling zeitgeist in International Patent Law, on the other hand, conspicuously excludes mention of any second tier patent protection, Utility Models included. Effectively therefore, the inclusion or otherwise of Utility Models within a county's domestic laws is a matter of policy left to each individual nation and is not imposed by any contemporary international law or treaty. It is submitted that this very incongruence amongst countries that allow Utility Models and those that do not, may work to India's advantage, as it has in the case of Germany and China. Every developed country has at some point in time walked the quintessential tightrope by balancing international obligations against its own commercial interests. Utility Models may play a crucial role in such cases by allowing India to push for better reciprocal concessions, while allowing us to maintain and preserve the country's interests within international obligations that regulate traditional patent law but which leave the Utility Model system untouched. The absence of such straitjacket International obligations provides the necessary leeway to mould the law and incorporate it within the present system without significant changes.

III. Synergies Of Scale: The Dawn Of A New Policy-Supplement?

The idea that a sub-patent regime could help improve the innovation climate in a country and consequently be beneficial to an economy is gaining greater credence. Today Utility Models are the most recommended means of improving innovation in developing countries.[13] The importance of implementing policy toward the establishment of a Utility Model regime would lie in the numerous benefits accruing from

[13] Lewis and Reichmann, 'Using Liability Rules To Stimulate Local Innovation in Developing Countries: A Law and Economics Primer' 6.

securing the interests of domestic industry and specifically by promoting innovation amongst SMEs.[14]

A. Redistributing The Right To Innovate In India

The importance of SMEs to Indian industry is undoubted. It is estimated that India's 3 million SMEs account for almost 50 per cent of industrial output and 42 per cent of India's economic exports.[15] Studies have also indicated that at one point of time they accounted for 80 per cent of the industrial workforce.[16] Any measures for significant economic development in India must therefore take into account the needs and requirements of Small Industry.

In the past the Government resorted to measures such as reserving items solely for manufacture by small scale industries. Over the years however, the number of items reserved exclusively for the small scale sector has been reduced, although there is an export obligation for those other than small industries entering such areas, together with a licensing requirement.[17] Government policy seems to favour such de-reservation and it is therefore expedient in light of opening up of these sectors that promotion of innovation be encouraged through market mechanisms so as to lessen the blow and to allow small scale industry to compete on equal terms.

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[14] *Small and Medium Scale Enterprises (SMEs).* Thus the effects of Indian accession to the TRIPS agreement and consequent requirement for protection of domestic industry, the needs and synergies of the patent system given the "New Indian" emphasis on Foreign Direct Investment (FDI) as a model of development and the importance of promoting innovation amongst SMEs, especially keeping in mind the emergence of a strong Indian information technology and pharmaceutical sector are all relevant issues in light of which a policy shift incorporating Utility Models should be analysed.

[15] VP Kharbanda, 'Facilitating Innovation In Indian Small And Medium Enterprises – The Role Of Clusters' (10 February 2001) vol 80 [3] *Current Science* 343.

[16] BL 1996:1 as cited in Sreedhar Srikant, 'The Role Of Public Policy In Promoting Innovation Among Small And Medium Enterprises : A Comparative Study Of India And Korea,' *available at* http://www.cherry.getech.edu/sim/students/papers975/srikant.PDF (last visited 10 August 2007).

[17] Report on Economic Policy, Government Law College Policy Dossier 2007, 24.

When it comes to innovation, SMEs though forming the backbone of Indian industry are as yet in technological backwaters and are plagued by low levels of Research and Development (R&D).[18] This would in no small part be due to the large expense involved in research activities which are not within the financial means of small industry.

Utility Models appear to be the most direct way of addressing SMEs being priced out of innovative activities. The nature of the Utility Model, which requires only an inventive as opposed to an innovative step, would obviously require less amount of R&D and therefore permit small industries to participate more freely. This most basic feature of the Utility Model would in a most simple and logical manner drastically reduce the price of innovation. Additionally, Utility Models are cheaper and quicker to obtain given the less stringent examination requirements. Thus, reforming the low levels of innovative activity with regard SMEs in India by providing a cheap alternative to patents would increase their productivity. It has further been argued by Cordsen that even if Utility Models are only used as a marketing tool, it will lead to cost/benefit ratios substantially favourable to SMEs.[19]

Given the impact and the importance of SMEs to the Indian economy and labour force, increased economic benefit to SMEs would not only increase industrial output but also have far reaching consequences given the share of the labour force employed by SMEs. By focusing on SMEs as the fundamental vehicles of Indian industrial growth and enabling them to compete in a free market, we would be achieving an 'inclusive industrial growth' that has a direct effect both on the GDP as well as on employment.

B. Competition, Protection and Innovation in the Post TRIPS Era

India has now largely fulfilled obligations agreed to at the time of joining the World Trade Organisation and acceding to TRIPS. The TRIPS regime

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[18] *Supra* n. 15.

[19] Peter Cordsen, 'Use Of Patents And Utility Models For Enhancing The Competitiveness Of SMEs', (2003) WIPO/IP/DYU/03/3.

universally establishes minimum standards for patents. In India, the effect in the legal regime has been that now both process and product patents are protected and this has prevented Indian companies from reverse engineering[20] inventions, most notably in the pharmaceutical sector.

A discernable repercussion is that the number of patent filings and consequently holdings of domestic companies will steadily decline. According to WIPO, as of 2005, 63 per cent of patent applications in India were from non-resident Patent holders as against a world average of 38 per cent.[21] This is evident of a larger trend in patent filing applications. There has been an 8 per cent decrease in patent filings by residents and a consequent 7.8 per cent increase in patent filings by non-residents in India.[22] The greater share of innovative activity in India therefore seems to be from non-resident actors. Given these developments, it is the view of the authors that affirmative steps have to be taken to encourage innovation in domestic industry.

A shift to Utility Models could be one such measure that ensures that a larger part of the innovative pie is available to Indian Small Scale Industry. TRIPS does not regulate, inform on or indeed make any mention of Utility Models and therefore Utility Models remain unaffected by its minimum standards. Local companies could theoretically make huge windfalls by adapting inventions to local conditions and needs. The lower threshold of inventive activity would greatly facilitate such intense competitive activity from small scale industries. Empirical evidence, in countries like Japan seems to support the proposition that Utility Models assist domestic industry to compete against foreign patent holders. Local Japanese industries specialised in adapting and improving inventions

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[20] Reverse engineering is the process of pulling apart an object to see how it works in order to duplicate or enhance the object.

[21] *Available at* http : // www.wipo.int / ipstats / en / statistics / patents / patent_ report_ 2007. html #P403_24859 (last visited 20 Sestember 2007).

A recent analysis of the spill-over effects of FDI on innovation has been carried out in China, which is the largest recipient of FDI in the world. The effect of the great influx of foreign capital in China has had discernable spill-over effects on domestic patent holdings among local Chinese firms,[27] effects that are both positive and significant. Statistical data analysed between 1995 and 2000 has shown that in China, a 1 per cent increase in FDI can result in a 0.12 per cent increase in the number of applications for Invention Patents,[28] a 0.18 per cent increase in Utility Models and a 0.47 per cent increase in Design Patents which cumulatively amounts to a 0.27 per cent increase.[29] The relatively large effect on design patents and Utility Models is also consistent with the 'demonstration effect' of FDI in that it is easier for domestic innovators to follow the examples of the external characteristics of foreign products or processes in creating their own new methods.[30] It is theorized that similar benefits will accrue in India though some basic differences in the economies in the two countries exist. For example, factors such as the fact that India's developmental model is more private sector oriented as well as more entrepreneur based than that of China would only strengthen the prospects of a Utility Model regime and its positive effects on small scale private sector Indian firms; and would be in keeping with the general developmental policy in India.

Though the Chinese example provides no guarantee of translation to India, in the absence of any field level research in the country, the general findings are practical demonstrations of theoretical projections such as the 'demonstration effect'.

Incorporating a Utility Model law would therefore maximise the effects of the FDI policy on developing a self-sustaining vibrant Indian industrial sector, resulting in the possible economic policy supplement.

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27 K Cheung, P Lin, '*China Economic Review*' 15 (2004) 25, 23.
28 A regular patent is referred to as an Invention Patent in China.
29 *Supra* n. 27, 36.
30 *Supra* n. 27.

D. The Opposition To Utility-Models

There have been some objections raised about the viability of Utility Models. The very concept of a Utility Model involves the government adopting protectionist legislation; further curtailing what some would consider the 'freedom to innovate'. Though one may argue that it is only through such protection that competition can be increased, the fact is that it does curtail freedom of the use of information not amounting to conventional intellectual property.

From a theoretical perspective there are certain countries which consider a weaker patent system to be more damaging to the innovative climate. The US position on intellectual property rights, for example assumes that the additional innovation induced by stronger patent systems is substantial.[31] Certain authors, relying on empirical data have argued to the contrary, that firms are largely unresponsive to a change in patent scope.[32]

There are also concerns about the lack of a substantive examination system, which would give rise to uncertainty for third parties. Though it is difficult to test the validity of such a concern, it is noteworthy that a survey carried out on behalf of the European Commission in the UK, France, Germany, Spain and Italy found that on average 50 per cent of industry was "partly to wholly dissatisfied" with the current implementation of Utility Models at present, with satisfaction being greater among SMEs. Thus, 76 per cent of SMEs surveyed expressed high interest in the adoption of a community wide Utility Model system while interest among larger companies was smaller.[33]

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[31] Mariko Sakakibara and Lee Branstett, 'Do Stronger Patents Induce More Innovation? Evidence From The 1988 Japanese Patent Law Reforms', NBER project on Industrial Technology and Productivity, 1.

[32] For example: Jaffe (The U.S. Patent System in Transition: Policy Innovation and the Innovation Process, Research Policy, Vol. 29 (2000), pp. 531–557) in the United States and Mariko Sakakibara, Lee Branstett (Do stronger patents induce more innovation? evidence from the 1988 Japanese patent law reforms, NBER project on Industrial Technology and Productivity) in Japan.

[33] Uma Suthersanen, 'Utility models and Innovation in Developing Countries', Feb 2006 UNCTAD-ICTSD Project on IPR and Sustainable Development, 9, *available at* www.unctad.org/TEMPLATES/Download. asp?docid=7060&lang=1&intItemID=2068 (last visited 26 September 2007).

In addition to theoretical considerations there are practical difficulties. One of the greatest liabilities of the system in India would relate to infrastructure. A Utility Model regime would see a consequent rise in litigation owing to the existence of a new regime. Given the pressure on the judicial mechanism, questions may be raised about the viability of the mechanism. It has been pointed out, that the famed backlog and slow rate of disposal in the Indian Judicial system would seriously hamper the efficacy of a Utility Model system. The general aversion of courts towards the granting of an injunction in cases of alleged infringement may render the Utility Model redundant, since by the time a final decision is arrived at, the period of protection of 6 to 12 years may have run out.[34]

The objections to Utility Models however are largely a matter of governmental policy and it is the particular circumstance which would determine its incorporation. A Utility Model law would not considerably differ from the general policy that is being followed by the Government of India. It seems that the government has been espousing a more liberal market economy in the hopes of maximum benefit accruing to the consumer and the ordinary citizen. Such companies may also develop technical expertise and in the long run could shift to the development of patentable inventions.

Thus, though the Utility Model certainly entails incurring certain liabilities; the fact that in India it appears that given its similarities and synergies with government policy and the Indian developmental context, it would be a very viable measure for promoting increased innovative activity specifically among SMEs. SMEs in over 48 other countries[35] have the competitive advantage of Utility Model regimes which enable them to undertake some form of inventive activity despite lack of large capital investment in R&D and it is desirable that Indian industry also receive similar incentives.

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[34] Authors' interview with Mr Himanshu Kane, Advocate, High Court of Judicature at Bombay, Editor, *The Law Review* Volume 6 on 25 January 2008. The learned Editor further suggested a three-fold device to mitigate this problem: The creation of a separate legal system for Intellectual Property, in the long run; increased use of arbitration mechanism in resolution of disputes; and the imposition of exemplary damages and cost for frivolous suits as well as frivolous claims.

[35] World International Property Organisation, 'Where Can Utility Models Be Acquired', *available at* http://www.wipo.int/sme/en/ip_business/utility_models/where.htm (last visited 20 September 2007).

IV. Probing The Quintessential Dissimilarity: Traditional Patent Law And Utility Models

A. Extant Edict: The Trinity Test Of Patentability

Traditional statutory patent law contemplated only novelty and utility of an invention as essential pre-requisites of Patent protection.[36] The requirement of Inventiveness is a recent inclusion.[37] However in actual application and usage, the requirement of Inventiveness has always formed the crux of judicial interpretation. For instance in 1978, in the case of *Bishwanath Prasad* v. *Hindustan Metal Industries,* the Supreme Court observed,[38] 'The fundamental principle of Patent Law is that a Patent is granted only for an invention that is new and useful. That is to say, it must have novelty and utility. [I]t must satisfy the test of invention or an inventive step.'

The present Patent law reiterates the Trinity Test of Patentability,[39] wherein the requirements of Novelty, Inventiveness and Utility are central to any Patent protection. Section 2(1)(j) of the Patents Act defines an Invention as a *new* product or process involving an *Inventive Step* and capable of *Industrial application.*[40] Inventive Step is defined as a feature of the invention that involves a *technical advance* as compared to the existing knowledge or having *economic significance* or *both*, and which makes the invention *non-obvious to a person skilled in the art*.[41]

Most latter-day litigation on the point has centred around and focussed on determining the constituents of Inventiveness. In *Windsurfing International* v. *Tabur Marine*,[42] the four step test to determine Inventiveness

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36 The definition prior to the Amendment describes an invention as a new and useful improvement of an art, process, method or manner of manufacture; machine, apparatus or other article; and substance produced by manufacture. *See* section 2(1)(j) prior to *The Patents (Amendment) Act, 2002*.

37 *The Patents (Amendment) Act, 2002* incorporated the present definition of Invention.

38 AIR 1982 SC 1444, paras 18 and 21.

39 VJ Taraporewala, *Law of Intellectual Property* (1st edn VJ Taraporewala Mumbai 2005) 35.

40 Section 2(1)(j), *Patents Act, 1970.*

41 Section 2(1)(ja), *Patents Act, 1970.*

42 1985 RPC 59.

was laid down. It was held that the steps included identifying the inventive concept, conjuring a normally skilled but unimaginative person, identifying differences between existing knowledge and the alleged invention through the lenses of that person and finally, considering whether the differences so identified would seem an obvious conclusion of the established existing knowledge to that person or whether he would upon the contrary, associate a certain inventiveness to it.

Terrel on Patents further substantiated the meaning of each of these steps.[43] As per that interpretation, the Court is required to identify a skilled man and the existent *common general knowledge.* Next, it must identify the nearest prior art and identify the lacuna between that and the alleged invention. Finally, in coming to its conclusion it must be unfazed by hindsight.

The Supreme Court in answering the question has applied a dual strict and objective test.[44] It held that, '[T]he first question that must be asked was: Whether the alleged discovery lies so much out of the track of what was known before as not naturally to suggest itself to a person thinking on the subject, it must not be the obvious or natural suggestion of what was previously known?[45] The second question that must be asked is: Would it be obvious to a skilled worker, in the field concerned, in the state of knowledge existing at the date of the patent to be found in the literature then available to him, that he would or should make the invention the subject of the claim concerned?'[46]

Therefore, it is submitted that the law on the point stands firmly entrenched. The tests applied to it are strict ones and interpretation of the impugned question has been far from liberal. It may be realised that the Indian position is really only an extension of the British one. The

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43 Terrel, *Terrel on Patents* (15th edn) para 7.26. *See also* VJ Taraporewala, *Law of Intellectual Property* (1st edn VJ Taraporewala Mumbai 2005) 49.

44 *Bishwanath Prasad* v. *H.M. Industries* AIR 1982 SC 1444, paras 25 and 26.

45 *Bishwanath Prasad* v. *H.M. Industries* AIR 1982 SC 1444, paras 25 and 26. Quoted from *Rado* v. *John Tye & Son Ltd.* (1967) RPC 297.

46 *Bishwanath Prasad* v. *H.M. Industries* AIR 1982 SC 1444, para 27. Quoted from Halsbury, (3rd Edn, Vol. 29), 42.

interpretation of the Apex Court proceeds on similar basis. Hence, the possibility of the Supreme Court reading into the Patents Act, lower and more liberal thresholds of Inventiveness, seems remote.

Yet, this hope may not be without a rational basis. As will be submitted subsequently, the inclusion of *economic significance* as a possible proof of inventiveness in the amended definition opens up new vistas.

B. The Disparity

Utility Models represent the second tier of a Patent system. As substantiated earlier, the key difference between the two lies in the reduced thresholds of Inventiveness expected, and the corresponding reduced protection accorded. Another difference lies in the absence of any substantive examination of the petty patent. These factors have been instrumental in accentuating the underlying economic importance of the Utility Model system, particularly for a rapidly developing country such as India.

Therefore, while traditional Patents require far greater inventiveness than Utility Models, they also enjoy greater periods of protection than Utility Models and have a more exhaustive examination. Utility Models accord protection for lesser periods but at the same time are quicker and cheaper to obtain and most importantly, *do not require the same level of inventiveness.* Further, while traditional Patents require *invention,* Utility Models would require only *innovation.* They need not make path-breaking advances but must substantially contribute to their field.

A pertinent question which then arises is this: what are the standards to be applied in determining the inventiveness of a Utility Model? Traditional Patents are adjudged through the lens of the 'expert skilled in the art.' By what test is the inventiveness of a Utility Model to be weighed? One suggestion put forth is that the inventiveness required for a Utility Model need not appeal *expert skilled in the art,* but rather *to a man of ordinary intelligence.*[47] The Utility Model sought to be protected, need not be inventive enough to impress an expert already skilled in that field.

[47] Authors' interview with Mr. Himanshu Kane, Advocate, High Court of Judicature at Bombay, Editor, *The Law Review,* vol 6 on 25 January 2008.

However, if it appeals as being inventive to a reasonable man of ordinary intelligence, it may qualify as a Utility Model.[48]

As explained earlier, the inclusion of economic significance opens up a vista of possibilities. The absence of any normative precept, British or Indian, further allows the Court, room for manoeuvrability. It is submitted that the term economic significance may mean one of the three things:

1. It may represent the same good being produced at a lower cost due to some technical advance.
2. It may represent the possibility of producing a greater number of goods at same or lower prices due to a technical advancement.
3. Lastly, it may represent a good of better quality being sold at the same price.

Setting aside the nitty-gritty's of the meaning of 'economic significance', it is submitted that the most significant conclusion of the amendment lies in the explicit acceptance of cost efficiency as a constituent of Inventiveness. It is submitted that this newfound realisation firmly places Utility Models as an important offshoot of Traditional Patents. Given that the focus of Utility Models lies in encouraging cost efficiency, if dwarfed, it may only be matter of time before their inclusion within domestic laws becomes necessitated and even mandated.

V. Models Of Utility: Transnational Law And Practice Relating To Utility Model System

A study of the evolution of Utility Models and the law regulating them in various countries is an essential part of the effort to draft a Utility Model law for India. Due to the lack of uniformity on the exact scope of the term Utility Model, this part, in an attempt at clarity, contains a comparative analysis of the Utility Model law of various countries.

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[48] *Ibid.*

The primary parameters that characterize the variance between the different Utility Model systems are the 'Subject Matter of Patentability'[49], the 'Criteria for Protection'[50], the presence or absence of 'Substantive Examination'[51] and the 'Duration of Protection' and it is along these lines that the analysis will be conducted.

A. The Three Utility Model Systems

1. The Patent System

The Patent System of Utility Model law is prevalent in countries like the Netherlands[52], among others[53]. It is considerably similar in most respects to the regular Patent system. The 'Patent system' of Utility Model law is described by Suthersanen as quick 'reservation' systems for patents.[54] The only difference between this variation and the regular Patent Law occurs in the non-examination policy and the shorter term of protection.

An example of the 'Patent system' of utility model is the French 'certificat d'utilité'.[55] The French code is the same as the patent regime in terms of the 'Subject matter of patentability' and 'the criteria of protection'.[56] It however varies from the patent law in as much as it provides for a six

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49 The 'Subject Matter of Patentability' relates to any restrictions put on the type of inventions that can be patented or registered as Utility Models. Thus any requirements for an invention to conform to certain specifications relating to shape, form, physical dimensions or arrangement would tend to restrict what 'subject matter' could be eligible for protection as a Utility Model. Further certain Subject matter can be excluded from protection based on public policy considerations, which would be spelt out in the act. It therefore essentially relates to the actual 'physical object' or 'thing' that is being protected.

50 The 'Criteria for Protection' would constitute the level of Novelty required for an Invention to qualify for protection. It is a reflection of the inventive activity that is required in order to the invention becoming eligible for protection.

51 'Substantive Examination' is the actual verification process by which it is determined by the relevant authority that the novelty and other pre-requisites to the granting of a Utility Model have been complied with.

52 Patents (WTO), Act (Amendment), 14 December 1995.

53 Other countries include Ireland (IE027 Patents, Act, 27/02/1992, No. 1) and France (Intellectual Property Code, Law No. 92-597 of July 1, 1992).

54 Suthersanen *supra* n. 33, 12.

55 Intellectual Property Code, Law No. 92-597 of July 1, 1992.

56 Intellectual Property Code, Law No. 92-597 of July 1, 1992.

year protection, shorter than the twenty year protection available to the long term patent and does not require a prior search report.[57] The differences from the regular patent law are therefore not substantial but merely make registration of the invention less cumbersome, the price being a shorter period of protection.

2. The Classic System And The Raumform Requirement

The Classical Utility Model system is the most popular model used in European countries.[58]

Prior to the overhaul in German law, its utility model regime provided that not all 'small inventions' would qualify as 'utility models.'[59] The *'form'* requirement is brought out in a substantive definition of the 'Gebrauschmuster' by Crotti, who emphasises the necessity for 'Raumform' (spatial-form), described as the 'quality of inventive distinction of the subject matter, perceivable by the senses and is usually a change in the shape of the device'.[60] It is the presence of 'Raumform' which characterises the ability to register a utility model.

A good example of the requirement for 'Raumform' is that a merely technical principle, such as electricity, cannot be subject to a Gebrauchsmuster registration, but a particular switch or circuit which is part of an exterior object, and which determines the Raumform in some way, may be protected.[61] This form requirement is also characteristic of

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57 Article L611-2, Intellectual Property Code, Law No. 92-597 of 1 July 1992.

58 The Classical Utility model system is found in the legal systems of Italy (Royal Decree No. 1411 25 August 1940), Spain (Patents [Utility Model] Law [Consolidation] 20/03/ 1986 [30/12/1998] No. 11 [No. 50]), Denmark, (Act No 130 of 26 February 1992), Greece (Utility Model Law 1733/87, 1 January 1988) Finland Act (800/91) of 1 January 1992), Portugal (Industrial Property Code (Law No 16/95), 1 June 1995) and formerly in Germany.

59 Nicbakht-Djordan, De La Protection Des Petites Inventions, 63-65, University of Geneva, Faculty of Law, Thesis no. 471, 1951 reported in Kelsey Martin Mott 'The Concept Of Small Patent In European Legal Systems And Equivalent Protection Under United States Law' (Mar., 1963) Vol. 49, No.2 *Virginia Law Review* 232, 261.

60 Crotti, 'The German Gebrauchsmuster' (1957) 39 J Pat. Off. Soc'y 566, 569.

61 Kelsey Martin Mott, 'The Concept Of Small Patent In European Legal Systems And Equivalent Protection Under United States Law', *Virginia Law Review* (March, 1963), vol 49 [2], 239.

other countries that follow this system and therefore in Spain[62] as well as Finland[63], similar definitions emerge.

Thus, the classic Utility Model system, like that prevalent in Germany, was originally conceived as a sort of design protection,[64] which differed from the traditional patent largely by the manifestation of form that was required from it, in addition to shortened periods of protection.

In other aspects, the German law is similar the provisions of patent law. Inventions must be novel, have a technical purpose and cannot be illegal or immoral. The novelty level was of slightly a slightly complex nature and was closely related to the external form requirement. The level of novelty did not require a completely new technical principle to be developed but was satisfied even if an existing principle was manifested in different physical form.

Thus, the required level of inventiveness though high, is focused on the external manifestation of the idea or principle and therefore this underlying principle or idea need not conform to the innovation requirements. Thus, as we shall see, the concept of novelty as embodied here is different from that present either in the Patent or the Second-Tier regime.

Therefore, countries in the classical system have laid down a two step test: a tangible form (three dimensional or two dimensional), and a novelty of concept, closely related to this form requirement.

3. The Second-Tier Patent System

There is a third system of law which governs Utility Models in the world today. The German transition to the second-tier patent system and a survey of the law of Australia[65] would be the fields of the present study.

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62 Article 145 Patents (Utility Model), Law (Consolidation), 20/03/1986 (30/12/1998), No. 11 (No. 50).

63 Finnish Utility Model Act. (Act 800/91) 1 Jan 2002.

64 Mark D Janis 'Second Tier Patent Protection' (1999) 40 *Harvard International Law Journal* 151, 159.

65 Australia took the first steps towards establishing the second-tier system with its 'Petty Patent System' and has now adopted a fully fledged second-tier system by adopting the 'Innovation Patent'.

a. *Amended German Law*

The formal transition to the new utility model regime in Germany commenced with the attempt at harmonization of European patent laws.[66] The paradigm shift brought in its wake removal of the Raumform requirement and the lowering of threshold required for novelty. The former in particular increased the scope of the Utility Model law and brought a wider field of subject matter under the scope of the utility model law. The German Utility Model law also lays restrictions on the subject matter of a utility model in a similar manner to the Patents Act by not permitting discoveries, scientific theories, mathematical methods, aesthetic creations of form, plans, rules and procedures for mental activities, for plays or for business activities as well as programs for data-processing systems and biotechnological inventions.[67] Thus, now all inventions that are Patentable are eligible for registration as Utility Models.

b. *Australia*

i. 1979-2000: The Petty Patent Years

Since 1979, the Australian second tier Utility Model regime was termed a 'Petty Patent' regime.[68] A petty patent is a short term patent which could be obtained quickly and more cheaply than a regular patent. The petty patent had most of the characteristics of a Utility Model.

The petty patent law did not have any requirements of form as necessitated by the classic system and the criteria were thus the same as for an ordinary

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66 The spatial requirement under German law restricts not only the subject matter of the Utility Model but also its scope. If therefore, protection was provided only for external design or manifestations it was easy for competitors to 'modify' the design appropriately to ensure a different design but appropriate functionality. Apparently, some German courts looked for ways to effectively confer functional protection. *See* Rudolf Krasser 'Developments in Utility Model Law' (1995) 26 *International Review of Industrial and Copyright Law* 950, 254.

67 Article 1(2), Utility model law in the version of the proclamation from 28 August 1986 BGBl. I, P. 1455 www.transpatent.com, translation by http://babelfish.altavista.com/ (last visited 2 August 2007).

68 AU029 Intellectual & Industrial Property Act, 15/12/1939 (19/12/1973), No. 66 (No. 216).

patent.[69] Another major aspect of this petty patent law, seem by many as its primary deficiency was the fact that the same levels for inventive step was applied both to the regular as well as the petty patent,[70] a view that has been confirmed by Australian courts.[71]

The petty patent though making strides in shrugging off the requirements of spatial-form did not constitute a modern 'Second-Tier' regime as the level of novelty was the same as that required of Patents.

ii. The Innovation Patent

In 2000, the Australian government officially repealed the petty patent system and substituted in it place a new 'innovation patent' regime.[72] The novelty threshold for this new patent is an 'innovative step,' a significant softening of the old regime which required the same level of inventiveness as the regular patent.[73] This feature is derived from prior case-law in *Griffin* v. *Issacs*,[74] which adopted a subjective novelty approach.[75]

B. The Period Of Protection And Substantive Examination: Measures That Differ Regardless Of Systems

There are other aspects of Utility Model laws that cannot be confined to a discussion about the various systems as they vary across the three aforementioned systems.

The periods of protection for example vary considerably form country to country ranging from 6 to 15 years. These are all however considerably shorter than the period of Patent protection which is generally for 20 years.

The idea in waiving the examination process for Utility Models seems to greatly facilitate the goals of the Utility Model.[76] Japan and South Korea

69 Section 18, *Patents Act 1990,* Act 83 of 1990 (Cth).
70 Section 7(2) *Patents Act 1990,* Act 83 of 1990 (Cth).
71 *Elconnex Pty Ltd* v.*Gerard Industries Pty Ltd,* (1992) 25 IPR 173 (Full Fed Ct).
72 *Patents Amendment (Innovation Patent) Act 2000,* Act 140 of 2000 (Cth).
73 Section 7(4), *Patents Amendment (Innovation Patent) Act 2000,* Act 140 of 2000 (Cth).
74 12 ALJ 169(1938).
75 Janis *supra* n. 64.
76 Empirical evidence on patent filings shows a great increase in Japan and South Korea after the abolition of the substantive examination prior to grant of a Utility Model.

were the only countries where the old law provided for substantive examination of the Utility Model prior to grant. This was later scrapped by the governments of both countries.[77] Thus, an emerging consensus seems to have been formulated, which favours expediting or dispensing with the process for grant of a utility patent without prior examination, granting of protection for a lesser period than that of a traditional patent and requiring a level of inventiveness lower than that expected of a traditional patent.

There is also the question as to what should be considered as 'prior art' for the purposes of a Utility Model law. 'Prior art base' in Spain is local and therefore restricted to anything that has been published in Spain by any means;[78] the same is true in practice for Italy, though manifestly the law requires a universal examination for novelty.[79] In Denmark,[80] Greece[81] and Finland[82] absolute novelty is the norm, displaying considerable divergence on this point.

Thus depending on the needs of the country and the amount of protection that policy dictates should be afforded to Utility Models, the above criteria tend to vary from country to country.

VI. Evolving India's Model Law: An Ideal Utility Model System For India

A. Classic, Patent, Or Second-Tier- The Best Fit For India?

In drafting a model law for India with regard utility patents, a noteworthy building block is the Model for Development, as laid out by Uma Suthersanen. In elaborating on the principles for formulation of a Utility Model law, she identifies certain key areas that are fundamental in drafting

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77 *Supra* n. 8, 247

78 Article 145 Patents (Utility Model), Law (Consolidation), 20/03/1986 (30/12/1998), No. 11 (No. 50).

79 Suthersanen *supra* n. 33,13.

80 Section 3 Designs Act (Consolidation), 27/05/1970 (17/04/1989), No. 218 (No. 251).

81 Patents (Utility Models Applications), Minister's Decision, 1987, No. 15928/EFA/1253.

82 Section 2, Models Act (Consolidation), 10/05/1991 (22/12/1995), No. 800 (No. 1696).

law on the subject, therefore, the subject matter of protection, the criteria for Novelty, the presence or absence of an examination system and the period of protection.[83] Each of these specifics will have to be addressed in order to the framing of a utility model law for India. While following the general model of the 'Second-Tier patent' system, as is now followed in Germany (modern German) and Australia we shall therefore proceed to lay down the proposed utility model for India.

B. The Specifics Of The Proposed Indian Legislation

1. The Subject Matter

The subject matter protected by the 'Second Tier System' would encompass all those inventions currently protected by the patent regime. Certain exceptions, conforming to public policy considerations in India would, as a matter of course, be granted exemption. This would generally mirror the provisions of the Patent regime and would include all the exceptions envisaged by section 3 of the Act.[84]

2. Inventiveness

The question of terminology in order to define the lower standard of inventiveness is relatively easier to resolve in the Indian context. The German use of the term "inventive" step cannot be applied, as this corresponds to the threshold as laid out in Indian law.[85] The Australian concept of introducing the term 'innovative step' would therefore be more appropriate in the Indian context. It may be appreciated that one of the foremost reasons cited in favour of the Utility Model regime are the reduced and relaxed thresholds of inventiveness that in turn afford protection– not just to patentable inventions but also, more significantly, to *patentable inventions-in-the-making*. Therefore, the authors propose that the test for inventiveness be two-fold: One, the inventiveness required is lesser than that for a traditional patent. A test that may be applied is that

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83 *Supra* n. 33, 38.

84 Sections 3 and 4 together, put forth as many as 16 exceptions.

85 Section 2(1)(j), *The Patents Act, 1970.*

of being inventive enough for a reasonable man of ordinary intelligence rather than a person skilled in the art.[86]

Two, it must be of some utility. As was held in *Griffin* v. *Isaacs,*[87] the Utility Model must not vary in ways 'that make no substantial contribution to the working of the invention.'[88]

The authors further believe that local or domestic novelty in determining the state of the art should be applied as opposed to universal novelty. The establishment of universal novelty would provide for a cumbersome verification process, in effect delaying the process at hand which would be fundamentally opposed to the purpose of a utility patent. Moreover, in the absence of a universal utility patent regime, it may place administrative burdens upon a system incapable of dealing with the same.

Lastly, a competitive advantage would also ensue, giving effect to Indian policy in protecting and encouraging domestic industry.

3. The Term of Protection

The term of protection granted to a Utility Model differs across countries and even within similar systems. Incorporating the idea of a tiered system into the term of protection, the authors would recommend a two tiered system of protection, with renewal of the utility patent having to be applied for after the initial period. The inclusion of such a tiered system will have a significant impact on the system of examination. The idea of 'renewal fees' in order to dispose of Utility Models that have not attained a certain measure of commercial success would also be a useful addition, the actual amount depending on the circumstances.

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86 *Supra* n. 47.

87 12 ALJ 169 (1938). *Also see* Greek Utility Model Law 1733/87, 1 January 1992; *Finnish Utility Model Act* (Act 800/91) of 1 January 1988.

88 It is submitted that the requirement is analogous to the principle of Inadequacy of Consideration contained in sections 2(d) and 25 of the *Indian Contract Act, 1872*: It would not matter whether or not the change was substantial, so long as it real and not illusory. The Utility Model need not meet patentable levels of inventiveness but must possess the quality of effecting a real change in the efficacy of the product.

As to the actual term of the Utility Model in India, the authors, noting that industry would need to be assured of protection to their product, suggest two periods of six years each. The Utility Model thus has protection for the first six years after which it becomes necessary to renew the same for a period of six years, thus providing a twelve year protection to inventions that qualify for renewal. Though most countries provide for ten year protection, with five year tiers, the authors prefer a longer period in light of the fact that indigenous Indian research with its stifling infrastructural hassles and devoid of the same cutting edge technology available to industries in other countries, may need an additional two period to convert the innovation into a patentable invention.

4. Examination Requirements

Relating to the substantive examination requirement, the authors suggest in keeping with the tiered approach a two phased examination requirement. Thus, for the first six years of protection, only a *prima facie* examination is required while substantive examination would be a prerequisite for renewal for a further six years.

Data relating to the effect of a substantive examination is contradictory. When Japan abolished the substantive examination system, a sharp decline in the amount of Utility Model filings was detected (191,785 in 1980 to 8,169 in 2003).[89] However South Korea, with similar laws and policy experienced an increase in filings following the abolition of their substantive examination policy (28,665 in 1992 to 39,187 in 2002).[90] Though many reasons for such a divergence have been put forth, including a different 'innovation culture', the inability to fully understand macroeconomic trends on the basis of filing statistics[91] is reason enough for the authors to believe that a renewal based system, with a *prima facie* examination for the first stage and substantive examination for the second would be the best path forward. Further, given the reluctance of judges to grant injunctions restraining infringement, it would be better suited to

89 *Supra* n. 33, 18.
90 *Supra* n. 33, 18.
91 *Supra* n. 33, 19.

the Indian legal system to have a *prima facie* examination in the first instance rather than none at all.[92] Further, it has been suggested that requirements for advertisement and pre-grant objections etc. be dispensed with so as to expedite and make the grant of a Utility Model more inexpensive.[93]

The system would also enable the Indian Patent authorities to best judge the feasibility of the utility p atent and provide for requisite regulation that may help curb frivolous protection claims.

VII. Conclusion

In fulfilling India's TRIPS obligations, concessions not entirely in the country's interest have been made. Yet, given the blistering pace of our growth, the bigger challenge now is to sustain this newfound resurgence. Increasingly, India is becoming the suited destination to carry out extensive research in several technical fields due to the easy availability of cheap skilled manpower. The economic liberalisation has also played a role in making cutting edge research indispensable. No longer protected, the Indian businesses are coming to terms with competition from the best in their respective fields. Hence, the newly acquired impetus on research is here to stay.

In this scenario, India must look to strike a balance between conferring monopolies obviously contrary to public interest and encouraging the growing trend of competitive research. Utility Models may help find that balance, so essential to the country's sustained development.

The explicit inclusion of *economic significance* as an element of inventiveness, accentuates the evolving patent rationale. No longer are inventions confined to path breaking advancements that occur sporadically and inconsistently. The present day law is as concerned with major technical breakthroughs, as it is with relatively diminutive but economically

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92 Authors' interview with Mr Himanshu Kane, Advocate, High Court of Judicature at Bombay, Editor, *The Law Review*, vol 6 on 19 February 2008.

93 Authors' interview with Mr Himanshu Kane, Advocate, High Court of Judicature at Bombay, Editor, *The Law Review*, vol 6 on 19 February 2008.

significant improvements. This evolving trend is in keeping with the core purpose of Utility Models. An incorporation of the Utility Model system now would subserve India's interests better than at any other time.

Admittedly, Utility Models are not without their shortcomings. Yet, the efficacy of every minor advance deserves to be recognized for it is these small steps that may ultimately lead to Patentable technical advancement. As the Privy Council aptly summarized,[94] 'It may be a small step, but it is a step forward, and that is all that is necessary so far as the subject matter is concerned.'

[94] AIR 1930 PC 1. *See supra* n. 1.

GLOBALISATION AND THE INDIAN LEGAL SERVICES SECTOR: OPPORTUNITIES AND CONSTRAINTS[†]

Anirudh Hariani[*]

I. INTRODUCTION

Globalisation is the latest exhortation that has come to dominate the world in the past two decades. The frontiers of the global economy have expanded, with increased reliance on the market economy in the fields of labour and cross-boundary professional services. It has been said that a legal services sector of international standards is absolutely essential to support an economy that aims to be world class. India, being one of the fastest growing economies, has already undergone liberalisation in many sectors. Investment and financial flows initiated in the nineties have progressively lowered the barriers to competition and hastened the pace of globalisation. There are, therefore, several foreign investors and multinationals who are already present in India today and who require business solution services in local jurisdictions. Hence, a need has been felt for the liberalisation of the legal services sector to provide high-end legal services from lawyers who have both geographic capability and substantive expertise in international transactions.

In the last decade and a half, liberalisation of the legal services sector and international trade in legal services in most developed countries has increased significantly. Axiomatically, in India too, the opening up of the legal services market for foreign law firms was expected. However, till date, the issue of whether foreign firms and foreign legal professionals should be allowed entry into India and on what terms, remains a topic of debate.

[†] This article reflects the position of law as on 7 August 2007.

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Initially, bearing in mind the socialistic overtones of the post-independence era and the then conservative biases, the idea of opening up the legal services market to foreign firms and individuals was met with strong opposition from the legal fraternity and subsequently from the Bar Council of India (BCI)[1] and non-statutory bodies. However, of late there has been a paradigm shift in the attitude of the legal fraternity with regard to the entry of foreign law firms. The latest reported consensus among non-statutory professional bodies such as the Bar Association of India (BAI) and the Society of Indian Law Firms (SILF) seems to be that there can be no opposition to the entry of foreign lawyers, but this should only be done provided certain concessions are made to Indian lawyers and law firms.[2] The All India Bar Association (AIBA) too has reportedly changed its stance on the issue, dropping its opposition to the entry of foreign law firms in India; subject to the condition that foreign legal professionals will not be permitted to appear in courts in India.[3] An amendment to the *Advocates Act, 1961* (the Act), which currently states that a person is allowed to practise law in India only if '... (a) he is a citizen of India...'[4], is anticipated.

In light of the present scenario, several questions arise. Should foreign legal professionals be allowed to practise in India? Will foreign law firms pose a threat to Indian law firms? Further, will allowing foreign firms entry compromise the nobility of the legal profession, by bringing in commercialism, consumerism, and unrestricted competition? Due to its contentious nature, this issue has the potential of substantially changing the complexion of the Indian legal profession.

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1 The BCI is the Central regulatory body of the legal profession, which was established under the *Advocates Act, 1961*. The constitution of the BCI is given in Section 4 of the Act.

2 Dhananjaya Mahapatra, 'Should Foreign Law Firms Get Entry Into India?', *The Times of India* (28 November 2005), *available at* http://timesofindia.indiatimes.com/India/Should_foreign_law_firms_get_entry_into_India/articleshow/msid-1309940,curpg-2.cms (last visited 12 May 2007).

3 Rashmee Roshan Lall, 'Bar Panel Okay With Foreign Law Firms', *The Times of India* (9 March 2007), *available at* http://timesofindia.indiatimes.com/Bar_panel_okay_with_foreign_law_firms/articleshow/1738524.cms (last visited 10 May 2007).

4 Section 24 of the Act.

II. An Overview Of The Indian Legal Profession

A. Ground Reality

India is considered to have the second largest legal profession in the world.[5] Despite this, there are only 6 lawyers for every 10,000 people, which is far less than the ratio of lawyers to people in most developed countries.[6] Though the origins of the Indian legal practice and its regulatory framework are rooted in the old British legal tradition, which includes strong legal ethics and the belief that the practise of law is a 'noble profession' and not a business, the ground reality is somewhat different. In India a large number of advocates practise not as firms but as sole practitioners. Due to numerous restrictions, a majority of legal practices remain small or medium-sized.[7] Also, traditionally in India there is a greater emphasis on family-based firms. On the other hand, law firms from the US and UK have an advantage over Indian law firms due to the structure of their legal sector which primarily consists of large and medium sized law firms, rather than sole practitioners.

As stated earlier in the article, the legislation that governs the right of lawyers and law firms to practise in India is the Act.[8] The only recognised class of persons entitled to practise law in India are 'advocates', ie legal professionals recognised under the Act.[9] Moreover, section 24 provides that only an Indian Citizen has the right to practise and be enrolled as an advocate in India.[10]

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5 India has approximately 600,000 advocates, second only to the United States, which has 800,000 legal professionals. *See* Report on Trade in Legal Services by the Indian Council for Research in Economic Relations, Ministry of Commerce, Government of India, 'Trade in Services: Opportunities and Constraints' (1999).

6 *Ibid*. For example, in California there are around 200,000 lawyers registered with the State Bar as of 31 December 2006, making it approximately 60 lawyers per 10,000 people. *See* The State Bar of California, '2006 Report on State Bar of California Discipline System' (April 2007), *available at* http://calbar.ca.gov/calbar/pdfs/reports/2006_Annual-Discipline-Report.pdf (last visited 8 June 2007).

7 *Infra* Part III.

8 The *Advocates Act, 1961* is the statute that 'regulates the legal profession in India'.

9 Section 29 of the Act. *See also,* section 2(1)(a) of the Act, which defines 'Advocate' as 'An Advocate entered in any roll under the provisions of the Act.'

10 *Supra* n. 4. There is a proviso to this section which states that a national of any other country *may* be admitted as an advocate, if citizens of India are permitted to practise law in that other country.

B. Reciprocity

The only provisions of the Act that allow for the possibility of foreign legal professionals to practise in India are the proviso to section 24, and section 47; which deal with 'Reciprocity'[11]. The principle of reciprocity in international relations fundamentally means that the privileges, benefits, or penalties that are granted by one State to the citizens or legal entities of another, should be returned in kind by the other State. The reciprocity factor is grounded on national honour, professional self-respect, and the desire to use it as a bargaining chip with other countries.[12] Today, no foreigner is allowed to practise the profession of law in India unless: (i) there is a reciprocal right of the same kind in the country of his origin[13] and (ii) he has obtained a degree from a University recognised by the Bar Council of India.[14]

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[11] Section 47 of the Act states: 'Reciprocity. –
(1) Where any country, specified by the Central Government in this behalf by notification in the Official Gazette, prevents citizens of India from practising the profession of law or subjects them to unfair discrimination in that country, no subject of any such country shall be entitled to practise the profession of law in India.
(2) Subject to the provisions of sub-section (1), the Bar Council of India may prescribe the conditions, if any, subject to which foreign qualifications in law obtained by persons other than citizens of India shall be recognised for the purpose of admission as an advocate under this Act.'

[12] Delep Goswani, 'Should The Indian Legal And Accountancy Profession Be Allowed To Advertise And Thrown Open To Foreign Competition?', July 2006, *available at* http://www.icsi.edu/cs/July2006/Articles/Should %20the %20Indian% 20Legal%20and% 20Accountancy%20% 20Profession%20be% 20Allowed%20to%20Advertise%20and% 20Thrown%20Open%20%20to%20Foreign%20Competition%20%20by% 20Delep%20Goswami-5.pdf (last visited 3 June 2007).

[13] Rule 5 of Res. No. 6/1997 of *Bar Council of India Rules, 1975* states:
'No foreign lawyer shall have right of audience in a court of law in India unless there is a reciprocal right of the same kind to an Indian lawyer in the country of that lawyer's origin.'

[14] Rule 3 of Res. No. 6/1997 of *Bar Council of India Rules* states:
'Subject to the provisions of the *Advocates Act, 1961*, a foreign national who has obtained a degree in law from any Institution / University recognised by the Bar Council of India and who is otherwise duly qualified to practice law in his own country would be allowed to be enrolled and /or allowed to practice law in India provided that a citizen of India, duly qualified, is permitted to practice law in that country.'

Whether the right to 'practise the profession of law' only refers to the right to *appear* before courts, tribunals and quasi-judicial authorities is presently under consideration before the Bombay High Court in the matter of *Lawyers Collective* v. *Chadbourne and Park and Others*[15]. 'Lawyers Collective' had filed a petition in the High Court against foreign law firms viz, Ashurst (UK), Chadbourne and Parke Associates (US) and White and Case (US). The Reserve Bank of India had permitted the above-mentioned firms to operate merely as liaison offices as permitted under section 29(1)(a) of the erstwhile *Foreign Exchange Regulation Act, 1973*, as opposed to Section 30 of the *Foreign Exchange Maintenance Act, 1999* (which dealt with grant of permission to practise any profession). A liaison office is permitted to merely act as a channel of information and communication for the Head Office; it is not permitted to undertake any commercial, trading, or industrial activity, directly or indirectly. However, it was alleged that the offices of these firms were involved in active legal practice by providing consultancy services to Indian as well as non-Indian clients.

The High Court at the interlocutory stage held that the words 'to practise the profession of law' have a very wide mandate and cannot be limited merely to being given audience before a court, tribunal or quasi-judicial authority.[16] Under the Act there is no distinction between an 'advocate' and a 'solicitor';[17] as a result, even a lawyer who merely renders advisory legal services is considered to be an advocate, and hence is considered to be practising law. Therefore, the High Court held in the interim order

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15 Writ Petition No. 1526 of 1995.

16 UK – India JETCO Report on opening up of Legal Services, 23 January 2006.

17 Till the year 1976 a dual system prevailed in the High Courts at Bombay and Calcutta on the side of Original Civil Jurisdiction, like in England, whereby a litigant could approach the Court and file a suit only through a Solicitor (commonly referred to as Attorney) and the right of audience to the Courts was granted only to a Barrister or an Advocate duly instructed by that Solicitor. The said system is now abolished and in the whole of India all lawyers are now designated as Advocates.

that only an Indian citizen can be a solicitor/advocate under the Act.[18] Chadbourne & Parke Associates (US) and White and Case (US) subsequently withdrew from India and Ashurst (UK) was the only firm from among those firms that, at that time, continued to have a licensed office in India.[19]

A contrary point of view may be canvassed viz, that legal professionals who do not intend to 'act or plead' before a judicial authority do not necessarily fall within the ambit of the Act.[20] Under section 33 of the Act, only an advocate is permitted to appear before a Court or Authority.[21] However, it is not expressly stated at any point that the right to give legal advice or legal counselling is solely that of an advocate. Also, with reference to section 45 of the Act it is apparent that only 'practising before a court or other authority' is prohibited by a person who is not an advocate.[22] Again, there is no provision for punishment of an individual providing merely consultancy services. Hence the question remains, is it unlawful

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18 The matter was subsequently appealed, and it came before the Supreme Court of India in March 1996. The Supreme Court did not however decide on the essence of the issue, but remanded the matter back to the High Court of Bombay. The case is presently *sub judice* before the Bombay High Court.

19 Today, most foreign firms may not have an office in India, but a number are active on international transactions involving the country, and work in conjunction with domestic firms.

20 Report on Trade in Legal Services by the Indian Council for Research in Economic Relations, Ministry of Commerce, Government of India, 'Trade in Services: Opportunities and Constraints' (1999).

21 Section 33 of the Act states: 'Advocates alone entitled to practise–Except as otherwise provided in this Act or in any other law for the time being in force, no person shall, on or after the appointed day, be entitled to practise in any court or before any authority or person unless he is enrolled as an Advocate under this Act.'
It needs to be noted here that in spite of such a rule in force, there exist a few quasi-judicial courts wherein persons who have obtained a particular professional degree are allowed to appear and plead for and on behalf of their clients although they are not 'advocates'. For instance, the Income Tax Tribunal, the Securities Appellate Tribunal etc *inter alia* allow Chartered Accounts to practice before them. But this right of audience to non-lawyers is restricted only to persons who have obtained the requisite qualification which has been recognised and approved of by the Government.

22 Section 45 of the Act states: 'Penalty for persons illegally practising in courts and before other authorities–Any person who practises in any court or before any authority or person, in or before whom he is not entitled to practise under the provisions of this Act, shall be punishable with imprisonment for a term which may extend to six months.'

for foreign firms to have a presence in India, even if only to provide consultancy services? According to the existing regulations, it *may not be*.

Although in Indian law there is no clear statutory or regulatory categorisation of legal services, the World Trade Organization (WTO) Secretariat in its Background Note on Legal Services[23] has identified and defined three different functional types of services that can be brought under the generic classification of 'legal service'. These are counselling, pleading and notarial. Legal Services have also been classified in detail under the General Agreement on Trade in Services (GATS) and in the WTO's Services Sectoral Classification List[24].

It is said that the advocate is an 'officer of the Court'. The legal profession is neither a business nor a trade, but a service provided for the furtherance of justice, to society and the nation; hence its sanctity, dignity, unity and autonomy should be preserved and maintained. However, the new school of thought recognises legal services as services to be provided to consumers, for commercial gain in a 'buyer's market'. The conflicting contemporary viewpoint may be summarised in Adlai E Stevenson's observation, 'Law is not a profession at all, but rather a business service station and repair shop.'[25]

III. Inherent Constraints Faced By The Indian Legal Profession

The profession of law in India faces several rigorous regulatory barriers. These restrictions on law firms as well as lawyers impede the development of the legal profession, effectively deterring Indian law firms from competing with foreign law firms. Protection of the 'dignity of the profession' is the justification given for these stringent and restrictive regulations.[26]

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23 Background note by the WTO Secretariat on Legal Services (S/C/W/43), 6 July 1998, *available at* http://www.wto.org/english/tratop_e/serv_e/w49.doc (last visited 3 May 2007).

24 WTO document no. MTN.GNS/W/120, 10 July 1991.

25 *The Papers of Adlai Stevenson*, Little, Brown 72.

26 Anand Shankar Jha, 'Indian Profession And Trade In Legal Services', *available at* http://www.tradelawonline.com/search/articles/?99dceae2-50ed-438d-ba26-11e92ffc8aa2 (last visited 10 July 2007). *See Indian Council of Legal Aid and Advice* v. *Bar Council of India* AIR 1995 SC 691, *Parmanand Sharma* v. *Bar Council of Rajasthan and Anr.* AIR 1999 Raj 171; *Dr. Hansraj Chulani* v. *Bar Council of Maharashtra and Goa* AIR 1996 SC 1708.

A. Prohibition On Advertising Or Information Dissemination

Advertising or information dissemination in any form is disallowed for law firms and legal practitioners in India. Rule 36 in Part VI, Chapter II of the *Bar Council of India Rules*, *1975* prohibits an advocate from soliciting his work or advertising, either directly or indirectly, by circulars, advertisements, touts, personal communications or interviews, furnishing or inspiring newspaper comments, having entries in law directories, maintaining websites[27], or any other form of promotion. This is a highly restrictive measure, which makes it difficult for the person in need of legal advice to obtain information about lawyers and the legal profession. Hence, the client can only make a choice as to legal representation through indirect means.

B. Partnership As The Only Form Of Collective Legal Practice

In India, a partnership is the only way in which lawyers can practice together. Only natural persons who are registered as 'advocates' are entitled to practise law in India. Therefore, a partnership of advocates would be the only form of an association of persons allowed to provide legal services in India. Further, the *Companies Act*, *1956* lays down a limitation on the number of partners in a partnership to twenty partners.[28] Therefore, there cannot be very large law firms in India, unlike in the West.

C. Nature Of Liability

Partners in law firms have unlimited, joint and several liability.[29] In view of the increasing role of the services sector in the national economy and

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[27] According to recent reports the BCI has now acceded to the requests of the lawyers to allow the maintenance of websites. During the hearing of a petition before the Supreme Court challenging Rule 36, Chapter II of the BCI Rules, the BCI declared that a resolution had recently been passed between the BCI and the State Bar Councils agreeing to amend the Rules to enable lawyers to provide information regarding their address, standing, qualification and specialisation through a website. *See* 'Lawyers Can Own Website: Bar Council', *The Hindustan Times* (29 January 2008).

[28] Section 11(2) of the Indian *Companies Act, 1956* read with Section 4 of the *Indian Partnership Act, 1932*.

[29] Section 25 of the *Indian Partnership Act, 1932*.

the growing number of professionals, a need has been felt for a new corporate form with limited liability which would enable professionals to organise and provide a larger range of services.[30] The Ministry of Corporate Affairs has recently submitted a draft paper regarding possible changes to the present legislations to allow Limited Liability Partnership (LLP).[31] It is pertinent to note that the LLP Bill on a stand-alone basis will not be enough to allow foreign law firms entry. This is because the proposed LLP law is a procedural law, whereas the Act explicitly prohibits the practise of law by non-citizens.[32]

D. Bar On Partnership With Non-Advocates

As per Rule 2, Chapter III of the *Bar Council of India Rules*, *1975*, advocates are prohibited from forming a partnership to provide legal services with anyone who is not an advocate as prescribed under the Act.[33] There are currently no provisions for 'multi-disciplinary' partnerships

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[30] An LLP has elements of a partnership and a corporation. In an LLP, all partners have a form of limited liability, similar to that of shareholders of a corporation. However, the partners have the right to manage the business directly, and (in many areas) have a different level of tax liability than in a corporation. To date, as per the provisions of the *Indian Partnership Act, 1932* and the Indian *Companies Act, 1956*, an LLP is not permitted in India.

[31] *The Limited Liability Partnership Bill, 2006* was introduced in the Rajya Sabha on 15 December 2006. Various Committees and Expert Groups have previously recommended the introduction of LLP legislation in India, including the Abid Hussain Committee (1997), the Naresh Chandra Committee on Regulation of Private Companies and Partnerships (2003) and Dr. Irani Committee on New Company Law (2005). The LLP structure is permitted in countries like UK, USA, Australia, and Singapore among others. The proposed LLP Bill is broadly based on UK and Singapore LLP legislations. *See* 'Limited Liability Partnership Bill Introduced', Press Information Bureau, Government Of India, *available at* http://pib.nic.in/archieve/others/2006/dec06/r2006121530.pdf (last visited 3 May 2007). The Society of Indian Law Firms (SILF) and the Ministry of Corporate Affairs (MCA) too have shown confidence in the LLP structure, and have organised a number of seminars relating to LLP.

[32] KR Srivats, 'Limited Liability Partnerships Bill Not Enough For Foreign Law Firms', *Business Line* (India 28 May 2007), *available at* http://www.thehindubusinessline.com/2007/05/28/stories/2007052802471100.htm (last visited 4 June 2007).

[33] Rule 2 of Chapter III reads as under:
'An Advocate shall not enter into a partnership or any other arrangement for sharing remuneration with any person or legal Practitioner who is not an Advocate.'
The same may be inferred on the coalesced reading of sections 29 and 33 of the *Advocates Act, 1961* which *inter alia* state that only 'advocates' are allowed to practise in India.

that would permit delivery of composite services. The justification given is that the independence of a lawyer could be compromised in associations bringing together professionals subject to different ethical standards. However, the Institute of Chartered Accountants of India has now permitted tie-ups between advocates and Chartered Accountants. This is a move towards providing 'single-window services' or 'one-stop shops' in India, which means providing not merely accountancy but also legal and other financial support services within a single firm.[34]

To augment professionalism and the quality of legal services provided in India, statutory reform is essential. Also, without reform, the fear of some is that Indian firms will not be able to compete with global law firms on a level playing field. However, it is important to ensure that if foreign firms are eventually allowed to practice in India, the *Bar Council of India Rules, 1975* and the restrictions mentioned therein will apply to them as well due to the territorial application of the said Rules throughout the territory of India.

IV. Indian Legal Profession In The Global Perspective

A. India's Obligations Under GATS

The General Agreement on Trade in Services (GATS) is a treaty of the WTO that came into force in January 1995 as a result of the Uruguay Round negotiations.[35] While GATS is a state-to-state agreement, it establishes a framework of international rules within which firms operate around the globe. India is a member-state and signatory to GATS[36] and is obliged to conform to its principles.[37]

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34 *Supra* n. 12.

35 The treaty was created to extend the multilateral trading system to services, in the same way the General Agreement on Tariffs and Trade (GATT) provides such a system for merchandise trade.

36 All members of the WTO are signatories to the GATS. The basic WTO principle of most favoured nation (MFN) applies to GATS as well. *See also* Paul D Paton, 'Legal Services And Gats: Norms as Barriers to Trade', 9 *New England Journal of International and Comparative Law* 361-416.

37 There is great pressure on India to open up its services sector to foreign countries. *See* 'India and the Doha Work Programme, Opportunities and Challenges', 2006 UNCTAD – Ministry of Commerce, Government of India – DFID Project Strategies and Preparedness for Trade and Globalisation in India, *available at* http://www.unctadindia.org/Studies_IndiaAndTheDohaWorkProgramme.pdf (last visited 7 May 2007).

The fundamental principles which are prescribed under GATS include:

(i) National Treatment under Article VII, whereby member states have to provide equal treatment to foreign firms as they do to domestic firms (unless there is an exception expressly set out for National Treatment in the Member's Schedule of Commitments);

(ii) Market Access under Article XVI, which states that there can be no restriction for entry of foreign firms into the services market by quotas, economic needs tests, maximum foreign shareholding limits, and others, unless by exception to the Schedule of Commitments;

(iii) Domestic Regulation under Article VI (4), which affords that statutory domestic regulations must be administered in a reasonable, objective and impartial manner and that qualifications, licensing requirements and technical standards must be fair and not unnecessary; and

(iv) Transparency, ie the member-states must provide all relevant information as is required under the GATS, and must inform the WTO for any changes in domestic policy, regulations, and administrative functions.

It is relevant to note, however, that in the Uruguay Round of the GATS, India had not made any commitments.[38] If the Indian legal profession is to be liberalised, India must provide some open-minded concessions to facilitate mutually beneficial bilateral schemes. It may be noted that there are already statutory regulations in place for reciprocal arrangements between India and other countries.[39]

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[38] During the Uruguay Round, out of the total 58 countries who made commitments, 23 made commitments in advisory host country law, 53 in advisory international law, 52 in advisory home country law, 5 in third country law, and 6 in other legal services (including legal documentation and certification services and other advisory and information services).

[39] The concept of Reciprocity. *See supra* n. 11.

Several member countries, including the likes of USA, Australia, Japan, China, Switzerland, Singapore, New Zealand, Brazil and others have made requests for India to make commitments in legal services. However, the requests have been only for engagement in a consultative capacity mainly on the grounds of commercial association between foreign and local lawyers.[40]

Despite the requests of foreign countries, a foreign law firm cannot set up a practice in India, as Indian advocates are prohibited from entering into profit sharing arrangements with persons who are not Indian advocates.[41] In spite of this, in India today there are already several foreign firms who have 'preferred firm' relationships or arrangements in other forms with certain Indian firms.

B. Comparative Analysis Of Size And Economic Power Of Foreign Law Firms

The US, UK and Canadian law practices are front-runners in international trade and corporate transactions. This is due to several reasons, including the following:

(i) Large and medium sized firms which are ubiquitous in the US and UK, have a competitive advantage over individual professionals and smaller firms present in India;[42]

(ii) English and New York law is recognised as the generally accepted law for international business transactions.[43] In many cases, it is mutually beneficial for both parties to voluntarily subject themselves to laws of foreign jurisdictions. Adopting the jurisdiction of New York and English law is considered advantageous not only because of the law itself, but also due to direct and efficient judicial remedies. For this reason, New

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40 Report by Trade Policy Division, Department of Commerce, Government of India, 'Trade In Legal Services – A Consultation Paper on Legal Services Under GATS', *available at* www.commerce.nic.in/wto_sub/services/consultation-paper-legal-services-GATS.pdf (last visited 10 May 2007).

41 *Supra* n. 33.

42 *Supra* n. 24,8.

43 *Supra* n. 24,8.

York and London are established international seats of arbitration;

(iii) Law firms in common law countries have a global advantage of language – English – over law firms from other developed countries.

The Indian firms' economic output pales in comparison with law firms from the US and UK. In 1992, the output of legal services in the United States was 95 billion dollars, while in the European Community it reached 52 billion dollars.[44] Comparatively, the Indian commercial law practice is estimated at about Rs. 600 - 650 crore per annum[45]. A new and increasing constituent to the output of foreign law firms is international trade in legal services. In the early 1990s, the US and the UK had a combined net trade balance in legal services of almost 2 billion US dollars. The UK accounted for 830 million US dollers, which represented 15 per cent of the entire UK net trade balance from services.[46] In contrast, export in legal services of Indian law firms is negligible.

The rigid restrictions imposed on the Indian legal profession impede the growth of large sized firms in India. It is contended that having functioned within a limiting framework for the past fifty-years, the Indian legal profession is thus far 'ill equipped to compete on par with international lawyers, who have grown their practices in liberalised regimes and have vast resources at their disposal.'[47]

Thus, there is great disparity between foreign firms and their Indian counterparts. Any move to allow foreign lawyers into India, without providing the Indian advocates an opportunity to prepare themselves for a liberalised regime, would in effect, jeopardise the interests of the Indian legal profession.

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44 'Promising Approaches And Principal Obstacles To Mutual Recognition', *International Trade in Professional Services: Advancing Liberalization Through Regulatory Reform*, OECD Publications, 1997. *See also supra* n. 20.

45 Approximately $150-162.5 million (assuming $ 1 = Rs. 40). *See supra* n. 20.

46 *Supra* n. 20.

47 *Supra* n. 16.

C. Regulatory Framework Existing In Other Countries Of Asia

Internationally, the legal framework governing foreign lawyers and law firms is as diverse as the countries themselves. It is therefore worthwhile to consider the applicable regimes for foreign law firms in other countries of Asia.

1. China

When the Chinese economy opened in the early 1980s, there was no organised legal profession or framework prevalent in China to guide and protect foreign investment. Hence, it was imperative that the Chinese government allow foreign lawyers access to the market in order to comfort foreign investors.[48] The policy goal of opening up China's legal services market was also to facilitate the development of the Chinese legal profession. However, even today foreign law firms can provide legal services in China only in the form of representative offices. Foreign legal professionals are only allowed to conduct a limited number of activities, and are required to have practised for at least two years outside China.[49]

2. Singapore And Malaysia

Singapore and Malaysia, despite being relatively unrestricted economies, have nevertheless put several regulatory restrictions on foreign legal professionals. Foreign law firms with offices in Singapore are unable to practise Singapore law, cannot employ Singapore lawyers to practise Singapore law, and cannot litigate in local courts. In Malaysia, foreign

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[48] Hongming Xiao [Duan WC (tr)], 'Legal Profession In China: Past, Present And Future' (1999) vol 1 no 4 *Perspectives, available at* http://www.oycf.org/perspectives/4_022900/legal_profession_in_china.htm (last visited on 5 May 2007).

[49] Hongming Xiao [Zhimin WEN (tr)], 'The Internationalization of China's Legal Services Market' vol 1 no 6 *Perspectives, available at* http://www.oycf.org/Perspectives/6_063000/internationalization_of_china.htm (last visited 5 May 2007).

law firms can provide legal services only through companies incorporated in Labuan, a federal territory of Malaysia.[50]

Foreign law firms in Singapore can only provide legal services in relation to Singapore law through a Joint Law Venture (JLV) or Formal Law Alliance (FLA) with a Singaporean law firm, subject to the 'Guidelines for Registration of Foreign Lawyers in JLV to Practise Singapore Law'.[51] Similarly, in Malaysia a new draft legislation proposes that foreign law firms will be allowed to establish JLV with Malaysian law firms.[52] Malaysian legal professionals and practitioners are already making good use of indirect alliances with foreign law firms.[53]

3. Japan

To date Japan is the most liberalised of all Asian countries with reference to its legal services sector.[54] As far back as in 1986 a 'special measure law' regarding the handling of legal business by foreign lawyers (the 'Foreign Attorneys Law') was enacted in Japan. Today, under this law, foreign lawyers who satisfy certain conditions, including reciprocity, are qualified to provide only consultancy and advisory services in Japan limited to services in relation to the laws of their own jurisdictions of qualification.

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50 Lim Chze Cheen, 'Malaysia: Strategies For Liberalization Of The Services Sector', Managing the Challenges of WTO Participation–Case Study 25, World Trade Organization, *available at* http://www.wto.org/english/res_e/booksp_e/casestudies_e/case25_e.htm (last visited 5 May 2007).

51 'Foreign Trade Barriers – Singapore', National Trade Estimate Report 2004, Office of the United States Trade Representative (USTR), *available at* http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_National_Trade_Estimate/2004_NTE_Report/asset_upload_file185_4795.pdf (last visited 6 May 2007).

52 Mah Weng Kwai & Associates, 'Current Regulatory Barriers Against Foreign Lawyers Practicing In Malaysia', *available at* www.lawcouncil.asn.au/shared/2437057897.pdf (last visited 4 May 2007). *See also supra* n. 16.

53 *Supra* n. 50.

54 Sato Iwao, 'Judicial Reform In Japan In The 1990s: Increase Of The Legal Profession, Reinforcement Of Judicial Functions And Expansion Of The Rule Of Law', *Social Science Japan Journal* 2002; 5: 71-83.

These licensed foreign legal consultants cannot represent clients in court or in administrative proceedings.[55]

D. Constraints Faced By Indian Lawyers In The UK And The US

There are several regulatory measures for foreign lawyers in developed countries. These restrictions extend to Indian lawyers as well.

1. United Kingdom

In the UK, theoretically speaking anyone is allowed to practise the law. This notionally liberal regime has assisted in establishing London as the centre for international legal services. This is evident from the fact that in 2005 exports generated by UK law firms totalled to £2.2 billion, which was more than three times that of 1995.[56] Foreign lawyers are allowed to practise English law, European law, public and private international law, and the law of their own country. The liberties of foreign lawyers in the UK include:

- establishing offices to practise under the home title;
- entering into partnerships with English solicitors, and employing both English solicitors and foreign lawyers within those partnerships;
- gaining temporary admission to the Bar and a right to appear in the English courts in specific cases where specifically authorised and instructed to by an English solicitor;

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55 *Ibid.*

56 Sectors Group Annual Report 2006/07, UK Trade & Investment, Government of the United Kingdom, *available at* https://www.uktradeinvest.gov.uk/ukti/appmanager/ukti/sectors?_nfls=false&_nfpb=true&_pageLabel=SectorType1&navigationPageId=/financial_services (last visited 4 August 2007).

- practising English law with the exception of certain activities reserved by statute to English solicitors and barristers.

Therefore ostensibly, Indian lawyers in the UK are allowed to provide local and global services for their clients. However, entry of a foreign lawyer is subject to regulatory scrutiny.[57] A certificate from the Law Society of England and Wales stating to the effect that a foreigner seeking entry for purposes of 'practise of the law' is a qualified legal professional is necessary to merely get a visa. Also, special qualification is required for foreign lawyers to be certificated as solicitors or barristers in England and Wales, and also for the right to call themselves by the said titles. Even if an Indian lawyer is recognised as a solicitor in India, he has to take a prescribed examination – the Qualified Lawyers Transfer Test (QLTT), to qualify as an 'English solicitor'. Unless a foreign lawyer is qualified as an 'English solicitor' or 'barrister', he does not have the right of audience in the Courts. Further discrimination can be seen in the fact that several areas of law are reserved for the local lawyers and firms. These include drawing up court documents, property transfers, succession, immigration advice and immigration services.

Other restrictions faced by the Indian lawyers are less direct. Experiences also indicate that there exists a 'glass ceiling' with regard to working with barristers and solicitors as articled clerks or interns.

2. United States

There are greater regulatory barriers for foreign lawyers in the US. The American legal system is structured around the federal system of government; therefore each state has its own Bar Association. Each Bar Association has its own set of criteria to apply to join the Bar. For example, a lawyer who wishes to enrol in the New York Bar has to attend a post-graduate law course at a recognised US university for seeking eligibility

[57] *Supra* n. 16.

to appear for the New York Bar examination.[58] Therefore, immediate entry into the law profession is not possible for foreign lawyers, as their international qualifications are not recognised by the individual Bar Associations. It must be noted that the rules for qualification to give the Bar exam vary from one State Bar Association to the next. However, after joining the Bar, there are further restrictions placed on foreign lawyers practising in that state.[59]

Unless these barriers are either fully removed or effectively minimised (in conformity with the Principle of Reciprocity), there remain doubts as to whether foreign lawyers from these countries will be allowed to practise law in India.

V. The Chartered Accountancy Profession – An Analogous Case Study

The Chartered Accountancy (CA) profession in India is fraught with restrictive regulatory measures. The profession is regulated by the *Chartered Accountants Act*, *1949*, and the *Cost & Works Accountants Act*, *1959*.[60] There are a lot of similarities between the profession of CA and the legal profession. In both these fields there are several regulatory barriers and norms which have been enforced to preserve long-standing systems, which are now considered obsolete in this modern era of globalisation.[61] With respect to the CA profession also, concerns have been expressed regarding restrictions pertaining to the size of a firm and the number of partners in a firm and the number of audits per partner, among others.

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58 Rules of the Court of Appeals for the 'Admission of Attorneys and Counselors at Law', State of New York, Part 520, *available at* http://www.nybarexam.org/court.htm (last visited 15 July 2007).

59 For example, the practise of host-country law is permitted only in New Jersey, New York, Alaska, District of Columbia, Hawaii, Oregon, and Ohio. Also, Ohio does not permit partnerships with local lawyers.

60 The Institute of Chartered Accountants of India (ICAI) is the body that regulates the profession of Chartered Accountants in India.

61 *See Supra* n. 12. The concepts of restricted competition and 'sheltered profession' are no longer valid. The world is becoming a smaller place; healthy unfettered competition must be promoted if India is to survive.

Today, the CA profession in India is liberalised, and foreign accounting firms by now have a hold over the market which caters to large multinational clients. There are several foreign accounting firms in India already, including what the world calls the Big Four[62], which have formed collaborations in the form of 'surrogate firm' relationships with Indian firms. A foreign firm is allowed to provide consultancy services under its own name. Consultancy services contribute significantly to the revenue of a CA firm, and foreign firms do have control over a large portion of the consultancy market. However, foreign firms are not independently allowed to work on tax audits or provide tax-related services independently in India, the affiliated Indian partner is required to sign on all such documents. Therefore, it is no wonder that nine out of the top ten largest auditing firms in India owe allegiance to one or the other of the Big Four.[63]

The Indian Chartered Accountant today provides services that are on par with international accounting standards. Nonetheless, questions have been raised as to why the Indian Chartered Accountant is, despite being on par with any global accountant, unable to reap the benefits of such parity, and how much longer will India have to wait before Indian qualified accountants have the same standing in foreign countries as they have in our country.[64] The consolatory response given is that although the principles of mutual recognition and reciprocity are not yet in place, Indian Chartered Accountants are already well recognised in certain countries abroad, as may be seen by the fact that over 10,000 of them

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62 KPMG, Ernst & Young, Deloitte and PWC constitute the 'Big Four' firms of the auditing world. All of them have their presence in India.

63 Research report published in March 2006 by Prime Academy, Chennai. The audit firms were ranked on the basis of five key parameters, viz the size of the firm (number of partners), number of audits, turnover of the company audited, turnover of the audit firm and the geographical spread of the firm. *See* D Murali, 'Firms Will Have To Build Size', *Business Line* (22 February 2007), *available at* http://www.blonnet.com/2007/02/22/stories/2007022202380900.htm (last visited 12 June 2007).

64 Interview with Mr TN Manoharan, President of the ICAI, *Hindu Business Line* (6 February 2006), *available at* http://www.thehindubusinessline.com/mentor/2006/02/06/stories/2006020600041100.htm (last visited 11 May 2007).

hold important positions in foreign governments and also in corporate and other business enterprises world over.[65]

The priorities of the CA profession must now be to provide impetus to the anchoring role of the profession in the growth of the Indian economy and to promote the brand value of the Indian CA firms and individuals in the field. However, as far as liberalisation is concerned, the opening up of the sector has not necessarily been detrimental for the growth of the CA profession in India. The interests of the Indian Chartered Accountants and firms have been preserved due to the limitations placed on the foreign CA firms in India, who are dependent on their Indian partners and cannot exist on a stand-alone basis.

VI. The Road Ahead – Propositions And Possible Outcomes

It is clear that some form of liberalisation is essential for a healthy growth of the legal services sector and for the reduction of unassailably rigid legal barriers. Similar to Business Process Outsourcing (BPO) and other service sector related developments, the recent trend in Legal Process Outsourcing (LPO) will also give impetus to the already booming services industry.[66]

There are several options available to the legal profession today, to name a few:

A. Statutory Reforms

Reforms in the present regulations would afford the Indian legal profession a level playing field, and allow a greater understanding and experience of how international transactions take place. It is important to note that

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[65] The ICAI is currently in the process of negotiation with foreign countries and their respective professional accounting bodies for provision of reciprocal rights for Indian Chartered Accountants, including the Singapore Institute of Certified Public Accountants (SICPA). Similar negotiations are also planned to be taken up soon with the UK, Sri Lanka and Nepal and others. *See ibid.*

[66] The services sector in India is growing rapidly. In 2005-2006, the share of services in the country's GDP was 54.1 per cent. Within this sector, the IT enabled Services (ITeS) and BPO segments have emerged as the main drivers of growth. India's revenue from BPO grew by 50 per cent to a staggering US $3.6 billion in 2003. *See supra* n. 40.

despite several limitations, there are already a number of inherent advantages of the legal system in India–including an established legal lineage, a time-tested Constitution, and the advantage of the English language. Hence the acceptance of reforms would help the Indian law profession exploit its immense potential.

Reforms are required in the following areas:

- The number of partners in a partnership must not be restricted to 20 as is presently the case.
- Limited Liability Partnerships (LLP) should be allowed.
- Advertisement and information dissemination must be permitted.
- Multi-disciplinary partnerships must be allowed to be formed with persons who are not advocates.
- Currently there exists neither statute nor rules relating to the prosecution against or protection from negligent professionals, be it in the legal sector or any other sector. Given the transient nature of practise in India, there must be provisions to penalise lawyers who are proven guilty of professional misconduct. In *Srimathi* v. *Union of India*,[67] it was held that advocates practising law were providing a 'service' as defined under Section 2(o) of the *Consumer Protection Act, 1986* and therefore consumers could seek redressal against advocates for

[67] AIR 1996 Mad 427. *See also P. Krishna Rao & Anr.* v. *Mandipalli Devaiah*, Revision Petition No. 962 of 2002; *M/s Amritsar Haldi Sales Corpn.* v. *Punjab State Electricity Board*, Revision Petition No. 606 of 2002; *M/s Diamond Elastomers Pvt. Ltd.* v. *United India Insurance Co. Ltd.*, Miscellaneous Petition No. 125 of 2002 in Original Petition No.(s) 60 and 61 of 1991 at the National Consumer Disputes Redressal Commission, New Delhi.

deficiency in service in the consumer redressal forums.[68] However, another option is the expansion of the powers of the BCI Disciplinary Committee, which currently only has the power to suspend or revoke a *sanad* (license) and to include passing orders awarding damages. Possibly, a concept such as mandatory professional negligence insurance could be put into place. This measure will ensure greater accountability, and therefore help in enhancing the quality of legal services provided in India.

B. Phased Liberalisation In The Form Of Regulated Joint Ventures

Another possible outcome would be the setting up of Joint Ventures with Indian law firms and advocates, as has been sanctioned in Singapore. Singapore has liberalised its service sector to the effect that foreign law firms are allowed to have relationships in the form of Joint Ventures with firms from their own country. A similar system in India will regulate the distribution of work and prevent the foreign firms from monopolising high-end services. In this system, the services provided by foreign firms in collaboration with Indian legal firms will only be in an advisory capacity.

The limited licensing approach in the form of a Joint Law Venture (JLV) is also similar to the concept of Foreign Legal Consultants (FLC)[69]. FLCs face important regulatory barriers in the form of licensing requirements. Therefore in a JLV the foreign lawyers will enjoy diminished rights under

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[68] Section 2(o) of the *Consumer Protection Act, 1986* reads as:
'service' means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.'

[69] The FLC concept was first introduced by the New York Bar in 1974. Foreign lawyers were allowed to be licensed as legal consultants without an examination, provided they were licensed to practise in their home country or in another country. Some countries require foreign legal consultants to have practised for a certain number of years in their home country following their qualification in order to be licensed as FLCs in the host country. This requirement may be relaxed by taking account of years of practise in other jurisdictions including the host country jurisdiction. This license is granted on the grounds that the foreign lawyer is in good standing in his home jurisdiction. *See supra* n. 37.

the 'limited license' scheme.[70] Also, the key personnel in the JLV scheme present in the Indian offices will be the locals, in this manner all the managerial, executive and administrative functions will be effected only through Indian citizens. A foreign lawyer in a JLV will only practise particular laws such as those relating to banking, finance and corporate work. Although the concept of JLV is liberal in form, restrictions on foreign lawyers from appearing before any Indian court or authority will need to be put in place. This will be acceptable to the foreign law firms, as consultancy services themselves form a majority of the revenue in the legal service industry.[71]

Already the 'referral' mechanism has gained some currency, regarding alliances between Indian and foreign law firms. Foreign law firms have already constituted 'preferred firm' relationships with Indian firms. Legal 500, on its website, lists over 25 international law firms which already provide some sort of legal services in India *in spite of* not having their own offices in India.[72] These services are provided through tie-ups and affiliations with firms in India. The 'surrogate firm' relationship as seen in the Chartered Accountancy profession or the regulated Joint Venture system is merely the next step in this steadily developing trend of global tie-ups.

It is argued however, that JLVs are more restrictive than other forms of legal practice in the work they can take on, because the two separate firms combined are more likely to have conflicts of interest with or about a potential client than a single firm would have, no matter what size it is. Also, JLVs are considered to be temporary arrangements and hence 'less durable structures'. A party to a JLV can walk away far more easily from it than, for instance, a party to a partnership or an LLP or an incorporated company.

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70 The International Bar Association (IBA) has suggested a two-pronged approach, full licensing and limited licensing, whereby professional bodies regulate the practise of law by foreign lawyers. Under the limited licensing approach, foreign lawyers are given access to only a few areas of legal practice. Generally, court work and other representation services are not allowed to be taken up by foreign lawyers under the scheme of limited licensing.

71 The global legal services market has been estimated at US$20 billion annually. 60 per cent of the revenue earned from legal services comes from consultancy services. *See* s*upra* n. 40.

72 *Available at* http://www.legal500.com (last visited 6 May 2007).

Despite the criticism of the concept of JLV, at the moment this is one of the most viable options, partly due to the fact that it has already been successfully implemented in several countries.

C. To Directly Allow Non-Indians To Practise In India

The most liberal approach to the issue of the entry of foreign law firms and legal professionals is to amend the Act in such a way so as to allow the direct setting up of foreign legal practices in India. The benefit of such a direct approach is that it will significantly benefit the financial sector. There will be high-end legal services provided in India without undergoing the process of gradually liberalising the legal profession.

However, this measure may not be the best solution as, until recently, there was strong opposition to liberalisation. Such a radical step must only be taken if reciprocal arrangements are in place, and the legal profession is on a stable footing to accept these changes unanimously.

There are several other possible outcomes to the current state of affairs, which could include continuing with the 'protectionist' approach and not allowing liberalisation in any form at all. Although similar eventualities exist, they are improbable, as the hype has already built up considerably for the opening up of the legal services market. If at all the legal profession supports such action, or rather 'non-action', it will merely be a temporary setback. Surely in time to come, the issue of foreign legal professionals and law firms providing services in India is bound to arise again – and then drastic measures will be taken towards liberalisation, because 'the philosophy of protectionism is a philosophy of war'.[73]

VII. CONCLUSION

The Indian economy is currently in a state of hyper activity, and in that context most multinationals have their presence in India today. To facilitate the smooth performance of the economy as a whole, the efficient functioning of both the financial sector and the profession of law in tandem

[73] As aptly put by Ludwig von Mises, noted economist and social philosopher of the twentieth century (*Human Action* at 683).

is a *sine qua non*. Therefore, development of the profession of law by means of liberalisation is imperative.

There is no easy solution to the quandary faced by the Indian legal profession today. The key is to strike a fair balance between the concessions given to the foreign firms and the reservation of rights for the Indian advocates. In conformity with the practical principle of '*consilia multorum requiruntur in magnis,*'[74] the due opinion of members of the legal fraternity will have to be considered. After all, the future of all lawyers is at stake.

To cut the Gordian knot, the most logical step would be to implement the concept of JLVs, albeit by means of a phased model. JLV is a feasible concept, which has already been put into implementation in several countries. Moreover, as previously discussed, the advantages of a JLV are many and varied. A globalised legal services sector will promote an unfettered marketplace as a dynamic instrument, organising relations between India and other countries. Large foreign firms will bring with them thousands of jobs, and also provide comparatively higher salaries. Fresh law graduates will also benefit from the job opportunities and large pay packages.[75]

In lieu of the above, there are several questions which need answering today. Will the Indian legal profession survive once faced with direct competition from foreign law firms? It most certainly will. Moreover, it is the view of many that the legal profession in India will thrive with the accession of higher standards of professionalism and an enhanced quality of legal services provided, which foreign firms will bring with them. Secondly, will the dignity of the profession of law be upheld in this modern

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74 'The advice of many is sought in great affairs'.

75 *See* Ashwini Chawla, 'Opening Up The Indian Legal Market: A Threat Or A Sea Of Opportunities', *available at* http://www.lawstudent.in/bcashwinichawla.htm (last visited 30 April 2007). It reads: 'contrary to popular thought (or shall I say misconception), foreign firms in India shall not really eat into the pool of available jobs. They would mainly recruit law school grads, and in the process provide an opportunity to them to gain a first-hand experience in cross-border and even domestic commercial transactions, that will be the mainstay of such firms.'

age of unbridled competition and promotion of corporatist interests? The answers remain to be seen in the future. However, the real question today is *how soon* and in *what form* will globalisation come to pass. Globalisation is unavoidable, and as Kofi Annan succinctly stated, 'It has been said that arguing against globalisation is like arguing against the laws of gravity.'

GLOBAL WARMING AND THE ALIEN TORT CLAIMS ACT: DESPERATE TIMES, DESPERATE MEASURES?†

*Dhvani Mehta**

I. INTRODUCTION

The ambivalent attitude of world forces—both political powers and corporate czars, to the scientific link between human activities and climate change has undergone a marked shift over the past decade. From outright scepticism, denial,[1] and even the deliberate concealment of data,[2] to a full-fledged debate in the United Nations Security Council (UNSC),[3] policy-makers and scientists alike are acutely aware that the adverse impacts of global warming are no longer a remote possibility, but serious consequences to be faced in their own lifetime. The Fourth Assessment

† This article reflects the position of law as on 26 August, 2007.

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1 *See* Antony Barnett, 'Bush Attacks Environment "Scare Stories'' *The Observer* (New York United States of America 4 April 2004), *available at* http://observer.guardian.co.uk/international/story/0,6903,1185292,00.html#article_continue (last visited 14 May 2007). A memo sent to Republican Congressmen in the run-up to the November 2004 United States (US) Presidential elections urges the use of denial tactics on environmental issues, citing a lack of proof of global warming. In fact, it advises the propagation of the idea that the environment is actually improving. *See also* 'Suing The Climate Criminals-Global Warming Lawsuits Planned By Friends Of The Earth' [November 2000] *The Ecologist*, *available at* http://findarticles.com/p/articles/mi_m2465/is_8_30/ai_67448382 (last visited 21 June 2007). Attorneys of the British Petroleum (BP) Corporation went so far as to assert that climate change itself has not been proved.

2 *See* Andrew C Revkin, 'Bush Aide Softened Greenhouse Gas Links To Global Warming' *The New York Times* (New York United States of America 8 June 2005), *available at* http://www.nytimes.com/2005/06/08/politics/08climate. html?ex= 1275883200&en = 22149dc70c0731d8&ei = 5090 (last visited 15 May 2007). A certain White House Official, Philip Cooney was responsible for editing government climate reports to play down links between emissions and climate change. *See also* Andrew C Revkin and Matthew L Wald, 'Material Shows Weakening Of Climate Reports' *The New York Times* (New York United States of America 20 March 2007), *available at* http://www.nytimes.com/2007/03/20/washington/20climate.html?ex=1332043200&en=cdd70fe34e08f0f4&ei=5088 (last visited 15 May 2007).

3 An open debate on energy, security and climate was held by the UNSC on 17 April 2007.

Report (FAR) recently released by the Intergovernmental Panel on Climate Change (IPCC) provides the most damning indictment yet of the impact of anthropogenic activities on rising temperatures, affirming a greater confidence[4] in the effect of the unfettered burning of coal and oil on warming trends. Apart from the geological effects,[5] highlighted with a more frightening degree of specificity than ever before, there are several social, economic and humanitarian issues which also arise from the chillingly real and near effects of climate change. The IPCC states that by 2080, one-third of the Earth's population will be short of water, 600 million short of food and up to 7 million will face coastal flooding.[6] A report entitled 'Human Tide: The real migration crisis' by Christian Aid, an organisation combating extreme poverty, believes that by 2050, the number of people displaced globally by climate change, and now acquiring the label of 'environmental refugees' is estimated at one billion.[7] Similar concerns also find reflection in the United Kingdom (UK) concept paper at the UNSC open debate on Climate Change.[8] After years of staunchly denying the causation between human activities and the greenhouse effect, the US, which is also the world's largest polluter/emitter, has decided to gird its loins and tackle global warming; if for nothing else, at least in acknowledgment that it poses a threat to its own national

4 *See* Climate Change 2007: The Physical Science Basis, Summary for Policymakers, Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, *available at* http://ipcc-wg1.ucar.edu/wg1/Report/AR4WG1_Pub_SPM-v2.pdf (last visited 21 June 2007). The FAR states that '[m]ost of the observed increase in globally averaged temperatures since the mid-20th century is *very likely* due to the observed increase in anthropogenic greenhouse gas concentrations. This is an advance since the TAR's (Third Assessment Report) conclusion that "most of the observed warming over the last 50 years is *likely* to have been due to the increase in greenhouse gas concentrations." (emphasis supplied)

5 *Ibid.* The FAR projects snow cover contraction, the shrinking of Arctic and Antarctic sea ice, heat waves, heavy precipitation and more intense tropical cyclones.

6 Jeremy Lovell, 'Climate Change To Make One Billion Refugees-Agency', *available at* http://thestaronline.com/news/story.asp?file=/2007/5/14/worldupdates/2007-05-14T083041Z_01_NOOTR_RTRMDNC_0_-298078-1&sec=Worldupdates (last visited 15 May 2007).

7 *Ibid.*

8 *Available at* http://unfccc.int/files/application/pdf/ukpaper_securitycouncil.pdf (last visited 14 May 2007). *See also* 'Security Council Holds First-Ever Debate On Impact Of Climate Change On Peace, Security, Hearing Over 50 Speakers', *available at* http://www.un.org/News/Press/docs//2007/sc9000.doc.htm (last visited 15 May 2007).

security.[9] Leaving aside the daunting prospects of mitigating and adapting to these social effects of climate change, the world community must come to terms with the fact that to a certain extent, it is already too late. The FAR states that 'anthropogenic warming and sea level rise would continue for centuries due to the timescales associated with climate processes and feedbacks, *even if greenhouse gas concentrations were to be stabilized*.'[10] (emphasis supplied). In layman's terms, this means that in spite of human efforts to control emissions, the consequences of global warming are marching forth and several communities are already feeling and will continue to feel the heat.[11] Even if it is assumed that heightened awareness will cause countries and corporations to change their policies, the question of compensating those who have already suffered or will inevitably suffer as the result of human-induced climate change remains unsolved. This article will examine the legal, as opposed to scientific solutions, (the US is ever ready to harp on the promotion and development of clean fuel technology, without showing any signs of willingness to commit itself to legally binding instruments),[12] not only to urge nations to cut down on emissions, but also to devise mechanisms to make erring corporations or countries with lax regulations pay up for harm already incurred or

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9 A panel of retired US admirals and generals released a report on 16 April 2007 entitled 'National Security and the Threat of Climate Change' *available at* http://securityandclimate.cna.org/report/ (last visited 15 May 2007).

10 *Supra* n. 4.

11 Farmers in Tuvalu, a tiny Pacific island nation, already face the impacts of coastal erosion, flooding and the increasing salinity of water, while the food security of indigenous Arctic communities is at risk, because of the changed migratory patterns of their staple diet and the extinction of certain species. *See* Kristin L Marburg, 'Air And Atmosphere: Combating The Impacts Of Global Warming: A Novel Legal Strategy' [2001] *Colorado Journal of International Environmental Law and Policy* 171, 175 and Margeurite E Middaugh, 'Linking Global Warming to Inuit Human Rights' [2006] *San Diego International Law Journal* 179, 185.

12 *See* 'US Hesitant About Achieving Global Warming Goals' *The Times of India* (India 5 May 2007), *available at* http://timesofindia.indiatimes.com/World/The_United_States/US_hesitant_about_achieving_global_warming_goals/articleshow/2006001.cms (last visited 15 May 2007). US officials dismiss suggested target emission levels in the IPCC report as meaningless, while pushing for the use of renewable fuels like ethanol.

inevitably imminent. One of the suggested remedies garnering a lot of attention for its novelty is the concept of environmental class action litigation under an ancient American statute called the *Alien Tort Claims Act* (ATCA). The very novelty of this remedy, however, raises questions about its success. Part II of this article provides a brief overview of the environmental cases litigated under the ATCA and hints at a different outcome for global warming claims. Part III discusses other hurdles that will have to be overcome for claims to succeed, while Part IV examines the expected benefits of pursuing ATCA claims. The conclusion suggests the need of an explicit mandate from the American Congress to strengthen the ATCA for the successful presentation of climate change claims, besides indicating that successful claims could pave the path for more sustained responses to the global warming crisis in the future.

II. The Alien Tort Claims Act: An Ageless Panacea Or An Anachronism?

The efficacy of a 200 year old legislation in combating modern day environmental villains is debatable, necessitating a thorough analysis of the statute in question. This part discusses the history of the ATCA, the development of judicial principles determining its application, and finally, environmental cases litigated under the act and the subsequent prognosis for global warming litigation.

A. Evolution

Enacted in 1789 as a part of the *Judiciary Act*, the ATCA[13], alternatively referred to as the *Alien Tort Statute* (ATS) reads 'The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations, or a treaty of the United States.' The vast reach of the ATCA is evidenced by the fact that it contemplates one non-US citizen suing another (foreign corporations included) for a tort which need not have been committed in US territory. Such cases are litigated generally when the defendant is to be found in the US, either in terms of physical presence or attachable assets.

[13] 28 U.S.C. § 1350 (1988)

Up to 1980, the ATCA was rarely invoked until it was applied in *Filartiga* v. *Pena-Irala*,[14] a case concerning the torture of a Paraguayan by a Paraguayan police officer. The latter was sued by the family of the victim, Joelito Filartiga, after having received information that the officer in question was residing in Brooklyn. By holding that torture clearly violates the law of nations,[15] the Second Circuit Court of Appeals opened the floodgates for overseas human rights litigation; thus recognizing for the first time, that the ATCA was not merely a jurisdictional statue,[16] but could be extended to substantive matters as well. Subsequent cases[17] have reiterated this, doing away with the necessity of plaintiffs basing their cause of action on the law of the forum or the site of the tort.[18]

B. Judicial Parameters

Of the conditions applicable to claims under the ATCA that have been evolved by the courts over the years, most deal specifically with the nature of the 'law of nations', which must be violated before an action is entertained. Thus, the 'law of nations' refers to a norm of customary international law.[19] An indicator of the definition of customary international law is contained in the Restatement (Third) of Foreign Relations Law.[20] Courts however have refined the scope of customary norms, requiring

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14 630 F 2d 876, 878 (2d Cir 1980).

15 630 F 2d 884 (2d Cir 1980).

16 *Contra Tel-Oren* v. *Libyan Arab Republic* 726 F 2d 774 (DC Cir 1984) per Judge Robert H Bork, as cited in Gary Clyde Hufbauer, Nicholas K Mitrokostas, *Awakening Monster: The Alien Tort Statute of 1789* (Institute for International Economics July 2003) 3.

17 In *Sosa* v. *Alvarez-Machain* 542 US 692, 719 (2004), the court held that the ATCA was not intended to be 'a jurisdictional convenience to be placed on the shelf for use by a future Congress or state legislature that might, some day, authorize the creation of causes of action or itself decide to make some element of the law of nations actionable for the benefit of foreigners.' *See also Xuncax* v. *Gramajo*, 886 F Supp 162, 183 (D Mass 1995) as cited in Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What Sosa v. Alvarez Machain And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 168.

18 *Xuncax* v. *Gramajo*, 886 F Supp 162, 181-183 (D Mass 1995).

19 *Kadic* v. *Karadzic* 70 F 3d 232, 239 (2d Cir 1995).

20 *See* § 102(2). 'Customary international law results from a general and consistent practice of states followed by them from a sense of legal obligation.' The sense of legal obligation referred to is also known as *opinio juris*.

them to be 'specific, definable, universal and obligatory.'[21] Thus, 'the parameters of specificity and definability are the product of judicial interpretation, and not necessarily international prerequisites for the recognition of a norm as customary.'[22]

Secondly, a more stringent requirement was imposed when courts refused to entertain claims based on misconduct, unless it constituted a 'shockingly egregious' violation of international law.[23] Thirdly, and more positively for environmental litigants, the customary international law to be taken into consideration by the courts does not refer to the law extant in 1789, at the time of the enactment of the statute, but to current customary international law.[24] However, a final condition carved out by the *Sosa* v. *Alvarez-Machain* case has also sounded a warning note to judges hearing claims under the ATCA, and does not bode well for creative, judicial expansion of the scope of customary international law. The court emphasized the necessity of 'judicial restraint and a narrow interpretation of the class of rights protected by the ATCA.'[25]

C. Environmental Cases and the ATCA

Cases involving environmental torts have not proved to be successful in US courts. Some of them are discussed below to derive principles to guide future global warming litigation and provide further insights into ATCA jurisprudence.

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21 *In re Estate of Fernando Marcos Human Rights Litig.,* 25 F 3d 1467, 1475 (9th Cir 1994); *Tel-Oren* v. *Libyan Arab Republic,* 726 F 2d 774, 781 (DC Cir 1984) as cited in Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What *Sosa* v. *Alvarez* Machain And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 169.

22 Richard L Herz, 'Litigating Environmental Abuses Under The Alien Tort Claims Act: A Practical Assessment' [2000] *Virginia Journal of International Law* 545, 556.

23 *Zapata* v. *Quinn* 707 F.2d 691, 692 (2d. Cir 1983) as cited in Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What *Sosa* v. *Alvarez Machain* And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 165.

24 *Sosa* v. *Alvarez-Machain* 542 US 692, 725 (2004).

25 Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What *Sosa* v. *Alvarez Machain* And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 170.

1. *Aguinda* v. *Texaco, Inc.*[26]

Flagrant violation of petroleum industry standards, which saw large-scale spilling of crude oil into the Amazon, besides the dumping of toxic water into open pits,[27] prompted indigenous Ecuadorians to file a claim against Texaco. In late 1999, Texaco revealed that preliminary negotiations were on for a settlement with the plaintiff's attorneys.[28] Encouragingly, the court suggested that the plaintiffs may have a cause of action under Principle 2 of the Rio Declaration on Environment and Development[29] for the 'world-wide impact from the effects on tropical rainforests.'[30] However, the trial court, in 2001 dismissed the suit, citing *forum non conveniens*, a decision affirmed by the Second Circuit the next year.[31] The *forum* argument might well be a stumbling block in ATCA cases,[32] impeding the actual articulation of customary international law and creation of environmental rights.

2. *Amlon Metals, Inc.* v. *FMC Corp.*[33]

This case alleged the violation of Principle 21 of the Stockholm Declaration, almost identical to Principle 2 of the Rio Declaration.[34] The court granted

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26 No. 93 Civ 7527 (VLB), 1994 WL 142006 (SDNY Apr. 11, 1994).

27 Russell Unger, 'Brandishing The Precautionary Principle Through The Alien Tort Claims Act' (2001) 9 *N.Y.U. Environmental Law Journal* 638, 639.

28 Judith Kimerling, 'The Story From The Oil Patch: The Under-Represented In Aguinda v. Texaco' (2000), *available at* http://www.cceia.org/resources/publications/dialogue/2_02/articles/612.html (last visited 15 May 2007).

29 'States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental and development policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.' *available at* http://www.unep.org/Documents.Multilingual/Default.asp?DocumentID=78&ArticleID=1163 (last visited 11 June 2007).

30 Unger *supra* n. 27, 644.

31 Gary Clyde Hufbauer, Nicholas K Mitrokostas, *Awakening Monster: The Alien Tort Statute of 1789* (Institute for International Economics July 2003) 59.

32 *See Abdullahi* v. *Pfizer, Inc.* 01 Civ. 8118, 2002 U.S. Dist.LEXIS 17436. *But see Presbyterian Church of Sudan* v. *Talisman Energy, Inc.* 01 Civ. 9882 (AGS), 2003 U.S. Dist. LEXIS 4085 (SDNY, 2003) and *Wiwa* v. *Royal Dutch Petroleum Co.* 226 F.3d 88 (2d Circ. 2000)

33 775 F Supp 668 (SDNY 1991).

34 *Supra* n. 29.

a motion to dismiss seeming to rely on the 'specificity' requirement mentioned above. It believed that the language of Principle 21 was too hortatory to create any definable obligations for States.

3. *Beanal* v. *Freeport- McMoran, Inc.*[35]

Indonesian plaintiffs sued two Delaware corporations for mining operations in Irian Jaya, which polluted the river system and rendered the water unfit for drinking. The plaintiffs argued that Freeport's mining operations destroyed their native habitat and displaced them, their actions amounting both to environmental abuses as well as cultural genocide.[36] Once again emphasizing the 'specificity' requirement, the court dismissed the claims, stating that the 'polluter pays' principle and the 'precautionary' principle were not clearly delineated and did not form a part of the corpus of international law.[37] Further, in a surprising construction of Principle 2 of the Rio Declaration,[38] the Fifth Circuit Court, in appeal, stated that 'federal courts should exercise extreme caution when adjudicating environmental claims under international law to insure that environmental policies of the United States do not displace environmental policies of other governments.'[39]

The restriction imposed by this 'extreme caution' stricture, coupled with the narrow interpretation advised in the *Sosa* v. *Alvarez-Machain* case seems to defeat the purpose of the statute. After all, the ATS contemplates the filing of suits by aliens who do not hope to achieve success in their domestic forums precisely because of their domestic policies.[40] The claim of cultural genocide failed on two counts – the court did not believe that the plaintiffs had adequately substantiated their claim, nor could it consider

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35 97 F 3d 161, 163 (5th Cir 1999).

36 97 F 3d 161, 163 (5th Cir 1999).

37 97 F 3d 383, 384 (5th Cir 1999).

38 S*upra* n. 29.

39 97 F 3d 167 (5th Cir 1999) as cited in Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What *Sosa* v. *Alvarez Machain* And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 165.

40 Unger *supra* n. 27, 647.

cultural genocide a violation of the law of nations.[41] The latter pronouncement does not seem very encouraging for claims based on a conjunction between the environment and human rights.

4. *Flores* v. *Southern Peru Copper Corporation*[42]

Peruvian residents alleged that the corporation's mining, smelting and refining operations had created pollution, which in turn lead to lung diseases. They urged a deprivation of their rights to life, health and sustainable development.[43] The court, however, found these claims too vague, besides refusing to find that customary international law prohibits 'intranational pollution.'[44]

5. *Doe* v. *Unocal*[45]

In an important step for environmental litigants, the court held the ATCA applicable to trans-national corporations (TNCs). The claim was filed by Burmese villagers, alleging that the Government of Burma, on behalf of Unocal Corp, had committed gross human rights abuses, including forced labour, in connection with the construction of a natural gas pipeline, a joint venture between Unocal Corp and the Government of Burma. The court rejected the contention that the ATCA was inapplicable to corporations on the ground that international law governs relations between states only.[46] Imposing a greater degree of responsibility on multinationals than ever before, the Ninth Circuit held that Unocal Corp could be made liable on grounds of constructive liability, if there was sufficient proof to establish that it 'should have known' that its operations would encourage states to violate norms of customary international law.[47] Constructive liability helps in establishing that a corporation 'aided and abetted' a government in the commission of tortious acts violating

41 97 F 3d 161, 163 (5th Cir 1999).
42 414 F 3d 233, 248 (2d Cir 2003).
43 414 F 3d 237 (2d Cir 2003).
44 414 F 3d 255 (2d Cir 2003).
45 963 F Supp. 880 (CD Cal 1997).
46 963 F Supp. 890 (CD Cal 1997).
47 Kelsey Deye, 'Can Corporations Be Held Liable Under The Alien Tort Claims Act' (2006) 94 *Kentucky Law Journal* 649, 664.

customary international law.[48] Apart from the 'aiding and abetting' plank to nail TNCs under the ATCA, theories based on analogous principles of international criminal law have also been propounded.[49] In 2004, however, in a starkly contrasting view,[50] the court rejected the argument that the ATCA allowed liability for 'aiding and abetting.'[51] Dismissing claims of genocide, forced labour and torture brought by victims against multinational corporations doing business with the apartheid South African administration, the court refused to recognize aiding and abetting international law violations as a recognized international law violation in itself.[52]

6. *Sarei* v. *Rio Tinto PLC*[53]

Residents of Papua New Guinea alleged that the dumping of waste by the mining company, Rio Tinto into international waters constituted marine pollution, thus violating the United Nations Convention on the Law of the Sea (UNCLOS). In a decision indicating that US foreign policy may not always dictate ATCA cases, the Ninth Circuit upheld the district court's finding that treaty provisions could constitute customary international law actionable under the ATCA even though the US itself may not have ratified the treaty.[54]

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48 *Ibid.*

49 *See* Tarek F Maassarani, 'Four Counts Of Corporate Complicity: Alternative Forms Of Accomplice Liability Under The Alien Tort Claims Act' (2006) 38 *N.Y.U. Journal of International Law and Policy* 39. The author discusses the concepts of joint criminal enterprise, conspiracy, instigation and procurement as tools to hold corporations liable under the ATCA. *See also* Barnali Choudhury, 'Beyond The Alien Tort Claims Act: Alternative Approaches To Attributing Liability To Corporations For Extraterritorial Abuses' (2005) 26 *Northwestern Journal of International Law and Business* 43, Courtney Shaw, 'Uncertain Justice: Liability Of Multinationals Under The Alien Tort Claims Act' (2002) 54 *Stanford Law Review* 1359.

50 *South African Apartheid Litigation* 346 F Supp 2d 538 (SDNY 2004).

51 Mini Kaur, 'Global Warming Litigation Under The Alien Tort Claims Act: What *Sosa* v. *Alvarez Machain* And Its Progeny Mean For Indigenous Arctic Communities' [2006] *Washington and Lee Journal of Civil Rights and Social Justice* 155, 172.

52 *Ibid.*

53 221 F Supp 2d 1116 (CD Cal 2002)

54 The decision was however withdrawn in April, 2007 and a superseding opinion issued in which the substantive claims are not addressed.

D. The ATS, Bhopal And Climate Change-Old Wine In A New Bottle?

India's first brush with the ATCA came in the wake of the Bhopal Gas Leak Tragedy,[55] in the case of *Bano* v. *Union Carbide,*[56] where plaintiffs brought actions against the corporation and its head, Warren Anderson. Racial discrimination, 'cruel, inhuman and degrading treatment', violations of the right to 'life, health and security', and gross environmental and human rights violations were urged as violations of the law of nations under the ATCA. Earlier, claims brought by the Indian Government on behalf of the Bhopal victims, claiming damages for injuries sustained, on the basis of theories of absolute and strict liability and negligence had been dismissed on the grounds of *forum non conveniens.*[57] In the *Bano* case, the plaintiffs' claims were dismissed on the grounds that all civil claims had been finally settled by the 470 million dollar settlement ordered by the Supreme Court of India in 1989, and therefore, a substantive discussion of the ATCA claims did not arise. The earlier 1986 order citing *forum non conveniens* discussed the principles laid down in *Piper Aircraft Co.* v. *Reyno*,[58] which lays down a two-pronged test for the application of this doctrine— courts must not only determine that the proposed forum is 'adequate' but also balance 'relevant public and private interest factors.' The latter test entails the vesting of a considerable amount of discretion in the judiciary. In the exercise of this discretion, Judge Keenan considered the factors mentioned in *Gulf Oil Corporation* v. *Gilbert*,[59] of which the private ones include access to sources of proof and witnesses. The possibility of viewing the actual plant also played a vital role. The public interest factors that had to be weighed included administrative roadblocks and the interests of the countries involved (ie

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55 In December 1984, forty tons of toxic methyl isocyanate escaped from Union Carbide's chemical plant in Bhopal, initially killing 2,500 people, (the official government death toll) while the deaths of 2,800 others can be attributed to exposure to the poisonous gas. Shyam Divan and Armin Rosencranz, *Environmental Law and Policy in India* (2nd Edition Oxford University Press New Delhi 2002) 547.

56 273 F 3d 120 (SDNY, 2000).

57 *In re Union Carbide Corporation Gas Plant Disaster at Bhopal, India in December* 1984 634 F Supp, 842 (SDNY, 1986).

58 454 US 235, 102 S.Ct. 252, 70 L.Ed.2d 419 (1981).

59 330 US 501, 67 S.Ct. 839, 91 L.Ed. 1055 (1947).

India and the US). Judge Keenan found both private and public interest factors tilting heavily in favour of the defendants, and it is evident that these arguments would have to be met in other ATCA cases as well, including claims brought for global warming.

From the IPCC report on the impact of climate change in South Asia, it is evident that India, with its deltas, floodplains and lengthy coastline, will be hit hard.[60] ATS suits filed in US courts on behalf of Indian victims will similarly have to meet the same threshold requirements as the Bhopal claims. One of the most important distinguishing factors between the two claims, however, is the site of the environmental wrong suffered. While the Bhopal Gas leak can be pinned down to a specific factory in a specific state in the Indian sub-continent, 'climate change knows no political boundaries.'[61] Some of the very aspects of global warming that make its cause-and-effect chain difficult to ascertain,[62] may work to its advantage while meeting the seemingly impenetrable defences set up by the *forum* argument. Corporations the world over are responsible for greenhouse gas emissions, and with the US topping the emission charts, its companies are the most obvious targets. Consequently, emission records and policy decisions taken by the management, as integral sources of proof are more easily accessible in the US. Also, claims will not be forthcoming only from India,[63] and it lies in US interests to ensure that its corporations are not subjected to varying degrees of liability across a spectrum of jurisdictions. When the environmental torts urged in earlier ATCA cases are substituted by the all pervasive, trans-boundary character of global warming, some of the hurdles set up seem easier to overcome. For example, in *Aguinda* v. *Texaco*, while dismissing the claims on the basis of the *forum* doctrine, courts held that '[T]hese cases have everything to do

60 In addition, the melting of Himalayan glaciers will see floods, followed by freshwater shortages. Frequent heat waves, more freakish weather incidents and a drop in crop productivity are also projected. *See* Sunita Narain (Director, Centre for Science and Environment), 'How Should India Respond to Climate Change?' *The Economic Times* (Mumbai India 17 July 2007), *available at* http://economictimes.indiatimes.com/How_should_India_respond_to_climate_change/articleshow/2208577.cms (last visited 5 August 2007).

61 *Ibid*, per Mr V Raghuraman, Principal Advisor, Confederation of Indian Industries.

62 *Infra* Part III.

63 *Infra* Part III.

with Ecuador and nothing to do with the United States',[64] an argument that is unlikely to hold water when one considers the global havoc wreaked by climate change. Another factor that urged the court to uphold the defendant's motion to dismiss was the fact that all the records of the decisions taken by the offending Consortium were located in Ecuador, coupled with the plaintiffs' inability to prove that decisions concerning oil drilling operations were taken in the US. This may not be an obstacle in ATCA cases, since suing corporations based in the victims' country is not a requisite in the first place. Failure to join the Republic of Ecuador as an indispensable party was also one of the reasons for dismissal. In the light of India's increasing emissions and its non-acceptance of binding emission reduction targets under the Kyoto Protocol, US courts are likely to view its policy making as an equal perpetrator. Plaintiffs may have to implead the Indian government to guard against such preliminary dismissal of their claims. This is in sharp contradistinction to the *Bhopal Gas Leak* case, where the *Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985* was promulgated to ensure that the Indian government held the exclusive right to represent Indian plaintiffs.

The reasoning in the *Beanal* v. *Freeport McMoran Inc* case points even more encouragingly the green way. In this case, the claims failed on several grounds, including the lack of factual specificity of claims, the fact that international law violations arise only when the wrongs alleged are of 'mutual' and not merely 'several' concern, that wrongful activities did not affect other countries, and finally, the lack of definable parameters against which to measure the environmental torts alleged.[65] These challenges may well be rebuffed when the mining atrocities are replaced by climate change. The accuracy and depth of scientific data in the field is only increasing by the day, and if there ever was a threat which had the potential to unite the world, then global warming is it. Neither can states

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64 142 F Supp 2d 537.

65 With particular reference to the last claim, the judgment reads 'The sources..cited.. merely refer to a general sense of environmental responsibility and state abstract rights and liberties devoid of articulable or discernible standards and regulations to identify practices that constitute environmental abuses or torts.'

argue that the steps required to be taken by them to curb global warming are vague. The Kyoto Protocol, with its clear-cut mandates on the adoption of energy-efficient technology and its unambiguous emission-reduction targets provides one of the most specific parameters against which the responsibility of states (notwithstanding their non-ratification) may be judged.

III. Breakers Ahead: Barriers To Successful Litigation

Plaintiffs under the ATCA include a cast of actors ranging from the residents of tiny Pacific island nations like Tuvalu, (a country so besieged by the problems of rising sea levels that it is actually contemplating relocating its 10,000 strong population to neighbouring Australia and New Zealand)[66] to the Indigenous Arctic communities ie the Inuits, whose traditional hunting culture is in serious jeopardy.[67] Such a diverse breadth of litigants alone is enough to warrant the reaction of an environmental lawyer for the Pacific Legal Foundation,[68] when environmental groups including Greenpeace, World Wild Life Fund, National Resources Defence Council and Friends of the Earth International met to discuss the possibility of filing a global warming class action lawsuit.[69] This is inevitable when one considers the innumerable hurdles that must be overcome if such litigation is to be initiated successfully. Some of these problems are discussed below.

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66 'Tiny Tuvalu Sues United States Over Rising Sea Level' (2002), *available at* http://www.tuvaluislands.com/news/archived/2002/2002-08-29.htm (last visited 16 May 2007).

67 Melting sea ice has lead to a decline in the population of species that the Inuits depend upon for subsistence. Traditional hunting routes have been rendered unsafe by the melting ice and warmer temperatures entail a variety of problems ranging from vulnerability to coastal flooding to insect infestation. *See* Margeurite E Middaugh, 'Linking Global Warming To Inuit Human Rights' (2006) 8 *San Diego International Law Journal* 179, 186. However, it is essential to litigation under the ATCA that the plaintiffs be aliens. The Inuit community in Alaska, at least, fails to meet this requirement, and has filed a petition at the Inter-American Commission of Human Rights, jointly with Canadian Inuits. The petition was filed by Ms Sheila Watt-Cloutier, the elected chair of the Inuit Circumpolar Conference. The full text of the petition is available at http://www.inuitcircumpolar.com/files/uploads/icc-files/FINALPetitionICC.pdf (last visited 16 May 2007).

68 *Ibid*. Ann Hayes succinctly described the proposed litigation as 'nuts'.

69 Kristin L Marburg, 'Air And Atmosphere: Combating The Impacts Of Global Warming: A Novel Legal Strategy' [2001] *Colorado Journal of International Environmental Law and Policy* 171, 172.

First, for federal courts to assert jurisdiction over a particular matter, plaintiffs must establish standing to sue.[70] This implies that plaintiffs must establish an 'injury in fact', which courts have interpreted to mean a 'particularized, concrete harm.'[71] A majority of global warming cases involve imminent harm, not fully materialized, which might fail to meet the requirements of standing.[72]

Apart from the 'standing' barrier, lawyers will also have to worry about issues of causation. In the face of hard-hitting scientific evidence, courts will find it increasingly difficult to reject the contention that human activities, especially the industrial burning of coal and oil are major contributors to global warming. However, when asked to quantify damages, courts will be faced with a near-impossible task. Empirical data pinpointing the rise in sea-level caused by the emissions of a particular corporation will be hard to come by. For example, how does one prove that the emissions of Company A were responsible for a rise of X degrees Centigrade, which in turn, caused a certain rise in sea-level at island B, which in turn increased the salinity of the soil, for which the farming community now seeks damages? Again, how does the court determine the compensation to be awarded for a certain degree rise in temperature or a certain centimetres rise in sea level? Attributing responsibility and apportioning blame equitably are some of the biggest challenges posed by litigation of this character. While there are clear indicators implicating corporations for warmer temperatures, the role played by other supervening factors must be factored in by courts while awarding damages.

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70 *Steel Co.* v. *Citizens for a Better Environment* 523 US 83, 102 (1998).

71 For a more detailed understanding of the 'standing' test, see *Lujan* v. *Defenders of Wildlife* 504 US 555, 560-61 (1992), which also lays down that the injury must not be 'conjectural' or 'hypothetical' and that there must be a discernible connection between the injury and the conduct complained of.

72 *See* Blake R Bertagna, ' Standing Up For The Environment : The Ability Of Plaintiffs To Establish Legal Standing To Redress Injuries Caused By Global Warming' [2006] *Brigham Young University Law Review* 415. Discussing the concepts of particularized, concrete, actual and imminent injury, the author argues that plaintiffs stand a better chance of proving standing on the basis of procedural, rather than substantive injuries.

The impacts of farming on the environment,[73] large scale urbanization and solar activity all contribute to a rise in global temperatures. The proximity factor will also play a role in determining causation, and it will not always be easy to prove that the emission of greenhouse gases at one place contributed to warming at another point several thousands of miles distant. Keeping this in mind, plaintiffs are mostly likely to hold corporations responsible for their overall contribution to global warming in general (which, per se, not harmful, has undoubtedly set in motion natural disasters that are) At the same time, it goes without saying that corporations have a huge hand to play in rising temperatures. Since the emission of pollution which causes harm to third parties is a standard environmental tort,[74] but footprints left by corporations are hard to trace, plaintiffs should base their claims on the general detrimental complicity of corporations in global warming, rather than attempt to trace *specific* environmental disasters to *specific* perpetrators.

In addition, there are several economic hurdles to be overcome. The co-ordination of varied plaintiffs from all across the globe promises to be a massive exercise in administration. The expensive nature of such litigation is not helped by the fact that the majority of plaintiffs will be from poor, developing countries, pitched against the money power of the defendant multinationals.

IV. Nothing Ventured, Nothing Gained: The Positive Effects Of Initiating ATCA Claims

It is generally acknowledged that notwithstanding the failure of litigation under the ATCA in American courts, the publicity garnered thereby will spread awareness and prompt nations and corporations to adopt measures conducive to the global fight against climate change. ATCA claims

[73] Approximately 85 per cent of the methane (a gas 21 times more potent than carbon dioxide and responsible for nearly half the planet's human-induced warming) is released by the digestive processes in livestock, *available at* http://earthsave.org/globalwarming.htm (last visited 16 May 2007).

[74] Eric A Posner, 'Climate Change And International Human Rights Litigation: A Critical Appraisal' *available at* http://www.law.uchicago.edu/Lawecon/index.html (last visited 26 August 2007).

however may serve greater purposes than publicity-building exercises, both jurisprudential and practical.

The interplay between international law and domestic policies involved in ATCA litigation has assumed the character of a vicious circle of sorts. Courts are reluctant to recognize new norms of customary international law, while custom itself evolves through judicial decisions in domestic courts and national policies. Global warming claims under the ATCA present an opportunity to courts to articulate new norms of international environmental law in the face of stronger scientific evidence than ever before. The recognition of claims in American courts may influence the outcome of disputes in international forums like the International Court of Justice (ICJ),[75] the Inter-American Commission of Human Rights and the Human Rights Committee. The relative strength of international human rights norms over environmental law may be reinforced and newer concepts like the 'right to culture' and the rights of indigenous communities may gain a stronghold in international jurisprudence.

Besides academic contribution to the body of international law, such litigation is likely to serve as a deterrent to corporations and compel them to adopt cleaner technologies. The argument that such litigation will impose an American-framed standard of tort liability on foreign corporations[76] is an American-economy oriented argument which fears the migration of foreign corporations out of the US. The shifting of assets and operations is an expensive exercise, and corporations, under the fear of back-breaking damages, are more likely to clean up their act by switching to greener technology. Further, the reluctance of foreign states to allow the imposition of heavy damages on their corporations might also drag the US to the negotiating table to develop international solutions to the global warming problem.

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75 *See* Rebecca Elizabeth Jacobs, 'Treading Deep Waters: Substantive Law Issues In Tuvalu's Threat To Sue The United States In The International Court Of Justice' (2005) 14 *Pacific Rim Law and Policy Journal* 103.

76 Posner *supra* n. 74.

V. Conclusion

The hurdles that must be overcome for the successful presentation of ATCA claims may seem insurmountable. Detractors of the ATCA as a tool to combat global warming may well argue that an environmental crisis of this nature is better addressed in other forums-scientific, political and social. For example, they may press for greater budgetary expenditure on the development of cleaner, alternative sources of energy. They will argue for new age polluters like China, India and Brazil, leave alone the US, to adopt binding emission reduction targets. The creation of a fund not unlike the International Oil Pollution Funds (IOPC Funds)[77] which provide compensation for oil pollution damage resulting from persistent oil spills could be suggested. Monetary contributions corresponding to the emissions of corporations could be converted into a corpus to meet claims for future damage due to global warming. Similarly, with insurance coverage for climate change related damages being factored into the price of products, it would be possible to ensure that the costs of compensating the victims of global warming are borne partly by the consumers of 'environmentally irresponsible' products, so to speak. Higher premiums exacted from companies with lower emission standards and consequently greater vulnerability to litigation, will serve as an incentive to adopt cleaner technology. All these measures, are of course, much desired and will go a long way in tackling the climate change crisis in a more thorough, sustained manner in the long run. Where the ATCA comes in however, is in the nature of a catalyst to all this change. The successful presentation of an ATCA claim and the resulting damages awarded could provide the spark needed to galvanise politicians into action and induce corporate social responsibility.

[77] 1971 Fund, 1992 Fund and Supplementary Fund. In this case, initial liability, up to a certain limit is borne by the owner of the tanker, while additional claims are met from a fund contributed to by member states.

There is no doubt, however, that the ATCA was not originally enacted to punish perpetrators of a world-threatening environmental disaster. The 'law of nations' as understood by legislators was intended to encompass offences on the high seas, like piracy, violations of the safe conduct of ambassadors and prize captures.[78] However, the legislative history indicates that the punishment of these offences was authorized because they were of such a character that the inability of the Continental Congress to cause them to be punished would have entailed dire consequences in terms of the diplomatic relations of the US. The enactment of the statute during the country's birthing period is indicative of an anxious desire on the part of the US to put on record its commitment to international law and to establish the faith of foreigners in its judicial system as a forum for redressing their wrongs. There is a sense of urgency in the global warming debate in diplomatic circles today, and growing hostility to the refusal of the US to accept responsibility, and provide redressal for the harm incurred because of its profligate energy spending. Apart from the ATCA, there seems to be no other route for victims of global warming to bring errant corporations in the US to book. Surely the magnitude of the threat that thousands of people across the world are facing has assumed at least as serious proportions as the assault of a secretary of the French legion, the incident that prompted the passage of the ATCA in the first place. While rejecting the proposition that the ATCA is a 'jurisdictional convenience' the *Sosa* court stated that '[t]he anxieties of the preconstitutional period cannot be ignored easily enough to think that the statute was not meant to have practical effect.'[79] The ATCA was intended to evolve to allow the US to meet its responsibilities in the international sphere. In the aftermath of Hurricane Katrina, the US anticipates greater expenditure on more frequent freak weather incidents. Moreover, unstable conditions exacerbated by climate change in Asian, Latin American and African nations, coupled with refugee populations fleeing from drought and food production, pose a security threat to the US and it fully anticipates being called on to reconstruct and provide aid in such areas.[80] It is in the interests

78 *Sosa* v. *Alvarez-Machain* 542 US 692 (2004).
79 *Sosa* v. *Alvarez-Machain* 542 US 692 (2004).
80 *Supra* n. 9.

of Congress if corporations share the burden of some of this heavy expenditure entailed. However, it seems unlikely that even judicial creativity can interpret the ATCA as it stands today to recognize global warming claims. In this light, it is imperative that Congress specifically authorize federal courts to recognize and interpret environmental wrongs as a cause of action under the ATCA. This authorization, coupled with the appointment of environmentally sympathetic judges, should go a long way in recognizing the claims of those affected by this modern-day version of the Biblical Great Flood.

DISGORGEMENT†

An Introduction Of A New Concept Or A Precedent To A Debacle?

Fatema Dalal * and *Murtaza Kachwalla***

I. Introduction

The Securities and Exchange Board of India (SEBI) is a body established by the Government of India in 1988, which was vested with statutory powers by the *SEBI Act, 1992* (SEBI Act). SEBI's stated statutory mandate is to protect the interests of investors in securities and promote the development of the securities market through appropriate regulation.

The concept of 'disgorgement' is one of the few concepts which are well established and applied by capital market regulators worldwide. 'Disgorgement is an equitable monetary remedy "designed to deprive a wrongdoer of his unjust enrichment and to deter others" from future violations.'[1] In India, the remedy for a tort or for a breach of contract is damages, penalty or restitution. Disgorgement was never recognised or applied in India as a remedy under Securities law.

SEBI, with the aim of matching the pace of other developed countries and in seeming haste to take credit for introducing the concept of disgorgement in India, passed an order dated 21 November 2006 (Disgorgement Order).

In the Disgorgement Order, SEBI found the Depositories[2] and Depository

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† This article reflects the position of law as on 3 May 2008.

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1 Federal Trade Commisssion, 'Policy Statement on Monetary Equitable Remedies in Competition Cases 2003', *available at* http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2003/03-19722.htm (last visited 8 May 2007).

2 'A depository is an entity that holds shares of investors in the form of electronic accounts in the same manner as a bank holds money for depositors', *available at* http://www.abhipra.com/products.htm (last visited 15 September 2007).

Participants[3] guilty of 'contributory negligence', non-compliance of the Know Your Customer (KYC) norms[4] and other obligations flowing from the *Depositories Act, 1996* (Depositories Act) and supplemental regulations. SEBI acted against the Depositories and their Participants alleging that they were a part of the 'Initial Public Offerings (IPO) scam' (where shares normally reserved for the retail portion of public offerings of securities in the Indian primary market, were alleged to have been cornered by certain operators and financiers by using a range of applicants as fronts to apply for shares and then taking over their shares after allotment), on the basis of the alleged non-compliance with KYC norms. SEBI's case was that the IPO scam could have been averted if the Depositories and their Participants had not allowed the opening of securities accounts by various such applicants in breach of KYC norms. SEBI assessed the value of the shares that would have otherwise been allotted to retail investors, but which instead went to the so-called operators and financiers, by taking into account the closing price on the first trading day when the shares got listed. SEBI declared that the Depositories and their Participants shall be jointly and severally liable to 'disgorge' such amount. SEBI divided such amount by half and made the Depository pay one half on-account, and the Participants pay the other half, leaving the liability as joint and several.

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3 'A depository participant is described as an agent of the depository. It is an intermediary between a depository and the investors; an entity who is registered with SEBI under the provisions of the SEBI Act. As per the provisions of the Depositories Act, 1996, a depository participant can offer depository-related services only after obtaining a certificate of registration from SEBI.', *available at* http://sify.com/finance/fullstory.php?id=13397848 (last visited 15 September 2007).

4 'As part of KYC principle, Reserve Bank of India (RBI) has issued several guidelines relating to identification of depositors and advised banks to put in place systems and procedures to help control financial frauds, identify money laundering and suspicious activities, and for scrutiny/monitoring of large value cash transactions. Instructions have also been issued by the RBI from time to time advising banks to be vigilant while opening accounts for new customers to prevent misuse of the banking system for perpetration of frauds', *available at* http://www.rbi.org.in/commonman/English/Scripts/Notification.aspx?Id=117 (last visited 16 September 2007).

SEBI had indeed acknowledged that the key operators and the financiers were the ultimate beneficiaries of the share allotments that were considered by SEBI to be illegal. The Disgorgement Order directed that the Depositories and their Participants were free to file civil suits to recover from the operators and financiers the amounts paid to SEBI by way of 'disgorgement'.

The Depositories and their Participants were therefore slapped with a claim of Rs. 115.82 crore without affording them a hearing. In doing so, the question that arose from SEBI's action was whether the Disgorgement Order produced for an equitable remedy or if the nature of the remedy was punitive.

Though the measure of disgorgement is a very important one, the concept has not been correctly applied by SEBI. The Disgorgement Order now stands set aside. However, in doing so, the Securities Appellate Tribunal (SAT) has primarily based its judgment on the fact that the order was premature and was passed without first determining the guilt and arriving at a finding on who was responsible for the IPO scam. Besides, the proceedings too were in violation of the principles of natural justice.

One has to acknowledge the active role played by SAT while giving its order dated 2 May 2008, in the case of *Karvy Stock Broking Ltd.* v. *SEBI*,[5] (Karvy Order) wherein it has not only given an elaborated explanation of the concept of disgorgement, but has also criticised SEBI for targeting the Depositories and their Participants and for '*turning a Nelson's eye*' towards the financiers.

Though the Disgorgement Order now stands set aside, since the two orders passed by SAT in the case are rather short, the concept of disgorgement, sought to be introduced into Indian securities law by SEBI, merits analysis.

This article seeks to elaborate on the concept of disgorgement and the areas to which it has been and can be applied. It also seeks to emphasize the misapplication by SEBI of its Disgorgement Order, and the route it

[5] Appeal No. 6 of 2007.

ought to have taken, having due regard to its acceptable application as an equitable remedy in the international scenario in different cases.

II. Disgorgement – The Road To Equity Vis-à-Vis Other Remedies

A. The True Interpretation

The concept of disgorgement as introduced by SEBI *vide* its Disgorgement Order, invites several questions on its application, arbitrary disposition and wrongful interpretation. The authors seek to analyse the true nature of the concept, which is well evolved and well-established in other parts of the world. Disgorgement is recognized to be one of the equitable powers available in the hands of the court to restore the wrongdoer to his status before his wrongdoing. As held in the case of *Curtis Mfg. Co.* v. *Plasti-Clip Corp*,[6] '[A]mong the equitable powers of a court is the power to grant restitution and disgorgement.' '[B]eing an equitable remedy, it may be tailored in each individual case, to reach the ends of justice and equity.'[7]

Disgorgement does not penalise, but merely deprives wrongdoers of ill-gotten gains. It is meant to place the deceived victim in the same position he would have occupied had the accused not induced him to enter into an impugned transaction. It prevents the accused from being unjustly enriched by his fraud.[8]

Whilst calculating the amount of disgorgement, the United States Court of Appeal has ordered that the amount disgorged need only be a reasonable approximation of profits causally connected to the violation.[9] It further clarified that the remedy of disgorgement primarily serves to prevent unjust enrichment and may not be used punitively.[10] It should not be confused with other remedies like penalty or damages. The court's power to order disgorgement extends only to the amount with interest

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6 933 F Supp 94, 104 (DNH 1995).

7 George E. Palmer, 'The Law of Restitution' § 2.12, at 158 (1978).

8 *Federal Trade Commission* v. *Febre,* 128 F 3d 530.

9 *Securities and Exchange Commission* v. *First City Financial Corporation Limited,* 890 F 2d 1215.

10 *Securities and Exchange Commission* v. *First City Financial Corporation Limited,* 890 F 2d 1215.

by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment.[11]

B. Equitable And Not Alternative Remedy

The authors seek to highlight the importance of disgorgement in consonance with other remedies such as penalty, damages, and restitution. The authors further endeavour to emphasise that the equitable remedy of restitution is different from that of disgorgement; the latter should not be confused to be a part of the former. Both the remedies though equitable in nature, function at different stages independent from each other.

1. Penalty

Penalty is imposed pursuant to a wrongdoing with the aim of penalizing the wrongdoer. The Depositories and their Participants are governed by *The Depositories Act, 1996*, which was enacted to provide for regulation of Depositories in securities and for matters connected therewith or incidental thereto. The authors state that should SEBI have been right in its factual findings against the Depositories and the Participants, instead of asking the Depositories and their Participants to pay an amount equal to the gains alleged to have been lost by retail investors, which did not correspond to any gain made by the Depositories and their Participants, the Depositories and their Participants should have been proceeded against under the penal provisions of the Depositories Act.

Section 16[12] of the Depositories Act indeed provides for indemnification to be made by the Depositories and their Participants for their negligence. However, such an indemnity claim can only be made by a person who has suffered a loss and is able to prove a loss as having been caused by the actions of the Depository. Indeed, SEBI did not pursue this course because the Disgorgement Order was passed even before SEBI concluded its primary proceedings and arrived at any finding of guilt.

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11 *Securities and Exchange Commission* v. *Mac Donald*, 699 F 2d 47.

12 'When any loss is caused to the beneficial owner due to the negligence of the Depository or the Participant, the Depository shall indemnify such beneficial owner. Where the loss due to the negligence of the Participant under the above provision is indemnified by the Depository, the Depository shall have the right to recover the same from such participant.'

Although SEBI claimed to '*disgorge*' and not '*penalise*' the Depositories and their Participants, it has forgotten the preliminary difference between the two. Penalty is imposed for the purpose of punishing the wrongdoer, with the aim of setting up a retributive precedent for the wrongdoer and others, whereas, disgorgement is used to strip the wrongdoer only to the extent of its unjust enrichment. Though SEBI claims to disgorge the Depositories and their Participants in the Disgorgement Order, its claim being much more than the unjust enrichment, the Depositories and their Participants could have possibly gained, the Disgorgement Order served to have a penalising effect.

2. Unjust Enrichment

The doctrine of unjust enrichment 'permits the recovery in certain instances where a person has received from another a benefit, the retention of which would be unjust under some legal principle, a situation which equity has established or recognized.'[13]

The doctrine of unjust enrichment was originally based in English Law upon the principle of *assumpsit* or 'had and received'. It underwent certain changes through judicial interpretation and came to be based more and more on the doctrine of restitution. In India the principle of unjust enrichment is based on restitution, and the doctrines are much wider in scope compared to the application of the doctrine in England.[14]

Unjust enrichment, also recognised as a gain-based remedy, is now characterised in India to be either 'restitution' or 'disgorgement'.[15]

Until the Disgorgement Order, gain-based remedies under Securities law in India have received recognition only by means of restitution. SEBI

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[13] Decateur Reed, 'Restitution as a Contract Remedy' United States Jurisprudence, *available at* http://www.unitedstatesjurisprudence.com/uploads/Restitution% 20as% 20a % 20 Contract % 20Remedy.doc (last visited 10 May 2007).

[14] Makranda, The Indian Contract Act, 1872 (2006) Wadhwa Publication, 974, *See also Nelli Wapshara* v. *Pierce Leslie and Co. Ltd* AIR1960 Mad 410.

[15] RB Grantham and E.F. Rickett, 'Disgorgement For Unjust Enrichment?' 2003 *The Cambridge Law Journals, available at* http://journals.cambridge.org/action/display Abstract; jsessionid = 546C698 AAEB 41DAD 7B4F62F70F1A49E9. tomcat1? fromPage = online & aid = 162515 (last visited 10 May 2007).

vide its Disgorgement Order has added to the scope of the equitable remedies, by taking recourse to a new remedy 'disgorgement'. However, it is extremely unfortunate that such an important move was taken in the wrong direction and without application of mind to the fundamental concept. SEBI has confused the remedy available for unjust enrichment with that of penalty.

a. *Restitution*

As a judicial remedy, restitution is designed to prevent the unjust enrichment of one party at the expense of another.[16] Restitution is the giving back of wealth received by a defendant from a claimant, which must be given back or restored because it amounts to an unjust enrichment at the claimant's expense.[17]

In *Nelson* v. *Larholt*,[18] Lord Denning has observed as follows:

'It is no longer appropriate to draw distinction between law and equity. Principles have now to be stated in the light of their combined effect. Nor is it necessary to canvass the niceties of the old forms of action. The right here is not peculiar to equity or contract or tort, but falls naturally within the important category of cases where the court orders restitution if the justice of the case so requires.'

Restitution in India is based on the general principle of justice and equity which imposes an obligation on the person who has unjustly enriched himself to indemnify the other party. The juristic basis of restitution is founded upon a third category of law, namely quasi-contractual relationships. Sections 69[19] and 70[20] of the *Indian Contract Act, 1872* lay down the principle of restitution.

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16 Reed *supra* n. 13.

17 Grantham and Rickett *supra* n. 15.

18 (1948) 1 KB 339.

19 'A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.'

20 'Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such another person enjoys the benefit thereof, the letter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.'

b. *Disgorgement*

The traditional Common Law approach is that relief in the disgorgement measure is not available in a claim for damages for breach of contract.[21] Just as restitution, disgorgement is to prevent unjust enrichment. Disgorgement, however, is the giving up to a claimant of a gain made by a defendant, as a consequence of a *wrongdoing* committed against the claimant, but received from a third party.[22]

The purpose of disgorgement is to prevent unjust enrichment ie those who have violated the Securities law are not allowed to gain by their illegal conduct. Accordingly, disgorgement is a powerful deterrent against misuse of material, non-public information.[23]

Though both the remedies of restitution and disgorgement are equitable in nature, they should not be confused to be identical or latter being deracinate of the former. Unlike restitution, under disgorgement, the unjust enrichment should have been as a consequence of a wrongdoing. The wrongdoer would therefore be disgorged of the unjust enrichment or its benefits. The underlying nature of the remedy is not punitive but deterrent and equitable. If the facts of the case are such that the same would not fit within the arena of a tortious claim, contractual obligation or quasi contractual relationship, though unjust enrichment is the outcome of the wrongdoing, courts should be at liberty on the grounds of equity and justice to disgorge the unjust enrichment from the wrongdoer. Disgorgement therefore serves as a germane equitable remedy. The concept if used appropriately would serve great ends.

III. Application In The International Scenario

A. Blake's Case

The remedy of disgorgement was used by the English Courts in the case *Attorney General* v. *Blake*.[24] George Blake, accused herein had been a

[21] John D. McCamu *infra* n. 24.

[22] Grantham and Rickett *supra* n. 15.

[23] Reed *supra* n. 13.

[24] *Attorney General* v. *Blake and Another* [2001] 1 AC 268. *See also* John D McCamu, Disgorgement For Breach Of Contract: A Comparative Perspective' 2003, *available at* llr.lls.edu/volumes/v36-issue2/mccamus.pdf (last visited 10 May 2007).

member of the British security and intelligence services from 1944 to 1961. He became an agent for the Soviet Union in 1951 and provided information to the Soviet Government over the next nine years. When his treachery was uncovered, Blake was convicted of five charges under the *Official Secrets Act, 1910*, and sentenced to 42 years of imprisonment. Blake escaped from prison in 1966 and fled to Berlin, and then to Moscow, where he wrote an autobiography recounting his exploits as a spy. On 4 May 1989, Blake entered into a publishing agreement with the publisher Jonathan Cape, Ltd. By writing and agreeing to publish the volume, Blake violated his employment contract with the Crown, wherein he agreed 'not to divulge any official information gained by him as a result of his employment, either in the press or in book form.'

The Attorney General was entitled, and rightly so, to bring a claim against Blake for damages for breach of contract. The issue was whether an alternative claim for disgorgement of his ill-gotten gains should be permitted. The House of the Lords held that the Attorney General is entitled to be paid a sum equal to whatever amount is due and owing to Blake from Jonathan Cape under the publishing agreement of 4 May 1989.

The House of Lords held that the remedy of disgorgement should be available in two situations:

- in cases of skimped performance (where the gain would take the form of expense saved); and
- where the defendant has obtained his profit by doing the very thing which he contracted not to do.

B. Tobacco case

On 26 May 2004, the trial judge, Gladys Kessler in the case of *United States of America* v. *Philip Morris USA INC*,[25] rejected the tobacco industry's

[25] Court File No. C1-94-8565 before the Second Judicial District Court of the State of Minnesota,. *See also* http://stic.neu.edu/MN/1615.doc (last visited 8 May 2007).

motions for summary judgment on the issue of whether the Government could seek disgorgement of 280 billion dollars of allegedly ill-gotten gains that the industry acquired between 1970 and 2000 through sales of cigarettes to minors or people addicted as minors. The tobacco industry/ defendants asked the trial court to allow an interlocutory appeal to move forward while the rest of the case proceeded and the latter granted that request.

The tobacco companies argued that it would be impossible for the Government to prove that the taking of 280 billion dollars would prevent or restrain future violations. They argued that any available remedy must be 'forward looking' and that disgorgement is clearly 'backwards looking.' Also, the Government's model for calculating disgorgement is crude and does not clearly distinguish between legally and illegally gained moneys. The trial court found that disgorgement is an effective form of deterrence and that deterring is a means of preventing or restraining future violations. A three-judge panel of the United States Court of Appeals for the District of Columbia held that disgorgement of ill-gotten gains was not an available remedy in the Department of Justice's Racketeer Influenced Crime Organization Act (RICO) case against the cigarette industry. The 2-1 ruling overturned the trial judge Gladys Kessler's pre-trial decision that permitted the Government to seek to strip the tobacco industry defendants of their ill-gotten gains.[26]

C. Carson case

The decision of the United States Court of Appeals in *United States* v. *Carson* is termed to be 'well reasoned and persuasive'. The abovementioned case held that the remedy of disgorgement is available to the Government in a civil case, but is limited to the amount of any ill-gotten gains received by the Defendant(s).

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[26] 'Despite Elimination Of Disgorgement, Many Remedies Remain In Department Of Justice's Strong Rico Case Against The Cigarette Industry' (2005), *available at* http://tobacco.neu.edu/litigation/cases/DOJ/ccadc_Disgorgement.htm (last visited 8 May 2007).

The Court of Appeals in this case observed that whether disgorgement is appropriate in a particular case depends on whether there is a 'finding that the gains are being used to fund or promote the illegal conduct, or institute capital available for that purpose.'

In recent orders, the court has confirmed that to obtain disgorgement in this case the Government must:

- prove that there is a reasonable likelihood that Defendants will commit violations in the future; and
- distinguishing any ill-gotten gains from Defendants lawful gains.[27]

V. The Disgorgement Order And Its Setting Aside

A. Background

SEBI suspected a possibility of large scale off-market transactions immediately following the date of the allotment and prior to the listing of the shares on the stock exchanges. Based on this suspicion, SEBI conducted a preliminary scrutiny in the matter wherein it found that multiple dematerialized accounts with common addresses were opened by a few entities.[28]

B. The Fraud

SEBI found that certain entities had cornered IPO shares reserved for retail applicants by making applications in the retail category through the medium of thousands of allegedly fictitious/*benami* applicants, with each application being for small value so as to be eligible for allotment under the retail category. Subsequent to the receipt of IPO allotment, these allegedly fictitious/*benami* allottees had transferred shares to their respective principals who in turn transferred the shares to the financiers, either directly or through a web of transactions. The financiers in turn sold most of these shares on the first day of listing, thereby realising the windfall gain

[27] 'Disgorgement Summary', *at* http://www.altria.com/download/pdf/media_doj_disgorgement_summary_2005_03_10.doc (last visited 10 May 2007).

[28] Para 1 of the Disgorgement Order.

of the price difference between IPO allotment price and the price on the first day of listing.

C. The April Order

Pursuant to investigations, SEBI passed an interim order dated 27 April 2006 (April Order), wherein *inter alia* it directed 24 key operators and 82 financiers not to buy, sell or deal in the securities market including in IPOs, directly or indirectly, till further directions. The April Order was challenged before SAT by various parties and the proceedings in appeal were underway at various stages.

D. The Disgorgement Order

Pending the hearing of appeals by SAT, SEBI proceeded to pass the Disgorgement Order stating it to be a part of the *interim* April Order. The Disgorgement Order introduced the concept of disgorgement as an equitable remedy seeking to disgorge the Depositories and their Participants for the unjust enrichment made by them out of the illegal transaction by means of the IPO scam. The Disgorgement Order was passed without granting the parties an opportunity of being heard. Moreover, the order stated that no individual opportunity would in fact be granted to the parties to present their case. The Disgorgement Order was purported to be an interim order which would be followed by a final order based on the findings of SEBI's investigation.[29] The abovementioned position taken by SEBI makes the Disgorgement Order arbitrary and unfair on the face of it.

E. Role of the Depositories and Depository Participants

SEBI in the Disgorgement Order held the Depositories and its Participants liable for violation of Regulation 3 of *SEBI (Prohibition of Fraudulent and*

[29] Para 47 of the Disgorgement Order.

Unfair Trade Practices Relating to Securities Markets) Regulations, 2003,[30] Regulation 42 (2),[31] 42 (3),[32] 43,[33] 46[34] and 52[35] of *SEBI (Depositories and Participants) Regulations, 1996* and clauses 3,[36] 9,[37] 12,[38] 16,[39] 19,[40] 20[41] and 22[42] of Code of Conduct specified in Regulation 20 (a) of *SEBI (Depositories and Participants) Regulations, 1996* and the provisions of *Depositories Act, 1996*.

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30 'Prohibition of certain dealings in securities. No person shall directly or indirectly-
(a) buy, sell or otherwise deal in securities in a fraudulent manner;
(b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;
(c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
(d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.'

31 'A participant shall register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner and thereafter confirm the same to the beneficial owner in a manner as specified by the depository in its bye-laws.'

32 'Every entry in the beneficial owner's account shall be supported by electronic instructions or any other mode of instruction received from the beneficial owner in accordance with the agreement with the beneficial.'

33 'Every participant shall provide statements of account to the beneficial owner in such form and in such manner and at such time as provided in the agreement with the beneficial owner.'

34 'Every participant shall have adequate mechanism for the purposes of reviewing, monitoring and evaluating the participant's internal accounting controls and systems.'

35 'No participant shall assign or delegate its functions as participant to any other person, without the prior approval of the depository.'

36 'A Participant shall maintain high standards of integrity in all its dealings with its clients and other intermediaries, in the conduct of its business.'

37 'A Participant shall not divulge to other clients, press or any other person any information about its clients which has come to its knowledge except with the approval / authorisation of the clients or when it is required to disclose the information under the requirements of any Act, Rules or Regulations.'

38 'A Participant shall not make any untrue statement or suppress any material fact in any documents, reports, papers or information furnished to the Board.'

39 'A Participant shall follow the Maker - Checker concept in all of its activities to ensure the accuracy of the data and as a mechanism to check unauthorized transaction.'

40 'A Participant shall ensure that it has satisfactory internal control procedures in place as well as adequate financial and operational capabilities which can be reasonably expected to take care of any losses arising due to theft, fraud and other dishonest acts, professional misconduct or omissions.'

41 'A Participant shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.'

42 'A Participant shall ensure that good corporate policies and corporate governance are in place.'

In certain instances, the Depository Participants were alleged to have failed to obtain proof of identity and proof of address before opening dematerialised accounts, which is a mandatory requirement as per the SEBI circular dated 24 August 2004.[43] In certain other cases, the Depository Participants were alleged to have failed to ascertain the genuineness/ existence of the securities account holders resulting in opening of securities accounts in fictitious names. In many of these cases, the addresses of the securities account holders were alleged to be that of the sub-brokers of the Depository Participants who procured dematerialised clients for the Depository Participants. Some of the Depository Participants were alleged to have not only opened dematerialised accounts in fictitious/*benami* names but had also prodded IPO financing to such fictitious/*benami* account holders thereby allegedly facilitating the cornering of the retail portion of IPOs. However, surprisingly, SEBI had not initiated proceedings to impose penalty against every Depository Participant. The Disgorgement Order went on to state that if any of the actionees are found to be guilty in penalty proceedings, the Disgorgement Order would sustain against them, and if any of them got acquitted in penalty proceedings, the Disgorgement Order would lapse vis-à-vis such person. In fact, penalty proceedings were initiated in many cases after the Disgorgement Order was passed.

SEBI believed that the entire scheme of cornering the retail portion of IPOs could not have succeeded but for the active role played by the Depositories and their Participants facilitating or being negligent in (which was referred to by SEBI as 'contributory negligence') the opening of numerous dematerialised accounts in fictitious/*benami* names. In SEBI's view, had each of the Depositories and their Participants played their role diligently with a degree of real time sensitivity, the rampant cornering of IPO allotments would not have taken place.

With regard to the Depositories, SEBI was of the opinion that the Depositories and their Participants shared a principal-agent relationship and therefore the Depositories were liable for the acts of their Participants.

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[43] 'The Participant holding a certificate shall, at all times, abide by the Code of Conduct as specified in The Third Schedule.'

The Disgorgement Order therefore stated that the Depositories such as National Securities Depository Limited (NSDL) and Central Depository Securities Limited (CDSL) were under an obligation to oversee that their Participants were discharging their responsibilities and functions in accordance with the rules, regulations and guidelines prescribed by SEBI and the byelaws governing the Depositories. Investigation and succeeding inspections of the Depository Participants by the Depositories are stated to have revealed continuing violations by the Depository Participants. In spite of the above, the Depositories are alleged to have levied only token monetary penalties and not stringent penalties to prevent repetitive wrong-doings. Based on the probability that the Depositories and their Participants could be involved in the illegalities relating to IPOs, SEBI alleged that the Depositories had aided and abetted or contributed to the violations themselves.

F. Disgorgement – A Garbed Remedy

Disgorgement was introduced by SEBI to make the Depositories and their Participants pay the amount computed by SEBI as being the unjust enrichment out of the illegalities relating to the IPOs as a first measure. The Depositories and their Participants were left to chase the ultimate earner of the ill-gotten gains in the hands of wrong-doers by way of civil litigation to recover the amounts paid to SEBI.

SEBI held NSDL and its Participants jointly and severally liable for Rs. 90.02 crore; and held CSDL and its Participants jointly and severally liable for Rs. 25.80 crore. The amounts were to be deposited by the parties with SEBI within six months from the date of the passing of the Disgorgement Order.

G. SAT Order- The Last Hope

The Disgorgement Order was challenged by the Depositories and their Participants before the SAT *inter alia* for being in violation of the principles of natural justice. The SAT, had initially stayed the Disgorgement Order. On 22 November, 2007 the Tribunal set aside the Disgorgement Order on the following grounds:

- The Disgorgement Order is in violation of natural justice as SEBI had not afforded the Depositories and their Participants an opportunity to represent their case–in fact, SEBI had stated that they would not be heard;
- Not every erring entity could be 'disgorged'; only persons who have made illegal and unethical gains could be disgorged of their illegal gains;
- It was open to SEBI to initiate, in accordance with law, disgorgement proceedings against such entities as may become liable to disgorge.

VI. The Disgorgement Order And The SAT Order- Its Post-mortem

Though the Disgorgement Order has been set aside the SAT order, there have been several discrepancies in both, which the authors seek to discuss.

A. Lacunae in the Disgorgement Order

The Disgorgement Order though set aside as above, there are areas wherein SEBI's arbitrary move though quite ent, has not been brought to light by the SAT Order. The authors believe that these areas as discussed below are vacillating and grave, therefore need further analysis to avoid such blunders in the future.

1. Disgorgement - A Remedy or Just an Excuse?

SEBI *vide* its Disgorgement Order stated:

> *'It is well established worldwide that the power to disgorge is an equitable remedy and is not a penal or even a quasi-penal action. Thus it differs from actions like forfeiture and impounding of assets or money. Unlike damages, it is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched. Disgorgement is intended not to impose on defendants any demand not already imposed by law, but only to deprive them of the fruit of their illegal behaviour. It is designed to undo what could have been prevented had the defendants not outdistanced the investors in their unlawful project. In short, disgorgement merely*

> *discontinues an illegal arrangement and restores the* status quo ante *(See 1986 (160) ITR 969). Disgorgement is a useful equitable remedy because it strips the perpetrator of the fruits of his unlawful activity and returns him to the position he was in before he broke the law. The order of disgorgement would not prejudice the right of the regulator to take such further administrative, civil and criminal action as the facts of the case may warrant.'*

The concept, though very well defined in the Disgorgement Order, met with grave errors in its application in that very order. The remedy, which could be used to extract the unjust enrichment gained out of illegal behaviour, was applied by SEBI to make Depositories and their Participants pay upfront the gains made by someone else. The Depositories and Participants were of course told to chase the ultimate wrong-doers and claim from them. Arguably, even if assumed that the Depositories and their Participants were part of its illegal activity, the fruits of the illegal behaviour could be construed to be the fees or the account opening charges and transaction charges earned by them. However, in the present case, what SEBI wanted them to pay in the garb of disgorgement was far greater than the benefits, if at all any were gained by the Depositories and their Participants. As laid down by the United States Court of Appeals, the amount of disgorgement must be a reasonable approximation of the profits gained by the defendant, and cannot be calculated arbitrarily.[44]

Also as acknowledged by SEBI, disgorgement is a method of forcing the defendant to give up the amount by which he or she was unjustly enriched. As held in the case of *Securities Exchange Commission* v. *First City Financial Corporation*,[45] the US Securities and Exchange Commission bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment. But in the present case, SEBI had no clear finding of the amount which was unjustly gained by the Depositories and their Participants. SEBI's claim of Rs. 115.82 crore was baseless and not a result of a sound investigating process.[46]

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[44] SEBI Circular No.MRD/DoP/Dep/Cir-29/2004 dated 24 August 2004.

[45] *Securities and Exchange Commission* v. *First City Financial Corporation Limited,* 890 F 2d 1215.

[46] *Securities and Exchange Commission* v. *First City Financial Corporation Limited,* 890 F 2d 1215.

The disgorgement amount was calculated on the basis of a number of dematerialised accounts opened with the Depositories and their Participants wherein the number of shares received through IPO allotment was multiplied by the difference between the closing price of the first day of listing of the respective IPO's and the respective issue prices of these shares. SEBI thus believed that such a formula would have led them to the unjust enrichment accrued to the fictitious/*benami* account holders. Such a rationale would appear to be valid in case of disgorging the unjust enrichment of the *benami* account holders or the final beneficiaries. However, one wonders how this analogy could be successfully drawn in the case of the Depositories and their Participants because they were not recipients of any unjust enrichment out of the allotment, ownership and sale of shares allotted in the IPOs.

2. Punitive Nature

SEBI alleged that the entire IPO scam could not have occurred unless the Depositories and their Participants played an active role in facilitating the opening of numerous fictitious or *benami* accounts. Therefore, SEBI reasoned that for turning a Nelson's eye to the KYC norms or actively participating in the IPO scam designed by the key operators or financiers; the Depositories and their Participants should be liable for the loss to the retail investors.[47] SEBI alleged that it was solely because of the Depositories and their Participants' laid back attitude that such illegal behaviour was possible. SEBI's contention has weight to the extent of imposing a penalty on the Depositories and Participants for any proven negligence or complicity, but disgorgement not being a measure punitive in character, does not appear to be the remedy that could be applied with respect to the Depositories and their Participants.

[47] As stated in the Disgorgement order, it is an interim order, and a final order will be passed subsequent to the findings of the enquiry. Thus, the Disgorgement Order leaves scope for reaching final ends pursuant to an investigation or adjudication proceedings. How fair would the claim of almost Rs. 90 crore be on the basis of an interim, uninvestigated order.

SEBI stated in its Disgorgement Order that in the ordinary course of events the action or inaction of the Depositories and Participants would amount to 'contributory negligence' but given the scale of the IPO scam it is hard to believe that such manipulation escaped their attention, '[H]*ad they cared to know they would have known.*'[48] Thus SEBI itself accepted that in the ordinary course of events, such violation would amount to negligence but the authors are of the view that such violation or negligence would still attract only penalty and not disgorgement. The role of the Depositories or their Participants in contributing to the occurrence of the IPO scam is not proof of unjust enrichment gained by them, for such gains to attract disgorgement.

SEBI's allegation in the Disgorgement Order was based on a high-level of probabilities and remote findings which were not sufficient to endorse 'disgorgement' of the unjust enrichment from the Depositories and Participants that did not make the gains in the first place. Also as has been stated earlier, SEBI had prescribed a list of violations imposing the liabilities for the same on the Depositories and their Participants. However, in the immediately following line, the Disgorgement Order stated that '*[T]his order is not an order imposing administrative sanctions or penalties*.'[49] The statement in the Disgorgement Order does not free the order from the penalising effect. SEBI had tried to penalise and deter the Depositories and their Participants under the garb of disgorgement. The aim of the concept is to create a remedy being equitable in nature to prevent the wrongdoers from enjoying the benefits of the unjust enrichment; and not of penalising the wrongdoers for negligence or non compliance with legislation.

SEBI justified its stance on the basis that the Depositories and their Participants were entities that were regulated by SEBI and were registered with SEBI. However, SEBI was indeed aware of who the beneficiaries of the IPO scam were. In its April Order, SEBI had directed 24 key operators and 82 financiers not to buy, sell or deal in the securities market including in IPOs, directly or indirectly, until further directions. Therefore, purported

[48] Para 8 of the Disgorgement Order.
[49] Para 16 of the Disgorgement Order.

disgorgement from the Depositories and their Participants was either an attempt to take the credit for introducing the concept or an unjustified refusal to take up the responsibility for the allegedly illegal activities to the logical conclusion.

3. Joint And Several Liability

In the Disgorgement Order the Depository Participants of NSDL and CSDL and the Depositories were made to jointly and severally disgorge the amount of Rs. 90.02 crore and Rs. 25.80 crore respectively. Joint and several liability is rooted in the principle that a wrongdoer is liable for the reasonably foreseeable acts of his fellow wrongdoers committed in furtherance of their joint undertaking. One may therefore wonder how the Depositories and their Participants functioning independent of each other could be held jointly liable. The only thread of ence with SEBI was that *benami* accounts were opened by different Depositories and their Participants. There was no proof of a prior meeting of minds or a prearranged plan. The illegal activity by the key operators was a result of the guilty mind of the ultimate beneficiaries and the negligence or non compliance of the Depositories and their Participants. In the absence of ence showing a direct nexus between the activity of the key operators and the Depositories and their Participants, it would be illogical to impose sole liability on the latter for breach of obligations.

SEBI *vide* its Disgorgement Order stated that,

> *'The order is being imposed on a joint and several liability because the entire scheme/artifice was one large fraud where several entities either deliberately closed their eyes when the wrongdoers perpetrated their illegality or were actively involved in the transactions. This necessarily implies that the exact apportionment of the liabilities between the various parties can be decided by them inter se either by settlement or by suits of indemnity/contribution between each other and from all persons including financiers, master account holders, key operators and other violators. It is not in the interest of the public that the regulator should spend its time in deciding private disputes between various perpetrators of the IPO fraud/cornering of shares.'*

The aforesaid language shows that SEBI did not really care for the exact apportionment of the liability on each of the Depositories or their Participants. The underlying aim of SEBI was merely to get hold of the computed defrauded amount at any cost without regard to the position in equity or plain logic. The same was evident from the fact that SEBI had left it open for the Depositories and their Participants to claim on indemnity basis from the guilty financiers. One may be shocked at SEBI's move of 'disgorging' the amount claimed from the innocent Depositories and their Participants; and then giving them the contingent cause of action in the form of the remedy to chase the guilty financiers by way of indemnity. This kind of unfair practice prejudices the equitable nature of the concept.

SEBI imposed 50 per cent of the liability on the Depositories ie NSDL and CSDL. SEBI's justification for the same was that, '*[G]reater responsibility is on the depositories ... since they are, by virtue of their proximity to the developments in the markets, expected to check the happenings and take appropriate action real time by exercising supervisory authority.*' SEBI in its alacrity seemed to have overlooked that the remedy of disgorgement does not work on assumptions but on clear cut findings of unjust enrichment.

The imposition of the principle of joint and several liability attracts the principle of contribution. The claim made by the Disgorgement Order ranges from NSDL which was allegedly guilty for a loss of Rs. 45 crore to a claim of Rs. 1.63 lacs against Khandwala Integrated Financial Services Pvt. Ltd. By imposing joint and several liability, SEBI had opened doors to frivolous litigation between the Depositories and their Participants.

4. Distribution—A Far-Fetched Ideal

The apparent goal of the Disgorgement Order was to strip the Depositories and their Participants of the ill-gotten gains with an aim to recompense the genuine investors. However, the Disgorgement Order was silent on the scheme of distribution of the disgorged amount among the genuine investors. SEBI merely stated that the 'disgorged' amount would be collected in a separate account, with the aspect of restitution for the purpose

of compensating the so-called victims viz the retail investors who ought to have received allotment of shares left open. The remainder would be deposited in the Investor Protection Fund.[50] Such a scheme to compensate the investors was far from practical as the disgorged amount was not in shares but in hard cash. Even if SEBI presumed that each and every retail investor of India had suffered a loss as a result of the IPO scam, it would not be possible to calculate the loss to each of the genuine investors.

B. Discrepancies In The SAT Order versus The Karvy Order

SAT, in analyzing the concept has held, '*We do not think that the Court could direct the appellants to disgorge the aforesaid amount without first determining their guilt and whenever they had made any illegal gains. Again it is not that every erring entity is held liable to disgorge the amount. Persons who have made any illegal or unethical gains alone could be asked to disgorge their ill gotten profits.'* Credit has to be given to SAT for setting aside such a capricious order, but, with all respect, the authors contend that SAT by stating, '*We have no hesitation in setting aside the impugned order qua the appellants which we hereby do leaving it open to the Board to initiate, in accordance with law, disgorgement proceedings against such entities as may become liable to disgorge,*' has left it open to SEBI to again purportedly 'disgorge' negligent but innocent entities of amounts they never gained.

On the contrary, SAT in the Karvy Order has elaborated on the concept of disgorgement wherein it states as follows;

> *'Disgorgement is the forced giving up of profits obtained by illegal or unethical acts. It is a repayment of ill-gotten gains that is imposed on wrongdoers by the courts. Disgorgement is a monetary equitable remedy that is designed to prevent a wrongdoer from unjustly enriching himself as a result of his illegal conduct. It is not a punishment nor is it concerned with the damages sustained by the victims of the unlawful conduct. Disgorgement of ill-gotten gains may be ordered against one who has violated the securities laws/regulations but it is not every violator who could be asked to disgorge. Only such wrongdoers who*

[50] Para 23 of the Disgorgement Order.

> *have made gains as a result of their illegal act(s) could be asked to do so. Since the chief purpose of ordering disgorgement is to make sure that the wrongdoers do not profit from their wrongdoing, it would follow that the disgorgement amount should not exceed the total profits realized as the result of the unlawful activity. In a disgorgement action, the burden of showing that the amount sought to be disgorged reasonably approximates the amount of unjust enrichment is on the Board.'*

SEBI by an *ex-parte ad-interim* order dated 27 April, 2006, inter alia, directed Karvy Stock Broking Ltd. (Karvy) not to carry on the activities as a Depository Participant till the completion of the enquiry and the passing of a final order except for effecting transfer of beneficial owner account to another Depository Participant on request. Apart from Karvy, 24 key operators including Roopalben Panchal and 82 financiers had also been directed not to buy, sell or deal in the securities market including IPOs till further directions. Pursuant to an investigation by SEBI, Karvy had been found to have played a dubious role as a Depository Participant by allegedly opening large number of fictitious dematerialised accounts in collusion with Roopalben Panchal and others. By the Disgorgement Order, SEBI directed 10 entities including Karvy to disgorge a sum of Rs.115.82 crore. SAT allowed the appeals of the other nine entities on the short ground that the appellants therein had not been afforded an opportunity of a hearing before the impugned order of disgorgement was passed against them. Karvy did not want to be a party to the said appeal filed by the other nine entities and therefore separated its appeal from the bunch of other appeals.

The Karvy order is commendable, as elaborating on the concept of disgorgement. It criticised SEBI for violating the principles of natural justice by passing the Disgorgement Order without affording the party an opportunity of being heard. According to SAT, the Disgorgement Order deserves to be set aside on this ground alone. SAT stated,

> *'[I]f the illegal gains were made by financiers it was they who ought to have been directed to disgorge the amount. One is left guessing why the Board did not issue such directions to them. It did not even initiate*

> *disgorgement proceedings against them for reasons better known to the Board. It appears that after identifying the financiers who were the ultimate beneficiaries of the scam, the Board turned a nelson's eye towards them and chose to proceed against the depositories and their participants and that too, ex-parte which, to say the least, was most unfair. What is really amazing is that the Board has noticed the correct position in law in para 30 of the impugned order but did not follow the same and ordered disgorgement against those entities against whom no findings of ill-gotten gains have been made, leaving out those against whom such findings had been recorded in the ex-parte order of April 27, 2006.'*

The Disgorgement Order though struck down, one cannot disregard SEBI's move as a passing phase of its arbitrary behaviour or an ordinary order using a well established concept in a wrongful manner. The Disgorgement Order could serve as a precedent for the misapplication of an equitable concept of disgorgement.

VII. Still Not The End—Hope To Resuscitate

The purpose of this article is not just to bring out the flaws in SEBI's move and the SAT order but also to adopt a prospective approach highlighting areas where disgorgement could successfully serve as an equitable alternative remedy.

The following are the areas where Disgorgement can be used:

1. Contracts In Fiduciary Relationship

In case of a breach of contract under the *Indian Contract Act, 1872*, the remedy available would either be damages or specific relief; or in case of a quasi-contractual relationship, restitution. The authors propose that where the parties share a fiduciary relationship[51] it would be extremely difficult to assess the quantum of damages and therefore it is preferred that courts use disgorgement as an equitable remedy. Let us take an example: A is employed under B, a promoter of a software company, wherein A is

[51] A fiduciary relationship exists when a person claims to act in the best interests of, or on behalf of, another, and the other accepts that trust.

handling the source code of important software. A breaches the confidentiality agreement with B's Company and sells the assigned source code to a competitive company C. The authors propose that apart from the penal action to be initiated against A, it is only equitable that A should be disgorged of its unjust enrichment as a result of wrongdoing of breaching the confidentiality agreement with B. However, in this case the disgorged amount should be restricted to the amount gained by him as a result of the sale of the source code to company C.

The said idea of disgorgement in case of a fiduciary relationship has been endorsed in a recent New Zealand Supreme Court decision in *Chirnside and Rattray Properties* v. *Fay,*[52] which has the implication of parties investigating a potential profit-making opportunity together without any written agreement between them. In the abovementioned case, two property developers who were working together on such an opportunity in an informal way were, in fact, in a commercial joint venture. The Court held that, '*where parties join together in a venture with a view to sharing the profit obtained, their relationship is inherently fiduciary within the scope of the venture and while it continues. In such circumstances, a duty of loyalty arises, and one party will have to account to the other for any breach of loyalty in respect of the project.*' In the present case, this resulted in one of the developers, who had been wrongly excluded from the project, being awarded equitable damages representing a half share in the project. As to the relief, the Supreme Court held that the appropriate remedy was disgorgement of the profit wrongly made.[53]

2. Insider Trading

Another important scenario where disgorgement can be used as a remedy is insider trading. Insider Trading is buying or selling of security while having material, non-public information about the security, in breach of a fiduciary duty or other relationship of trust and confidence. The authors state that the ideal scenario where SEBI could have applied the concept

[52] [2006] NZSC 68.

[53] 'IPO scam-hit may get back monies' 2006 Business Line, *available at* http://www.blonnet.com/2006/11/23/stories/2006112305950100.htm (last visited 10 May 2007).

of disgorgement is in one of the enormous insider trading litigation pending before the courts in India. The following is a decided case before the United States Court of Appeals wherein the accused was guilty of insider trading, and the remedy of disgorgement was used against him. T, an Italian national residing in Switzerland, started his own investment company F. T is also a beneficial owner of the defendant company P. In March 1981, when the illegal transactions took place, he enjoyed discretionary power over their accounts at BSI, a Swiss bank based in Lugano, Switzerland.

T subsequently developed a business relationship with B, Chairman of the Board and CEO of company S, and in October, 1980. T, acting for company F, agreed to provide S with information and advice about foreign currencies. In the same month, company F agreed to invest and manage ten million dollars for company S in various currencies, bonds and notes. B also opened a personal account at company F, over which he gave T discretionary authority.

T, using inside information that was available to him, found out about company S's acquisition of a company called J and thus bought shares in J's company on behalf of company P. The judgment of the lower court awarding disgorgement of profits was affirmed by the Court of Appeals. The court finally held that the paramount purpose of enforcing the prohibition against insider trading by ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing. T and his satellites must therefore 'disgorge a sum of money equal to all the illegal payments they received.'[54]

3. Copyright And Trademarks

Sections 103 and 104 of the *Trade Marks Act, 1999*, prescribe penalty for applying false trademark and for selling goods which use false trademarks. The punishment for the said violation ranges from a minimum fine of Rs. 50,000 to a maximum fine of Rs. 2,00,000 only.

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[54] Russell Mcveagh, 'Fiduciary Obligations in Joint Ventures' (2006), *available at* www.russellmcveagh.com/doclibrary/public/Litigation/LitigationUpdateOct06.pdf. (last visited 10 May 2007).

Similarly, under the *Indian Copyright Act, 1957*, in case of a copyright violation, one can either envisage a civil remedy under section 55 seeking damages or a criminal remedy under section 63 imposing an imprisonment along with a fine which ranges from Rs. 50,000 to Rs. 2,00,000.

The authors propose that instead of the system of imposing a fine, Courts can use disgorgement to disgorge the offender of the unjust enrichment gained by him as result of the trademark or copyright violation. The usage of the said remedy apart from taking the tool of discretion from the hands of the Court would also appear to be equitable as the offender is disgorged of the amount as has been unjustly gained by him pursuant to a wrongdoing, leaving meagre scope for injustice.

The above list on the application of the remedy is not exhaustive. However, it is indeed unfortunate that our legislature has failed to give recognition to the same. In addition, SEBI has given the country and its legislature a further blundered picture of the remedy.

VIII. Conclusion

Torts usually give rise to compensatory damages; breaches of contract to expectation damages; unjust enrichments to restitution. The only obligation which seems to give rise to a disgorgement remedy is equitable obligations of good faith and loyalty. However, the same should be viewed as an important equitable remedy that is essential to meet the ends of justice. In India, in case of unjust enrichment the same could be remedied by the application of restitution, which is a quasi-contractual remedy. However, unjust enrichment subsequent to a wrongdoing attracted no judicial remedy. It was indeed essential that the concept was introduced in our country also. Credit has to be given to SEBI for introducing a debate over a pertinent and justiciable concept in India under Securities law. However, the fundamental flaw in its application had prejudiced the move of introducing the concept as an equitable remedy and not a punitive remedy. One can now only hope that such misapplication of the concept would not be repeated in the future.

JUS COGENS: A RULES-STANDARDS ANALYSIS[†]

Mandar Kagade[*]

I. INTRODUCTION

The term *jus cogens* means the compelling law.[1] In the *jus cogens* discourse, *jus cogens* are seen as norms from which no derogation is permitted. Though the concept as such has become a part of international law doctrine, its content remains a matter of debate. Other issues include identifying a definite institutional actor having the authority to articulate a norm as *jus cogens*.

This article applies the rules-standards analysis to the *jus cogens* puzzle. In so doing, it draws upon the literature of rules and standards that theorists have applied in various fields of law.[2] It argues that in the binary conception of the rules-standards universe, the norms that are supposedly identified as *jus cogens* have *rule-like* characteristics. It identifies the concerns associated with the *jus cogens* norms as those arising out of their *rule-like* orientation. In Part II, it traces the initial development of *jus cogens* in

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[†] This article reflects the position of law as on 4 September 2007.

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1 *Jus cogens* is defined in Article 53 of the *Vienna Convention on the Law of Treaties* (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 as follows: 'A treaty is void if at the time of its conclusion it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm is a norm accepted and recognised as such by the international community of states as a whole from which no derogation is permitted and which can be modified only a by a subsequent norm of general international law having the same character.'

2 For a survey of rules-standards literature, *see generally* Pierre Schlag, 'Rules And Standards' (1985) 33 *University of Chicago Law Review* 379; Cass Sunstein, 'Problem With Rules' (1995) 83 *California Law Review* 953; Louis Kaplow, 'Rules Versus Standards: An Economic Analysis' (1992) 43 *Duke Law Journal* 557; Duncan Kennedy, 'Form and Substance of Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685 (applying the rules-standards analysis to contracts); Joel Trachtman, 'The Domain Of WTO Dispute Resolution' (1999) 40 *Harvard International law Journal* 333 (applying it to the dispute resolution system of the WTO); Daniel Crane, 'Rules Versus Standards In Antitrust Adjudication' (2007) 64 *Washington And Lee Law Review* 49 (applying it to competition law).

international law. In Part III, it analyses the negotiation of *jus cogens*-related provisions at the Vienna Convention in 1969, using the rules versus standards dialectic. In Part IV, through the rules-standards prism, it analyses cases at the International Court of Justice (ICJ) where *jus cogens* could have played a part and concludes that the avoidance of the Court in making a definite pronouncement on *jus cogens* was the result of the wrong choices at the Convention. Further, it reads those cases as highlighting the problems that prevalent opinions concerning absolutist (non-derogable) *jus cogens* create. In Part V, it points out how the rule-oriented, absolutist vision of *jus cogens* may lead to inefficient outcomes in other circumstances in international settings where information is at a premium. In Part VI, it makes a normative claim that proposes a new definition of the *jus cogens* directive. Lastly, it argues that the proposed definition (that has a standard-like characterisation) of *jus cogens* is more in keeping with the fundamental nature of those norms. This vision is a better fit with the communitarian basis of such norms.

A. Rules and Standards: An Introduction[3]

Rules are sharp, communicating devices. 'A speed of over 100 miles per hour will be punished by a fine of 100 dollars' clearly defines the act and the punishment. The actors to whom the legal directive is addressed have a clear *ex ante* idea about the nature of activity that is expected of them. To the law enforcement agencies, imposing the fine of 100 dollars is a bright-line solution; they have merely to apply the penalty to each case where the driver crosses the 100 miles threshold. So we may say that the law enforcement actors have no discretion to make a case-by-case analysis of each instance of speeding. However, consider the following directive: 'Excessive speeds will be punished with a severe monetary fine.' This directive is different from the earlier one in that the actor to whom the directive is addressed is given the discretion to choose the speed at which he drives his vehicle. For the law enforcement actors, the 'severe monetary fine' allows the discretion to make a casuist analysis of each case of speeding and then decide the quantum of penalty. Such

3 Schlag *et al, supra* n. 2.

open ended and heuristic directives are called standards. The form of a directive as a rule or standard depends upon certain factors–for instance, a legal system might want to deter actors from crossing the 100 mile threshold because it was found that speeds in excess of 100 miles are more likely to lead to accidents. This means that the rule was aided by the information that the actors of the legal system had about the likelihood of the accident in settings where speeds of 100 miles are reached. The level of *ex ante* information always informs the choice of the form a legal directive takes. Hence it is more likely that in a setting where the *ex ante* information is easier, lawmakers will prefer rules. A standard is more likely to be used when the law makers do not know what particular speed is more likely to result in an accident. Hence they would try and distribute that information cost among various drivers and let each decide what the appropriate threshold is; thus the cost of gathering information is another dimension on which the form of a legal directive is contingent. Another important factor in determining the legal form is the degree of flexibility that actors who frame the directive show towards each other. The more flexibility they have amongst themselves, the more sharply they communicate. Low flexibility means they can only agree broadly and that would be reflected in shallower communicating devices.

To summarise, rules have the following characteristics:

- They involve heavy *ex ante* information costs and heavy political costs in areas where preference–cleavage among actors is high;
- They are cheaper to obey;
- They are more likely to emerge in legal systems where the lawmaker intends to retain control and minimise the discretion allowed to the law-applying agents (courts and agencies);
- They decide by offering a bright-line solution in a sharp on /off manner.

Standards have the following characteristics:

- They involve *ex post* information costs;

- They are costlier to obey;
- They are more likely to emerge in legal systems where the lawmaker trusts the law-applying agents and intends to give them maximum discretion;
- They decide according to a balancing of competing considerations and facts.

The difference between rules and standards is the amount of work required to be done in order to generate the content of the law before or after actors act.[4] Where the amount of work is less after the act, the directive is more likely to be a rule; when the work is more, the directive is more likely to be a standard. A standard means that the agent can employ a broad range of considerations to give content to the law that the lawmaker may only (if at all), implicitly control. A rule imposes fetters on the range of permissible considerations.

B. Jus Cogens as Rules

This section establishes a co-relation between rules as understood in rules-standards literature and the prevalent *jus cogens* discourse. Consider the definition of *jus cogens*—*jus cogens* are seen as norms from which no derogation is permitted. This characterisation of *jus cogens* is framed in absolutist terms and hence on a rule-standard continuum, it is rule-like. Further, for a norm to achieve *jus cogens* status, it has to be '*accepted and recognised by the international community of states as a whole*'.[5] This means that like in the case of rules, the lawmaker (States) controls the content of *jus cogens*.[6]

Now consider a purported *jus cogens* norm against the use of force. The proscription against the use of force is absolute, non-derogable and applies to all states across all events. It also draws a bright line and sharply communicates what is proscribed. Similarly, a claim that the prohibition of genocide, war crimes or crimes against humanity is *jus cogens* means

4 Kaplow, *supra* n. 2, 559.
5 *Supra* n. 1.
6 *See supra* Part IA for the characteristics of rules.

that all states have a duty to prohibit genocide or punish the guilty across all events and in all circumstances. To summarise, in as much as the concept of *jus cogens* and the norms of *jus cogens* have qualities of non-derogability or absolutism associated with them and in so far as they communicate sharply or draw the bright line, in the binary universe of rules-standards, they symbolise rules.

II. Jus Cogens In Traditional International Law

In 1937, a continental naturalist, Alfred Verdross argued that, like all other legal systems, international law also includes–indeed, must by necessity include–certain norms which, as an integral part of the *ordre public* of the international community, may not be repealed or changed by agreements between a smaller group of states.[7] Verdross drew attention to the fact that until the rise of legal positivism the existence of such peremptory rules was not disputed. Natural law scholars defended the view that positive international law rested on immutable norms *(ius necessarium).* For him, law and morality were interdependent by necessity and a 'general principle of law' undoubtedly existed belonging to the fundamental, peremptory category outlined in the preceding section, which prohibited States from concluding treaties that were *contra bonos mores.*[8] In *Forbidden Treaties*, he argued that 'no juridical order can admit treaties which are obviously in contradiction to the ethics of the Community'.[9] Verdross then enumerated a list of treaties that may never be admitted in the international juridical order.[10] He argued that the tribunal before which such treaties are sought to be enforced might properly regard them as void.

Thus, in the version of *jus cogens* before the Vienna Convention, the international judge rather than the community of states was the actor that would fashion a putative rule of *jus cogens*. Though judges are not equipped

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7 Alfred Verdross, 'Forbidden Treaties In International Law' (1937) 31 *American Journal Of International Law* 571.

8 Bruno Simma, 'The Contribution Of Alfred Verdross To The Theory Of International Law' (1995) 6 *European Journal of International Law* 1, 19.

9 Verdross, *supra* n. 6, 572.

10 Verdross, *supra* n. 6, 574-576.

to provide content to the law because they have limited tools for gathering information, in the instant case, the standard-like nature of delegation[11] compensated the information deficit that the judge might encounter. The *standard-like* nature of the concept meant that he had more discretion and hence greater incentive to engage in the task of formulating the content.

III Analysis Of The Vienna Convention's Provisions Of *Jus Cogens*

The following analysis of the *jus cogens* provisions of the *Vienna Convention on the Law of Treaties* (*Vienna Convention)* points out the wrong choices made at Vienna and how alternative options could have facilitated the emergence of *jus cogens*. These choices are seen through the rules-standards binary. The dictionary clause of Article 53 and the dispute settlement provision of Article 66 are the provisions investigated below.

A. Article 53

The International Law Commission in its commentary to draft Article 50 (which became Article 53 in the Convention) on *jus cogens* noted that the emergence of rules having the character of *jus cogens* is comparatively recent, while international law is in the process of rapid development. It considered that the right course ought to be, to provide in general terms, that a treaty would be void if it conflicts with a rule of *jus cogens*. This would leave the full content of this rule ought to be worked out by state practice and the jurisprudence of international tribunals. The International Law Commission decided not to use illustrative examples of *jus cogens* norms because there was a possibility that such illustration might be construed as exhaustive even with the most careful drafting.[12]

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11 '*Contra bonos mores*' or 'ethics of international community' are open textured phrases and allow a broad range of considerations in deciding which treaties would be void; hence they are standard-like forms. *See supra* Part I*A*.

12 'Draft Articles On The Law Of Treaties With Commentaries' *Yearbook of the International law Commission* (1966) vol [II], 247, *available at* http://www.ilc.org (last visited 18 August 2007).

However in truth, it did more than merely to provide in general terms; there is a difference between draft Article 50 and Article 53 as it finally stands. Article 53 went further and defined the *jus cogens* norm as one 'accepted and recognised by international community of States as a whole'. As we saw earlier, the form of the words used implies the intention of the lawmaker to (explicitly) control the content of *jus cogens* law and hence has the characteristic of rules.[13] However, in international law, there is no ritualised communication between the law maker (States) and its agent (courts) and the lawmaker communicates its intent in a myriad of ways.[14] Thus, the operative phrase, 'accepted and recognised by the international community of States as a whole', imposes heavy information costs on the courts because of the uncertainty in the evidentiary requirement.[15] What is acceptance? Whether unanimous voting for a resolution supporting a particular norm is enough? What is the scope of the words 'as a whole'? Does it mean universal acceptance? Would general acceptance, as in the case of customary international law suffice? What is 'international community of States'?[16] The heavy evidentiary requirement imposed by Article 53 makes this definition, in fact, a standard masquerading as a rule on the rules-standards continuum. This means that much work is left to be done *ex post facto*; at the same time fettering the range of permissible considerations when agents choose to perform that task. (In the Verdrossian version, which was a pure standard, the broad range of permissible considerations that the agents may apply compensates the information costs).[17] This makes it costlier for the courts to implement it.

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13 *See supra* Part I*B*.

14 This is in contrast to municipal law of a state where communication is more defined. It takes the form of statutes, rules, and regulations etc, which emerge from a defined process.

15 Bassiouni, 'International Crimes: *Jus cogens* And Obligatio Erga Omnes' (1996) 59 *Law And Contemporary Problems* 63, 67 (citing, inter alia, differences in evidentiary elements as reason why scholars disagree as to what constitutes a peremptory norm and how it rises to that level).

16 Jose Antonio Carrillo Salcedo, 'Reflections On The Existence Of Hierarchy Of Norms In International Law' (1997) 8 *European Journal Of International law* 583, 590 (pointing out that one of the shortcomings of the *Vienna Convention* is that the notion of 'international community of states' is a vague one).

17 *See supra* Part II.

As we shall see, such increased costs have hampered the creation of the content of *jus cogens*.[18] The lawmaker could have harnessed the value of vagueness by choosing not to define *jus cogens*. The agents confronted with a claim on *jus cogens* would have greater discretion in fashioning the content of *jus cogens* law. This progressive development of law prevented the emergence of content of *jus cogens* in one more way. The provision could play only a very limited role in the articulation of the content of *jus cogens* in international human rights law, a sphere where the concept wields the most influence. This is because the major human rights instruments entered into force before the *Vienna Convention*. For instance, the twin Covenants, the *International Covenant on Civil and Political Rights*[19] and the *International Covenant on Economic, Social and Cultural Rights*[20] entered into force in 1976, while the *Genocide Convention*[21] entered into force in 1951. Given that the modern conception of *jus cogens* involves the progressive development of law, Article 4,[22] of the *Vienna Convention* will be triggered and Article 53 will not be applicable to those Conventions. The compatibility of reservations appended to these Conventions or the fulfillment of obligations under them is outside the ambit of the *Vienna Convention*. A *standard-like* ambiguity would have allowed agents to read the doctrinal understanding of *jus cogens* to be applicable, when confronted with a claim concerning *jus cogens*. (The doctrinal understanding was a pure standard as articulated in Part II above). Article 4 of the *Vienna Convention* would not have triggered in that case. Resultantly, it would have been possible to question reservations or non-fulfillment of obligations under the human rights treaties as violations of *jus cogens*. In sum, it must be said that the lawmaker failed to see the value in vagueness at Vienna that could have been harnessed by retaining Article 50 in the final text.

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18 *See infra* Part III.

19 Adopted 16 December 1966, entered into force 23 March 1976 999 UNTS 171.

20 Adopted 16 December 1966, entered into force 3 January 1976 993 UNTS 3.

21 *Convention on the Prevention and Punishment of the Crime of Genocide* (adopted 9 December 1948, entered into force 12 January 1951) 78 UNTS 277.

22 Article 4 reads: 'Without prejudice to the application of any rules set forth in the present Convention to which treaties would be subject under international law independently of the Convention, the Convention applies only to treaties which are concluded by States after the entry into force of the present Convention with regard to such States.'

B. Article 66

Article 66 is the dispute settlement clause of the *Vienna Convention.* It mandates that 'any one of the parties to a dispute concerning the application or the interpretation of Article 53 or 64 may, by written application, submit it to the International Court Justice (ICJ) for a decision unless the parties by common consent agree to submit the dispute to arbitration.' The articles in question relate to conflicts between treaties and peremptory norms of general international law.

However the possibility of recourse to the ICJ through the device of Article 66 looks remote because States have appended reservations to it, which in effect immunises them from justifying an alleged *jus cogens* violation in adjudication.[23] This considerably reduces the deterrence effect of the prohibition contained in Article 53.

The reasons for appending reservations may be understood through the rules-standards analysis. As we noted earlier, it was decided that the tribunals could provide the content of the *jus cogens* law but that the directive defining *jus cogens* imposes very high evidentiary requirement, thus making it a standard because of the associated high information cost. In standards, the content of the law being uncertain, actors at whom the directives are aimed incur costs in knowing the content of the law *ex ante* and hence they are costlier to comply with.[24] Thus the possibility of non-compliance is high in standards. In municipal settings, where there is compulsory adjudication, persons may invest in advice and incur costs. In international law, actors have the choice *not* to make themselves

[23] Tunisia, for instance, appended a reservation to the effect that invoking the jurisdiction of the World Court could only be with the consent of all the parties concerned. Syria too appended a reservation to similar effect. States which have chosen to object have appended illogical objections. Sweden, for instance, framed its objections in the following words: 'The treaty relations between Tunisia and Sweden shall not include articles 53 and 64.' *See* EW Vierdag, 'The Law Governing Treaty Relations Between Parties To The Vienna Convention On Law Of Treaties And States Not Party To The Convention' (1982) 76 *American Journal Of International Law* 779, 798.

[24] Kaplow, *supra* n. 2, 621.

amenable to a justificatory discourse before courts. (A State may, for instance, not make a declaration under Article 36(2) of the Statute of the ICJ or append reservations to the compromissory clause of a treaty). Because standards involve *ex ante* investment of resources to discern the content of the law and the possibility of non-compliance is high, there is an incentive to not submit to the mandatory jurisdiction. Also, the sanction of non-compliance in the instant case is nullity. Given that States as rational actors would engage in conduct or enter into treaty relations only when it is efficient to do so, they would be understandably reluctant to let an efficient bargain scuttle away because of a hypothetical higher norm where the possibility of judicial error is high and no insurance (by way of appeal/ remand authority) is available against it. If the content of the law is specified *ex ante*, actors have a clear idea of the conduct expected of them and hence the possibility of them agreeing to mandatory dispute settlement is greater. This is because the possibility of being found violating the law is less as actors ascertain the conduct required of them with lower costs. If the content is to be worked out *ex post facto*, the possibility of States consenting to submit to the mandatory jurisdiction is less in as much as it is costly to ascertain the conduct expected of them and the possibility of non-compliance is high. The lawmaker then had two options: codify all norms of *jus cogens* or include a *no reservation* clause in the treaty for Article 66. The former could have incentivised voluntary acceptance of the dispute settlement clause, while the latter could have in effect coerced States into being subject to the mandatory jurisdiction. It did neither.[25] The Spanish proposal to have a *no reservation* clause for Part V of the treaty was rejected. [26]

Seen in terms of the rules-standards binary, this may be seen as the reluctance of the International Law Commission to be *rule oriented*. It is ironic that the Commission otherwise preoccupied with rules and rule-like drafting at the Convention did not legislate for the rules where the situation clearly demanded it.

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[25] *Supra* n.12, 248 (the commentary notes that the Commission believed that codification of *jus cogens* norms would have taken it beyond the mandate of the Convention).

[26] Vierdag, *supra* n. 23, 780.

This reluctance meant that in effect there exists no institutional actor to objectively determine the *jus cogens* character of a particular norm. In the absence of a defined body to declare a particular treaty/conduct as being repugnant to a *jus cogens* norm, the field is left open to diplomatic claim making. Given that the primary attribute of a *jus cogens* norm is its indelibility, this is a disincentive to the *jus cogens* discourse itself– because different States, at different stages may claim that a set of norms are peremptory, with each side claiming victory.[27] There is lack of a medium to disseminate information about defectors and violators. It introduces relativism into the process. No act may be void or real; instead an act could be void for some and valid for others. This has a detrimental effect on certainty and stability – attributes of any legal system. The opposition to the concept of *jus cogens* by a section of publicists[28] may be understood in the light of this defect.

IV. *Jus Cogens* In Practice

This part analyses whether the ICJ was alive to the delegation that the lawmaker at Vienna chose to make. It aims to analyse some cases at this forum, which were related to *jus cogens* norms. With Shelton,[29] it concludes that the ICJ has been reluctant to acknowledge the doctrine of *jus cogens*; however going further, it explores the reasons for such reluctance through the rules versus standards dialectic.

A. Case Concerning East Timor

The *Case concerning East Timor,*[30] (East Timor) provided an opportunity to the International Court of Justice to apply the *jus cogens* discourse to the law of state responsibility. Portugal, placing reliance on a treaty entered

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27 Salcedo, *supra* n.16, 590 (noting that in the absence of an impartial third party empowered to decide, *jus cogens* is inevitably taken over by inter subjective logic that could undermine the reasons that led to its consecration).

28 Schwarzenberger, 'International *Jus cogens*?' (1965) 43 *Texas Law Review* 455, 477-78 (stating that the concept opens up a way for devaluing the written word and the rule of *pacta sunt servanda*).

29 Dinah Shelton, 'Normative Hierarchy In International law' (2006) 100 *American Journal Of International Law* 291,305 (noting that the ICJ seemed to take pains to avoid any pronouncement on it).

30 Case concerning East Timor (*Portugal* v. *Australia)* (*Judgment*) [1995] ICJ Reports 90.

into by Australia with Indonesia, argued that the establishment by Australia of treaty relations with Indonesia, (the subject matter whereof concerned the exploitation of mineral resources in the Timorese continental shelf) constituted recognition of Indonesian occupation of East Timor. This, Portugal claimed, violated the right of the East Timorese people to self-determination. It was implicit in Portugal's argument that because the principle of self-determination was a peremptory norm, it was Australia's obligation to treat the Indonesian occupation as a *non-est,* whereas by entering into treaty relations with Indonesia, (which was occupying the territory by force), it was providing legal recognition. This involved international responsibility on its part. Australia rejoined on various counts, inter alia claiming that Indonesia's right of entering into treaty relations was the very subject matter of the dispute and hence the real dispute was between Portugal and Indonesia and not itself and Portugal; further, in the absence of Indonesia's consent, the ICJ could not enter into the merits of the dispute. For Portugal, the illegality of Indonesian occupation was a fact; it argued that the political organs of the United Nations have so determined independent of the ICJ. The Court had two choices– one was the claim that invited it to hold certain conduct violative of a *jus cogens* norm; the other was the defence that asked it hold that it had no jurisdiction, since the process of determining would have involved the assertion of jurisdiction over a State that had not subjected itself to it. A positivist choice here would mean that any benefit of the doubt as to whether the ICJ does or does not have jurisdiction would go to the State concerned. In terms of prior jurisprudence, it had two competing precedents; the *Monetary Gold case*[31] (which ultimately lead the ICJ to deny jurisdiction) and the more recent *Certain Phosphate Lands in Nauru*[32] (where the Court held that incidental determination of other States' rights would not be a bar). The ICJ conceded the *erga omnes* character of self-determination[33] but held that it could not have subject matter competence

[31] Monetary Gold Removed from Rome in 1943 : *Italy* v. *France, United Kingdom of Great Britain & Ireland, & United States* [1954] ICJ Reports 19.

[32] Case concerning Certain Phosphate Lands in Nauru(*Nauru* v. *Australia)* (*Preliminary Objections*) [1992] ICJ Reports 261.

[33] Case concerning East Timor (*Portugal* v. *Australia)* (*Judgment*) [1995] ICJ Reports, 102, para. 29.

because of the lack of consent on the part of Indonesia. That the Court was even willing to resurrect a principle, which in similar circumstances it had recently not applied, clearly points to the fact that it was seeking to avoid the articulation of a norm as *jus cogens*. In hindsight, it is submitted that *East Timor* could have been better argued under the Law of Treaties. Had Portugal contested the validity of the Timor gap treaty by placing reliance on Article 53 of the *Vienna Convention*, it would have compelled the ICJ to make a definitive pronouncement.

Understood in terms of the rules versus standards analysis, there could be other reasons for this avoidance. Avoidance is the choice incentivised when the given rule is uncertain. The claim is uncertain because despite it being well received in the doctrine of *jus cogens*, the bundle of entitlements the principle of self determination bestows upon its holders has not been exhaustively articulated.[34] Therefore, a claim as to violation of self determination would require the Court to inquire into all settings in which the principle of self determination applies,[35] the precise content of the obligation it entails,[36] and determine the *ratione personae* holders of the entitlement.[37] With the limited information tools at its disposal,[38] it may be safely assumed that the information costs of finding a variant 'accepted and recognised by international community of states as a whole' would have proved too much for the Court. Given the high information costs, chances of judicial error were high and the same may have raised

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[34] Deborah Cass, 'Re-Thinking Self-Determination: A Critical Analysis Of Current International Law Theories' (1992) 18 *Syracuse Journal Of International Law And Commerce* 21, 22 (stating that self-determination is a term which has a wide penumbra of uncertainty).

[35] There is state practice which suggests that it does not apply to democratic polities C*f.* India's reservation to Article 1 of the International Covenant on Civil and Political Rights, which has not been objected to by other parties to the Covenant.

[36] The obligation to respect the right of self-determination may, depending on the setting, vary between merely respecting and protecting universal suffrage to recognizing secession. The Covenant on Civil And Political Rights does not define it. *See International Covenant on Civil and Political Rights* (adopted 16 December 1966, entered into force 23 March 1976) 999 UNTS 171.

[37] *See* John Kiwanuka, 'The Meaning Of "People" In The African Charter On Human And Peoples' Rights' (1988) 82 *American Journal Of International Law* 80, 82. (noting that none of the instruments that codify the right of self determination have defined it).

[38] *See* Article 50 of the Statute of the ICJ, *available at* http://www.icj-cij.org (last visited 18 August 2007).

legitimacy concerns. In conclusion it must be said that the Court was not wholly incorrect in choosing judicial discretion over valour. The *East Timor* experience indicates that the information costs courts encounter in fashioning the content of *jus cogens* might be one of the factors that prove to be a disincentive in fashioning its content. If *jus cogens* discourse is to make sense and the puzzle of its content is to be solved, lawmakers would have to explore more inclusive/malleable form of words to define it.

B. Case Concerning Arrest Warrant of 11 April 2000

The *East Timor case* showed that the ICJ had to avoid the issue to mask the excessive information costs. Seen through the rules-standards prism, the *Case Concerning Arrest Warrant of 11 April 2000,*[39] (Arrest Warrant) in which the court once again failed to respond to the argument in terms of *jus cogens*, may be seen as reflective of the problems associated with non-derogable absolutist vision of existing *jus cogens* norms. The ICJ in the instant case avoided application of an over inclusive *jus cogens* norm to arrive at a more efficient solution. The Democratic Republic of Congo instituted litigation against the State of Belgium for violating the immunity of the Congolese Minister of Foreign Affairs by the issuance of criminal process against him for serious crimes against humanity and war crimes. The ICJ found that in international law, a Foreign Minister enjoys absolute immunity from both the jurisdiction and enforcement of a foreign state. And also that in international law there are no exceptions to the immunity of high-ranking officials even when they are accused of violations of grave crimes.

Ultimately, the ICJ held that the Foreign Minister enjoyed absolute immunity. But even in so doing the ICJ was alive to the value of the other interest at stake (the effective combating of grave crimes) and hence the concession that the immunities enjoyed under international law by an incumbent or former Minister of Foreign Affairs do not represent a bar

[39] Case Concerning Arrest Warrant of 11 April 2000(*Democratic Republic of Congo* v. *Belgium*)(*Judgment*) [2002] ICJ Reports 3.

to criminal prosecution in certain circumstances.[40] The ICJ then applied what we may call the *but for* test; was it the case that the Minister would be condoned for his crimes by merely immunising him from the arrest warrant? The answer was in the negative.[41] Immunity would therefore not necessarily prejudice the interest the community of states had in the effective combating of international crimes. On the other hand, the mutual interest of the two States in maintaining a friendly official interaction would necessarily be prejudiced (without any appreciable gain to the other competing interest). In sum, therefore a bright line solution in favour of human rights would have produced an inefficient outcome. The ICJ by avoiding the use of *jus cogens* was able to arrive at a more efficient outcome.

These cases clearly bring out the paradox between the *jus cogens* discourse in doctrine and that in practice. While in theory and doctrine, *jus cogens* is looked upon as set of non-derogable rules accepted and recognised by the international community of states as a whole, the practice has been reluctant to identify it as such. The ICJ's consistent practice of avoiding the invocation of *jus cogens* then supports the argument that we must reinterpret the concept of *jus cogens*.

V. Costs Associated With Codification Of Norms Of *Jus Cogens*

Other *jus cogens* rules such as non-use of force or genocide show under inclusive or over inclusive tendencies. For instance, consider the rule against the use of force that is well received as a *jus cogens* norm in doctrine. It has at least one recognised exception in the right to use force in self defense. But the varied species of the exceptions (preemptive or anticipatory) clearly indicate the under inclusivity of the rule in that it does not apply to fact matrices where it ought to apply. On the contrary, apply it to a setting where the government of country A is engaging in policy of genocide; given the *jus cogens* character of non-use of force,

[40] Case Concerning Arrest Warrant of 11 April 2000(*Democratic Republic of Congo* v. *Belgium*)(*Judgment*) [2002] ICJ Reports 3, 25 (para 61).

[41] Case Concerning Arrest Warrant of 11 April 2000 (*Democratic Republic of Congo* v. *Belgium*)(*Judgment*) [2002] ICJ Reports 3, 25 (para 61).

humanitarian intervention as an obligation is ruled out. If no derogation from the norm of *jus cogens* is permitted, a right of humanitarian intervention to prevent genocide must indeed be part of positive international law. The establishment of *ad hoc* tribunals to bring to justice perpetrators of such conduct cannot countenance the fact that acts contrary to purported norms of *jus cogens* are allowed to be committed in the first place. The rule against use of force becomes over inclusive in such settings in that it obligates actors to respect it even in cases where respect to it may generate unjust outcomes. Conversely, in the absence of an objective third party to determine, one may never know the line between true humanitarian intervention and the use of force in violation of *jus cogens*. Further in settings such as this, State A does not communicate with the rest of the actors.[42] In the resultant informational deficit, the likelihood of other States making wrong judgments is greater. Risk-averse groups would choose not to intervene while adventurous would intervene; one or the other norm is subordinated. Similar claims could be made about norms obligating punishment for war crimes and crimes against humanity; they are over inclusive when compliance to them is obligated in settings where a 'let bygones be bygones policy' would be more appropriate.[43] Indeed, the establishment of tribunals to punish those crimes may be seen as in conflict with the norm of self determination if those societies have a preference to peace over justice. To ensure that such a situation does not arise, the lawmaker would be required to draft a directive in a manner that would be absolute across all events. The directive may state the rule exhaustively (to counter the problem of under inclusivity) that may impose heavy administrative costs with exceptions to counter problems of over inclusivity. The exceptions serve to avoid the injustice of the rule. But as Critical Legal Theory has shown us, justice always assumes the form of standards rather than rules. And the standard has the tendency to devour the rule altogether and reduce the rule to a presumptive equity.[44] Thus in the end, we are left with no *non-derogables*.

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42 Through a gag on the international press, other domestic and non-domestic non-state actors and factual denials at international forums.

43 *See* Anthony A. D'Amato, 'Peace Vs. Accountability In Bosnia' (1994) 88 *American Journal Of International Law* 500.

44 Martii Koskiniemmi, 'Hierarchy In International Law- A Sketch' (1997) 8 *European Journal Of International Law* 566, 571.

VI. A Suggested Definition Of *Jus cogens*

Having analysed how the rule-like characteristics of *jus cogens* are problematic, in this part, a normative claim is made about the form of *jus cogens*. This article articulates a definition of *jus cogens* that has a standard-like orientation. Since this article criticises the absolutist non-derogable vision of Article 53, it does not claim a set of norms as absolute but rather identifies a definition of the concept and the source from which such norms would emerge. However, before this a brief summary of the problems associated with *jus cogens* is offered.

- The voluntarist basis of the Article 53 definition of *jus cogens* that causes theoretical confusion about the concept and the origin;
- The information costs associated with the 'accepted and recognised by international Community of states as a whole' threshold of Article 53;
- Preference cleavage among States that would make codifying the content of *jus cogens* a costly exercise.

Due to their peculiar nature, *jus cogens* norms could be more properly explained by assuming that the basis of obligation in international law lies in natural law. However the modern variant that stipulates that the norm must be accepted and recognised by the international community of states as a whole is reflective of the fact that consent is the basis of the modern version of *jus cogens*. This brings in an inevitable circularity of reasoning. It also seems paradoxical because even in jurisdictions dominated by positivist influences, it is the adjudicators that establish public policy. Translated, that means the lawmakers do not retain control (any explicit control at any rate) over public policy norms. If *jus cogens* is the international law equivalent of public policy norms, this positivist rule like formulation is an oddity.

As natural law best explains the basis of *jus cogens*, we have to find a formulation that has its roots in naturalist origins. This would solve the theoretical problems associated with the *jus cogens* discourse. Secondly, because natural law as we have seen, increases the range of permissible

considerations that the adjudicator may apply in fashioning a norm of *jus cogens*, it compensates the information deficit and the costs of fashioning such a norm. Thirdly, given that a *de novo* framing of the definition of *jus cogens* is going to be a costly exercise due to the preference cleavage among states, the source has to be found in devices already existent. Accordingly, this article proposes Article 38(1) (c) of the Statute of the ICJ as a conception of *jus cogens*. As framed, much work still needs to be done by the ICJ and hence on the rules–standards continuum, it is a standard. It satisfies the first problem associated with the *jus cogens* puzzle in that it owes its roots to natural law.[45] It greatly reduces the information costs because owing to accidents of history, the principles may be gleaned from study of just two systems of law, to wit: the common law and civil law. Finally, the source is already a part of the Statute of the ICJ and will not require additional negotiating costs.

VII.A Better Fit With The Characteristics Of *Jus cogens*

A standard like definition of *jus cogens* is a better *fit* with characteristics that are associated with *jus cogens*. As pointed out above, *jus cogens* are inclusive norms. – Norms that do not further the interests of a particular actor – but a community of actors as such; the communitarian basis lends credence to the argument that the *jus cogens* discourse stems from the altruistic rather than the individualistic. Thus, the prescriptive claim that this essay makes about having a standard based *jus cogens* is well founded as it mirrors Kennedy's claim that altruism takes the form of standards rather than rules.[46]

Other authors have articulated a Constitutional role of *jus cogens*;[47] the standard-like model that this essay advocates is a *better fit* with that role. As pointed out in Part I, Constitutions have a preponderance of standard-

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45 Simma, *supra* n. 8, 16 (stating that Article 38 (1) (c) of the Statute *shook the positivist view* (emphasis supplied)).

46 Kennedy, *supra* n.2, 1685 (stating that altruistic views lead to willingness to resort to standards while individualistic views are more likely to lead to rules).

47 *See* Stephen Kirchner, 'Relative Normativity And The Constitutional Dimension Of International Law: A Place For Values In The International Legal System?' (2004) 5 *German Law Journal* 47.

like directives and the form of words is heuristic. The designing of Constitutions as standards is in part because of the fact that Constitutions are designed for longevity. *Jus cogens* norms share this characteristic of *entrenchism*. To the extent therefore that *jus cogens* are akin to norms having Constitutional status, they are better viewed as standards.

VIII. Conclusion

The rules-standards analysis clearly brings out the paradox between the *jus cogens* discourse in law and in practice. In settings marked by numerous heterogeneous actors, lawmakers would increasingly encounter exorbitant negotiation costs to fashion *jus cogens* as rules. Assuming that such rules are framed, given the information deficit in international law, they may become over inclusive or under inclusive at times and may lead to inefficient outcomes. The *rule-like* orientation moreover leads to circularity in reasoning. The modern conception of *jus cogens* imposes significant information costs on agents thereby fettering their incentives to provide content to the *jus cogens* discourse. This article therefore argues for a *standard-like* conception of *jus cogens*. This vision is better because it explains the *jus cogens* doctrine without logical fallacy. It facilitates emergence of *jus cogens* law by identifying a neutral arbiter and eases information costs therein by allowing it unfettered discretion. Additionally, the characteristic of inclusivity and the communitarian basis of *jus cogens* are better explained by having *jus cogens* as standards. International lawyers have in recent times, increasingly taken to interdisciplinary studies to find solutions to vexed issues such as compliance of international law.[48] The debate surrounding *jus cogens* is one such issue. The new institutional economics of rules–standards may well be the solution to the *jus cogens* puzzle.

[48] *See generally,* Harold Koh, 'Why Do Nations Obey International Law' (1997) 106 *Yale Law Journal* 2599.

BEYOND A TUDOR APPROACH TO TRANSFER PRICING: EVOLVING A MODEL FOR EFFECTIVE USE OF SECRET COMPARABLES †

Neha Tayshete *

'We all say so and thus it must be true.'

- Rudyard Kipling

I. Introduction

The introduction of transfer pricing in India since the year 2001 has no doubt witnessed a new era in the taxation of international transactions that is markedly detailed and specific. It has also unfortunately witnessed the almost dystopian practice of use of secret comparables.[1] While some concede that the use of secret comparables may be considered a necessary evil in the light of its significant relevance and necessity, the practice is not without its fair share of detractors.

The use of secret comparables has been likened by many to be an inequitable procedure wherein taxpayers are told 'We know your prices are wrong but we won't tell you why and you have the onus of proving they are not',[2] that is reminiscent of the dark days of the early Tudor Regime. Since the use of secret comparables, in its essence, refers to the

† This article reflects the position of law as on 15 December 2007.

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1 KR Srivats, 'Transfer Pricing Audits- Government Unlikely To Do Away With "Secret Comparable" Practice' *The Hindu Business Line, available at* http://www.thehindubusinessline.com/2006/01/30/stories/2006013001431400.htm (last visited 26 December 2007).

2 Joel Nitikman, 'Obtaining Disclosure Of Secret Comparables In Canadian Transfer Pricing Litigation:Policy And Practise' (2002) 50(1) *Canadian Tax Journal* 28, *available at* http://www.ctf.ca/pdf/ctjpdf/2002ctj1_nitikman.pdf (last visited 14 May 2007).

use of income tax returns, audits and third party information, it raises valid concerns as to confidentiality, disclosure, burden of proof and potential misuse by tax authorities. These concerns are further compounded by the fact that the legislation pertaining to the use of secret comparables in India is fraught with patent ambiguities and controversies as to its nature and extent.[3] Disturbingly, there also exists no international guidance or consensus on the same.

It must be ultimately remembered that the parent legislation of secret comparable use in India, the transfer pricing procedure, as laid down in Section 92 of the *Income Tax Act* (the Act), is largely a reproduction of the guidelines issued by the Organisation for Economic Co-operation and Development (OECD) in 1995 on transfer pricing. Subsequently, the OECD has issued several supplements to the guidelines on various issues pertaining to transfer pricing that are widely followed and adopted.[4] The OECD guidelines are also considered to be a guiding force in the application of Section 92 of the Act. It is pertinent to note, then, that as recently as 2006, the OECD has issued a Discussion Draft on Comparability of Transfer Pricing that many believe may be the precursor to crystallisation. The abovementioned document exhorts countries to develop guidelines and safeguards on the issue of secret comparables, while simultaneously, tacitly acknowledging their relevance.[5]

In light of these compelling factors, this Article contends that the task of evolving an effective and functional, yet fair framework for the use of secret comparables in transfer pricing must be undertaken urgently and proposes a model for the same. Part II of this Article deals with the

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3 *Infra* Part III A.

4 Examples of detailed supplements released by the OECD include The 1996 Report on Transfer Pricing of Intangibles, The 1996 Report on Transfer Pricing of Intra Group Services, The 1997 Report on Transfer Pricing of Cost Contribution Agreements, The 1998 Annex on Practical Examples, The 1998 Report on Transfer Pricing of Electronic Commerce, The 1999 Update on Transfer Pricing of Cost Contribution Agreements.

5 OECD Discussion Draft on Comparability, *at* http://www.oecd.org/dataoecd/59/38/36651642.pdf (last visited 7 July 2007). It may also be noted that recent decisions at the tribunal level such as the Aztec Software 107 ITD 141 (SB) decision and Mentor Graphics 109 ITD 101 (Del) decision too emphasise transfer pricing procedure.

patent ambiguities and controversies relating to the legislation governing the nature and extent of the use of secret comparables in transfer pricing, along with an introduction to fundamental concepts. Part III of this Article puts forth a case for the relevance and necessity of the use of secret comparables, particularly in the light of the recently issued OECD Discussion Draft, as well as in a sector specific manner. Lastly, Part IV of the Article postulates the recommendatory aspect.

II. A Law Without A Law: The Legislation Governing Secret Comparables

A. An Introduction To Fundamental Concepts In Secret Comparables And Transfer Pricing.

'Transfer pricing' applies to the conducting of international transactions at manipulated prices as opposed to open market prices between related or associated enterprises. An oft-cited example of transfer pricing supposes that an Indian Company A purchases goods worth, say Rs 200. It sells the goods to its sister concern or associated enterprise, Company B, in a foreign country X, for a price of Rs 400. Company B then sells the same goods in the foreign country at a price of Rs 500 in the open market. Had the goods been directly sold by Company A in the foreign country X, it would have resulted in a profit of Rs 300. The routed transaction through Company B and the selling of goods at a lower price to it, on the other hand, results in a profit of Rs 200. Selling of goods to its sister concern at a lower price certainly results in the illusion of lowered profits for Company A. Company A can thereby effectively avoid payment of taxes on the actual profit of Rs 300, instead paying it on the lower and deceptive amount of Rs 200, resulting in significant losses to the Exchequer and corrosion of the nation's tax base.[6] With the objective of tackling this growing menace, section 92 of the Act was amended with effect from 1 April 2002. The aforementioned section, prior to its amendment, merely sanctioned an adjustment to the profits of a resident if it appeared to the Assessing Officer that they were manipulated. Post amendment however,

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6 *See* DP Mittal, *Law of Transfer Pricing* (2nd edn Taxmann Allied Services (P) Ltd 2006) 6.

the Section has received a considerable overhaul due to the incorporation of the OECD Transfer Pricing Guidelines of 1995. The aforesaid Section now mandates that every international transaction in the nature of sale, provision of services, lending of money or otherwise, between related enterprises or 'associated enterprises'[7] must be priced at the 'arm's length price'. Arm's length price refers to the price charged for the transaction as if the companies were completely unrelated to each other or at an arms length from one another. While the Act has prescribed procedures for calculation of arm's length price,[8] the gist of the procedures is simply that prices or margins in controlled transactions (ie transactions between 'associated enterprises'), must be comparable with prices/margins charged by unrelated or independent enterprises. For the comparison to be effective, it follows that the transactions must be similar or adjustments are made to account for some dissimilarities. To proceed from the

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[7] Section 92A of the Act–'For the purposes of this section and section 92, section 92B, section 92C, section 92D, section 92E and section 92F, associated enterprise, in relation to another enterprise, means an enterprise–

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,-

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent. of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent. of the voting power in each of such enterprises; or…

(c) … (m)…'

[8] Section 92C of the *Indian Income Tax Act,1961* and Rule 10 B of the *Indian Income Rules, 1962* generally lay down and elaborate the procedures of comparable uncontrollable price method (where arm's length price is simply the price an unrelated party charges for the same good or service), resale price method (where arm's length price is the price at which goods or services acquired from the associated enterprise are resold to the unrelated enterprise less profit, expense considerations and other relevant considerations), cost plus method (where arm's length price is taken to be the direct and indirect costs of production plus adjusted profit mark-up), profit split method (where arm's length price proceeds from the adjusted and apportioned profit attributable to the entity subject to transfer pricing) and transactional net margin method (where the net profit margin of an unrelated transaction is compared to a related transaction).

abovementioned example itself, Company A will be compelled to charge Company B, its sister concern in a foreign country, the same price for the same product or service as it would charge its unrelated enterprise Company C (or such that the margins are equal, depending upon the method of computation of arm's length price adopted). Since the transaction between Company A and Company C has been compared to the transaction between Company A and Company B and a synergy is attempted between the prices/ margins of the latter with the former, the latter in transfer pricing parlance is termed a 'comparable'. Since the comparable in question is obtained within Company A's transactional business network itself, it is considered an internal comparable. First, the abovementioned Company A must maintain documentation on the basis of which it has determined its arm's length price, ie documentation regarding the transaction between Company A and C must be maintained. There are often cases however, when the Company in question undertakes a transaction with an associated enterprise but does not undertake or has never undertaken a similar or comparable transaction with an unrelated or independent enterprise. In such a scenario, the former transaction shall be priced at an arm's length price by resorting to the use of third party comparable information ('external comparable')—ie Company A will now be required to price its international transaction, say that of selling automobile parts, with Company B, its associated enterprise, such as Company X, a third party prices a similar transaction of selling automobile parts with an enterprise that is not its associated enterprise.[9] This third party information is availed by means of databases, trade association journals, internet sources etc that are available in the public domain). If external comparables or third party information is thereby used to effect the arm's length price, then documentation regarding the same must also be maintained (that is, copies of the database or trade journal or internet source used etc). If, on the basis of information in his possession, the Assessing Officer by virtue of his powers under Section 92C (3) during the course of any proceeding for the assessment of income,

[9] Practically external comparables generally come first. However, as per the OECD draft, preference must be given to internal comparables since they are more accurate. *See supra* n. 5, 18.

is of the opinion that the arm's length price as calculated by the taxpayer is suspect,[10] he may proceed to calculate the arms length price of his own accord. While calculating the arms length price, he must first adhere to the legal requirements of providing a show cause notice[11] so that the taxpayer is afforded a say in the calculation of arm's length price. Further, under section 92D, documentation or other information can also be procured by the Assessing Officer. The burden of proof as to the suitability of the arm's length price is primarily on the taxpayer. However, in case of due maintenance or furnishing of prescribed documentation on demand, this burden shifts to the Revenue.[12] As has been already observed, the Assessing Officer, in the computation of arm's length price must use the information in his possession. Due to the lack of adequate comparable data available in the public domain, however, tax authorities may take recourse to information that is available to them by means of income tax returns filed or audits that are quite obviously confidential. These sources are commonly referred to as 'secret comparables'. Tax authorities may also in some setups utilise accessible tax records and information relating to listed companies, import and export declarations, and corporate registrations as sources comprising 'secret comparables'.[13]

[10] In the case of *Aztec Software* 107 ITD 141 (SB) it has been held that it is not a legal requirement under the provisions of Chapter-X that the Assessing Officer should *prima facie* demonstrate that there is tax avoidance before invoking the relevant provisions. It is also not essential for the Assessing Officer to prima facie demonstrate that any one or more of the circumstances set out in clauses (a), (b), (c) and/or (d) of sub-section (3) of section 92C of the said Act are satisfied in the case of any assessee, before his case is referred to the Transfer Pricing Officer under sub-section (1) of section 92CA for computation of the arm's length price.

[11] It is necessary to note the following paragraph in the decision of *Aztec Software* in this regard : 'if any collected material is to be used against the assessee, then it should be put to the assessee. That is how principles of natural justice are required to be applied and satisfied. So it is at the stage of use of material the assessee is to be associated and not at the stage of collection of material. It is therefore, not possible to accept that even before making reference, a step in the process of collection of material, the assessee should be heard and his objection taken note of, elaborate reasons recorded and *pucca* case made out. Such view would make statutory machinery unworkable.'

[12] Mukesh Butani, *Transfer Pricing: An Indian Perspective* (2nd edn LexisNexis Butterworths (A division of Reed Elsevier India Pvt Ltd) New Delhi India 2007) 181. *See also Aztec Software* 107 ITD 141 (SB) and *Mentor Graphics* [2007]109 ITD 101(Delhi).

[13] George Chou and Bell Cheng, Taiwan, 'Effective Transfer Pricing Risk Management' [October 2006] *International Tax Review* (*Supplement – Asia Transfer Pricing*), *available at* http://www.internationaltaxreview.com/?Page = 17&PUBID = 211&ISS = 22655&SID = 655948&SM = &SearchStr = secret%20comparables (last visited 14 May2007).

B. Patent Ambiguities In The Legislation Governing Secret Comparables

The law governing secret comparables in India suffers from several inconsistencies. At the very outset, it may be stated that the use of secret comparables in transfer pricing receives its sanction from two provisions in the Act. However, like most controversial powers, the abovementioned power too has not been defined with clarity and precision. In this Section, it is proposed to analyse the sanctioning provisions to stress upon their ambiguity.

1. Section 92C (3): The First Sanctioning Provision

First, sanction for the use of secret comparables may be derived from section 92C (3) of the Act which lays down that the Assessing Officer must form an opinion as to the arm's length price on the basis of 'material or information in his possession'. There are however two key reservations to this derivation.

a. *The Crestbrook Reservation*

The first reservation to section 92C (3) being used as a sanctioning provision outlines that this provision primarily poses the pertinent question whether the wealth of possibly confidential, third party information collected by Tax Authorities in the form of income tax returns and audits may be considered to be 'material or information in the possession' of the Assessing Officer? Tax Practitioner DP Mittal negatives this proposition, citing in support of his contention, the Canadian case of *Crestbrook Forest Industries* v. *The Queen,*[14] (the Crestbrook case). In the impugned case, tax authorities used data collected from wood pulp and newsprint exporters which was disclosed on an implicit understanding as to its confidentiality. The usage of such confidential data for purposes

[14] 92 DTC 6187. *See* Mittal *supra* n. 6, 300.

other than what it was revealed for was prohibited by the Court and it laid down the dicta:

> '[W]here the Crown has obtained information in confidence from taxpayers on a voluntary basis and for a specific and defined purpose, it may not subsequently make use of that information for a different purpose, namely the reassessment of other taxpayers, in circumstances where such use will almost inevitably result in a breach of the Crown's undertaking of confidence.'[15]

On the basis of this judgment, it is contended that the Assessing Officer cannot take recourse to third party information in the form of income tax returns or audits. This contention may however be proven unsound since it does not account for the fact that the abovementioned decision of *Crestbrook* has been distinguished in another Canadian case of *The Promex Group Incorporated* v. *The Queen*[16] (the Promex case). In the *Promex case*, it was laid down that if information was *not obtained in confidence*, then it could be used for a purpose besides that what it was intended for. It follows from the *Promex case* then, that if it is proven that income tax returns as filed are not with the express or implied belief that they shall remain confidential, they may be used in transfer pricing litigation. It has been argued that since income tax returns are filed as a mandatory legal process or as a regulatory involuntary process, there is no 'duty of confidence' created therein.[17] Further, a considerable number of Indian judicial decisions may also support the contention that income tax returns filed or audits are not made in 'official confidence'[18] leading to the

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15 92 DTC 6187, 6188, as cited in Nikitman, *supra* n. 2, 35.

16 98 DTC 1588 (TCC).

17 *Supra* n. 2, 36. *See also Re Killi Suryanarayan Naidu* AIR 1954 Mad 278.

18 *Bhalachandra* v. *Chanbasappa* AIR 1939 Bom 237, *Chirag Din Mhd Baksh* v. *Crown* 52 Cr LJ 161(Lah), *BR Srinivasan* v. *B Parakala Swamy Mutt* AIR 1960 Mys 186, *Jethanand* v. *State of Rajasthan* 1972 Cr LJ 1496 (Raj). Even though there has been a recent decision in *Farida Hoosenally,* it is submitted that the same is to be read under the aegis of the *Right to Information Act.* Moreover, it is a decision by the Central Information Commissioner, Mr MM Ansari, on 30 March 2006 and it may be said that the decisions of the various High Courts would be the guiding authority in this regard. For criticism of the decision, *see generally* http://www.bcasonline.org/policy/R%20to%20I%20May%202006.htm (last visited 12 January 2008).

irresistible conclusion that they may be used as 'secret comparables' in transfer pricing.

b. *The Self Disclosure Reservation*

The second reservation to accepting section 92C (3) as the source of secret comparable use relies on section 138 of the Act which prohibits disclosure of information received or obtained in the performance of the duty of an Assessing Officer, unless so authorised by The Central Board of Direct Taxes or any other authority subject to its satisfaction of certain criteria. It is argued that this disclosure relates not just to third persons but also self disclosure—disclosure to the Assessing Officer himself—thus the Assessing Officer may not use information in the nature of returns filed or audits unless he is so expressly authorised by the Commissioner.[19] However, there exists contrary opinion on this point.[20]

Thus the concerns raised as to confidentiality with respect to the *Crestbrook case* and the prohibitive provisions of section 138 of the Act incontrovertibly render section 92C (3) ambiguous and controversial as a legislative sanction to the use of 'secret comparables'.

2. Section 92CA (7) : The Second Sanctioning Provision

The second legislative provision governing the use of secret comparables in transfer pricing discourse is section 92CA (7). This Section mandates that the Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in clauses (a) to (d) of sub-section (1) of section 131 or sub-section (6) of section 133. The powers under the relevant subsections of sections 131 and 133 deal generally with calling of information by the Revenue. Thus, sensitive data relating to pricing can be called for by the Revenue and used as a comparable for transfer pricing purposes. sections

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19 Mittal *supra* n. 6, 300.

20 Srinivasa Rao and Rajendra Nayak, India, 'How Transfer Pricing Rules Have Developed In India' [September 2004] *International Tax Review* (*Supplement–Asia Transfer Pricing*) *available at* http://www.internationaltaxreview.com/?Page = 17&PUBID = 211&ISS = 13152&SID = 488155&SM=&SearchStr=secret%20comparables (last visited 14 May 2007).

133 and 131 were however, enacted at a time when the very concept of transfer pricing was a stranger to Indian Jurisprudence. Their intent originally seems to be to call for information in case of suspicion as to disclosed or spurious income under section 131 and for the purpose of proceedings under section 133. Therefore, clearly their legislative intent is discordant with their ultimate utilisation in transfer pricing. While it is conceded that the provisions are general in nature, they are characteristic of 'machinery provisions'[21] and must be applied after 'due application of mind'. They must not be in the nature of 'a roving or fishing inquiry'[22]. Thus, it is submitted that while transmuting them to fit in the world of transfer pricing, some guidance must be provided to facilitate the transition of provisions intended for other purposes to act as viable tools for comparable (including secret comparable) data gathering in transfer pricing. This is more so since these provisions are very wide in their mandate.

III. The Difficulties In The Seeking Of Comparable Data: Is Secret Comparable Use A Necessary Evil?

A. Significant Difficulties In Ensuring Comparability

Prima facie, the process of transfer pricing on account of its lucid logic appears almost simple—comparison of transactions with similar transactions. However, it may not be considered impertinent to say that the simplicity ceases at the altar of similarity. At the outset, for the sake of clarity, it may be reiterated that secret comparable data is a subset of comparable data; comparable data may either be the data availed by a company's own business network or from public domain sources. The process of availing similar or *comparable* data that is in the public domain is no mean feat. When the Assessing Officer therefore proceeds to calculate the arm's length price, he is often compelled to use confidential data. Similarly, it may also be said that the assessee too is unable to adequately establish an uncontested arm's length price due to the lack of adequate

[21] *Peerless General* v. *AO* 248 ITR 113, *CIT* v. *Basana Rani* 243 ITR 780, *CIT* v. *Amiya Bala* 240 ITR 378.

[22] *DBS Financial* v. *George* 207 ITR 1077.

data in the public domain. Most rely upon this difficulty while arguing for the retention of the use of secret comparables. While these difficulties have been analysed since the very inception of transfer pricing, the very recent 2006 OECD Discussion Draft on Comparability, which tacitly upholds the use of secret comparables, makes its overview and analysis particularly relevant.

The difficulty in the seeking of comparable data primarily exists since comparable data must comply with a series of tests before equality is enforced.[23]

The OECD has prescribed five tests that require compliance before the test of comparability is met and even their simple juxtaposition on paper offers an insight into the Herculean task that is attaining a suitable comparable.

1. A Jury Of Peers: The Common Characteristics Test.

The first test outlines characteristics of property and services. This test mandates that the characteristics of property or services in uncontrolled transactions to be compared with controlled transactions must ideally be similar.

Thus, if an international transaction between associated enterprises (controlled transaction) of selling branded consumer goods, say Nike sneakers, is to be priced, it does not suffice to merely compare it with another transaction involving the sale of sneakers that are unbranded. It is obvious that the Nike sneakers would be charged more than their unbranded counterpart. Though the goods in question are the same, the characteristic of the goods in the controlled transaction—that of having considerable brand value—would render it incomparable with the uncontrolled transaction. It is imperative that the goods in question also share similar physical features, quality and reliability, brand value,

[23] A near facsimile of the factors governing comparability have also been incorporated in Rule 10 B(2) of the *Income Tax Rules, 1962*.

availability and volume of supply.[24] This meticulousness is essential to ensure that the transactions compared function within the same parameters of market, functions, assets, risks associated and thus merit comparison.[25] As may be expected, availability of data as to prices/margins for products or services that have similar characteristics with respect to the products and services for which transfer pricing procedures are undertaken is difficult to obtain and commentators have gone so far as to term it a rare incident.[26] Furthermore, the comparability in question is often subjective, a matter of judgement and thus controversial.[27]

2. The All Animals Are Equal But Some Are More Equal Than Others Rationale: The Functional Test.

The second comparability indicia is the analysis of functions and risks that the parties undertake to ensure there is sufficient merit or equity to their comparison. Even if a taxpayer is able to successfully complete the mammoth task of compiling data with regard to uncontrolled transactions dealing with similar product/service characteristics, it is deceptive to believe that this is sufficient. It is imperative that the taxpayer avails information as to *functions and risks* that the parties involved in uncontrolled transactions undertake to ensure there is sufficient merit or equity in their comparison with the taxpayer's controlled transaction. The OECD Discussion Draft has illustrated the importance of this process of functional analysis as follows:[28] Suppose a taxpayer A carries out sales and distribution functions for electronic items for its associated enterprise; to price the sales and distribution of these electronic items, he avails information as to companies which provide sales and services for unrelated enterprises.

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[24] Mittal *supra* n. 6, 185. In case of a transaction involving intangible property, the similarity must extend to, not merely, the similar form of patent or trademark or know how, but also to duration and level of protection, the form of transaction (whether in the nature of licensing or sale) and the underlying anticipated benefits. Finally, in case of pricing of services, similarity of characteristics alludes to nature and extent.

[25] *Supra* n. 5, 27, para 12.

[26] *See* Ernst and Young Report on the OECD Discussion Draft on Comparability 2006 APP-17, *at* http://www.oecd.org/dataoecd/54/40/37859809.pdf (last visited 7 July 2007).

[27] *Supra* n. 5.

[28] *Supra* n. 5, 39-40.

However, this information does not afford a real comparison unless the unrelated enterprises also function from the standpoint of whether along with undertaking sales and distribution of electronic companies, they have also contributed to research and development of the product; in case of marketing, whether the unrelated enterprise is provided material or resources from the financer and at what financial considerations; whether training programmes are provided by the supplier to the unrelated enterprise that carries out the function of sales and distribution; whether warranty extensions are provided by the unrelated enterprise that performs sales/distribution functions besides the legal warranty provided by the suppliers, foreign exchange exposure—existence and extent, payment terms agreed upon with suppliers and customers which, collectively, is by no means an easy task within the restraints of limited information available. Essentially, a taxpayer must ascertain information as to assets and costs/risks.[29] This difficulty is further compounded by the fact that there is a presumption of differences with regard to functional analysis, as vertically integrated companies (companies involved in various processing activities such as input generation in the nature of raw material manufacture, or relating to output structure such as distribution and marketing along with production) are likely to seek to avoid duplication of effort. Also, they do not often operate at the same level of the market.[30] Also in some sectors, some functions (for example the sales function in the pharmaceutical sector) are always performed by the Promoter Company and there is thus lack of independent players which form a requisite for transfer pricing.[31]

[29] *Supra* n. 5, 40. While information as to assets employed alludes to their nature, market value, age, location, availability of property rights protection, use as joint owner or lessee etc, information as to risks refers to market risk, such as input cost and output price fluctuation, risks of loss associated with investment in and in use of property, plant and equipment; risks of success or failure of investment in research and development; financial risks, such as those caused by currency exchange rate and interest rate viability; credit risks and so forth. The importance of considering assets and risks is that compensation is provided for assets used or risks assumed which significantly must be subtracted from the price to ensure comparability with a transaction wherein no such risks are assumed or assets utilised.

[30] *Supra* n. 5, APP-17, *Deloittes' Comments on A Series of WP6 Issue Notes On Comparability, at* http://www.oecd.org/dataoecd/17/26/37835242.pdf (last visited 7 July 2007).

[31] PricewaterhouseCoopers' Transfer Pricing Network Comments on the OECD Discussion Draft on Comparability, *at* http://www.oecd.org/dataoecd/5x5/56/37862093.pdf, 5 (last visited 7 July 2007).

3. Contracted Yet Genuine: The Contractual Test

The third test mandated relates to contractual terms. In illustration of the importance of this test, to proceed from the example mentioned above, when a comparison is carried out with regard to distribution/sales of electronic items, it is necessary to analyse the contract entered into between the suppliers and manufacturers of the electronic items and the unrelated enterprise that carries out the distribution and sales of the product in question. The analysis of the contract would reveal not only the risks, costs, research and development between the parties but also payment terms, delivery conditions, commitments to purchase, given quantities and exclusivity of rights conferred (in cases of royalties).[32] Besides the confidentiality of contracts, unless they are subject to industry norms or regulatory standards,[33] companies also often undertake transactions for improving efficiency and management of risks by a series of integrated transactions (long term/short term contracts) which in their singularity may be deceptive[34] all of which reduces availability of contractual data in the public domain.

4. Protective Discrimination Rationale In Transfer Pricing: The Economic Circumstances Test

The fourth compliance burden upon the taxpayer—the compliance with the economic circumstances test—follows the simple logic that the unrelated enterprises which form the elements of the uncontrolled transaction must be in similar economic circumstances as the taxpayer. For example, when a taxpayer decides to price his product or service when selling the same to an associated enterprise, he cannot compare it with the price charged by a company that is a bankrupt company or a start up company.[35]

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32 *Supra* n. 26, 40-41.

33 *Supra* n. 26, App-17.

34 *Supra* n. 26, App-19, *Deloittes' Comments on A Series of WP6 Issue Notes On Comparability, at* http://www.oecd.org/dataoecd/17/26/37835242.pdf page 3 (last visited 7 July 2007).

35 *Supra* n. 5, 41 para 29. The size, capital, staff of a company, sales (when relevant), inventories in absolute or relative value (for example when the taxpayer is a toll manufacturer that does not take title of inventories) economic/ business/ product cycle must also be accounted for. *See ibid,* at 41.

5. Mind Over Matter: The Business Strategies Test

The last compliance test of business strategies also presents substantial difficulties as to its availability. The rationale of this test is above reproach, since two transactions can never achieve comparability if they are under the influence of different business strategies—to name a few differential pricing, that is, charging different customers different prices for the same product or service, or that of support payments.[36] Business strategies are however, as may be expected, of an extremely sensitive nature and thus obviously not available in the public domain. The same are only available in the public domain by annual reports filed by companies, or when companies are in a market penetration phase, which is a process wherein one of the objectives is to restructure a mature market by means of competitive pricing strategy so as to render the market unattractive for competitors.[37] Business strategies are also subjective by nature. These sources are further unsound, since the reports published by companies are often misleading as they reveal only partial information, while penetration strategies can fail since it may take an indeterminate and variable period of time for realisation of profits by a company contrary to the premise assumed by the OECD guidelines.[38] As a solution to the conundrum of comparable data, the process of carrying out adjustments to account for differences is often looked to as a panacea. However, the OECD has failed to provide any 'clear and concrete' guidance as to the carrying out of these adjustments.[39] Furthermore, they are also to a large extent fallible.[40]

The OECD draft has also expressed marked preference for internal comparable data as opposed to external comparables or the deductive approach.[41] As already observed, while internal comparables refer to the data available from uncontrolled transactions carried out by the same Company whose controlled transactions are subject to transfer pricing,

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36 *Supra* n. 26. App-20. *See also SPG International Ltd* v. *The Queen* 98 DTC 1796.
37 *Supra* n. 5, 41 para 43-44.
38 *Supra* n. 26 App-20.
39 *Ibid* APP-10.
40 *Ibid* APP-23.
41 *Supra* n. 5, 47.

external comparables refer to data available from public databases that give information as to third party uncontrolled transactions that may be similar to the controlled transactions of the party subjected to transfer pricing.

This divisional analysis of comparable data too reveals its intrinsic inhibitions.[42]

B. A Sector Specific Analysis Of Lack Of Comparables

It is not within the scope of this article to revisit the entire gamut of transfer pricing transactions that have suffered due to the lack of comparable data; since such an analysis may possibly be redundant. It is this author's contention, however, that even with five years of transfer pricing audits in India as of 2006, India's transfer pricing experience is still inhibited by lack of comparable data. It is proposed, therefore, that a brief recapitulation of some of the controversies and opinions limited to around *the last assessment year* within the framework of its impact on India's industrial sectors, would bolster the case for retention of use of secret comparables. For example, the transfer pricing of the service sector has always been fettered by lack of comparable data, particularly due to issues as to functional analysis and the existence of contract manufacturers,

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[42] *Supra* n. 26. Tax firm Ernst and Young observes that though internal comparables are favoured, since they require the often illusory and unattainable benchmark of perfect similarity, a small percentage of transactions are priced with the help of internal comparables. With respect to the issue of external comparables OECD Discussion Draft divides databases, which occupy a significant part of external comparables, into commercial databases and proprietary databases. Commercial databases are available on a subscription basis and contain accounts filed by companies compiled by editors from which price/ margin information can be made available for transfer pricing purposes. This source suffers due to its expensive nature that is ill afforded by small companies and its lack of detail. The proprietary databases developed by consulting firms on the other hand are fallible due to their inexhaustible, unreliable nature and availability issues. Further, sources in the field of external comparables are industry reports prepared by financial experts, annual reports published by listed companies, shareholder's information, trade publications, etc and information published on company websites. Flaws herein are first, that these sources are not designed for the purpose of transfer pricing and thus do not often meet its objects, aspirations and standards. Furthermore, these lack a concise functional analysis. Ernst and Young also argues that transparency and reproducibility (with, for example, the data obtained from the internet) is also a significant concern.

that is, those who provide services without the undertaking of any risks.[43] Even with considerable transfer pricing experience, it is difficult to confine the complexity of service sector transactions within the parameters of available comparable data. As late in the day as January 2006, the New York Division of Tax Appeals has dealt with the issue of lack of comparables in the provision of services of distribution and marketing. The issue raised therein was that the comparables relating to services of distribution and marketing were not suitable since they differed with respect to owning of product brands, operation of retail outlets or designated products and period of operation of distribution.[44] The availability of comparable data is also restricted since some of the prices charged for services account for the applicable service tax whereas some do not, and ascertaining the same is not an easy process. Another facet that is peculiar to the service sector is the pricing of transactions with the inclusion of bonuses and/or commissions along with the consideration thereof. While the issue of bonuses is intrinsic to the service sector and may result in lack of comparable data due to the difficulties in its computation,[45] more recently, the issue of commissions has been discussed. Commissions are often charged on an incentive basis in case of positive results and on a penalty basis in case of an unfavourable result; and it follows that no two transactions will end in sufficiently similar results to warrant comparison. Lastly, mention must be made of the Information Technology or Business Process Outsourcing fields where India has been particularly in the forefront for the last assessment year. It is particularly arduous however, to avail comparable data in these two fields due to the inherent uniqueness of transactions herein.[46]

Just like the service sector, the lending sector too has traditionally suffered from incomparable data. This is primarily due to the sheer magnitude of factors that must be taken into account before any two lending and

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43 *See Sunstrand Corp* v. *Commissioner* 96 TC No 12 (1991).

44 Samir Kanabar and Rekha Ranganathan, 'Recent Developments In Transfer Pricing' (2006) 39-B *Bombay Chartered Accountants Journal,* 436.

45 *Safety Boss Ltd* v. *The Queen* (2000) DTC 767.

46 Mital Chokshi, 'Income Tax-International Transactions' (February 2006) vol. XXXI No. 11 *Income Tax Review* 64.

borrowing transactions are effectively compared.[47] Recent experience with transfer pricing in this field has highlighted difficulties with elements such as credit standing and penal rates being charged for transactions being used for benchmarking, which limit the availability of comparable data.[48]

The last assessment year has also witnessed discussion as to two other industries that have witnessed particular growth and corresponding difficulties in the seeking of comparable data. The Pharmaceutical Sector experiences difficulties due to generic drugs and ensuring their comparability as well as research and development costs.[49] The lack of any standard price list for various types of diamonds since they have many variables for their valuation has also been the subject of debate.[50] The issue of timing factors for comparables is also one, that while being the subject of concern globally, has particular significance in India. This is because Rule 10 B of the *Income Tax Rules*, *1962* restricts the use of comparables only to data concerning the financial year in which the transaction has been entered into (along with a saving clause that data relating to not more than two years prior to the financial year may be considered in some circumstances). Considering product cycles, etc sometimes it is needed to consider data beyond the available years and this opportunity is denied to the tax payer.

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47 These include purpose of the loan, amount and currency, duration of the loan, existence of security guarantees, prevailing market conditions, credit standing of the borrower, borrower's capacity to meet interest and principal payments as and when due, commercial practises of unrelated parties, debt market considerations and third party interest rates, debt to equity ratio, return on capital of borrower, state of economy of borrower. *See supra* n. 6.

48 *See Sunstrand Corp* v. *Commissioner* 96 TC No 12 (1991)10.

49 Shyamal Mukherjee and Sanjay Tolia, India, 'Taxpayers And Revenue Get To Grips With New Auditing Era' [October 2006] *International Tax Review* (Supplement–Asia Transfer Pricing), *at* http : // www . international taxreview . com / Default.asp? Page =17&PUBID=211&ISS=22655&SID=655932&SM=&SearchStr=secret%20comparables (last visited 14 May 2007).

50 In the Office of Commissioner of Income Tax (Appeals) XVII, Mumbai Appeal No. CIT(A) XVII/ACIT,16(3)/IT 110/05-06 *M/ s S Narendra* v. *Department.*

IV. Evolving A Paradigm For Effective Use Of Secret Comparables

In the last part of the Article, a case has been made out for retention of the use of secret comparables as well as the urgency of evolving a framework of guidelines and safeguards for the same. The considerable task of evolving such a framework is, at the very outset, constrained by the absence of any international standard or consensus in this regard. Nevertheless, it is submitted that an analysis of the policies of certain countries with respect to the use of secret comparables would serve as credible indicia of the same. India may, for example, fruitfully benefit from the experience of Japanese tax authorities with respect to transfer pricing. First, the use of secret comparables is limited to non co-operation, that is, only when the taxpayer is lax with regard to submission of information as to data or documentation when required. Secondly, explanation is afforded to the taxpayer as to the secret comparables used without compromising on the confidentiality of the taxpayer.[51] This explanation must ideally cover screening the contents of transactions and the method of adjustment for differences.[52] The safeguards as to the use of secret comparables in Japan have found considerable reflection in the policies of other countries as well.

Malaysia, like Japan, follows the safeguard of redacted information, that is comparability or suitability of data is shown without revealing the identity of its origin.[53] Canada, on the other hand uses secret comparables subject to qualification of the Japanese test of 'co-operation.' The test therein is

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[51] Karl Gruendel *et al*, Japan, 'How Regulations And Administration In Japan Have Changed' [October 2006] *International Tax Review* (*Supplement–Asia Transfer Pricing*), *at* http://www.internationaltaxreview.com/Default.asp? Page= 17&PUBID=211&ISS = 22655&SID=655932&SM = &SearchStr=secret%20comparables (last visited 14 May2007).

[52] Daisuke Horiguchi, Japan- A Special Report [October 2002] *International Tax Review*(*Supplement–Transfer Pricing*), , *at* http://www.internationaltaxreview.com/?Page=17&PUBID=211&ISS=13173&SID=487940&SM=&SearchStr=secret%20comparables (last visited 14 May2007).

[53] Yvonne Chan and Bernice Tan, Malaysia, 'Managing Transfer Pricing Risk' [October 2006] *International Tax Review* (*Supplement–Asia Transfer Pricing*), *at* http://www.internationaltaxreview.com/?Page = 17&PUBID=211&ISS = 22655&SID=655933&SM = &SearchStr=secret%20comparables (last visited 14 May2007).

whether reasonable efforts are made by the taxpayer to provide arm's length price that is above reproach such that it does not require the use of secret comparables.[54]

Another alternative available to India is to regulate the use of secret comparables by retaining them, yet limiting their scope. In Argentina, for example, policy evidences the use of secret comparables only in cases where secret comparables may not be used for a tax audit according to transfer pricing rules, except for administrative process or court cases and only to challenge the most appropriate method considered by the taxpayer.[55] Another possible model could be such that the use of secret comparables shall be restricted merely as part of a secondary test in support of a primary test using publicly available data, thereby watering down their deleterious effect.[56]

While most other countries follow a policy oriented approach, Germany provides one of the few examples of express judicial direction in the matter of use of secret comparables. The Federal Tax Court of Germany, by its decision dated 17 October 2001, expressly allowed the revenue to use secret comparable data taken from other taxpayers' files in preparing benchmarking studies. The safeguards as developed by the German Court to ensure transparency in the use of this procedure would provide particular guidance in the Indian framework. The Court has directed that in order to protect the privacy of the other taxpayers' data their identity is not to be revealed.[57] On the other hand, once in court, the

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54 Gary Zed and John Oatway, Canada- A Special Report [October 2002] *International Tax Review* (*Supplement–Transfer Pricing*), *at* http://www.internationaltaxreview.com/?Page=17&PUBID=211&ISS=13173&SID=487931&SM=&SearchStr=secret%20comparables (last visited 14 May2007).

55 Horacio Dinice, 'The Significance Of Transfer Pricing For Taxpayers In Argentina' [November 2006] *International Tax Review* (Special Features–Argentine), *at* http://www.internationaltaxreview.com/?Page = 22&PUBID = 224&ISS = 20910&SID = 596462&SM = &SearchStr=secret%20comparables (last visited 14 May2007).

56 Dave Rutges *et al*, 'Regional Trend' [July 2004] *International Tax Review* (*Supplement–Transfer Pricing*), *at* http://www.internationaltaxreview.com/?Page = 17&PUBID = 211&ISS = 13156&SID=488108&SM=&SearchStr=secret%20comparables (last visited 14 May2007).

57 IStR 2001, 745.

revenue must satisfy the authorities with respect to all reasonable questions (for example, on data selection, comparability criteria, adjustments) so as to evaluate the appropriateness of the revenue study.[58]

Interestingly, the decision also rejects the Japanese and Canadian test of 'non co operation', that is¸ permissibility of the use of secret comparables if taxpayers fail to co-operate with documentation and/or provision of information of data requirements. The burden of proof too, is squarely placed upon the Revenue.[59]

An intricate analysis of this decision would also reveal that the route as offered by the German Court differs from the policy followed in, for example, Japan since the revealing of content of transactions and adjustments that is eschewed in the process of redacted disclosure is made mandatory at the litigation phase. On the one hand, it must be remembered that policy is often an administrative tool which conveniently shirks the burden of in-depth analysis that is characteristic of the judicial process. One would assume then that India would be afforded considerable respite by a rare instance of judicial discourse as afforded by the German decision in the murky waters of secret comparable use that were formerly a policy bastion. On the other hand, we cannot easily forget that the German decision too has received has its fair share of flak before we label it the panacea to our secret comparable woes. The decision has widely been perceived as being totally pro-business and anti-fiscal and in the opinion of many has resulted in the erosion of the nation's tax base. The German Legislature too has diluted the effect of this judgement

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[58] Stephan Schnorberger, 'Transfer Pricing In Times Of Transition: A Special Report' (January 2003) *International Tax Review* (*Supplement–Germany*), *at* http://www.internationaltaxreview.com/?Page = 17&PUBID = 211&ISS = 13171&SID = 487962 & SM = & SearchStr=secret%20comparables (last visited 14 May 2007).

[59] Alexander Vögele and William Bader, Germany, 'High Court Redefines German Transfer Pricing Framework' [December 2001/ January 2002] *International Tax Review, at* http://www.internationaltaxreview.com/?Page = 10&PUBID = 35&ISS = 12624&SID = 469142&SM = &SearchStr=secret%20comparables (last visited 14 May 2007). It is pertinent to note however that the test of non cooperation has been reinforced by a consequent legislative decree in Germany which overrules the decision of the German Court. This flux only highlights the intrinsic uncertainty plaguing the principles involved in secret comparable use worldwide and thus makes their crystallisation by Indian legislators necessary.

considerably, almost overruling some parts. Without dwelling upon the merits of the judicial decision or the legislative decree that overruled it, it may not be considered impertinent to say that the legislature's 'magic wand' which renders nugatory judicial decisions is a phenomenon that is no stranger to Indian Jurisprudence either. Nonetheless, it is this author's contention that in the Indian scenario, both the German Court decision and the legislation that overruled it must be observed and examined independently, since both offer equal guidance and aid in the shaping of India's definitive stance on use of secret comparables.

An analysis of the extant regulatory frameworks relating to transfer pricing reveals that they either attempt to reduce the scope and incidence of use of secret comparables or they attempt to eliminate the negative impacts of their use. For example, while the Argentina model which restricts the use of secret comparables only to cases where the computation method is in dispute attempts to reduce the scope and incidence of use of secret comparables; the Malaysian model attempts to ameliorate their ill effect by allowing partial disclosure of secret comparables. It is this author's submission that the latter model is perhaps more suited for India since it is more in consonance with the realisation of the need for secret comparables in the Indian framework.

The primary issue with the use of secret comparables being lack of transparency, an effective paradigm for their use must essentially involve disclosure. While complete disclosure is clearly unfeasible, attempts must be realised towards reconciling a balance between ensuring that taxpayers are adequately informed of the nature and comparability of data used without compromising on the confidentiality and the economic interests of the Company that offers this information, whether voluntarily or indirectly through income tax returns filed or audits. The incorporation of such disclosure standards and safeguards may be analysed within the parameters of the *Right to Information Act*, *2005* and section 138 and section 92C (3) of the Act.

A. Disclosure Guidelines Under The Right To Information Act, 2005.

The *Right To Information Act, 2005* as it presently stands, would prove ineffectual to provide disclosure of secret comparables. This would

primarily be due to section 8(1) of the aforementioned Act, under which there is no obligation to provide any disclosure as to any information, including commercial confidence, which would harm the competitive position of a third party. A comparable analysis of the experience of foreign countries with corresponding provisions reveals that the likelihood of the *Right to Information Act, 2005* affording any relief as to the disclosure of secret comparables is remote since it would fall within the purview of 'commercial confidence, which would harm the competitive position of a third party'.[60] It must however be admitted that this legislation may not prove to be entirely lacking. This is due to the fact that once the information which relates to third party confidential information is requested, the *Right To Information Act, 2005* places the burden of proving that the information must not be disclosed upon the third party in question.[61] This legislation may, thus prove fruitful for Indian taxpayers, since there may be stray cases where the third party is unable to adequately prove confidentiality of their used data which is used as a secret comparable for transfer pricing purposes. Also, this will restrict non disclosure to cases where it is strictly necessary rather than adopt a blanket clause.

B. Disclosure Guidelines Within The Framework Of The Income Tax Act, 1961

Under section 138(b) of the Act, pursuant to an application made to requisite authorities in the prescribed manner, the Chief Commissioner, or Commissioner, may furnish any information relating to any assessee which has been received by or obtained by any income tax authority in the performance of his functions under the Act. The difficulty with respect to obtaining secret comparables is the qualifying condition of this section which mandates that this information must be made in public interest. The determining of whether maintenance of transparency in assessments or confidentiality of third party economic information is of more interest

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60 As to Indian guidance on this point *see Farida Hoosenally* v. *CCIT-IX, Mumbai, available at* http://www.bcasonline.org/policy/R%20to%20I%20May%202006.htm (last visited 12 January 2008).

61 *See* Nitikman *supra* n. 2. The corresponding provision in Indian law is section 11 of the *Right to Information Act, 2005.*

to the public is a complicated process. Confidentiality of the source used by the Revenue was considered to be in public service privilege even though the information was evidence under a criminal case.[62] It may appear then, that the disclosure of secret comparables cannot be afforded by this Section. In the case of *State of Maharashtra* v. *O. V Pawar*[63], the Court has held

'In cases where the considerations for and against disclosure appear to be fairly evenly balanced, the courts should uphold the claim to privilege on the ground of public interest and trust the head of the department concerned to do what he could to *mitigate the ill-effects of non-disclosure.'* (emphasis supplied).

It is submitted therefore, that requisite legislative intervention must provide for provisions in the law wherein information can be given to a taxpayer in case of transfer pricing, but post redaction, such that the confidentiality of the third party source is not compromised while at the same time sufficient information is also provided to the taxpayer and thus ill-effects of non-disclosure are mitigated.

While discussing disclosure provisions in the Act, mention must also be made of the proviso to section 92C (3) which states that before an adjustment is made to the price in an international transaction, the Assessment Officer must afford the taxpayer an opportunity to be heard in consonance with the principles of natural justice. Courts have held that this show cause notice must be such that the case against the taxpayer is informed to him if it is to his detriment[64] and it must contain reasons which in the case of transfer pricing may be the available third party information due to which the price charged is doubted.[65] In the case of *H EH Nizam's Jewellery Trust* v. *Assistant CWT* it has been held that material, information or document relied for tentative conclusions must be supplied to the taxpayer.[66] It also follows that the show cause notice must provide

62 *State of Maharashtra* v. *O V Pawar* 165 ITR 233.
63 *State of Maharashtra* v. *O V Pawar* 165 ITR 233, para 13.
64 *Selvarajan* v. *Rice Relations Board* (1976)1 All ER 12(CA).
65 *Rawani Dal and Flour Mills* v. *CST* (1992)86 STC.
66 (1997) 227 ITR 52 (AP). *See also supra* n. 11.

reasonable opportunity of defence[67] and it has been held that this opportunity includes the right to observe the material on which the authority is going to take the decision.[68] While these decisions may lead to the conclusion that secret comparables must be disclosed, the Courts do not seem to have contemplated the scenario of when the information relied upon is so material to the case that its disclosure alone would effect a reasonable opportunity for defence and at the same time, such information is third party confidential information.

V. Conclusion

In summation, it is perhaps most poignant to educe to the prescience of the OECD that wherein tax authorities continuously grapple with lack of data in transfer pricing, the scenario is bound to turn bleaker with increased dynamism of industry, commerce and science.[69] While this author has argued for redacted disclosure in this Article, it is submitted that the law as it presently stands is ineffectual as to its realisation. This stalemate must be resolved by legislative intervention.

In any event, the need for data that forms the very foundation of transfer pricing must correspond to a parallel legislative development and there is dire need for the same in the Indian economic scenario.

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67 *Saptagiri Enterprises* v. *CIT* (1991)189 ITR 705(AP).

68 *Smt Varshaben Bharatbhai Shah* v. *Appropriate Authority* (1996) 221 ITR 819(Guj).

69 *Supra* n. 5.

TIME TO 'CAN'-SPAM? †

Rahul Donde *

'Let's see something happen now. You can break that big plan into small steps and take the first step right away.'

Indira Gandhi

I. Introduction

Technology poses one of the strongest challenges to conventional legislations, often eviscerating lacunae therein and requiring the conception and recognition of *new* rights. A sterling example of the inadequacy of existing legal paradigms to cope with pace of technological progress is the untrammelled growth of unsolicited commercial e-mail and unsolicited bulk e-mail, commonly referred to as spam[1]. Spamming, once viewed as a mere nuisance, is now posing some alarming problems,[2] with global spam related revenue losses in 2006 alone crossing the 200 billion dollar mark.[3] Besides clogging up inboxes and increasing transaction costs, spam often contains false, fraudulent, or misleading information[4] with children being worst affected.[5]

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† This article reflects the position of law as on 27 August 2007.

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1 The etymology of the word 'spam' is traced to the continuous usage of the term in a British Television serial titled 'Monty Python'. Spam is also referred to as an acronym for 'Sending Phenomenal Amounts of Mail'.

2 'Radicati Spam Statistics' (2003) *at* http://www.itfacts.biz/index.php?id=P203 (last visited 30 August 2007).

3 *Ibid.*

4 Sabra-Anne Kelin, 'State Regulation of Unsolicited Commercial E-mail' (2001)] 16 *Berkeley Tech LJ* 435, 437 at 2.

5 'Symantec Survey Reveals More Than 80 Percent of Children Using E-mail Receive Inappropriate Spam Daily' (2003) *at* http://www.symantec.com/press/2003/n030609a.html (last visited 30 July 2007).

The rapidly increasing internet-user base coupled with the absence of spam control measures (whether legislative or technological), have made the country a fertile breeding ground for spammers.[6] India has been projected as the next major spam source in the world,[7] with the number of inbred spammers increasing by the day.[8] The inability of existing legislation to arrest the phenomenal increase in spam volumes has not only resulted in astronomical economic losses[9], but also has fostered other rights violations.[10] The first judicial consideration of the legal challenges posed by spam in *Tata Sons Ltd.* v. *Amait Kumar Gupta* (Amait Kumar Gupta's case) has highlighted the necessity of legislation in this regard.

In light of the above, it is clear that spam poses a clear and present threat to India today. The purpose of this article is to postulate an ideal spam law, which, if adopted, would provide a panacea to control the growing malaise of spam in the country. This ideal law counterbalances globally accepted principles to tackle spam with the Indian milieu, where regulations governing the internet are relatively non-existent or primordial. Besides providing a comprehensive definition of spam and imposing penal sanctions on spammers, the law envisages the constitution of a Spam Control Authority, modelled on the Australian Spam Authority as one of the methods of regulating commercial e-mail. By imposing stringent penalties not only on the spammer, but also on the commercial enterprises at whose behest spam is sent, the law adopts a top-down approach to tackle spam.

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6 MessageLabs, an e-mail security company estimates that 91% of e-mail traffic sent to Indian PC users is spam *See* 'India Is Top Target For Spam' (2006) *at* http://www.gss.co.uk/news/article/2644/India_is_top_target_for_spam/?highlight=spam (last visited 23 September 2007).

7 Nandini R Iyer, 'India Global Leader In Junk Mail: Report' *available at* http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=a9bf2a49-bdba-4884-b110-a304119c930a&&Headline=India+global+leader+in+junk+mail (last visited 30 July 2007); *See also* Corporate Law and Accountability Research Group Working Paper No. 2, Mark Robert Bender, 'Australia's Spam Legislation: A Modern-Day King Canute?'.

8 'Most Recent Comment Spammer List' (2007) *at* http://www.projecthoneypot.org/bsc_X19tb2RlPWdsb2JhbCZjdHJ5PWlu (last visited 30 July 2007).

9 At present, losses caused to US corporations due to spam are estimated at 70 billion dollers per year and are expected to be considerably higher in India, given the absence of regulation.

10 Incidents such as *phishing* and identity theft are now becoming increasingly common. *See* Anil Sagar and Rashmi Singh, 'Analysis Of Phishing Incidents Year-2006', *CERT-IN White Paper CIWP-2007-01.*

II. Technical and legal aspects

A. Origins

The term 'spamming' was first used on the ARPANET to refer to disruptive, repetitious messages on MUD games[11]. It then came to refer to the voluminous self-advertising of lawyers and businessmen who flooded Usenet groups with copious promotional schemes and offers.[12]

Broadly speaking, spam may be defined as Unsolicited Bulk E-Mail or Unsolicited Commercial E-Mail.[13] In either case, it is important to note that spam is 'unsolicited'[14] which means that there is no prior relationship between the parties concerned and the recipient has not consented to receive the communication.

B. Economic Advantages

A major contributing factor to the astronomical increase in spam volumes over the past decade has been the increasing usage of the internet as a promotional tool for businesses.[15] As opposed to the conventional forms

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[11] MUD is a term for a real time multi-person shared environment, ie a shared world where users can chat, move around and interact with locations and objects in the environment.

[12] 'History of Spam', *at* http://www.mailmsg.com/SPAM_history.htm (last visited 30 July 2007).

[13] OECD defines spam in a general way as 'unsolicited and unwanted commercial electronic messages or e-mails that are sent to large numbers of people' Organisation for Economic Cooperation and Development, 'Proposal For Work On Unsolicited E-mail Messages (Spam): Report, Directorate For Science, Technology And Industry' (2003); while Spamhaus adopts a more technical definition:
'An electronic message is "spam" if:
(1) the recipient's personal identity and context are irrelevant because the message is equally applicable to many other potential recipients
And
(2) the recipient has not verifiably granted deliberate, explicit, and still-revocable permission for it to be sent.' *At* http://www.spamhaus.org/definition.html (last visited 30 July 2007).

[14] In the context of telemarketing, *The Direct Marketing Telephone Calls (Regulation) Bill, 2006* 'unsolicited' has been defined as 'any direct marketing telephone call to which an individual has not given his consent for receiving.'

[15] Helen Leggatt, 'Spam Volume To Exceed Legitimate E-mails In 2007' (2007), *at* http://www.bizreport.com/2007/04/spam_volume_to_exceed_legitimate_emails_in_2007.html (last visited 30 July 2007).

of advertising, where the advertiser has to balance his cost of advertising against expected returns and accordingly decide how broad or narrow a group of prospects to target; by sending bulk e-mails, the advertiser is able to transfer the cost of advertising to the recipient, the recipient's mail site pays most of the costs, in terms of bandwidth, processing time, and storage space.[16] Advertisers therefore bear a very low cost burden, paying as little as 0.025 cents per e-mail.[17] Additionally, low start-up costs[18] coupled with hefty premiums from business houses for harvesting address lists make spam an attractive business opportunity.[19] The economies of scale of advertising over the internet coupled with the dearth of spam control measures to regulate the same have greatly contributed to the growing malady of spam worldwide.

C. Incidents

Spam creates a plethora of problems affecting consumers, Internet Service Providers (ISP) and governmental agencies alike. It has come to represent a significant proportion of all e-mail traffic,[20] consuming massive amounts of network bandwidth, memory, storage space, and other resources. Apart from this massive consumption of resources, the spate of spam related offences has also increased significantly. Incidents of *phishing* in which spammers send fake e-mails that purport to come from genuine businesses or genuine banks in an attempt to secure personal information such as credit card numbers of recipients and *malware* in which spammers send

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16 A study undertaken by www.e-mailresults.com indicates that in telemarketing and postal mail the sender bears 90 per cent of the advertising cost, whereas in spam the sender bears only 0.01 per cent of advertising costs. Tom Geller, 'The True Cost of Spam' *at* http://www.emailresults.com/article.asp?ContentID=6 (last visited 30 July 2007).

17 Saul Hansell, 'Totalling Up The Bill For Spam' (2003), *available at* http://query.nytimes.com/gst/fullpage.html?sec=technology&res=9502E5DB1E3FF93BA15754C0A9659C8B63 (last visited 30 July 2007).

18 An average spammer's costs include finding a cooperative ISP, composing the message text, sending the spam and setting up a system for receiving payment and processing orders, which costs are independent of the volume of messages that are sent.

19 'Why Spammers Spam: An Incursion Into The World Of Spammers' *at* http://72.14.235.104/search?q=cache:o4ERMbFwusIJ:www.antispam.gov.hk/docs/english/techpapers/NEP_SPAM.pdf + Why + spammers + spam + an + incursion + into&hl=en&ct=clnk&cd=1&gl=in&client=firefox-a (last visited 30 July 2007).

20 *Supra* n.15.

viruses or worms to elicit personal data from recipients have now become commonplace. With the increasing e-commerce across the country, *phishing* attacks are increasing[21] with State Bank of India and a host of other banks bearing the brunt.[22]

D. Technological Approaches

The first line of defence against spam normally consists of self-help and other technical mechanisms which can be implemented by consumers, ISPs, as well as by various third parties, which specialize in battling spam. *Filtering and blocking* in which ISPs maintain a '*blacklist*' of internet hosts frequented by spammers and '*opt-out*' procedures in which the spammer is required to remove the recipient from the spammers mailing list are some of the technological approaches adopted to tackle spam. Although some softwares are available for identifying and curbing spam, it is seen that technology in the absence of a strong legal background remains largely toothless. Technical approaches are unlikely ever to eradicate spam, partly because of the time and resources that spammers devote to their activities and partly because of the inherent openness of the internet and e-mail protocols. Moreover, technical approaches are costly and have deleterious effects in as much as they affect legitimate communications as well.[23] If a strict technical approach is adopted there would be a lack of transparency and accountability encouraging spammers to act with impunity. Anti-spam measures must be mandatory and backed by punitive provisions in order to have the necessary impact.

E. Legal Issues

Apart from the technical problems outlined above, spam poses a number of legal challenges as well. As privacy rights in most jurisdictions are not absolute, spammers argue that the '*right to be left alone*' must be

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[21] More than 50 per cent of spam involves *phishing,* which alone is expected to cause damages worth 2.8 billion US dollars. *See* 'Phishing Statistics' *at* http://www.marshal.com/trace/phishing_statistics.asp (last visited 27 August 2007).

[22] Zoheb Hossain, 'Hook, Line And Sinker–Beware Of Phishing' *at* employment.indlaw.com/publicdata/articles/article218.pdf (last visited 30 July 2007).

[23] Michael Schrecker, 'Spam: Pigeon Of The Internet' (2004) *at* http://www.techsoup.org/learningcenter/internet/page5259.cfm (last visited 21 September 2007).

counterbalanced by the '*right to communicate'*. In the first judicial consideration of the issue in the country, a Division Bench of the Delhi High Court was called upon to consider the legality of spam in *Amait Kumar Gupta's case*. Multifaceted arguments concerning trespass, nuisance and invasion of privacy came to be raised before the Court. Although the matter remains at an interim stage,[24] the case has, for the first time in the country brought to the fore the myriad issues that spam poses.

1. Trespass To Property

Trespass in its widest sense signifies any transgression or offence against law or nature, or of society, or of the country, whether relating to a man's person or to his property. As observed in the seminal case of *Entick* v. *Carrington,*[25] '[E]very invasion of private property, be it ever so minute, is trespass.' The question as to whether spam constitutes an invasion of property or 'entry into the land of the plaintiff' however remains in doubt. The United States (US) Federal court in *CompuServe Inc.* v. *Cyber Promotions, Inc.,*[26] (Compuserve case) found that electronic signals generated and sent by computer were sufficiently physically tangible to support a trespass cause of action. The Court, while asserting that the volume of messages generated by mass mailings placed a substantial burden on the equipment and storage capacity of the plaintiff ISP, held that 'the use of personal property exceeding consent is a trespass.' However, the High Court in *Penfolds Wines* v. *Elliot*,[27] (Penfolds case) while considering whether a trespass to goods can be committed by a non-physical interference with it, cited the Halsbury's laws of England, 'Trespass to goods is any direct infringement of the possession by another of corporeal personal chattels by means of an asportation or other *physical* invasion...' (emphasis supplied). It is submitted however, that in India, reliance placed on trespass as a defence to spam would be inherently fallacious. At the outset, as seen in the *Penfolds case* above, trespass to goods is essentially a common

[24] The Court has however passed an interim injunction against the Defendant, directing him to 'stop sending unsolicited commercial e-mail' to the Plaintiff.

[25] (1765) 19 St Tr 1066.

[26] 962 F Supp 1015, 1020 (SD Ohio 1997).

[27] (1946) 74 CLR 204.

law principle relating to *physical corporeal* property. Extending the principles to an *intangible incorporeal* e-mail inbox as seen in the *Compuserve case* would require considerable judicial creativity, seldom seen in India. Moreover, even if the physical property argument is accepted, it would be difficult to sustain, as common law implies a licence to the general public to 'come to the front door and knock',[28] even if the recipient does not have any prior relationship with the owner.[29] Thus, extending the argument to the internet, common law would not prohibit a spammer from knocking (viz. sending spam) until the owner expressly denies the entry of that person, notwithstanding that the owner has put a 'do not disturb' sign outside his door. Finally, an action for trespass is essentially *personal* in nature i.e. the property of the complainant must have been trespassed and he must have suffered some damage as a result of it. Hence, while an ISP might be able to sustain a trespass claim,[30] an individual recipient might not be so fortunate. Moreover, the action of trespass would crumble in cases where the ISP itself ties up with spammers as was seen in the *Savvis case*.[31]

2. Nuisance

The term 'nuisance' is derived from the French word *'nuire'*, to do hurt, or to annoy; and an action for nuisance arises in respect of an act producing material injury to property or an act producing personal discomfort. As spam consumes internet resources, imposes considerable transaction costs and often compels the unwilling recipient to put up with pornography and obscenity,[32] it can hardly be argued that spam does not constitute a 'nuisance' in the common sense of the word. In India, however, nuisance is of two kinds; public and private. 'Public nuisance' or 'common nuisance' as defined in section 268 of the *Indian Penal Code, 1860* (IPC) is an

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28 *Holden* v. *White* [1982] QB 679.

29 *Evans* v. *Forsyth* (1979) 90 DLR 3d 155.

30 *See Compuserve* and *Amait Kumar's* cases.

31 Paul Roberts, 'Leaked Memos link spammers to ISP Savvis' (2004), *at* http://www.infoworld.com/article/04/09/08/HNleakedmemos_1.html (last visited 30 July 2007).

32 This has considerable significance when recipients are children as laws in several countries make it an offence for children to view adult material.

offence against the public either by doing a thing which tends to the annoyance of the whole community in general or by neglecting to do anything which the common good requires.[33] 'Private nuisance' on the other hand, affects some individuals as distinguished from the public at large and requires special damage to be actionable. The application of the common law nuisance doctrine to spam raises a number of issues. First, nuisance actions would be decided on an individualist case-to-case basis and will not serve as a deterrent to prospective spammers. Moreover, as spam affects millions of users, individual nuisance actions would have to be maintained against spammers, leading to multiplicity of proceedings in an already overburdened judicial system. It also remains to be seen whether nuisance caused by spam would be held as a criminal offence under the *Indian Penal Code*, *1860*, a question which would again require considerable judicial deliberation.

3. Fraud

Spam content can include material such as online gambling, pyramid selling and get rich schemes that are often illegal and deceptive. A report to the US Federal Trade Commission estimates that roughly half of all spam contains fraudulent or deceptive content.[34] While an action for fraud might appear to be a suitable defence, in reality its applicability to spam remains questionable. As observed by the Apex Court in *S.P. Chengalvaraya Naidu* v. *Jagannath,*[35] '"Fraud" is an act of *deliberate deception* with the design of securing something by taking unfair advantage of another. It is a deception in order to *gain by another's loss.* ...' (emphasis supplied). As seen above, in most cases, the spammer is merely a *medium*

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[33] Section 268: 'Public nuisance: A person is guilty of a public nuisance who does not act or is guilty of an illegal omission which causes any common injury, danger or annoyance to the public or to the people in general who dwell or occupy property in the vicinity, or which must necessarily cause injury, obstruction, danger or annoyance to persons who may have occasion to use any public right.'
A common nuisance is not excused on the ground that it causes some convenience or advantage.'

[34] 'Final Report Of The Noie Review Of The Spam Problem And How It Can Be Countered' (2003), *available at* http://www.dcita.gov.au/__data/assets/pdf_file/21064/SPAMreport.pdf (last visited 22 September 2007).

[35] (1994) 1 SCC 1.

used by commercial enterprises and as such he is not concerned with of the content of the spam. In the absence of such knowledge, it can hardly be argued that the spammer had any *intention to deliberately deceive* the recipient or that he did so with an *intention of securing some advantage* to himself. Further, this defence would be futile in cases where the recipient is spammed liberally but with '*legitimate*' e-mails.

4. Invasion Of Privacy

All spam actions include an 'invasion of privacy' claim. Privacy in the information age has been described as 'the claim of individuals, groups, or institutions to determine for themselves when, how, and to what extent information about themselves is communicated to others.'[36] The right to privacy has been aptly described as '*the right most valued by civilised men, ...'* (emphasis supplied)[37]. Spam infringes on individuals' right to privacy, his right 'to be let alone'.[38] In *Cyber Promotions Inc.* v. *AOL,*[39] the Court found that the invasion of one's personal space violates privacy and as an e-mail inbox constitute personal space, spam, by invading e-mail inboxes, violates the privacy of e-mail users. In *Rowan* v. *United States Post Office Department,*[40] the US Supreme Court held that a mailer's right to communicate ended at the mailbox of the unreceptive addressee.

There is no statutory recognition of the right to privacy in India. Privacy however, is to a limited extent regulated by the *Indian Telegraph Act, 1885 (*Telegraph Act*)* and the *Indian Telegraph Rules, 1951* which prohibit the usage of the personal data of the consumer for purposes not solicited

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36 Fred H Cate, 'Privacy In The Information Age' Washington, D.C.: Brookings Institute Press, 1999, 22.

37 *Hill* v. *Colorado* 530 U.S. 703, 716-717 (2000).

38 *R. Rajagopal and Another* v. *State of Tamil Nadu* (1994) 6 SCC 632.

39 948 F Supp 436, 442 (ED Pa 1996).

40 397 US 728.

by him.[41] They prohibit subscribers from using their telephones in a manner which disturbs or irritates persons or otherwise disrupts maintenance of public order.

The first judicial consideration of the right to privacy in India arose in *Kharak Singh* v. *State of UP*,[42] where a majority of judges surprisingly ruled *against* the constitutional recognition of privacy. The minority view expressed by Justice Subba Rao, however, held that the concept of 'liberty' in Article 21 was comprehensive enough to include privacy and that a person's house, where he lives with his family is his 'castle' and that '*nothing is more deleterious to a man's physical happiness and health than a calculated interference with his privacy...'* (emphasis supplied). Several judicial pronouncements considered the position of the right to privacy in light of the Fundamental Rights,[43] but it was only in *People's Union for Civil Liberties* v. *Union of India,*[44] where the Court expressly recognised the right to privacy as an integral part of the right to life under Article 21. India has also ratified the *International Covenant on Civil and Political Rights, 1966* which *inter alia* provides that no one shall be subject to arbitrary or unlawful interference with his privacy and that everyone has the right to protection of the law against such interference or attacks.[45]

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41 Section 427 of the Telegraph Act states as under;
'Illegal or improper use of telephone- A subscriber shall be personally responsible for the use of his telephone. No telephone shall be used to disturb or irritate any persons or for the transmission of any message or communication which is of an indecent or obscene nature or is calculated to annoy any person or to disrupt the maintenance of public order or in any other manner contrary to any provision of law. Section 513: 'Illegal or improper use-(1) No telex connection shall be used for the transmission of any message or communication which is of an indecent or obscene nature or calculated to annoy any person disrupt the maintenance of public order or in any other manner contrary to any provision of law.'

(2) No telex connection shall be used for sending or receiving messages other than those originating from, or meant for, a subscriber, subject to the fact that messages of associates or subsidiaries of a subscriber-firm may be sent or receive with the previous permission of the telegraph authority.'

42 AIR 1963 SC 1295.

43 *Sheela Barse* v. *State of Maharashtra* (1987) 4 SCC 373; *See also Prabha Dutt* v. *Union of India* (1982) 1 SCC 1; *Kaleidoscope (India)(P) Ltd.* v. *Phoolan Devi* AIR 1995 Del 316.

44 (1997) 1 SCC 301.

45 Article 17, International Covenant on Civil and Political Rights, 1966. Adopted 16 December 1966, entered into force 23 March 1976) 999 UNTS 171.

However, these laws remain woefully inadequate to effectively deal with spam. While the inclusion of privacy within the ambit of the right to life under Article 21 of the Constitution is commendable, the true import of such inclusion is that an action for invasion of privacy can be maintained only against the State. As a result, an individual who has received copious amounts of spam cannot maintain an action against the spammer, as fundamental rights are actionable only against the State. Further, even if it is argued that a privacy claim may be sustained against an individual spammer on the basis of the *common law* of privacy, the argument cannot be sustained as the common law does not apply to information which is already a part of public domain.[46] As it is reasonable to expect that the recipient's e-mail address appears somewhere on the internet, this would be sufficient 'publication' to exclude the common law of privacy. Recourse to the Telegraph Act or Rules would also be futile as spam is clearly not within their ambit.

5. Trademark/Passing Off

Spam also involves issues of trademark infringement, if the spammer includes in the subject line (or the content) any matter for which a trademark subsists. It may also occur when a spammer uses a trademarked domain name, a practice frequently adopted by spammers to induce recipients into believing that the e-mail is genuine. If a spammer uses such a domain name in conjunction with its own advertising service in a manner that causes confusion as to the origin of its service, the spammer may be liable for trademark infringement or fraud. Similarly, if a spammer uses an ISP's trademark in a manner that results in the dilution of the distinctive quality of the mark, the spammer may be liable for trademark dilution. Again it is apparent that trademark violations would not occur in all spam so as to give a cause of action in all spam cases.

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[46] *R. Rajagopal* v. *State of T.N* (1994) 6 SCC 632.

III. Comparative Analysis

Spam legislations have been enacted by almost all countries in the world today. Several technologically backward nations have also enacted spam laws in an endeavour to end the spam menace. Although the basic principles on which these legislations have been enacted are largely similar, the effectiveness of these legislations depends upon the seriousness with which their respective governments have implemented them. Australia, for instance, once ranked within the top ten spammers of the world, has seen a significant reduction in spam volumes after the passage of its *Spam Act, 2004*.

A. Australian Spam Act, 2004

Australia was one of the few nations of the world that adopted a pre-emptive approach to curbing spam. It enacted its spam legislation, the *Australian Spam Act, 2004,* when its contribution to global spam was not significant. Subsequent to its enactment however, spam volumes have considerably reduced in Australia, owing largely to the comprehensive approach adopted by the Act to effectively deal with spam.

The Act, widely touted as the strictest in the world, comes down heavily on spammers, proscribing all commercial e-mails that are not expressly solicited while simultaneously ensuring that legitimate business communication activities are not affected. To fall within the ambit of the Act, the message must be commercial in nature, for instance offering a commercial transaction, or directing the recipient to a location where a commercial transaction can take place. Surprisingly, the Act makes no reference to bulk messaging–and hence even a single unsolicited commercial electronic message could spam under the Act.

The Act also empowers the Australian Communications Authority to issue formal warnings and grant injunctions against spammers, issue infringement notices and impose fines in lieu of court proceedings. Thus the Act adopts a novel approach to curbing spam- the creation of a quasi-judicial body to exclusively deal with spam related issues.

Further, the Act imposes the the most stringent penalty in the world up to 44,000 Australian Dollars a day for individuals, 220,000 Australian Dollars a day for organizations and 110,000 Australian Dollars for recalcitrant spammers. Courts have been empowered to grant compensation to victims of spamming and can compel spammers to surrender any financial benefit they have obtained from spamming. As a result, spam volumes in Australia have halved in the six months since the legislation was passed.[47]

B. The CAN-SPAM Act, 2003

As seen above, spam volumes in the US are the largest in the world and the US also suffers from the highest spam related losses globally. Despite several judicial pronouncements denouncing the invasion of privacy by unsolicited marketing, US remains one of the largest spammers in the world.[48] The problem was mitigated to an extent by the enactment of *The Federal Controlling the Assault of Non-Solicited Pornography and Marketing Act* (CAN-SPAM Act).

The CAN-SPAM Act regulates 'commercial advertisements or promotions of a product or service, including the content of a web site operated for commercial purposes.' It excludes from its scope transactional or relationship e-mails that are sent to facilitate, complete or confirm a commercial transaction, account statements, product updates and upgrades, memberships and other similar commercial relationships. Significantly the law is not restricted to spammers alone, but also penalizes persons that *aid* or *assist* in the sending of spam. Companies that allow the promotion of goods or services through e-mail messages are also subject to penalties if they knew or should have known that their goods or services were promoted through illegal messages and they received an economic benefit from such promotion without taking reasonable action to prevent or detect the transmission.

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47 'Australia Drops Off Top Spam List' (2004*) at* http://203.6.199.77/articles/c5/0c0259c5.asp (last visited 21 September 2007).

48 Sandra Rossi, 'U.S., China Top Quarterly Sophos List Of Spam-relaying Countries' (2007) *at* http://www.computerworld.com/action/article.do? command= viewArticleBasic & articleId=9027344 (last visited 21 September 2007).

The CAN-SPAM Act requires all unsolicited e-mail to meet the following specifications:

- Prohibition of False or Misleading Transmission Information – the organisation/individual sending the mail should not try to hide or misrepresent himself;[49]
- Prohibition of Deceptive Subject Headings – The subject line as well as the content should not mislead the recipient about its purpose or objective;[50]
- Inclusion of Return Address – An address must be specified wherein the recipient can express his intention not to receive future e-mails;[51]
- Clear and conspicuous identification that the message is an advertisement or solicitation.[52]

The first conviction under the Act came in 2003 itself, with Jeffrey Brett Goodin being sentenced to 101 years imprisonment for his spam-related infractions. Yahoo! successfully sued Eric Head, one of the world most renowned spammers for several thousand dollars in 2004. In 2006, Jumpstart Technologies LLC of San Francisco was directed to pay a 1,000,000 US dollars fine for sending people unsolicited sales pitches that appeared to come from their friends or acquaintances. Despite these successes, the Act has come under severe criticism. The 'opt out'[53] procedure adopted by the Act is held by many as a self-defeating provision. Nonetheless, inspite of its shortcomings, the Act has significantly contributed to an overall decrease in the spam volumes across the US.

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49 Section 5 of the CAN-SPAM Act.
50 Section 5 of the CAN-SPAM Act.
51 Section 5 of the CAN-SPAM Act.
52 Section 5 of the CAN-SPAM Act.
53 'Opt out' means that a recipient addresses a mail to the sender requiring him to remove the former from his mailing list.

IV. SUGGESTIONS

From the above it is clear that spam exposes a number of inadequacies in conventional laws. Tort law principles are inadequate to tackle spam as they generally have damages as their object, and not prosecution or punishment of the offender. Consequently, imposition of civil penalties on spammers would hardly deter hardcore spammers. Moreover, given the Indian legal scenario tort cases would take years to conclude and even then quantification of damages might be difficult. As a comparatively smaller volume of spam involves trademark infringement or fraud issues, it would be futile to place reliance on those grounds for providing a defence to spam. In the absence of legislation, spam litigations would have to be decided on a case to case basis, without reliance on codified law, which, given the jurisdictional challenges that spam poses, might be futile. Relying solely on separate existing prescriptions will thus result in piecemeal solution against spam.

A specific legislation governing spam is therefore the need of the hour to prevent the spam menace from spiralling out of control. Such legislation must not only impose penalties on spammers but also serve as a detriment to business houses which consider spam as a viable medium for marketing their products.

In light of the above discussion and in keeping with the common principles adopted to tackle spam globally, the following basic framework of an anti-spam legislation can be postulated for India:

THE SPAM (CONTROL) BILL, 2007

A Bill[54] *to provide stringent requirements for commercial electronic messages, to curb unsolicited commercial electronic messages and to establish a Spam Control Authority to facilitate these objectives.*

The following is a simplified outline of this Bill[55]:

- This Bill shall set up a scheme for regulating commercial electronic messages;
- Commercial electronic messages must contain a functional unsubscribe facility;
- It shall be an offence to send unsolicited commercial electronic messages;
- Commercial electronic messages must include information about the individual or organisation that authorise the sending of the message;
- The person authorising the sending of the unsolicited commercial electronic message, as well as the person sending the message shall be penalized;
- The main remedies for breaches of this Act are civil penalties and imprisonment;
- The Spam Control Authority established under this Bill is shall be the premier organisation dealing with spam.

It is pertinent to note that spam legislations in most countries[56] *include provisions for address harvesting*[57]*. In addition, some ongoing efforts are being made to*

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54 *Australian Spam Act, 2003; Singapore Spam Control Act, 2007.*

55 Adapted from the *Australian Spam Act, 2003*.

56 *Australian Spam Act, 2003; Singapore Spam Control Act, 2007.*

57 Address harvesting software is software that designed or marketed *inter alia* for searching the Internet for electronic addresses.

promote 'e-stamping' of e-mails[58] in order to transfer the cost of spam back onto the spammer. As both these issues are essentially technical in nature, they have not been considered in the discussion below.

1. Short Title, extent and commencement

Short Title, Extent and Commencement:

1. This Bill may be called the Spam (Control) Bill, 2007.
2. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint with immediate effect.
3. It shall extend to the whole of India, and shall apply to any offence or contravention hereunder committed outside India by a person of any nationality if the offence or contravention involves a computer, computer system or computer network, part of which may be located in India.

Section 1(3) above is a modification of section 1(2) and section 75 of the Information Technology Act, 2000 (IT Act). It confers jurisdiction upon Indian courts to prosecute offences and contraventions committed by persons of any nationality in two cases: firstly, when the offence or contravention is committed upon a computer, computer system or computer network located within India and secondly, when a computer, computer system or computer network located within India is used to commit the offence or contravention. Although the legitimacy and efficacy of this provision remains doubtful,[59] it nonetheless prima facie empowers Indian courts to deal with overseas spam involving India.

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[58] Stamped e-mail also known as authenticated e-mail, is a system in which senders of commercial e-mail messages pay a small fee to ensure that their messages will bypass spam filters to reach intended recipients. The use of a fee for e-mail has sometimes been called e-mail postage or e-stamping.

[59] *Singapore Spam Control Act, 2007,* section 3(1).

2. Definitions

Definitions:

i. '*Authority'* means the Spam Control Authority constituted under section 3 of this Act;

ii. '*commercial electronic message'* means any message, through the internet, which having regard to the content and presentation of the message, is sent, generated or transmitted:

a. to offer to supply goods or services; or

b. to advertise or promote goods or services; or

c. to advertise or promote a supplier, or prospective supplier, of goods or services; or

d. to offer to supply land or an interest in land; or

e. to advertise or promote land or an interest in land; or

f. to advertise or promote a supplier, or prospective supplier, of land or an interest in land; or

g. to offer to provide a business opportunity or investment opportunity; or

h. to advertise or promote a business opportunity or investment opportunity; or

i. to advertise or promote a provider, or prospective provider, of a business opportunity or investment opportunity; or

j. to assist or enable a person, by a deception, to dishonestly obtain property belonging to another person; or

k. to assist or enable a person, by a deception, to dishonestly obtain a financial advantage from another person; or

l. to assist or enable a person to dishonestly obtain a gain from another person; or

m. any other message received through an entity not known to the receiver, for commercial or business purposes, and which the receiver, in the usual course, would not want to receive; or

n. for any other reason as may be specified;[60]

iii. '*consent'* means either express or implied consent, whether oral or written;

iv. '*dealing with*' when used in relation to a commercial electronic message, includes accessing the message; responding to the message and filtering the message;[61]

v. '*electronic message*' is a message sent to an electronic address in connection with an e mail account or a similar account using an ISP;

Explanation 1: For the purposes of this section it is immaterial whether the electronic address exists or whether the message reaches its intended destination.

An altogether new definition of 'electronic message' has been introduced as the IT Act does not consider the term. As the scope of this proposed Act is limited to regulating e-mail messages alone, the wider conception of 'electronic message' provided above, which includes instant messaging and short messaging adopted by the Singaporean and Australian Spam Acts has been avoided. The Telecom Unsolicited Commercial Communications Regulations, 2007 limit the definition of 'telemarketer' (similar to spammer) by specifying that the message (as defined under those Regulations) must be sent for the purpose of 'soliciting or promoting a commercial transaction'. As spammers often are not concerned with the content of the message, they cannot be said to have solicited or promoted it. Hence, the definition of electronic message provided above does not ascribe any particular intent to the sender thereof.

60 *Australian Spam Act, 2003,* section 4.
61 *Australian Spam Act, 2003,* section 4.

vi. '*India Link*' means a commercial electronic message subscribing to the following:

(a) the message originates in India; or

(b) the individual or organisation who sent the message, or authorised the sending of the message, is:

(i) an individual who is physically present in India when the message is sent; or

(ii) an organisation whose central management and control is in India when the message is sent; or

(c) the computer, server or device that is used to access the message is located in India; or

(d) the recipient is:

(i) an individual who is physically present in India when the message is accessed; or

(ii) an organisation that carries on business or activities in India when the message is accessed; or

(e) if the message cannot be delivered because the relevant electronic address does not exist–assuming that the electronic address existed, it is reasonably likely that the message would have been accessed using a computer, server or device located in India;

The definition above ensures that both the person authorising the sending of the electronic message as well as the person actually sending it are both held equally liable. This is a departure from the Australian Act, which imputes liability only on the person authorizing the sending of the electronic message.

vii. '*message'* message includes information:

(a) whether in the form of text; or

(b) whether in the form of data; or

(c) whether in the form of speech, music or other sounds; or

(d) whether in the form of visual images (animated or otherwise); or

(e) whether in any combination of forms; or

(f) whether in any other form.[62]

The Telegraph Act defines 'message' in accordance with the provisions of section 3(3) of that Act. As spam is outside the purview of that act and considering that the IT Act does not define the term, a new definition of 'message' has been adopted following the Australian and Singaporean spam legislations.

viii. '*originator*' means a person who sends, generates or transmits any electronic message, or causes any electronic message to be sent, generated or transmitted and includes any person who on behalf of another person receives, generates or transmits that electronic message whether in the same or in an altered form.

The definition of originator has been suitably amended to give effect to the provisions of the proposed Act. It takes onto consideration that spam messages are often sent by spammers on behalf of commercial enterprises and ensures that in such a scenario, both the commercial enterprise as well as the spammer are punished. It also ensures that if a commercial enterprise sends a message to the spammer who alters it without the knowledge of the enterprise, it will still be penalised.

ix. '*person'* means an individual and shall include any company or association or body of individuals, whether incorporated or not;

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62 *Singapore Spam Control Act, 2007,* section 3(1).

x. '*recipient'* in relation to an electronic address means an authorised user of the electronic address to whom the electronic message is sent and where a recipient has one or more electronic addresses in addition to which the message was sent, the recipient shall be treated as a recipient with respect to each such address;[63]

xi. '*send'* includes an attempt to send;

xii. words and expressions not defined under this Act shall have the same meaning as assigned to them under the provisions of the IT Act.

3. Constitution of Spam Control Authority

Spam Control Authority

1. The Central Government shall within a period of one month from the entry into force of this Act by notification in the Official Gazette constitute a Spam Control Authority for the purpose of adjudicating disputes and performing such other functions as specified herein.

2. The Authority shall comprise of seven members; four of whom shall have legal qualifications while three shall have a technical background.

3. The complaints before the Authority under section 4 shall be heard by a Dispute Settlement Board of the Authority which shall comprise of two legal members and one technical member.

[63] The European Union, Korea, Australia have all adopted the opt-in model. The US however has adopted the 'opt-out' approach, which has come under severe criticism.

4. Resolution of Disputes

Resolution of Disputes

1. A person who has suffered loss or damage as a result of contravention of section 6 below or the Authority may *suo motu* file a written complaint to the Authority within a period of one year from the date of the alleged contravention.

2. The Authority shall, after conducting a preliminary investigation and on being satisfied of the complaint and giving a reasonable opportunity to the other side of being heard, settle the complaint by payment of such compensation as it deems fit to the complainant.

3. If either party to the said settlement is aggrieved by the terms of the settlement, it may file an appeal therefrom within a period of 21 days from the receipt of the order of settlement of the Authority in the High Court.

4. The Spam Control Authority shall have all the powers of a Civil Court under the provisions of the *Code of Civil Procedure, 1908*.

5. The settlement order of the Authority may include the following:

   a. a temporary injunction restraining the alleged defaulting party from sending any further commercial electronic messages;

   b. damages, in addition to the statutory damages under section 7 below.

6. While making the settlement order, the Authority shall consider:

   a. whether the defaulting party has committed a contravention earlier;

b. whether the nature of the commercial electronic message and the number of recipients to whom it was sent;

c. the benefit shown to have accrued to the defaulting party as a result of sending the commercial electronic message;

d. the need to prevent repetition of similar instances; and

e. any other matter it deems fit and necessary.

7. The settlement order of the Authority shall be binding in nature and any failure to obey the terms of the same shall be deemed to be contempt of court and actionable as such.

5. Requirements of Commercial electronic messages with India Link

India Link

1. All commercial electronic messages containing the India link must satisfy the following criteria:

   a. the commercial electronic message shall clearly indicate the originator thereof; and

   b. shall provide all relevant information about the originator thereof and where the commercial electronic message is sent on behalf of another person, all relevant information of such person which information shall be valid for a period of 30 days after the message is sent; and

   c. shall contain an electronic address in a clear and conspicuous manner to which the recipient may indicate its intention not to receive further commercial electronic messages containing information of the variety sent to him.

2. The originator shall not send a commercial electronic message as in sub-section (1) where the recipient thereof has indicated its intention not to receive further commercial electronic messages containing information of the variety sent to him.

3. A recipient aggrieved under sub-section (2) may file a complaint under section 4 above.

4. In case of contravention of sub-section (1) the Authority may *suo motu* impose a fine on the originator thereof which shall not be less than Rs. 10,000.

6. Commercial E-mail not to be sent without consent

Commercial Email

1. The originator shall not send or cause to be sent:

   i. a commercial electronic message;

   ii. an electronic message with an India link;

   without the express or implied consent of the recipient.

   Provided however that the originator shall not send or cause to be sent:

   i. more than 100 commercial electronic messages with the same or similar subject matter during a 24 hour period;

   ii. more than 1000 commercial electronic messages with the same or similar subject matter during a 30 day period;

   iii. more than 10000 commercial electronic messages with the same or similar subject matter during a one year period;

   without the express consent of all the intended recipients.

Provided further that the Central Government may vary the number of commercial electronic messages above by notification in the Official Gazette.

Explanation: For the purposes of this section, if the electronic address of a particular person has been conspicuously published for a particular

purpose and such publication is not accompanied by a statement that the person does not wish to receive commercial electronic messages or such a similar statement then that person shall be held to have impliedly consented to receiving commercial electronic messages if they pertain to that purpose.

The provision above states that commercial electronic messages may be sent only with the express or implied consent of the intended recipients. However, in addition, it lays down a further limitation by limiting the number of messages that may be sent by the same originator with the express consent of the recipient. This effectively means that the originator cannot send more than 100 commercial electronic messages of the same or similar subject matter to intended recipients who have impliedly consented to the same, further restricting the number of messages that can be sent. The provision also establishes the 'opt-in' approach of tackling spam rather than an 'opt-out' model, which has largely been condemned as legitimizing spam.

7. Penalties

Penalties

1. A person who aids, abets, procures or is in any way directly or indirectly involved in or is a party to or conspires with others to effect a contravention of section 6 shall be liable to pay a fine which may extend to Rs. 1,00,000 but not less than Rs. 10,000 for the first time he commits the contravention.

2. The person in sub-section (1) shall be liable for simple imprisonment for a term which may extend to five years but not be less than two years and a fine which may extend to Rs. 10, 00,000 but not be less than Rs. 1,00,000 for every subsequent time he commits a contravention as mentioned in sub-section (1).

Provided however that a person does not contravene section 6 merely because the person supplies an internet service that enables a commercial electronic message to be sent.

8. Act to be in addition to existing laws:

Addition to existing laws

This Act shall be in addition to and not in derogation of any existing laws presently in force.

Spam has wide reaching legal implications. It may contain obscene material or infringement of trademark or fraudulent material. As these are all offences under other legislations in force in India, this Act shall supplement those legislations.

IN DEFENCE OF BETHLEHEM†

*Rishab Kumar**

'He that will not accept new remedies must expect new evils, for time is the greatest innovator.'

Sir Francis Bacon, in his essay '*Of Innovation*'

I. INTRODUCTION

It is an interesting irony that history traces civilisation through warfare. Almost as old as warfare are the laws of war. The Old Testament, for example, states conditions under which enemy cities may be destroyed and people enslaved.[1] Also, much of what is today accepted as the law of warfare has its origins in the 17th century writings of Hugo Grotius.[2]

The United Nations Charter (the Charter) which is, at present, the governing law on the use of force by States was framed with the backdrop of World War I and World War II. War as understood in that sense, ie between the armies of nation States is now an anachronistic concept.[3]

The world today is far too interdependent and communicable. The world is less shaped by traditional military power of States and more by a complex political process that involves multinational corporations, international organisations like the U.N. and the World Bank and fundamentalist groups.[4]

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† This article reflects the position of law as on 15 May 2007.

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1 Deuteronomy, 20:10 (King James version). *See* Major Joshua E Kastenberg 'The Use Of Conventional International Law In Combating Terrorism: A Maginot Line For Modern Civilization Employing The Principles Of Anticipatory Self Defense & Preemption' (2004) 55 *The Air Force Law Review* 87.

2 *See De Jure Belli ac Pacis,* his most renowned work, written between 1623 and 1624.

3 *See* Thomas Franck 'Who Killed Article 2(4): Changing Norms Governing The Use Of Force By States', (1970) 64 *American Journal of International Law* 4, 809.

4 *See* Mary Kaldor, 'Winning A New Kind Of War', *The Nation* (Boulder United States of America, 5 November 2001), *available at* http://www.utne.com/2002-01-01/WinningaNewKindofWar.aspx?page=3 (last visited 15 May 2007).

For the most part of history, territory and sovereignty could be maintained through the protection of borders. The incidents on 11 September 2001, all too graphically shattered that illusion. Now, the enemy is not in uniform, and you will not see him on a battlefield. As States attempt to cope with this new kind of warfare, certain provisions of international law need to be examined with this perspective in mind.

The aim of this article is to analyse the provisions of international law that allow States to respond to terrorist attacks with force. To lend context to the discussion, the author uses the July War between Israel and Lebanon as a backdrop. Part II of this article sets out the relevant facts pertaining to the July War to facilitate a thorough discussion and analysis.

The twin concepts of *jus ad bellum* and *jus in bello*, which aid the study of 'use of force' jurisprudence have been analysed in Parts III and IV. In Part III of the article, the author will discuss the use of force as a measure of self defence under Article 51 of the Charter and will attempt to characterise Israel's actions as such a measure. Part IV of the article examines the *jus in bello* requirements of necessity and proportionality in acts of self defence.

Part V of the article will examine the issue of State responsibility and whether there was a breach of an obligation which involves responsibility of the State of Lebanon. Finally, in Part VI of the article, the author will compare the situation that led to the July War to the dispute between India and Pakistan over the state of Kashmir.

II. FACTS

On 12 July 2006, an incident between the Hezbollah military wing and Israeli Defence Forces (IDF) led to an upward spiral of hostilities in southern Lebanon that resulted in a major armed confrontation.[5] The situation began when Hezbollah fighters fired rockets at Israeli military positions and border villages to divert attention as another Hezbollah

[5] 'Report Of The Commission Of Inquiry On Lebanon Pursuant To The United Nations Human Rights Council Resolution S-2/1', (Geneva, 10 November 2006).

unit crossed the Blue Line[6] killed eight[7] Israeli soldiers and captured two.[8] In response, beginning 13 July 2006, Israel launched a massive assault in Lebanon by land, air and sea. The IDF also carried out a number of incursions into Lebanese territory.[9]

The 33-day conflict practically tore Lebanon apart. It exacted a heavy human toll and damaged economic and social structures, as well as the environment. During the campaign, Israel's Air Force flew more than 12,000 combat missions. Its Navy fired 2,500 shells, and its Army fired over 100,000 shells,[10] destroying as a consequence, large parts of the Lebanese civilian infrastructure, including roads, bridges and other 'targets' such as Beirut International Airport, ports, water and sewage treatment plants, electrical facilities, fuel stations, commercial structures, schools and hospitals, as well as private homes.[11]

On the other hand, according to Amnesty International, Hezbollah fired approximately 4000 rockets into Israeli towns.[12] These attacks killed 43 civilians, injured thousands and displaced many more.[13]

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6 The Blue Line is an officially accepted boundary between Lebanon and Israel which marks the withdrawal of Israeli troops in August 2000, *see* http://www.un.org/News/Press/docs/2000/20000618.sc6878.doc.html ,(last visited 18 August 2007). *See also* http://www.un.org/Depts/Cartographic/map/profile/southern_lebanon.pdf for an official map of the region.

7 Five of whom were killed in a tank that hit a mine, after the Israeli army made an initial rescue attempt. *See* 'Israel, Palestine and Lebanon: The Crisis Widens', *The Economist,* (London United Kingdom 15 July 2006) 39.

8 *Supra* n. 6.

9 *Supra* n. 6.

10 'The War In Numbers', *Jane's Defence Weekly* (Surrey United Kingdom 23 August 2006).

11 Information available on the website of the Presidency of the Council of Ministers – Higher Relief Council, Lebanon, *at* http://www.lebanonundersiege.gov.lb (last visited 18 August 2007).

12 'Israel/Lebanon Under Fire: Hizbullah's Attacks On Northern Israel', (a report by Amnesty International September 2006), *available at* http://web.amnesty.org/library/index/engmde020252006 (last visited 3 January 2008).

13 'Hezbollah Accused Of War Crimes', BBC News Report, *available at* http://news.bbc.co.uk/2/hi/middle_east/5343188.stm (last visited 18 August 2007).

On 11 August 2006, the Security Council adopted Resolution 1701[14] calling *inter alia* for:

> '[A] full cessation of hostilities based upon, in particular, the immediate cessation by Hezbollah of all attacks and the immediate cessation by Israel of all offensive military operations, and emphasizing the need to address urgently the causes that have given rise to the current crisis, including by the unconditional release of the abducted Israeli soldiers.'

On the same day, the Human Rights Council of the General Assembly, meeting in special session, adopted Resolution S-2/1.[15] The resolution accused Israel of numerous violations of international humanitarian law.[16]

Cessation of hostilities finally came into effect on 14 August 2006, at 0500 GMT.[17]

III. The Use of Force

This part deals with the use of force in response to terrorist attacks as a measure of self defence. It will be argued that the use of force by Israel against Lebanon was a justified act of self defence. The first part briefly traces the evolution of just war theory and the use of force. The second

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14 S/RES/1701 (2006), *available at* http://daccessdds.un.org/doc/UNDOC/GEN/N06/465/03/PDF/N0646503.pdf?OpenElement (last visited 15 May 2007).

15 Special Session Resolution of the Human Rights Council S-2/1 *available at* http://www.ohchr.org/english/bodies/hrcouncil/specialsession/2/docs/A.HRC.S-2.1_en.doc (last visited 18 August 2007).

16 Resolution S-2/1: '*The Human Rights Council...*

1. *Strongly condemns* the grave Israeli violations of human rights and breaches of international humanitarian law in Lebanon;
2. *Condemns* the massive bombardment of Lebanese civilian populations, especially the massacres in Qana, Marwaheen, Al Duweir, Al Bayadah, Al Qaa, Chiyah, Ghazieh and other towns of Lebanon, causing thousands of deaths and injuries, mostly among children and women, and the displacement of one million civilians, according to a preliminary assessment, thus exacerbating the magnitude of the human suffering of the Lebanese;
3. *Also condemns* the Israeli bombardment of vital civilian infrastructure resulting in extensive destruction and heavy damage to public and private properties;…'.

17 'Timeline Of July War 2006', *The Daily Star*, (Beirut Lebanon 20 August 2006) *available at* http://www.dailystar.com.lb/July_War06.asp (last visited 3 January 2008).

part deals with the proscription of force under the Charter and the relationship between Article 2(4) and Article 51 of the Charter.

A. Just War Theory and the Historical Development of the Use of Force Doctrine

The Just War Theory is essentially a school of thought that justified war and the use of violence in certain situations. As with most of our knowledge and understanding of the world, it was conceived by the Greeks and evolved by the Romans. However, the concept of 'just war' was extensively developed by Christian theologians[18] and traces of the theory can be seen even in the Bible.[19]

Later on in history, as nation States became stronger and more defined, the doctrine began to change. Grotius distinguished between wars that were righteous and wars that were unjust. He excluded ideological considerations as the basis of a just war, and attempted to redefine a just war in terms of self-defence and the protection of citizens and property.[20] Thus, the emphasis moved from the application of force to suppress wrongdoers to a concern to the maintenance of order by peaceful means.[21]

This attempt at preserving peaceful order is a tenet of the balance of power system that prevailed in the 19th century. World War I saw the end of the balance of power system as the dominant ideology that governed international relations. Incidentally, the League of Nations which was the

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18 St. Augustine (354-430 AD) defined the phrase 'just war' in terms of avenging of injuries suffered where the guilty party has refused to make amends. *See* Eppstein, J., *The Catholic Tradition of the Law of Nations* (1935) 65, as cited in Malcolm N Shaw, *International Law* (5th edn Cambridge University Press Cambridge United Kingdom 2005) 1014. St. Thomas Acquinas in the 13th century took the definition of just war a stage further when he wrote that war could be justified provided (i) it was waged by the sovereign authority, (ii) it was accompanied by a just cause and (iii) it was supported by the right intentions. *See Summa Theologica,* II, ii, 40, as cited above. *See also* Joachim Von Elbe, 'The Evolution Of The Concept Of Just War In International Law', (1939) 33 *American Journal of International Law* 669.

19 *See supra* n. 1.

20 Hugo Grotius, *De Jure Belli Ac Pacis Libri Tres,* as cited in Malcolm N Shaw, *International Law* (5th edn Cambridge University Press Cambridge United Kingdom 2005).

21 *Ibid.*

outcome of World War I did not prohibit war completely, it only restricted it. Although an attempt was made by the Kellogg-Briand Pact to prohibit war completely,[22] the agreement was far from unanimous as is evidenced by the outbreak of World War II.

At the end of World War II, the nations of the world agreed to the Charter of the United Nations and resolved to create the United Nations Organization. The primary purpose of this body was to maintain peace and security.[23] Article 2(4) of the Charter introduced a general prohibition on the use of force.[24] When read with Article 2(6) and the Declaration on Principles of International Law Concerning Friendly Relations;[25] this prohibition of force applies to all States regardless of their status of membership to the United Nations. This was indeed a radical departure from treaty law, albeit a necessary one.[26]

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22 *General Treaty for the Renunciation of War (the Kellogg-Briand Pact*) (adopted 27 August 1928, entered into force 24 July 1929) *available at* http://www.yale.edu/lawweb/avalon/imt/kbpact.htm (last visited 15 May 2007).

23 Article 1(1) reads: 'To maintain international peace and security, and to that end: to take effective collective measures for the prevention and removal of threats to the peace, and for the suppression of acts of aggression or other breaches of the peace, and to bring about by peaceful means, and in conformity with the principles of justice and international law, adjustment or settlement of international disputes or situations which might lead to a breach of the peace'.

24 Article 2(4) reads: 'All Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the Purposes of the United Nations'.

25 Declaration on Principles of International Law Concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations (A/8082, adopted on 24 October 1970), *available at* http://daccessdds.un.org/doc/RESOLUTION/GEN/NR0/348/90/IMG/NR034890.pdf?OpenElement (last visited 15 May 2007). *See also* Declaration on the Enhancement of the Effectiveness of the Principle of Refraining from the Threat or Use of Force in International Relations (A/RES/42/22, adopted on 18 November 1987), *available at* http://daccessdds.un.org/doc/RESOLUTION/GEN/NR0/512/54/IMG/NR051254.pdf?OpenElement (last visited 15 May 2007).

26 *Vienna Convention on the Law of Treaties* (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331; Article 35 of the Convention states that a State can injure a third State only if it accepts the obligation in writing. However, the justification for the departure from this rule lies in Article 38, which sets forth that treaty norms may become binding on third parties as rules of customary law. Thus, when international law crystallises as customary law a norm that has its genesis in a treaty, it becomes binding on a third State. *See* Jackson Nyamuya Maogoto, 'Walking An International Law Tightrope: Use Of Military Force To Counter Terrorism-Willing The Ends' (2006) 31 *Brook Journal of International Law* 405.

As such, Article 2(4) is generally viewed as outlawing any trans-boundary use of military force, including force justified by reference to the various doctrines developed in the pre-Charter era of forcible self-help, reprisal, protection of nationals, and humanitarian intervention.[27] Thus, Article 2(4) introduced a blanket restriction on the use of force regardless of the 'just' nature of the war.

However, the centuries of 'just war' jurisprudence was not done away with instantly. It was retained in the form of two exceptions, wherein the use of force is permissible.[28] First, States may use force when authorised by the UN Security Council acting in pursuance of Chapter VII of the Charter.[29] The second exception which is in a sense the last vestige of 'just war' jurisprudence, can be seen in Article 51 of the Charter.

B. The Right of Self Defence

The sovereignty of a nation depends on its ability to defend itself. For this reason, the right of self defence is enshrined in Article 51 of the Charter.[30] It is clear from the outset that the use of force is an appropriate response to an armed attack, but it is necessary to examine the restrictions which arise from the text of the Article. There are two issues which arise immediately from the text that merit further analysis. Firstly, there exists in international law an 'inherent right' of self defence and secondly, the concept of an 'armed attack'. For the sake of convenience the latter concept is dealt with first.

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27 Sean Murphy, 'Terrorism And The Concept Of "Armed Attack" In Article 51 Of The UN Charter' (2002) 43 *Harvard International Law Journal* 41.

28 *Ibid*.

29 This measure is largely unexplored because of the requirement of unanimous agreement of the permanent members of the UN Security Council.

30 Article 51 reads: 'Nothing in the present Charter shall impair the *inherent right* of individual or collective self-defence if an *armed attack* occurs against a Member of the United Nations, until the Security Council has taken measures necessary to maintain international peace and security. Measures taken by Members in the exercise of this right of self-defence shall be immediately reported to the Security Council and shall not in any way affect the authority and responsibility of the Security Council under the present Charter to take at any time such action as it deems necessary in order to maintain or restore international peace and security.' (emphasis supplied)

1. Armed Attack

Scholars, governments and the World Court seem to agree that acts of self defence under Article 51 are only permissible when an 'armed attack' occurs.[31] 'Armed attack' is a term of art,[32] and the justification of much bloodshed turns on its meaning. Thus, whether a terrorist act can be classified as an 'armed attack' is crucial.

As has already been noted, the UN Charter was framed with the backdrop of World War II. Therefore, many scholars are of the opinion that an 'armed attack' occurs only when there is a war in that sense, ie between two or more nation States.[33] This is known as the imputability requirement, for it requires an attack to be imputed to a State before it can be characterised as an 'armed attack'. By this reasoning it is implied that non-state actors like terrorist organisations cannot commit an 'armed attack' regardless of the scale of damage caused. The author will attempt to show that not only is this view unsustainable today, but incorrect in the first place.

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[31] Malcolm N Shaw, *International Law* (5th edn Cambridge University Press Cambridge United Kingdom 2005) 1026. *See also* Franck *supra* n. 3 and *Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua* v. *United States*) [1986] ICJ Reports 14.

[32] Although 'aggression' is a term distinct from 'armed attack', it may well be prudent to refer to its definition as it is the genus of which 'armed attack' is a distinct species. *See* Definition of Aggression, Annex to General Assembly Resolution 3314 (XXIX) UN GAOR, 29th Sess., Supp. No. 31, at 143, U.N. Doc. A/931 (1974), *available at* http://daccessdds.un.org/doc/RESOLUTION/GEN/NR0/739/16/IMG/NR073916.pdf?OpenElement,(last visited 15 May 2007). *See also Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua v. United States*) [1986] ICJ Reports 14.

[33] Michael J Glennon, 'The Fog Of Law: Self Defense, Inherence And Incoherence In Article 51 Of The United Nations Charter' (2002) 25 *Harvard Journal of Law and Public Policy* 539, 540. *See also* Matthew Scott King, The Legality Of The United States' War On Terror: Is Article 51 A Legitimate Vehicle For The War In Afghanistan Or Just A Blanket To Cover-Up International War Crimes?' (2003) 9 *ILSA Journal of International and Comparative Law* 457.

a. *Ordinary Meaning*

Nothing in Article 51 turns on whether the attack can be imputed to a State. To support this progressive interpretation, one must only look at the 'ordinary meaning' of Article 51.[34] The 'ordinary meaning' of the terms of Article 51 provides no basis for reading into the text a restriction on who the attacker must be.[35]

Indeed, reading the language in context leads to the same conclusion. If one compares the language used in Article 2(4) of the Charter, one finds that Article 2(4) speaks of use of force by a 'Member' against 'any state'.

This construct is not repeated in Article 51. Rather, Article 51 is silent on who or what might commit an armed attack justifying self defence.[36] Article 51 reads: 'Nothing in the present Charter shall impair the inherent right of individual or collective self-defence *if an armed attack occurs against a Member of the United Nations*...' (emphasis supplied). Evidently, it only requires that an 'armed attack' occur against any 'Member of the United Nations', leading one to the conclusion that there is no requirement that an 'armed attack' must be imputed to a State. The differential treatment by the framers of the Charter for the wording of Article 2(4) and Article 51 shows that it was not the intention to restrict the meaning of 'armed attack' to actions by States.

b. *International Opinion*

After the bombings of the World Trade Centre on 11 September 2001, the international community recognised the need of States to respond strongly to terrorist attacks. The international community in general

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[34] Article 31(1) of the *Vienna Convention on the Law of Treaties* (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331, which reads: 'A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.'

[35] Sean D Murphy, 'Self-defense And The Israeli Wall Advisory Opinion: An Ipse Dixit From The ICJ?' (2003) 99 *American Journal of International Law* 64.

[36] *Ibid.*

accepted the United States' response in Afghanistan without questioning the demand that the attack be first attributed to the Afghani government.[37]

Further, immediately after the attack on the World Trade Centre, the UN Security Council passed Resolutions 1368[38] and 1373[39] that recognised the need 'to combat by all means' the 'threats to international peace and security caused by terrorist acts.' No language in these resolutions indicates that the Security Council believes that terrorist acts must first be imputed to a State so as to trigger the right of self defence.[40] Thus, the view that certain authors have expressed that imputability is a requirement, must certainly be discarded.

c. *Military And Paramilitary Activities In And Against Nicaragua (Nicaragua* V. *United States) (Hereinafter Nicaragua)*

In *Nicaragua,* the World Court adjudged *inter alia* on the concept of 'armed attack'. Judge Nagendra Singh in his opinion for the majority, emphasised that the true test of whether an action of self defence is called for, is not based on the character of the perpetrator but the character of the event.

> 'There appears now to be general agreement... that an armed attack must be understood as including not merely action by regular armed forces across an international border, but also "the sending by or on behalf of a State of armed bands, groups, irregulars or mercenaries, which carry out acts of armed force

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37 *See* Shaw *supra* n. 31, 1028; Franck *supra* n. 3; King *supra* n. 33; Davis Brown, 'Use Of Force After September 11th: State Responsibility, Self Defense And Other Responses' (2003) 11 *Cardozo Journal of International and Comparative Law* 1. *See also* Judge Kooijmans' Dissenting Opinion in *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory* (*Advisory Opinion*) 43 ILM 1009 (2004).

38 UN Security Council S/RES 1368 (2001), *available at* http://daccessdds.un.org/doc/UNDOC/GEN/N01/533/82/PDF/N0153382.pdf?OpenElement (last visited 15 May 2007).

39 UN Security Council S/RES 1373 (2001), *available at* http://daccessdds.un.org/doc/UNDOC/GEN/N01/557/43/PDF/N0155743.pdf?OpenElement (last visited 15 May 2007).

40 Murphy *supra* n. 27.

against another State of such gravity as to amount to" (inter alia) an actual armed attack conducted by regular forces.

> The Court sees no reason to deny that, in customary law, the prohibition of armed attacks may apply to the sending by (or on behalf of) a State of *armed bands* to the territory of another State, if such an operation, because of its *scale and effects*, would have been classified as an armed attack rather than as a mere frontier incident had it been carried out by regular armed forces.' (emphasis supplied).[41]

This explanation of Article 51 and the term 'armed attack' has come to be known as the 'scale and effects' doctrine. Basically, in establishing that an 'armed attack' has occurred, the State invoking the right of self defence must establish that it was the target of a large scale use of force, such as an invasion or bombardment.[42] Thus, the focus shifts from the character of the perpetrator to the character of the event.

Although the final decision of the court has been criticised, the 'scale and effects' doctrine was accepted by Judge Jennings in his dissenting opinion as well. He notes: '[It] seems dangerous to define unnecessarily strictly the conditions for lawful self defence, so as to leave a large area where both a forcible response to force is forbidden and yet the United Nations employment of force, which was intended to fill the gap is absent.'[43]

The exposition of the court in *Nicaragua* regarding 'scale and effects' was also upheld in the *Oil Platforms case*[44] and also recently in the Israeli Wall Advisory Opinion.[45]

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41 *Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua* v. *United States*) [1986] ICJ Reports 14, 103; 76 ILR 349, 428.

42 *Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua* v. *United States*) [1986] ICJ Reports 14, 103; 76 ILR 349.

43 *Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua* v. *United States*) [1986] ICJ Reports 14, 543, 544; 76 ILR 877.

44 *Oil Platforms Case (Islamic Republic of Iran* v. *United States of America)* [2003] ICJ Reports 161.

45 *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory (Advisory Opinion)* [2004] ICJ Reports 131.

As the States attempt to strike out terrorism, it is imperative that the narrow interpretation be cast away. Such a restrictive interpretation would allow many acts of war and terror to take place without any legal response. Thus, interpreting the concept of 'armed attack' narrowly, only serves to transform a necessary State response under the UN Charter into an illegal one.[46]

In the July War, 'the situation began when Hezbollah fighters fired rockets at Israeli military positions and border villages while another Hezbollah unit crossed the Blue Line, killed eight Israeli soldiers and captured two'.[47] These events cannot be reduced to 'a mere frontier incident'; they were of a far more serious magnitude. Therefore, the kidnap of Israeli soldiers coupled with the bombing of northern Israeli towns, crosses the threshold of an 'armed attack'.

In light of repeated occurrences of large-scale terrorist attacks, it is submitted that while dealing with terrorism, States must be equipped with the legal justification to act when the situation so demands. There must evolve a principle, wherein first, a terrorist attack of sufficient gravity and effect itself constitutes an 'armed attack', and secondly, States responding to terrorism need not show an indissoluble link between the perpetrators of the act and the State harbouring the perpetrators.[48]

In the instant case, it is submitted that the acts of Hezbollah on 12 July 2006 are an offence grave enough to constitute an 'armed attack'. Hezbollah fighters not only breached territorial sovereignty and kidnapped Israeli soldiers, but also targeted northern Israeli towns with heavy rocket fire.[49] The acts, therefore, also meet the threshold of scale and effects as is laid down in *Nicaragua*. Thus, Israel may have been legally justified in acting in self defence.

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46 *Cf* King *supra* n. 33, 461.

47 *Supra* n. 5

48 There is already initial evidence of a change in this direction. *See* Shaw *supra* n. 31, 1027; Franck *supra* n. 3; King *supra* n. 33; Brown *supra* n. 37. *See also* Judge Kooijmans Dissenting Opinion in *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory* (*Advisory Opinion*) 43 ILM 1009 (2004).

49 *See supra* Part II.

2. Inherent Right

Although the modern right of self defence seems to exist only in the form of an exception to Article 2(4), the text of Article 51 lends a different connotation; the text indicates that there exists a right of self defence over and above the one in Article 51. The Article States that 'Nothing in the present Charter shall impair the *inherent right* of... self defence'. The text recognises the inherent right of self defence, ie, the customary law right over and above the specific provisions of Article 51. A number of academicians and some States agree that Article 51 merely elaborates one kind of self defence in the context of an 'armed attack'.[50] The World Court in *Nicaragua* has clearly established that Article 51 only reaffirms the inherent right of self defence as it exists in customary international law. The court noted:

> 'Article 51 of the Charter is only meaningful on the basis that there is a "natural" or "inherent" right of self defence and it is hard to see how this can be other than of a customary nature... It cannot therefore be held that Article 51 is a provision which "subsumes or supervenes" customary international law.'

Thus, the inherent right of self defence as it existed in customary international law merits examination. When considering the right of self defence under customary law, the *Caroline* incident of 1837 has for years been accepted as the defining law of the subject.[51] The dispute revolved around an incident in which British subjects seized and destroyed a vessel in an American port because the vessel had been supplying groups of American nationals, who had been conducting raids into what then was British territory.[52] In the correspondence that followed the incident, the American Secretary of State explained the concept of self defence and its conditions.[53] On the facts of the case itself, the *Caroline case* admits self

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50 J Brierly, *The Law of Nations* (6th edn, Oxford United Kingdom 1963) 417, 418 and D.P. O'Connell, *International Law* (2nd edn, London United Kingdom1970) vol.1,317. *See generally* King *supra* n. 33.

51 Shaw *supra* n. 31, 1024.

52 RY Jennings, 'The Caroline And Mcleod Cases' (1938) 32 *American Journal of International Law* 82.

53 *See infra* Part IV.

defence against non-state actors.[54] The American nationals who were held to be responsible for the damage caused to British territory were non-state actors, and no protest was raised by the Americans that their status as non-state actors would preclude Britain's right to resort self defence.[55] Similarly, although the Hezbollah fighters were largely non-state actors[56] they were capable of committing an 'armed attack' that would trigger Israel's right to act in self defence.

From the point of view of the legal principle of self defence, the similarity between the sequence of events in the July War and the *Caroline case* is plain to see. In both cases, non-state actors, responsible for activities prejudicial to the territory of another State and population triggered the right of self defence of that State. This similarity should serve to characterise Israel's response as a legitimate act of self defence in customary international law.

Thus, Hezbollah's acts on 12 July 2006 can be classified as an 'armed attack' under Article 51 therefore justifying Israel's response in self defence. Additionally, the use of force by Israel is also justified under customary international law as an exercise of the inherent right of self defence.

The principle in the *Caroline case* further requires that the acts in furtherance of self defence must be (i) necessary and (ii) limited to the extent of that necessity. These two principles have now evolved to become the doctrine of necessity and the doctrine of proportionality. They will be dealt with thoroughly in the next section.

IV. Jus In Bello

The term *jus in bello* is best understood as the 'law in war' as opposed to *jus ad bellum*, which deals with the right to use force. The two concepts are closely related, the latter being somewhat a precursor to the former.[57] The relationship between the two can be summed as: 'there must be a

54 Murphy *supra* n. 35, 64.

55 *Ibid.*

56 It must be noted that Hezbollah is a legitimate political party occupying seats in the Parliament. What bearing this has on their non-state actor status is a moot point.

57 Christopher Greenwood, 'The Relationship Between Ius Ad Bellum And Ius In Bello' 9 *Rev. Int'l Stud.*

right to go to war (*jus ad bellum*) before any discussion can follow as to the nature and extent of that right (*jus in bello*).' As the concept of the right to resort to force in self defence has already been dealt with; it is now imperative to examine the nature and extent of that right. The two basic principles of *jus in bello* are necessity and proportionality, and each must be given its due.

A. Necessity of Self Defence[58]

The most influential explanation of this concept is seen once again in the famous *Caroline case*, where the Secretary of State of the United States of America, Daniel Webster, laid down that in order for an act to be justified as self defence, there had to 'exist a necessity of self-defence instant, overwhelming and leaving no choice of means and no moment for deliberation.'[59]

Two principles can be derived from the above statement–firstly, there must exist an immediate and urgent need to respond at that instance in time and secondly, given the circumstances, there must be no other peaceful means available.

As far as the first requirement is concerned, the concept of necessity of self defence can be understood as requiring an immediate response. 'Immediacy' refers to a close-in-time response to the original act that

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[58] It is important to understand at the outset that Israel's actions are not sought to be justified by the existence of a state of Necessity under customary law (as codified in Article 33 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts). The acts are sought to be justified under article 51 of the Charter. Hence the concept of necessity as a circumstance that by itself precludes wrongfulness in customary international law and under article 33 of the Draft Articles is not relevant. The concept which is relevant for the discussion under article 51 is the concept of 'necessity of self defence'. It refers to an immediate and urgent need to respond in self defence to an 'armed attack'.

[59] Brierly *supra* n. 50.

precipitated the use of force.[60] This requirement can be inferred from Webster's words 'leaving no moment for deliberation'. This principle has also been deemed to be implicit in the meaning of Article 51 of the Charter.[61] Thus, an act of self defence cannot be considered 'necessary' if there is an excessive delay in the response.

In the July War, the IDF responded almost immediately to the capture of two soldiers, by attempting a rescue operation with a tank.[62] The rescue attempt failed and five soldiers were killed in this operation.[63] The very next day, Israel launched a large scale attack on Hezbollah in the south of Lebanon.[64] It must be noted that at the same time that these events occurred, Israel was being targeted by rockets and bombardment.[65] Admittedly, the timing of a response in self defence cannot be ignored.[66] The above sequence of events only goes to show that Israel's response was immediate and prompt.

As far as the second requirement of exhaustion of peaceful remedies is concerned, it must be understood that this requirement can only be judged after assessing the likelihood of success of the available peaceful methods.[67]

> 'As a matter of principle, there should be no quarrel with the proposition that force should not be considered necessary until peaceful measures have been found wanting or when they would clearly be futile. However, to require a State to allow invasion to proceed without resistance on the ground that peaceful settlement should be sought first, would, in effect, nullify the right of self

60 Schacter, 'Right Of States To Resort To The Use Of Force' (1984) 82 *Michigan Law Review* 1620; Schacter, 'Lawful Resort To Unilateral Use Of Force' (1985) 10 *Yale Journal of International Law* 291; King, *supra* n. 33, 467.

61 *Ibid.*

62 *Supra* n. 7.

63 *Supra* n. 7.

64 *Supra* n. 5.

65 *Supra* n. 5.

66 Schacter *supra* n. 60.

67 *Ibid.*

> defence ... In a case involving imminent danger to the lives of captured persons as in Entebbe or arguably in Tehran, it would be unreasonable to maintain that the continued pursuit of peaceful means must preclude armed rescue action.'[68]

From Oscar Schacter's interpretation of necessity and the right of self defence as above, it follows that although peaceful methods of settlement in dire circumstances must be considered, their non-employment does not defeat the legitimacy of an action in self defence.

The border between Israel and Lebanon known as the 'Blue line' is itself a negotiated cease-fire line,[69] which was breached by Hezbollah on 12 July 2006. Further, on 2 September 2004, the UN Security Council adopted Resolution 1559[70], that, *inter alia,* called for the disbanding of all Lebanese and non-Lebanese militia from the Israeli border. On 12 July 2006, when the Israeli soldiers were kidnapped, a statement was issued by the Israeli Cabinet Secretariat calling for the implementation of Security Council Resolution 1559.[71] This diplomatic background shows that the acts of Hezbollah itself were a breach of peaceful negotiations.

Significantly, the firing of rockets into Israeli territory posed a serious threat to Israeli personnel and property. Not to mention, the attack was perpetrated by terrorist militia and not the army of a State. Hezbollah is an organisation which was formed with the aim of resisting Israel with force; on what terms and at which forum would diplomatic negotiation have been possible? Any effort to employ peaceful methods of negotiation would have arguably been futile. And, as acquiescing to the heavy fire was not an option, Israel acted in the only way possible, armed self defence.

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68 Schacter *supra* n. 60.

69 *Supra* n. 6.

70 S/RES/1559 (2004), *available at* http://daccessdds.un.org/doc/UNDOC/GEN/N04/498/92/PDF/N0449892.pdf?OpenElement (last visited 18 August 2007).

71 Special Cabinet Communiqué - Hizbullah attack 12 July 2006, *available at* http://www.mfa.gov.il/MFA/Government/Communiques/2006/Special + Cabinet + Communique +-+ Hizbullah + attack+12-Jul-2006.htm (last visited 18 August 2007).

In the circumstances it is quite clear that there was 'no choice of means and no moment to deliberate'. The actions of Israeli forces in self defence were therefore necessary and permissible in International Law.

B. Proportionality

Proportionality is closely linked to the requirement of necessity in self defence. Acts done in self defence must not exceed in manner or aim the necessity provoking them. The requirement of the proportionality of the action taken in self defence, as we have said, concerns the relationship between that action and its purpose.[72] The purpose being to halt, repel or even prevent from recurring, the attack to which it is a response.[73]

It would be mistaken, however, to think that there must be proportionality between the conduct constituting the armed attack and the opposing conduct. What is relevant is the 'object of defence'. It has been recognised that the action needed to halt and repulse the attack may well have to assume dimensions disproportionate to those of the attack suffered.[74] Thus, proportionality when understood correctly means that the act of self defence must be proportional to the object of defence, which may rightly include acts required to quell the threat of a similar attack. The principle of proportionality in that context may encompass use of force necessary to halt, repel or even prevent a similar attack from recurring; but not 'suppressing' all future acts.

The attack that precipitated a response in self defence was the capture of Israeli soldiers coupled with the continued bombardment of northern Israeli towns.[75] Therefore, the military objective of the IDF was: (i) to rescue the soldiers and (ii) to prevent further rockets from being fired upon Israeli territory.[76]

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72 Judge Ago's Report to the International Law Commission on State Responsibility, *Yearbook of the ILC*, 1980, vol II, part 1, p. 69, para 121.

73 *Ibid.*

74 *Supra* n. 72.

75 *See supra* Part II.

76 *See* Israeli Ministry of Foreign Affairs Report 'Responding To Hezbollah Attacks From Lebanon: Issues Of Proportionality' (25 July 2006), *available at* http://www.mfa.gov.il/MFA/Government/Law/Legal+Issues+and+Rulings/Responding + to + Hizbullah + attacks + from + Lebanon- + Issues + of + proportionality + July + 2006.htm (last visited 18 August 2007).

Thus, a proportional response would be one that was limited to achieving these aims. It is argued that the IDF operations were indeed so limited.

However, it must be understood that achieving this aim would require that the IDF cause enough damage to the Hezbollah network and capabilities that would preclude them from being able to fire more rockets into Israeli territory. It is argued that the only way to do this satisfactorily would be to send in the IDF and support them with strategic air strikes. It is imperative to understand that the right to self defence extends to all actions required to ensure that the present danger posed by the enemy is suppressed. The south of Lebanon was a Hezbollah stronghold from which they operated.[77] Their strength and armed presence in the area posed a continuing threat to Israel. The acts of the IDF were aimed at and limited to suppressing this threat; and were therefore proportional to the object of self defence.

It is important at this juncture to explain the complexity involved in achieving Israel's military objective in the July War. This complexity stems from the inherently complex nature of responding to a terrorist attack. The difficulty to differentiate combatants and non-combatants in the fight against terrorism is now well known. Terrorist organisations regularly use their 'lack of uniform' to blend with the local populations. Often, militant bunkers and bases are located within the heart of civilian localities. There is documented evidence of Hezbollah bunkers being located within residential buildings in southern Lebanon.[78] An intricate network of underground tunnels and hideouts was also found in some of the most densely populated areas of the region.[79]

Additional Protocol I of the *Geneva Convention*, *1949*[80] (the Protocol) which is a modern codification of accepted principles of *jus in bello*,

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77 *See supra* n. 5.

78 BBC World Documentary: The World Uncovered- Hunting for Hezbollah. A synopsis is available at: http://www.bbcworld.com/Pages/Programme Feature.aspx?id=43&FeatureID=297 (last visited 15 May 2007).

79 *Ibid.*

80 Protocol additional to the Geneva Conventions of 12 August 1949 and relating to the Protection of Victims of International Armed Conflicts (adopted on 8 June 1977, entered into force on 7 December 1979).

strictly limits all attacks to legitimate military objectives. Article 52(2) of the Protocol defines military objectives as 'those objects which by their nature, location, purpose or use make an effective contribution to military action and whose total or partial destruction, capture or neutralization, in the circumstances ruling at the time, offers a definite military of advantage.'

All Hezbollah bunkers and firing positions would qualify as objects which contribute to military action. Logically, their destruction or neutralisation would be a legitimate military objective. The fact that these bunkers and firing positions were located in the heart of populated cities and towns would not take away from the legitimacy of Israel's military objective.

Interestingly, the drafters of the Geneva Conventions were aware of circumstances where civilians were used as protection from enemy fire.[81] The drafters therefore included the Article 28 in the Fourth Geneva Convention, which states: 'the presence of a protected person may not be used to render certain points or areas immune from military operations'.

Thus, Hezbollah's wilful use of civilian population as a shield is impermissible, and it does not in any way render Israel's actions illegal. Admittedly, as in any war, there was a considerable loss to civilian life, but that does not change the character of the response 'per se'.[82] This must be weighed against the 'military advantage' sought to be gained. If it is deemed to be imminently required, it is to that extent justified.

However, while regretting all loss of civilian life,[83] Israel claims that it acted in good faith and had exercised all due diligence required by

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[81] The commentary on Article 28 of the *Fourth Geneva Convention, Geneva Convention Relative to the Protection of Civilian Persons in Time of War* (adopted on 12 August 1949, entered into force on 21 October 1950), *available at*: http://www.icrc.org/ihl.nsf/FULL/380?OpenDocument (last visited 18 August 2007), states: 'During the last World War public opinion was shocked by certain instances (fortunately rare) of belligerents compelling civilians to remain in places of strategic importance (such as railway stations, viaducts, dams, power stations or factories), or to accompany military convoys, or again, to serve as a protective screen for the fighting troops. Such practices, the object of which is to divert enemy fire, have rightly been condemned as cruel and barbaric.'

[82] Judith Gardam, 'Proportionality And Force In International Law' (1993) 87 *American Journal of International Law* 391, 405.

[83] The focus of this article is to extract and shed light on certain principles. The author does not by this work condone any violations of humanitarian law and loss of civilian life.

international humanitarian law.[84] Further, the *Israeli Manual on the Laws of War*[85] imposes a heavy burden on the IDF to determine and avoid all civilian casualties. In fact, the IDF even dropped leaflets from the sky before air strikes warning civilians to leave danger zones.[86] Ideally, proportionality should be determined in relation to every target selected and every bullet fired.[87] But as such scrutiny is impossible; it is extremely difficult to reach any firm conclusion in all aspects of the IDF's actions.

However, when viewed in context of the objective, ie to terminate Hezbollah's capability to attack Israel, it is submitted that *Israel's actions were indeed proportional and the degree of departure from this principle, if any, would not be sufficient to vitiate the rightfulness of Israel's conduct.* Any violation of international humanitarian law must by all means be condemned, but as a matter of principle, Israel's actions in Lebanon were proportional to the object of defence.

The above discussion goes to show that the framework of law to deal with terrorist organisations exists. It is only a matter of strengthening it that remains.

V. State Responsibility

The July War can be seen from two angles—first, whether Israel's actions were justifiable and second, whether Lebanon is responsible for harbouring terrorists. Having dealt with Israel's actions and their legitimacy as acts of self defence, it remains to be seen whether Lebanon is responsible for the circumstances that led to the war. This part will deal with the obligations of States in international law and responsibility as a consequence of their breach.[88]

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84 *See supra* n. 70.

85 See *supra* n. 75.

86 *See* http://www.mfa.gov.il/MFA/Terrorism-+Obstacle+to+Peace/Terrorism+from+Lebanon-+Hizbullah/IDF+warns+ Lebanese+civilians+to+ leave + danger + zones + 3-Aug-2006.htm (last visited 18 August 2007)

87 *Supra* n. 81.

88 It must be noted that this discussion is merely academic. The breach of an international obligation by Lebanon does not justify Israel's response. The discussion however serves to address the natural question as to how states can be made responsible for harbouring terrorists.

State responsibility is a fundamental principle of international law, arising out of the nature of the international legal system and the doctrines of State sovereignty and equality of States.[89] It is crucial to the efficient working of international law as it makes States responsible for breaches of their obligations. It will be argued that the inaction of Lebanese authorities to curb the terrorist activities of Hezbollah was a breach of their international obligations.

It is a principle of international law accepted in state practice, judicial and arbitral decisions and writings of most highly qualified publicists that no state shall *knowingly* allow its territory to be used for acts contrary to the rights of other states.[90]

This obligation received sanction from the International Court of Justice (the World Court) in the *Corfu Channel Case*.[91] The World Court, that was invited to hold Albania responsible for damage caused to two British warships passing through territorial sea thereof, conceded that the mere fact that the defendant State exercised control over the territory would not justify 'per se' an inference of responsibility, but *should a State have knowledge of the act which is contrary to the rights of a foreign sovereign, international responsibility would accrue* (emphasis supplied).

In July 2006 the militant wing of Hezbollah,[92] operating from within Lebanese territory conducted a massive military operation that injuriously affected personnel and property in Israel. The activities of Hezbollah were by no means sporadic and were in fact organised with strategic intent.[93] The Lebanese government took no steps to prevent Hezbollah from bombing Israeli territory. In fact, Hezbollah is a recognised political

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89 Shaw *supra* n. 31, 694.

90 *Trail Smelter Arbitration* (*USA* v. *Canada*) [1949] ICJ Reports 4, 22. *See U.S.A* v. *Canada* , 3 RIAA 1905. *See also* Eagleton, *Responsibility of States in International Law* (New York University Press New York United States 1928) 80.

91 *United Kingdom* v. *Albania, (Merits)*[1949] ICJ. Reports.4, 16.

92 *Al-Muqawama al-Islamiyya* (The Islamic Resistance).

93 The operation was intended to divert the IDF's attention and capture Israeli soldiers and use them as leverage to demand the release of certain Hezbollah leaders that are imprisoned in Israel. The operation was called Operation Truthful Promise because the Hezbollah Leader Hasan Nasrallah had earlier promised to rescue the prisoners.

party that occupies around 11per cent of the seats in the Lebanese Parliament.[94] It would be rather difficult to argue that Lebanon was not aware of Hezbollah fighters firing Katyusha rockets into Israel.

Further, to improve the situation in southern Lebanon, the UN Security Council passed Resolution 1559 in September 2004. The resolution called for 'the disbanding and disarmament of all Lebanese *and non-Lebanese militias*' (emphasis supplied) and 'the extension of the control of the Government of Lebanon over all Lebanese territory.' The Lebanese authorities were therefore made aware of the presence of armed militia in the south. However, this resolution was never fully implemented. Hezbollah had been preparing militarily ever since the cease-fire in 2000 and continued to do so up till July 2006.[95] Thus, Lebanon was under obligation to ensure the disarmament of Hezbollah and as the events in July 2006 have shown, Lebanon was clearly in breach of this obligation.

It cannot be argued therefore that Lebanon was not aware of Hezbollah's activities. The *knowledge* requirement of the *Corfu Channel Case* being satisfied, it is clear that Lebanon at all times owed an obligation to ensure that activities from within its territory do not injuriously affect personnel and property in Israel. The bombing and kidnapping that Israel suffered in July 2006 unmistakably indicates a breach of this obligation.

This notwithstanding, States also have a specific obligation to curb terrorism.[96] This is evident from the Declaration of the Enhancement of the Effectiveness of the Principle of Refraining from the Threat or Use of Force in International Relations,[97] which codifies that 'States shall fulfil their obligations under international law to refrain from organizing, instigating or assisting or participating in ... terrorist acts ... in other States

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94 Angus Reid: Global Monitor, an organisation dedicated to researching election processes around the world, http://www.angus-reid.com/tracker/index.cfm?fuseaction=viewItem&itemID=6962 (last visited 15 May 2007).

95 *See generally,* Andrew Exum, *Hezbollah at War: A Military Assessment,* policy focus #63, the Washington Institute for Near East Policy, *available at* http://www.washingtoninstitute.org/templateC04.php?CID=260 (last visited 18 August 2007).

96 Brown *supra* n. 37.

97 *Supra* n. 24.

or acquiescing in organized activities within their territory directed at the commission of these acts.'[98]

It may well be argued that Lebanon did not do anything to contribute to the damage suffered by Israel. However, international responsibility is occasioned by an act or an omission. The obligation to not allow territory to be used for conduct prejudicial to foreign States carries with it the concomitant obligation to take measures effective enough to stop terrorist activities. Omission in the face of duty to act is as much culpable as active support. This imputation of responsibility on the basis of omission was recognised by the World Court in the 1980 litigation between Iran and United States of America—*The Diplomatic and Consular Staff Case*,[99] where the World Court found responsibility in Iran's inaction to take appropriate steps in circumstances where such steps were evidently called for. The *Corfu Channel* litigation[100] itself clearly indicates the same principle. Having found that Albania knew of the presence of mines, the court held it responsible for omitting to inform Great Britain of their presence.

Realising the importance of having uniform and codified rules of State responsibility, the International Law Commission (ILC) sought to codify customary law[101] on the subject in the form of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts (Draft Articles).[102]

Article 1 of the Draft Articles only reiterates the general rule that every internationally wrongful act of a State entails responsibility. Conversely, it can be understood that international responsibility can accrue only if there is a breach of an international obligation.

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98 Article I(6) of the Annexure to the General Assembly Resolution 42/22.

99 *United States Diplomatic and Consular Staff in Tehran* (*United States* v. *Iran*), [1980] ICJ Reports 3.

100 *Supra* n. 9.

101 Admittedly all the articles adopted by the ILC are not codification of custom. For a thorough analysis of the classification of specific Draft Articles as custom, *see* the ILC commentary of the Draft Articles adopted by the ILC at its fifty-third session, in 2001.

102 Text adopted by the ILC at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (at para 77). The report, which also contains commentaries on the draft articles, appears in the *Yearbook of the International Law Commission, 2001*, vol II, Part Two (reflecting the final edited text of the commentaries).

Thus, the inability of Lebanese authorities to take measures effective enough to prevent Hezbollah from committing terrorist attacks against Israel amounts to a breach of international obligations. This breach must necessarily entail international responsibility.

The standard of responsibility demonstrated above requires States to curb terrorist activities when they are aware of these activities. This author believes that this strict standard of liability will prove to be the defining legal principle in the fight against terrorism, as it reduces the threshold of responsibility from actual support to mere knowledge. Consequently it addresses the core issue that States who acquiesce to terrorist activities in their territory will be made culpable.[103] It is precisely the kind of inaction by Lebanon that led to the July War, which must be addressed by international law.

VI. The Kashmir Quagmire

The factual matrix that gave rise to the July War 2006 is very similar to the hostile character of the state of Kashmir that borders India and Pakistan. Kashmir, like the North of Israel is a disputed territory. The tension at the Line of Control (LOC) which is the UN sanctioned -fire line between India and Pakistan is very similar to the Blue Line between Israel and Lebanon. The similarity is made all the more relevant by India's claims that there are terrorist training camps on the Pakistani side of the border which are responsible for a number of insurgent terrorist activities.

India has made allegations that a number of terrorists trained in these terrorist camps are responsible for the attack on the Parliament on 13 December 2001[104] and the Mumbai Train Blasts in 2006.[105] The

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[103] There is already initial evidence of a change in this direction. *See generally* Shaw supra n. 31, 1027; Franck *supra* n. 3; King *supra* n. 33; Brown *supra* n. 37. See also Judge Kooijmans Dissenting Opinion in *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory* (*Advisory Opinion*), 43 ILM 1009 (2004).

[104] *See* Statement of the Union Home Minister on Tuesday, 18 December 2001 in Rajya Sabha (Upper House of Parliament) in connection with the terrorist attack on parliament house on 13 December 2001, *available at* http://rajyasabha.nic.in/photo/attack/stamentofhm.htm (last visited 28 September 2007).

[105] *See* Statements made by the Prime Minister of India, *available at* http://www.expressindia.com/news/fullstory.php?newsid=71060 (last visited 28 September 2007).

complication for India lies in showing evidence of a nexus between the particular act of violence and the presence of terrorist camps.

This article has highlighted the manner in which a State can respond to terrorist activities through the medium of self defence. For India to have a legitimate case for acting in self defence, India will have to prove the following:

(i) the occurrence of an 'armed attack' of the requisite scale and effects;

(ii) that the armed attack was committed by terrorist groups trained at the terrorist camps in Pakistan Occupied Kashmir (POK).

Incidentally, there have been a number of terrorist attacks in India that have satisfied the first of these two requirements; however, the second requirement is not easy to satisfy. Although in the aftermath of these attacks India has claimed a direct nexus between the terrorist camps and the terrorists responsible for these attacks, the evidence of this nexus is far from convincing.

However, the Kargil conflict is one incident where the criteria may have been satisfied. In May 1999, Pakistani troops along with militants from POK, infiltrated into Indian territory and occupied military positions on the Indian side of the LOC. Although Pakistan has denied any involvement of its troops, it has at least admitted that militants from POK were fiercely embroiled in the conflict.

In so far as the involvement of Pakistani troops is concerned, if their involvement is proved beyond doubt, the conflict escalates to an unlawful use of force by a sovereign nation that would justify an all out war. Therefore, for the purposes of comparison we shall restrict ourselves to the infiltration and attack by terrorist militia from POK.

The Kargil conflict can be understood in two stages. First, the armed infiltration and occupation of Indian territory. Second, the reoccupation of all Indian territory, which includes ensuring the withdrawal of all armed militia from the Indian side of the LOC. Interestingly, the first stage of

the invasion can be seen as the trigger for self defence and the second stage is relevant to understand the extent of the right of self defence.

With respect to the first stage, it is beyond any doubt that the armed infiltration of terrorist militia and their occupation of Indian territory satisfy the threshold of an 'armed attack'. Article III of the UN General Assembly Resolution on the Definition of Aggression clearly outlaws invasion, attack or any military occupation however temporary of the territory of any other State.[106] Thus, in the Kargil conflict, the occupation of the Zoji-la pass overlooking the arterial national highway NH1A was indeed an armed attack that justified the right of self defence.[107]

As far as the second stage is concerned, it is obvious that the right of self defence against an occupation of territory extends to re-occupation of that territory. India did in fact reoccupy its territory but, what merits consideration is whether India's right to self defence would extend to destroying the terrorist camps in POK so as to prevent any such insurgent activities in the future. In this article, it has been argued that the right of self defence extends to quelling the threat from acts of violence which triggered the right of self defence in the first place.

In the Kargil conflict, the trigger was a blatant infringement of sovereign territory by armed militia. The presence of these armed militia on the Pakistani side of the LOC would prove a constant threat to Indian territorial sovereignty. Thus, it is submitted that India did indeed have the right in law to attack and destroy the terrorist networks and capabilities on the Pakistan side of the LOC. At the time, it was the political circumstances that deterred India from breaching the LOC and conducting any full scale military operations on the Pakistani side of the LOC.

Since Kargil there have been a number of terrorist attacks in Kashmir and in other parts of India that at some level have been attributed to terrorist organisations that have training camps in POK.[108] In light of the

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[106] *Supra* n. 32.

[107] *See* http://www.globalsecurity.org/military/world/war/kargil-99.htm. (last visited 28 September 2007).

[108] *See generally,* the Indian Ministry of External of Affairs reports on violence Jammu and Kashmir, *available at* http://meaindia.nic.in/index.htm (last visited 28 September 2007).

recent international practice of actively tackling terrorism through the provisions of Article 51,[109] it is pertinent to ask whether, in today's geo-political scenario, India would have had the international support to confront the terrorist militia within POK.

VII. Conclusion

At this stage, it would be vital for the events of the July War to be put into perspective. First, the use of force in response to Hezbollah's attacks was *prima facie* a justified act of self defence under Article 51 of the Charter. Secondly, the force used was neither delayed nor unreasonably excessive, and was therefore within the ambit of what is permitted under the right of self defence. Lastly, the omission, in the face of knowledge, to curb terrorist activities makes the State of Lebanon responsible '*per se*' for the attacks on Israel.

There are those who argue that Article 51 does not apply to terrorist attacks. If this view is retained for too long, States using terrorism to achieve military objectives may be shielded by the Charter. That is a very real scenario and it highlights the need to legitimise responses to terrorist attacks. Far from implying that every terrorist attack is an 'armed attack', it is only advised that terrorism not be specifically excluded from the term either. Factors like the severity of the attack and the possibility of recurrence may serve to inform understanding.

Finally, it cannot be stressed enough, that to achieve these ends, acquiescence of States to terrorist activities must be made culpable. It is the only way to preserve the international security order envisaged by the Charter and at the same time further the goal of eliminating terrorism.

This article was based on the premise that war has evolved considerably from the drafting of the Charter and that seems to have its implications. The increasing severity and occurrence of terrorist attacks similar to the ones that led to the July War and the imminent need to respond to them legally, have shown the need, not for revision, but for a new perspective to international law.

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[109] *Supra* n. 47.

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