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Dated : 28/08/2014

MESSAGE

I am delighted to learn that National Law Institute University (NLIU), Bhopal is publishing its next issue of 'NLIU Law Review'.

The effort of NLIU, Bhopal in publishing 'Law Review' is laudable. For, the articles, case notes and book reviews complied together is bound to empower the students and enhance their knowledge in law. It would also encourage the authors to contribute different forms of literatures and research on critical issues of law.

I believe the present Law Review will not only be beneficial to students and lawyers but also come handy to the Judicial Officers. It will benefit all those engaged in the field of law.

I extend my warm greetings and felicitations to all those associated with the publication and best wishes for its grand success.

(A.M. Khanwilkar)

MESSAGE FROM THE PATRON

The NLIU Law Review, currently in its fifth year, has been an avenue for promoting quality academic research. The journal was conceived and implemented with a view to encourage intellectual awareness and scholarship and has received contributions from a cross-section of the legal community, including students, academicians, lawyers and industry experts. This variety has, in turn, led to versatility of opinion and perspective, and dissemination of knowledge throughout.

The journal follows a well-defined review procedure to ensure the quality of the content. The student body behind the Law Review has been an able group of students, backed by the faculty and alumni alike. The review process also receives support and guidance of legal luminaries who have helped the law review attain greater heights.

This issue is composed of articles which cover various areas of law including Constitutional Law, corporate laws and socio-legal concepts as well as emerging areas such as arbitration and telecommunication laws. It gives me immense pleasure to place this issue in your hands.

Prof. (Dr.) S.S. Singh
Director
National Law Institute University

MESSAGE FROM THE FACULTY ADVISOR

The NLIU Law Review over the course of time has been able to make noticeable progress, and I would like to recognise and congratulate the student body behind the Law Review for their efforts.

The articles in this Issue have dealt with a variety of topics including the Constitution, a cross-section of corporate laws, sociology etc. The inclusion of articles relating telecommunication laws and digital rights management are very much in furtherance of the objective of this Law Review to promote research in myriad areas of laws. The writings while throwing much light on the topics and making various propositions are in no way an answer to the difficult questions that are posed. It has been the Law Review's aim to promote intellectual scholarship and encourage individual opinions in order to evoke discussion, while being open to debate and criticism. We will consider ourselves successful in our endeavor if the writings included in this Issue are analysed in depth and commented upon.

I believe that contemporary writings in law deserve a far stronger scrutiny to provide new hurdles which can be tackled. Keeping this in mind I invite the readers to voice their opinions and to help the authors, students and the entire legal community in evolving newer dimensions of intellectual thought. I am thankful to Professor (Dr.) Sheo Shankar Singh, the Director of the University whose constant support and encouragement always invigorated our team to accomplish this task.

Prof. (Dr.) Ghayur Alam
Faculty Advisor

EDITORIAL NOTE

The recent decisions of the Hon'ble Supreme Court relating to the legal status of homosexuality in India, has come under much scanner particularly in the way the Supreme Court has claimed that its hands are tied. While the decision is sound with judicial logic, there are some further questions which need to be examined – given the progress in societal values which imperatively beckons changes in the legal frameworks.

Though not directly tackling these questions, the article on the powers of the Supreme Court under Article 142 to do 'complete justice' and an ensuing socio-legal critique offer very interesting perspectives into the contentious issue of morality. Articles dealing with corporate laws discussing topics such as the takeover code, international commercial arbitration, competition law etc. evokes new dimensions of thoughts and debates in a sphere of law which is the primary focus of many a student of our times.

We have always promoted scholarship in more obscure and underdeveloped areas of laws and the articles relating to telecommunication laws, legality of anti-satellite and digital rights managements is another step forward in our mission.

With such a vibrant brew of academic articles, the Law Review team hopes and wishes that the journal is a success for all its readers. Suggestions to improve the same are welcome. We also thank all those who have extended their support in the publication of this Issue of the Law Review.

Editorial Board

DEONTOLOGY AND CONSEQUENTIALISM IN THE INDIAN CONTEXT: ANALYZING THE MORALITY OF THE SUPREME COURT'S POWERS UNDER ARTICLE 142

Sachet Singh[*] *and Devdeep Ghosh*[**]

Abstract

Article 142 of the Constitution of India is the fountainhead of the Supreme Court's inherent powers to do 'complete justice'. A complete justice provision, by its very nature, is controversial and often debated. It is evident from an analysis of the case law pivoted around the use of Article 142 that the Apex Court has often shown scant regard to statutory law when the operation of such statutory law has been perceived as an impediment in the pursuit of justice. The purpose of this paper is to survey the decisions of the Apex Court and contextualize it within the framework of two schools of jurisprudential thought - deontology and consequentialism - in an effort to identify the

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underlying thought process of various benches of the Supreme Court over the years.

I. INTRODUCTION

Article 142 of the Constitution of India states that the Supreme Court of India 'may pass such decree or make such order as is necessary for doing complete justice in any cause or matter pending before it'. In using this provision, the Apex Court has often bypassed established statutory law in order to achieve a desirable consequence whereas in other instances, the Court has held that Article 142 must only be used with due regard to any established legal principle on the matter at hand and cannot run counter to such substantive dictum. The purpose of this paper is to analyze decisions of the Court in accordance with two jurisprudential schools of thought - deontology and consequentialism. While deontology judges the moral correctness of an act without regard to the consequences of such act, consequentialism lays greater stress on the ends rather than the means. Therefore, it is relevant to study the use of Article 142 by the Supreme Court of India in the context of these two schools in an attempt to understand the jurisprudential motivations of the 'people's court'.

Part I of this paper seeks to introduce the reader to the contours of deontology and its working. The purpose of this part is to equip the reader with an elementary, yet comprehensive, understanding of this school of thought in order to enable a more appreciative reading of the authors' final analysis of Article 142. Similarly, Part II serves as a brief primer to the consequentialist school of thought and shall highlight both its advantages and its faults. As explained later in this paper, these two schools of thought are largely irreconcilable and Part III seeks to illustrate this conflict by alluding to the landmark

American judgment of *Brown v. Board of Education of Topeka ("**Brown**")*[1] and critiques of the same from jurists subscribing to the divergent schools. The purpose of Part IV is to further qualify the concept of deontology as explained in Part I by reference to Ronald Dworkin's understanding of the concept. Finally, Part V shall elaborate upon Article 142 and its nature by seeking to understand the underlying intent of adopting such a 'complete justice' provision followed by a detailed study of the interpretation of the provision in different passages of the Apex Court's history.

II. UNDERSTANDING DEONTOLOGY

A. The Concept

Deontology is a school of thought that seeks to primarily evaluate the moralities of actions.[2] There are vast and varied theories within this school but the pivotal argument to each of these theories can be simplified to the proposition that 'the rightness of action is a function of whether the action is required, prohibited, or permitted by a moral duty'.[3] It's premised on the principle that 'an act must be evaluated by a characteristic that cannot be gathered from its consequences'.[4] Deontological thought finds its fingers in every pie - be it criminal law, in the retributive theories of punishment[5] and the grassroots principle that an act can only be termed a crime when it is a violation

[1]347 US 483 (1954).
[2]J. MacDonald & C. Beck-Dudley, *Are Deontology and Teleology Mutually Exclusive?*, 13 J. BUS. ETHICS 615-17 (1994).
[3]R. MCCORMICK, NOTES ON MORAL THEOLOGY 62 (1973).
[4]*Id*. at 34.
[5]C. Steiker, *No, Capital Punishment is Not Morally Required: Deterrence, Deontology and the Death Penalty*, 58 STANFORD LAW REV. 751, 759 (2005).

of moral duty;[6] tort law, in its principles of corrective justice;[7] or contract law, which is premised on the moral duty to perform a promise.[8]

B. Identifying Morally Right from Morally Wrong

Controversy arises when it is time to deem what actions are wrongful and what are not - while some acts are ipso facto wrongful, their morality may be vindicated when looked at contextually. For example, lying is morally wrong but its morality is turned on head when such lies give way to a greater good.[9] Another problem would be the matter of consensus[10] - what can be done when an individual's conception of what is moral does not agree with another's? The solution to these hurdles may lie in the method of 'reflective equilibrium' as exposited by John Rawls.[11] This methodology engenders objective principles, on the basis of which one can identify whether an act is morally right or wrong - therefore eliminating the element of subjectivity. These principles are arrived at by identifying a common thread that runs through precedents.[12] Should there be conflict between precedent and the principle, either one should be revised in keeping with the more overwhelming line of thought. This process was termed by Rawls as 'reflective equilibrium'[13] and aims to create a set a set of general principles on the basis of which morality

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[6] *Id.* at 751.
[7] K. Simons, *Deontology, Negligence, Tort and Crime*, 76 B.U. L. REV. 273, 299 (1996).
[8] *Id.*
[9] A. Isenberg, *Deontology and the Ethics of Lying*, 24 PHILOS. PHENOMENOL. RES. 463, 465 (1964).
[10] *Legal Theory Lexicon 010: Deontology*, LEGAL THEORY LEXICON http://lsolum.typepad.com/legal_theory_lexicon/2003/11/legal_theory_le_2.html.
[11] JOHN RAWLS, A THEORY OF JUSTICE 40 (1999).
[12] *Id.* at 43.
[13] RAWLS, *supra* note 11.

may be judged, thereby determining the content of a deontological moral theory.

Another way of doing so would be by recourse to Kant's 'categorical imperative'.[14] He sought to resolve the problem of specifying a morally right duty by building upon the concept of 'good will'[15] i.e. the impetus to act for good as opposed to acting to solely satiate one's own desires. His treatise, *The Groundwork of the Metaphysics of Morals*, began with his belief that "it is impossible to conceive of anything in the world, or indeed out of it, which can be called good without qualification save only a good will."[16] According to Kant, if one wishes to seek the moral option, one must act on the basis of a set of principles that does not see itself conclude in satisfying one's own desire or inclinations i.e. one must act with 'good will' which may be arrived at by the 'formula of the law of nature'[17] according to which one must act as if the principle on which your act was based would become a universal law of nature.[18]

C. Countering Deontological Theories

Jurists are uncomfortable with deontological moral theories because there is great indeterminacy over what the content of these theories actually are as the methodologies specified above are grossly inadequate. This hurdle to deontological thought is termed 'the indeterminacy objection'.[19] While Rawls' method of reflective equilibrium seeks to remove the element of subjectivity in arriving at the content of deontological theory, in practice, subjectivity persists

[14]A. Campbell Garnett, *Deontology and Self Realization*, 51 ETHICS 419, 437 (1941).
[15]*Id.*
[16]MACDONALD & BECK-DUDLEY, *supra* note 2 at 616.
[17]*Supra* note 10.
[18]MACDONALD & BECK-DUDLEY, *supra* note 2 at 421.
[19]J. Muirhead, *The New Deontology*, 50 ETHICS 441, 446 (1940).

as different people end up with different reflective equilibria.[20] It is also possible that an individual ends up believing that a vast spectrum of equilibria is possible, thereby perpetuating the indeterminacy of the deontological theory. Detractors argue that Kant's theory of the categorical imperative is also susceptible to the same weakness.[21]
Another criticism faced by deontologists is that even if a determinate answer is reached by the above stated methodologies, the answer is unrealistic and suffers from being too 'demanding or inflexible'[22] resulting in solutions that would not be practicable. This objection has been termed 'the rigor objection'.[23] A widely quoted hypothetical situation[24] is that of a German in Nazi Germany, seeking to protect certain Jews, being questioned of their whereabouts. Lying, being morally apprehensible would not be acceptable to a deontologist and the consequentialists argue that the deontologist would be bound to disclose the location of his beneficiaries. However, deontologists do not subscribe to such a simplistic, blanket reasoning and may rebut this criticism with the argument that deontologically, there is no moral duty to tell the truth to those seeking to use such truth for immoral purposes.[25]

Thus, we see that deontologist theories and consequentialist theories are not compatible and provide contradictory outcomes to every legal scenario, thereby rendering it a pertinent question as to what school a legal system claims to subscribe to and what school is actually implemented in practice.

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[20]S*upra* note 10.
[21]R. McCain, *Deontology, Consequentialism and Rationality*, 49 REV. SOC. ECON. 168, 173(1991).
[22]T. Schapiro, *Kantian Rigorism and Mitigating Circumstances*, 117 ETHICS 32, 37 (2006).
[23]*Id.*
[24]T. SCHAPIRO, *supra* note 22 at 51.
[25]A. ISENBERG, *s upra* note 9.

III. CONSEQUENTIALISM

A. Diametrically Opposite Concept to Deontology

Consequentialism, as a school of thought, highlights the correlation between an act's rightness and its consequences. An act can be considered to be morally good or legitimate only if its consequences are at least as good as any other alternative act open to the agent.[26] This is in contrast to deontology, which focuses on the nature of the act, rather than its end result. Consequentialism derives its foundation from classic utilitarianism. Classic utilitarianism goes on to say that an act is morally right only if it causes 'greatest happiness to the greatest number of people.'[27] Therefore, it can be said that utilitarianism aims at welfare maximization - a principle imbibed in consequentialism. There could be situations that require meting out a certain degree of harm or abandonment. Consequentialist theorists seem to be divided with respect to the course of action that should be taken in such circumstances, as recourse to the usual consequentialist presumption would lead to a less than optimal result. Consequentialists like Peter Railton opine that in such situations, the path that leads to best possible result should be adhered to. Thus, one may do the wrong thing during such times. However, the consequentialist school of thought demands that even in doing such a wrong thing, there must be a certain degree of aversion to performing such an act, as the absence of aversion in harming others could lead to

[26]Michael Slote & Philip Pettit, *Satisficing Consequentialism*, 58 PROC. ARISTOT. SOC. SUPPL. VOL. 139 (1984).

[27]For example, a consequentialist will not be concerned if the agent refuses to perform acts which he promised to do in the past unless it goes on to adversely affect other people. See Walter Sinnot-Armstrong, *Consequentialism*, THE STANFORD ENCYCLOPAEDIA OF PHILOSOPHY (Winter 2011 ed.), http://plato.stanford.edu/entries/consequentialism.

situations where a person inflicts harm upon other people even if it does not produce the optimum result.[28] Others, more particularly those known as 'rule utilitarians argue that notwithstanding that the end result would be harmful; agents should continue to give preference to the presumptions and aversions determined by the consequentialist school of thought, even though the outcome would less desirable than what was possible to achieve.[29]

B. Drawbacks

Consequentialism has often been criticized for separating the means from the ends. On one hand, it says that actions, being momentary, cease to matter after a point of time and all that holds relevance is the result. On the other hand, it also says that actions do hold relevance as they are among their own consequences. In the long run, like all things, results too fade away.[30] Consequentialism also tends to base its premise on the argument that every action undertaken by a person is motivated by an expected benefit, which might accrue to that person or someone else. Hence, overall benefit is the guiding factor of a person's actions. However, this argument can be rebutted by saying that there may be times when it is not the expected benefit which guides a person's actions but a certain principle that must be adhered to. For example, a person may perform a certain deed only because it has been promised or is required by law and hence, the consequence has no part to play.[31] Germain Grisez provides an interesting critique to the theory. He goes on to dismiss the consequentialist theory by describing it as 'dangerous nonsense'. He rejects the argument that

[28]SAMUEL SCHEFFLER, CONSEQUENTIALISM AND ITS CRITICS 7 (1988).
[29]*Id.* at 8. Rule utilitarianism says that an action is morally good or legitimate when it is in coherence with the rules that leads to the greatest good.
[30]William Haines, *Consequentialism*, INTERNET ENCYCL. PHILOS., http://www.iep.utm.edu/consequentialism/.
[31]*Id.*

every action must be performed by keeping in mind the 'greater good'. According to Grisez, the term 'greater good', as per consequentialists is to indicate that goods are measurable and commensurable. However, they lack reference. Goods cease to be measurable unless there is a particular standard available to them; and cannot be commensurable unless they are called 'good' in the same sense.[32] Judith Jarvis Thomson provides a more semantic argument against consequentialism. She opines that critical conclusion can be drawn by giving a correct interpretation of the meaning of 'good'. She substantiates against the consequentialist theory by stating that "all goodness is goodness in a way."[33] Therefore, it can be safe to conclude that the theory of consequentialism is yet to find settled shores. While its very name tends to imply that the morality of any act can only be judged by its consequences, some of its proponents are also of the belief that other factors like obedience of religion or law play a role in determining the legitimacy of an action, irrespective of its consequences.

Thus, we learn that both consequentialism and deontology suffer from inherent faults that must be valued against the benefits that accompany them. While a strictly deontological understanding of rights and liabilities may lead to situations where the law acts to the detriment of society rather than its welfare, a consequentialist view results in an ad-hoc application of supposedly universally binding principles and may have catastrophic consequences. This paper seeks to understand the view adopted by the Supreme Court of India, in particular, with the implementation of Article 142 - a complete justice provision and whether such view is justified in light of the underlying intent of the provision.

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[32]Germain Grisez, *Against Consequentialism*, 23 AM. J. JURIS.29 (1978).
[33]David Phillips, *Thomson and the Semantic Argument against Consequentialism*, 100 J. PHILOS. 475 (2003).

IV. DEVIATING MORALITIES - AN ILLUSTRATION OF THE CONFLICT BETWEEN DEONTOLOGY AND CONSEQUENTIALISM

As exposited earlier, the two principles contradict each other and cannot mutually co-exist except in rare situations.[34] The case of *Brown*[35] is illustrative of this issue. Deontology in the field of law would have the import of evaluating the morality of an act in consonance with established legal principles regardless of the consequences. The case being discussed held that the racial segregation of public schools was unconstitutional and in the process, overruled the longstanding decision made in *Plessy v. Ferguson ("**Plessy**")*.[36] While the case may be lauded on moral grounds, the real question is whether such morality ought to interfere with a judge's application of law i.e. whether such a consequentialist perspective on the morality of an act is supportive or detrimental to the rule of law.

[34]Certain scholars have voiced the opinion that the two principles needn't necessarily be treated as mutually exclusive and that there is a certain degree of common ground between them. See T.M Scanlon, *Rights, Goals and Fairness as in* SCHEFFLER, *supra* note 28 at 75 (where it has been argued that human rights, while essentially deontological, derive their validation by submitting to the consequences of having those rights). However, for the purposes of this paper, we shall proceed on the widely acknowledged belief that the two schools of thought are irreconcilable.

[35]See Brown v. Board of Education of Topeka, 347 US 483,495 (1954) [Hereinafter Brown].

[36]163 US 537 (1896) [Hereinafter Plessy]. The case upheld the constitutionality of racial segregation of public schools by applying the doctrine of 'separate but equal'.

The decision went on to be highly criticized. Justice Clarence Thomas, of the US Supreme Court condemned it as being a verdict made by relying on 'dubious social science' rather than 'reason and moral principles' as enshrined in the Constitution and Declaration of Independence.[37] Former Chief Justice of the United States, William Rehnquist, who was a well-known advocate of the 'separate but equal' doctrine as applied in *Plessy*, opined that:

> "*I realize that it is an unpopular and un-humanitarian position for which I have been excoriated by 'liberal' colleagues but I think Plessy v Ferguson was right and should be reaffirmed. To the argument, that a majority may not deprive a minority of its constitutional right, the answer must be made that while this is sound in theory, in the long run, it is the majority who will determine what the constitutional rights of the minority are."*[38]

However, the decision in *Brown* predictably found favor amongst consequentialists. According to Robert Bork, segregation rarely ever led to equality as equality and segregation could not be considered to be mutually consistent. Therefore, the only realistic choice before the Court was to allow segregation and abandon equality or forbid segregation and attain equality.[39] Numerous other jurists also opined that although *Brown* went against established constitutional principles of that age, the morality of the act could not be questioned as its

[37]Nathan Dean, *The Primacy of the Individual in the Political Philosophy and Civil Rights Jurisprudence of Clarence Thomas*, 14 GEORGE MASON UNIV. CIV. RIGHTS LAW J. 27, 41-42 (2004).

[38]See William Rehnquist, *A Random Thought on the Segregation Cases*, PBS http://www.pbs.org/wnet/supremecourt/rights/print/doc7.html. Nevertheless, Rehnquist never made any attempt to overturn Brown and often relied on it as precedent.

[39]ROBERT BORK, THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW 82 (1991).

effective consequence would result in alleviating the hardships of the marginalized African-American community: a morally right consequence.

V. DWORKIN'S DEONTOLOGY

Ronald Dworkin has long been a supporter of deontological principles and an understanding of his theory would enrich our final analysis of our Apex Court's jurisprudence. He attacked H.L.A Hart's theory that law was uncertain. According to Hart, it was up to the judge to resolve all uncertainties at the best of his abilities by exercising a certain degree of judicial discretion.[40] Dworkin on the other hand asserted that even in cases where statutes or precedents do not provide clear answers, courts are not called upon to exercise any discretion. In such cases, it is the 'principles' entrenched in our legal system that needs to be resorted to.[41]

Dworkin opined that in cases where principles conflicted, the judge should try to "*find a coherent set of principles*" that will go on to validate his decision. These principles are to act as guiding forces, to be selected on the basis of fairness, keeping in mind the 'institutional history' of the society's legal structure.[42] Therefore, his theory expounds that even where the law on a particular matter is ambiguous, it is incumbent upon a judge to cull out a coherent set of principles in accordance with which the matter ought to be resolved.

[40]Ronald Dworkin, *The Model of Rules*, 35 U. CHI. L. REV.14 (1967) wherein he critiques H.L.A Hart's theories.
[41]RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 22-31 (1977).
[42]Ronald Dworkin, *Hard Cases*, HARV. L. REV.1057 1098-99 (1972).

According to Dworkin, these principles could not be arrived at by only having regard to the consequence of their application.[43]

In his book 'Law's Empire', Dworkin examines the nature of 'theoretical disagreements', i.e. disagreements as to whether "*statute books or judicial decisions exhaust the pertinent grounds of law*."[44] Dworkin does this by analyzing the issue from the standpoint of a judge. He blatantly attacks the positivist school of thought. He says that if law is to be understood in its true sense, one must have an interpretive attitude. We must come to terms with the fact that law has a point and thus, individual legal provisions must be interpreted in the manner in which we envision that point to be.[45] Therefore, his theory permits for a less rigorous version of deontological thought as it carves a niche for a judge's interpretation of the set of principles on which he is to decide a case. However, this cannot be read as allowing a judge to completely bypass the established principles of a legal system. Therefore, Dworkin's theory finds relevance in the raging debate over whether Article 142 of the Indian Constitution allows for the Apex Court to ignore statutory law in order to do 'complete justice' between parties.

[43]See Ronald Dworkin, *No Right Answer?*, 53 N.Y.U. LAW REVIEW 1, 30 - 32 (1978) where he talks about situations where no one set of principles seems acceptable. In such a situation, recourse must be taken to evaluating the 'moral facts' at stake. These moral facts derive their basis from political theory, which ultimately go on to produce moral rights. He felt that there are extremely rare cases where one would find "no right answer".

[44]RONALD DWORKIN, LAW'S EMPIRE 3-5 (1986).

[45]George C. Christie, *Dworkin's Empire*, 1987 DUKE L.J. 159, 161 (1987).

VI. ARTICLE 142 - THE CONSEQUENTALIST RAMIFICATIONS OF A COMPLETE JUSTICE PROVISION

Article 142(1) of the Indian Constitution lays down that the Supreme Court may pass such enforceable decree or order as it deems necessary for the purpose of carrying out 'complete justice' in any matter pending before it.

A. The Underlying Intent of Article 142

To understand the true purport of Article 142 of the Indian Constitution, one must have regard to the Constituent Assembly Debates. Article 118 of the Draft Constitution, which was finally enshrined in the Constitution of India as Article 142, was debated on the floor of the Constituent Assembly on the 27th of May, 1949 and was added without debate or amendment.[46] The absence of debate over the inclusion of what could be an all-powerful weapon in the arsenal of the Apex Court is indicative of the intended purpose of Article 142 i.e. that it is purely procedural. The Constituent Assembly's debate on Article 112 of the Draft Constitution, which was later added as Article 136, is actually the only discussion of this 'complete justice' provision - but it has only been mentioned in passing as being critical to the wide appellate jurisdiction of the Court under Article 136 and not as being a substantive provision in itself. Pandit Thakur Das Bhargava commented that the inherent powers of the Apex Court, as recognized by Article 118, was allied to the wide jurisdiction of the Court under Article 112 and elevated the Supreme Court of India to the exalted position enjoyed by the Privy Council.[47]

[46]Constituent Assembly Debates, Vol. VIII, 679.
[47]*Id.* at 638. ".. At the same time the jurisdiction of the article is almost divine in its nature, because I understand that this Supreme Court will be able to deliver any

Shri Alladi Krishnaswami Aiyar also alluded to the complete justice provisions under Article 118 while debating the inclusion of Article 112 in the following words – "*If only we realize the plenitude of the jurisdiction under Article 112, if only, as I have no doubt, the Supreme Court is able to develop its own jurisprudence according to its own light, suited to the conditions of the country, there is nothing preventing the Supreme Court from developing its own jurisprudence in such a way that it could do complete justice in every kind of cause or matter*."[48]

In light of the Constituent Assembly Debates on Article 142, or rather the lack of it, it can be argued that the intent of the framers of our Constitution was to provide means for the Supreme Court to untether itself from the Executive as far as the enforcement of its decrees and orders were concerned as that had the potential to compromise the independence of the judiciary i.e. the nature of Article 142 is procedural.[49] However, as shall be elaborated upon later in this paper, judicial discourse in the hallowed courtrooms of the Supreme Court has given an entirely new sheen to its powers under Article 142 - one that was never the intent of the Constitution framers[50] and has been

judgment which does complete justice between States and between the persons before it. If you refer to Article 118, you will find that it says: 'The Supreme Court in the exercise of its jurisdiction may pass such decree or make such order as is necessary for doing complete justice in any cause or matter pending before it and any decree so passed or order so made shall be enforceable throughout the territory of India in such manner as may be prescribed by or under any law made by Parliament."

[48]*Id.* at 639.

[49]See R. Prakash, *Complete Justice Under Article 142*, (2001) 7 S.C.C. (J) 14, 16. ("Article 142 is an article which deals with procedural aspects and the two words 'complete justice' cannot enlarge the scope of the article.")

[50]Article 142(1) was initially intended to only support the Court's powers under Article 32 and Article 136.

described as self-serving.[51] Article 142 has been used to bestow upon the Apex Court an unbridled power to ignore statutory law on the grounds of attempting to achieve complete justice between the parties without expressly striking down the statute vide judicial review.[52] This enlargement of scope has largely been justified by the words 'complete justice' located in Article 142. However, the Court has interpreted this phrase *in vacuo* and thereby, given it a wholly new dimension. It has been left undefined in order to preserve its flexibility in enabling the Court to fully give effect to its powers under Article 32 and Article 136 but it is submitted that the Court may not act on its whim and fancy in the quest of achieving complete justice[53] - such a step must be taken with due regard to the rule of law which has been recognized as a part of the basic structure.[54] A more elaborate study of the evolution of the Constitution's complete justice provision shall greatly assist us in understanding the mind of the Apex Court.

B. The Evolution of Article 142 - Supplement or Supplant?

The scope of the Court's power under Article 142(1) has been scrutinized ad infinitum, most recently in the cases of *National*

[51]M.P. JAIN, INDIAN CONSTITUTIONAL LAW 262 (5th ed. 2008). ("The creative role that the Supreme Court has assumed under Article 142 of the Constitution is much wider than a court's creative role in interpreting statutes and is plainly legislative in nature.")

[52]See Delhi Judicial Service Assn. v. State of Gujarat,(1991) 4 S.C.C. 406 (per K.N. Singh, J.) where it was held that the "Court's power under Article 142(1) to do 'complete justice' is entirely of a different level and of a different quality. Any prohibition or restriction contained in ordinary laws cannot act as a limitation on the constitutional power of the Supreme Court."

[53]Delhi Development Authority v. Skipper Construction Co,. (1996) 4 S.C.C. 622.

[54]See Kesavananda Bharati v.State of Kerala, (1973) 4 S.C.C. 225; Indira Nehru Gandhi v. Raj Narain,1975 Supp S.C.C. 1; P. Sambamurthy v. State of A.P., (1987) 1 S.C.C. 362.

Insurance Co. Ltd. v. Parvathneni[55]and *University of Kerala v. Council of Principals of Colleges, Kerala*.[56] The primary reason this provision has gone on to court so much controversy is that interpretations given by the Court with respect to its powers under the provision have failed to be consistent. On one hand, in the cases of *Leila David v. State of Maharashtra*[57] and *Anil Kumar Jain v. Maya Jain*,[58] the Court considered its powers wide enough to waive statutory requirements, while on the other hand, in the cases of *Manish Goel v. Rohini Goel*[59] and *Poonam v. SumitTanwar*,[60] it refused to do so. It is the objective of this paper to conclusively determine the nature of this provision in light of the deontological and consequentialist schools of thought.

One of the earliest significant cases dealing with Article 142 was *Prem Chand Garg v. Excise Commissioner, UP*.[61] The issue before the Court was if the Supreme Court had the power to frame a rule or pass an order inconsistent with the fundamental rights as enshrined in the Constitution. The Court answered in the negative and held that the Court, even under Article 142(1), cannot pass an order inconsistent with any express statutory provision or constitutional provision. The same view was endorsed by the Court in *Naresh Shridhar Mirajkar v.*

[55](2009) 8 S.C.C. 785. (The question was referred to the Chief Justice of India for constituting a larger bench in order to decide as to whether the scope of the Court's powers under Article 142 is wide enough to enable it to create a liability where none exists.)

[56](2010) 1 S.C.C. 353, at 362. (One of the questions framed, which is to be referred to the Chief Justice of India, was as to whether Article 142 enabled the Court to perform functions of the Executive). See Rajat Pradhan, *Ironing out the Creases: Re-examining the Contours of Invoking Article 142(1) of the Constitution*, 6 NALSAR STUDENT LAW REVIEW 1 (2011).

[57](2009) 10 S.C.C. 337.

[58](2009) 10 S.C.C. 415.

[59](2010) 4 S.C.C. 393.

[60](2010) 4 S.C.C. 460.

[61]A.I.R. 1963 SC 996.

State of Maharashtra[62] and *A.R. Antulay v. R.S. Nayak*.[63] This goes on to highlight a restrictive and narrow interpretation given by the Court with respect to the scope of its powers under Article 142(1) and its unwillingness to exercise its power beyond a certain extent. It is therefore observable that in the earliest phase of interpretation, the Court adopted a deontological approach in that even where desirable consequences could have been achieved by using Article 142, the Court refrained from doing so.

A deviation from this restrictive approach was perhaps first noticeable in *K.M. Nanavati v. State of Bombay*,[64] wherein the Court, by comparing the clauses under Article 161, which gives the Governor the power to grant pardons, reprieves, etc. and Article 142 held that as both Article 142 and Article 161 contain no words of limitation, the area covered by them remains unregulated.[65] In *Delhi Judicial Service Association v. State of Gujarat*,[66] the Court went a few steps further and declared Article 142 to be a part of the basic structure of the Constitution. The Court went on to add that its powers under Article 142 are such that no limitation or restriction can be imposed on it through ordinary laws or any enactment by the Central or State Legislature, though in exercising such power, it must bear in mind the statutory provisions connected to the dispute.[67] The same approach was adopted in *Union Carbide Corporation v. Union of India*,[68] wherein it was held that no prohibitions or limitations contained in ordinary laws can go on to act as such prohibition or limitation on the powers of the Court under Article 142. This brought about a

[62]A.I.R. 1967 SC 1.
[63](1988) 2 S.C.C. 602.
[64]A.I.R. 1961 SC 112.
[65]*Id.* at 122.
[66](1991) 4 S.C.C. 406.
[67]*Id.* at 463.
[68](1991) 4 S.C.C. 584.

considerable change in outlook by the Supreme Court with respect to Article 142. With the aim of bringing about 'complete justice', the Court was adamant in not restricting its powers under Article 142 and would go on to interpret it in a manner so as to mold it according to the facts and circumstances of the case - a consequentialist approach in sharp contrast to the deontological one adopted in prior cases.

The case of *Supreme Court Bar Association v. Union of India*[69] led to a further development in the jurisprudence concerning Article 142, wherein the Supreme Court held that an advocate can only be suspended by the Bar Council of India under the Advocates Act and the Court cannot exceed its authority in this regard by invoking Article 142. It further went on to hold that:

> "*Article 142, even with the width of its amplitude, cannot be used to build a new edifice where none existed earlier, by ignoring express statutory provisions dealing with a subject and thereby to achieve something indirectly which cannot be achieved directly."*[70]

In *M.C. Mehta v. Kamalnath*,[71] the Supreme Court once again refused to exercise its powers under Article 142 in order to override specific provisions enshrined in any Act. The Court laid down that its powers under Article 142 must not come in direct conflict with what has already been provided for in any statute. Hence, it can be seen that in its latest decisions, the Court has gone on to attempt to harmonize its

[69](1998) 4 S.C.C. 409. The Court overruled its previous finding in *In Re,* Vinay Chandra Mishra, (1995) 2 S.C.C. 584.
[70]*Id.* at 431-432.
[71](2000) 6 S.C.C. 213. (The Court went on to hold that the Public Trust Doctrine was applicable in India, under which, common properties like air, rivers and forests, which were held by the government for free and continuous use by the general public, cannot be leased out to a motel located on the banks of river Beas, as it would cause an impediment to the natural flow of water.)

powers under Article 142 with express statutory provisions. Article 142 is meant to supplement substantive provisions and not supplant it. The Court cannot use its powers under this provision if specific statutory provisions already exist to deal with the issue, until and unless the Court is of the opinion that circumstances of the case merit it to do so in order to avoid any miscarriage of justice.

VII. CONCLUSION

In his book, *The Nature of the Judicial Process*, Cardozo J. wrote:

> *"... judges have, of course, the power, though not the right, to ignore the mandate of a statute, and render judgment despite of it. They have the power, though not the right, to travel beyond the walls of interstices, the bounds set to judicial innovation by precedent and custom. None the less, by that abuse of power, they violate the law*."[72]

The deontological thought has been aptly summated in the above extract and reflects the conclusion arrived at by the authors with regard to the applicability of Article 142. The purpose of this paper is not to choose one principle over the other but to highlight their contradictions for the purpose of understanding the flawed use of Article 142 by the Apex Court. The provision was adopted only to supplement the already wide powers of the Court and not to enlarge them to a boundless extent. It is incumbent upon the Apex Court to implement the law as propounded by the legislature and as erected by

[72]BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 129 (2008) as in PRADHAN, *supra* note 56 at 12.

the established principles of our legal framework and not to innovate law on an ad-hoc basis for the purpose of achieving desirable, but at the same time, momentary justice. A deontological perspective must prevail as regards the use of Article 142 in order to preserve institutional integrity. It is not contended that the law be applied rigorously and blindly by the Apex Court and here is where Dworkin's understanding of deontology comes into play. His understanding allows for an interpretative application of legal principles - one that gives due regard to established legal principles on a matter and permits a judge to choose between alternate interpretations in order to achieve substantial justice between the parties. In this regard, Article 142 greatly enhances the power of the Court but does not license the Court to wantonly ignore substantive law. If understood in the light of Dworkin's deontology, Article 142 shall fulfill its true purpose of achieving 'complete justice' while within the circumscribed boundaries of our legal system.

EVALUATING THE PROSPECTS OF EFFECTUATING A HOSTILE TAKEOVER IN THE INDIAN CORPORATE LANDSCAPE

Pallavi Arora[*]

Abstract

The central premise of this paper is to assess the theoretical possibility of conducting hostile acquisitions in India, as well as the defenses exercisable by the domestic targets to forestall such deals. To further this premise, the paper comprehensively analyses the extant hurdles to hostile takeover activity in India, arising due to dominant promoter holdings, regulatory restrictions imposed on the acquisition of finance and foreign direct investment in India. Thereafter, the author examines the anti-acquirer character of the Takeover Code, 2011, that inhibits a potential raider from effectuating a hostile takeover. Finally, the paper discusses the ineffectiveness of the traditional takeover defenses in India, which leaves target companies with few viable strategies to fend off hostile suitors.

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I. INTRODUCTION

Ever since India hailed the LPG bandwagon, India Inc. has transformed into a lucrative market for conducting mergers and acquisitions. A review of the M&A activity by Thomson Reuters illustrates that 2010 proved to be a banner year for India. The M&A deal volume was up more than threefold from $21.3 billion in 2009 to $67.2 billion in 2010.[1] Thereafter, in the first nine months of 2011, M&A deal volumes were valued at $26.8 billion, with a total of 177 transactions.[2]

In fact, a series of high profile transactions have heralded the arrival of booming M&A activity in India. In this regard, one may recall Vodafone's $11.1 billion acquisition of a controlling interest in Hutchison Essar, India's fourth-largest mobile phone company.[3] The $13.2 billion dollar Tata-Corus deal[4] and the $11 billion Airtel-Zain deal also proffer fitting examples to this effect.[5]

Thus, India's corporate boardrooms have witnessed multi-billion strides in negotiating friendly deals. Nevertheless, hostile takeover activity in India has remained rather dormant. In fact, India's

[1]Thomson Reuters' Full Year 2011 Preliminary Review M&A.
[2]According to Thomson Reuters the overall deal activity for announced M&A involving India slowed down as value and deal count declined 43.7% and 27.0% compared to M&A transactions in 2010.
[3]Phineas Lambert, *Vodafone: Hutchison Essar on Track to Close*, DAILYDEAL, http://www.thedeal.com.
[4]Jonathan Braude, *Tata Wins Corus Auction*, DAILYDEAL, http://www.thedeal.com.
[5]*BhartiZain to sign $10.7 billion deal within days*, THE ECONOMIC TIMES, http://economictimes.indiatimes.com/news/news-by-industry/telecom/bharti-zain-to-sign-10-7-bn-deal-within-days/articleshow/5722231.cms.

corporate vocabulary is strewn with instances of how most hostile takeover attempts have been convincingly thwarted.[6]

The existing literature on the dearth of hostile takeover activity has attributed this trend to the prevalence of founding families 'promoters', with dominant shareholding positions. The standing of the Indian promoters is further strengthened by the historic allegiance displayed by the domestic financial institutions. Even the Indian Takeover Code has a pro-promoter undertone, which allows promoters to consolidate their stakes without triggering penalties under the Code. Furthermore, the copious approvals and the inherent nationalist sentiment prevailing in the Indian regulatory environment, makes a classic hostile takeover fairly implausible.

This paper traces the advances in India's regulatory landscape to rebut the aforesaid contentions. An examination of the policy considerations articulated by the Department of Industrial Policy and Promotion, the Reserve Bank of India and the Securities and Exchange Board of India, reveal that hostile takeovers of Indian companies is now a real possibility. Nevertheless, there exist inconsistencies in the current regulations as regards the effectuation of hostile takeovers and the subsequent defenses available to the target companies.

In view of this, the author shall discuss how the Indian policymakers face an important regulatory opportunity at present. India's policy vis-à-vis hostile takeovers must weigh the benefits of scale, globalization and managerial efficiency, against the potential drawback of rendering domestic corporations vulnerable to unsolicited foreign control. Therefore, in order to foster greater investor confidence, India's policy intention as regards encouraging

[6]The only successful hostile deal in Indian history was the acquisition of Raasi Cements by India Cements in 1998.

or desisting hostile takeovers must be more consistent and coherent. In fact, the sprawling jurisprudence evolved by Delaware in this regard can serve as an educative blueprint for Indian regulators to emulate.

In a nutshell, the author attempts to assess the theoretical possibility of conducting hostile acquisitions in India, as well as the defenses exercisable by the domestic targets to forestall such deals. Part II deals with the protracted history of hostile takeover attempts in India. Under Part III the author shall examine the pro-promoter lineage of the Indian corporate landscape. Part IV and Part V assess the extant hurdles apropos of acquisition of finance and foreign direct investment in India, and its consequent effect on hostile takeover activity in India. To further this premise, Part V illustrates the various features of the Takeover Code, 2011, while Part VI evaluates the possibility of employing takeover defenses in India. It is imperative to state that the paper shall not analyze the policy merits or demerits associated with the advent of hostile takeovers in India. Moreover, an investigation into the financial viability of acquiring Indian corporations also, shall not form part of the paper's central inquiry.

II. HOSTILE TAKEOVER ATTEMPTS IN INDIA

The first hostile takeover attempt in India, even before the promulgation of the Takeover Code, pertains to the British businessman, Swaraj Paul's failed endeavour to acquire Escorts Ltd. and DCM. In spite of accumulating a greater stake than the

promoters,[7] the company refused to register Paul's newly purchased shares.[8] He also received stiff resistance from the political lobby and the Life Insurance Corporation, a state owned financial institution with a minority stake. Eventually, in the face of unfavourable circumstances, Paul was compelled to retract his bid.

Fifteen years after Swaraj Paul's unsuccessful hostile takeover attempt, the UK based I.C.I. paint company negotiated an agreement with one of the co-founders of Asian Paints to acquire his 9.1% stake in the company. Mounting disapproval of such a move by the remaining co-founders of Asian Paints, culminated in them refusing to register I.C.I.'s shares. Consequently, I.C.I. was pressurized to sell its stake to U.T.I. (a government owned mutual fund) and two other co-founders of Asian Paints.

The year 1998 witnessed the first successful acquisition of an Indian target by a predator via the hostile takeover route. India Cements acquired B.V. Raju's 32% stake in Raasi Cements, along with amassing nearly 20% shares on the open market. Notwithstanding, the vaulting resistance demonstrated by the founders of Raasi Cements and the Indian financial institutions, India Cements successfully acquired Raasi Cements, through a privately negotiated transaction.

Thereafter, in the year 2000, the Dalmia Group's predatory attempt to acquire GESCO was precluded by the recruitment of the white knight defense. The Dalmia Group had acquired a 10% stake in GESCO, and floated a bid to acquire a further 45% in the said target. The Sheth family of the GESCO fame had allied with the Mahindra Group to

[7]Roughly 7.5% and 13% stakes in Escorts and DCM, respectively.

[8]The Companies Act, 1956, § 111A(5), No. 1, Acts of Parliament, 1956 (India) (Pursuant to an amendment to the Companies Act providing for free transferability of shares, companies may not refuse to register shares unless the Indian Company Law Board finds the transfer to violate the law and suspends the voting rights of the shares).

buy out the remaining float for an even higher premium. The hostile bid was eventually thwarted when the Mahindra-Sheth group bought the Dalmia Group's 10% stake in GESCO.

Some recent deals with a deep hostile undertone include Emami Ltd.'s acquisition of Zandu Pharmaceutical Works Ltd; Pramod Jain's hostile bid for Dalmia Group's Golden Tobacco Ltd. and HB Stockholdings attempts to takeover DCM Shriram Industries Ltd. A few other examples to this effect include the protracted bidding wars between Grasim Industries Ltd. and Larsen & Turbo Ltd; Temptation Foods Ltd. and Kohinoor Foods Ltd. as well as rumors of a possible acquisition of Hindalco Industries Ltd. by Alcan Inc. and Sterlite Industry.

III. ROLE OF PROMOTERS

This part shall preview how the Indian corporate landscape is punctuated with dominant promoter holdings, which in effect forestalls any hostile takeover attempt. Generally, in order to defend against a potential takeover, the promoters of a corporation allocate their capital to their companies. It is submitted that while such a strategy may be effective as a takeover defense, it proves to be deleterious to the growth of the Indian economy. In view of the proposition, this part shall examine the various ways in which a predator can acquire *control* over a company, and how substantial promoter holdings can inhibit such predatory tactics.

A. Categories of Investors in Indian Corporations

To take the discussion forward, let us first discuss the major categories of shareholders in Indian companies.

The most prominent category of shareholders in India is that of the promoters. The ICDR Regulation of 2009 defines the term *promoter* as, "*i) the person or persons who are in control of the issuer; (ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public; (iii) the person or persons named in the offer document as promoters.*"[9] Thus, typically, promoters are founders or members of founding families of corporations, but for purposes of the Code, even a non-founder with de facto control would also qualify for *promoter* designation.[10]

Another relevant set of investors is the Indian Financial Investors. Historically, it has been recognized that domestic financial institutions vote in concert with the promoters. This trend owes its genesis to the pre-liberalization license permit quota raj, whereby firms granted the license to do business in India were almost guaranteed financial assistance by state run domestic financial institutions.[11] It is submitted that the historical loyalty of domestic financial institutions to promoters is a significant impediment to hostile takeovers.

The next category of investors is the Foreign Institutional Investors, which include many U.S. mutual funds, university endowments, and hedge funds investing in India.[12] FIIs must be registered with the Reserve Bank of India and SEBI. However, this special designation gives them the right to buy and sell Indian securities, repatriate any gains made in India and realize capital gains from Indian investments,

[9]Securities Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 § 2 (za).

[10]Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities*, 3 COLUM. BUS. L. REV.(2007).

[11]Tarun Khanna & Krishna Palepu, *Globalization and Convergence in Corporate Governance: Evidence from Infosys and the Indian Software Industr*y, 35 J. INT. BUS. STUD 484-88 (2004).

[12]MATTHEW, *supra* note 10.

inter alia. In contrast to the domestic financial institutions, foreign institutional investors have fewer links to the old business family elites. Thus, they would vote based purely on economic interest so as to fulfil their fiduciary duty toward the investors. In other words, foreign financial institutions are more likely to vote in favor of a hostile acquisition that offers a significant premium as against securing promoter interests. In view of the aforesaid analysis, it is submitted that the rapidly increasing influence and stakes of FIIs in Indian corporations, may herald the onslaught of hostile takeover activity in India.[13]

B. Whether a Hostile Acquirer Gains Control Over a Corporation, Irrespective of the Dominant Promoter Holdings

In order to gain control over a corporation, a hostile acquirer would have to replace the majority of the corporation's board of directors, or otherwise gain control over the management.[14]

Firstly, when the hostile acquirer achieves a 10% stake in the corporation, it can requisition the board to hold an extraordinary general meeting.[15]

[13]*Id.* According to a study conducted by Shaun J Mathew in 2007 the average FII stake in the BSE 100 exceeds 18%, or roughly nine times the average stake of the once-powerful Indian financial institutions.

[14]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 defines Control in Regulation 2(1)(e) ("Control" *includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner*).

Secondly, the hostile acquirer can seek to control the agenda of the meeting, by acquiring more than a 5% stake in the corporation and thereby gaining proxy access; as a result of which it can pitch a resolution to replace board members.[16] However, an application can be made by the incumbent board to seek to exclude shareholder proposals.[17]

Thirdly, the hostile acquirer can replace the board with a 50.1% majority stake. The removal of directors and appointment of new directors requires an ordinary resolution where the votes cast in favor of the resolution exceed the votes cast against.[18] After removing previous directors at a shareholder meeting, the hostile acquirer would require a simple majority to replace the directors.[19]

It is important to note that the hostile acquirer who holds a mere 50.1% majority is still substantially constrained in the management of the corporation. Several matters require a special resolution, where the votes for a resolution must be three times the votes against the resolution.[20] Important decisions, such as the alteration or amendment of the memorandum and articles of the corporation,[21] reduction of share capital,[22] voluntary winding up or liquidation,[23] preferential allotment of shares as a means of raising capital,[24] or even sanctioning of a merger or asset sale,[25] require a 75% majority in order to obtain the special resolution. Thus,

[15]The Companies Act, 1956, § 169(1), No. 1, Acts of Parliament, 1956 (India).
[16]*Id.* § 188(2). The option is also available to 100 shareholders acting together.
[17]*Id.* § 188(5).
[18]*Id.* § 189.
[19]*Id.*§ 189 (1). (It defines an ordinary resolution as a resolution in which the number of votes cast in favor of a resolution exceeds those cast against a resolution).
[20]*Id.* § 189(2)(c).
[21]*Id.* §§ 17, 31.
[22]*Id.* § 484.
[23]*Id.* § 100.
[24]*Id.* § 81(1)(a).
[25]*Id.* § 391 (read with § 394(a)-(b)).

a promoter with just over a 25% stake attempting to combat a hostile take-over could threaten to hold its shares and block all future special resolutions, including the corporate restructurings needed by the hostile acquirer to effectuate a change of control. Hence, while holding a 25% stake cannot prevent a hostile bidder from acquiring a majority stake and appointing a new board of directors, it could serve as a credible threat sufficient to deter potential hostile bidders from making bids in the first place.

Conversely, what this also means is that a hostile acquirer can throw a spanner in the works by acquiring a mere 25.1 percent stake in a corporation. A hostile acquirer who acquires a 25.1% stake in an Indian corporation has obtained de facto blocking rights capable of being exercised against promoters.[26] These rights can be used to negotiate with the promoters, either to acquire the promoters' stake in the corporation or to sell out their own stakes to the promoters at a premium.

Fourthly, Indian company law also makes the waging of a proxy war relatively hassle-free. The register of shareholders is open for inspection by any shareholder during ordinary business hours without the payment of a fee and to others with the payment of a fee.[27] The register of members is required to maintain the name, address, and occupation of members,[28] which makes it easier to contact them for proxy solicitation. Additionally, when an acquirer makes a tender offer to the shareholders of a target corporation, the board of directors of the target is required under India's Takeover

[26]In this context it is important to consider that under Indian law, even minority shareholders are capable of committing ―oppression, (i.e., fiduciary duty breaches) concerns typically raised against majority shareholders.
[27]The Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India),§ 163(2).
[28]*Id.* § 150(1)(a).

Code to provide the acquirer with information regarding shareholders eligible to participate in the tender offer.[29]

C. Defenses that Inhibit the Acquisition of 'Control' by a Hostile Acquirer

However, at least three latent defense mechanisms additionally inhibit the hostile acquisition route in India.

Firstly, share transfer restrictions may impede the ability of acquirers to acquire shares from willing but contractually bound sellers. The enforceability of transfer restrictions in the context of public companies is tenuous. The Supreme Court of India has held that share transfer restrictions must be incorporated into the articles of a private corporation in order for them to be binding.[30] However, as a result of conflicting High Court opinions, the interaction of this requirement with public corporations is not entirely clear.[31]

Secondly, pooling agreements may make it mandatory for some shareholders to vote with promoters to thwart the hostile acquisition

[29] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 23(2).

[30] Rangaraj v. Gopalakrishnan, A.I.R. 1992 SC 453.

[31] Messer Holdings Ltd. v. Ruia, (2010) 159 Comp.Cas. 29 (Bom.) (holding that pre-emptive rights are enforceable against public companies and that shareholders' agreements need not even be incorporated into the articles of association); W. Maharashtra Dev. Corp. Ltd. v. Bajaj Auto Ltd., (2010) 154 Comp.Cas.593 (Bom.) (holding that restrictions of transferability of shares, in this case a right of first offer or ―ROFO, are not enforceable against a public company); Pushpa Katoch v. Manu Maharani Hotels Ltd., (2006) 131 Comp. Cas. 42 (Del.); Mafatlal Ind. v. Gujarat Gas Co., (1999) 97 Comp.Cas. 301 (Guj.) ; see also KaramsadInvs. Ltd. v. Nile Ltd., (2002) 108 Comp.Cas. 58 (A.P.); Bombay Dyeing & Mfg. Co. v. Bajoria, (2001) 107 Comp.Cas. 535 (C.L.B.).

attempt.[32] These concerns are to some extent capable of being addressed. It is submitted that, pooling agreements would not restrict share transfers. For instance, if every institutional investor that acquires a stake in a corporation is required to sign a pooling agreement, that would not restrict the ability of the investor to exit the corporation and transfer its holding to the hostile acquirer.
The shares of many corporations in India are presumed to be held by friends of promoters, who are not considered a part of the promoter group, but whose loyalties reside with promoters. According to scholars this third latent defense may actually be more problematic than the previous two. This is because information on friends is not publicly available; therefore, it would be hard to ascertain those corporations in which friends of promoters have defensive stakes.[33]

IV. ACQUISITION OF FINANCE

This part shall analyze how the regulatory restrictions with respect to the acquisition of finance make it rather unattractive to effectuate a hostile takeover.

Firstly, according to §77(2) of the Indian Companies Act the leveraged buyout of a public company or its subsidiary using the assets of the target as collateral is prohibited. [34] Additionally, the

[32]A. Chandrachud, *The Emerging Market for Corporate Control in India: Assessing (And Devising) Shark Repellents for India's Regulatory Environment,* 10 WASH. U. GLOBAL STUD. L. REV. (2011).
[33]*Id.*
[34]The Companies Act, No. 1, Acts of Parliament, 1956 (India),§ 77(2). However, this restriction applies only to public companies and their subsidiaries,

Indian Takeover Code limits the ability of a hostile acquirer to re-finance its acquisition, by prohibiting the acquirer from disposing off, selling, or otherwise encumbering any substantial asset of the target or its subsidiaries or enter into any material contracts.[35]

The next set of restrictions is imposed by the Reserve Bank of India, which heavily regulates the borrowing and lending of funds for acquisition purposes. To better understand the sweep of the RBI regulations, let us consider the following three hypothetical scenarios.

In the first situation, both the target and the acquirer are domestic Indian corporations. Under the Reserve Bank's guidelines, popularly referred to as the ECB Guidelines,[36] Indian corporate houses cannot borrow funds from international banks or financial institutions for the purposes of acquiring a company, or any portion thereof, in India.[37] Thus, Indian corporate houses are restricted in their use of both domestic and foreign funds in any attempt to acquire a hostile Indian target. Additionally, bank credit is prohibited to non-banking finance companies for investment in any company's shares.[38]

In the second situation, the target is a foreign corporation and the acquirer is a domestic Indian corporation. Indian companies have been given general permission to obtain funds from a domestic

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theoretically leaving open the possibility of taking a private company using this route.

[35] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 Regulation 23(1).

[36] Reserve Bank of India, Master Circular No. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS, http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7353.

[37] *Id.*at I(A)(vi), B(vii).

[38] Reserve Bank of India, Master Circular DBOD.BP.BC.NO.4/08.12.01/2008-09, MASTER CIRCULAR- BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCS) § 5.1(ii) http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85374.pdf.

bank to participate in a bidding or tender offer process overseas,[39] subject to ceiling.[40] RBI approval is required in other cases.[41] Moreover, under the ECB Guidelines, overseas direct investment in joint ventures or wholly owned subsidiaries is permissible, although subject to existing guidelines on Indian direct investment in such ventures.[42] Further, the RBI guidelines do not apply in circumstances where the Indian acquirer is not permanently resident in India; for instance where the acquisition takes place through the use of funds held in a Resident Foreign Currency account or through foreign currency resources outside India.[43]

In the third situation, the target is an Indian corporation, and the acquirer is a foreign corporation. While foreign corporations may be subject to similar restrictions in obtaining funds from Indian banks, they would not be prohibited, under Indian regulations, from obtaining funds from foreign banks in order to carry out acquisitions in India, unless the national regulations to which the foreign bank is subject provide otherwise.[44]

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[39]Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/60901.pdf [hereinafter FEMA Transfer Rules].

[40]See, FEMA Transfer Rules § 6, as amended by Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Third Amendment Regulations, 2007, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/88452.pdf.

[41]FEMA Transfer Rules, § 9.

[42]Reserve Bank of India, Master Circular No. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS pt. I (A)(v)(b), http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7353.

[43]Reserve Bank of India, Master Circular No. 01/2009-10, MASTER CIRCULAR ON DIRECT INVESTMENT BY RESIDENTS IN JOINT VENTURE (JV)/WHOLLY OWNED SUBSIDIARY (WOS) § A.4,
http://rbidocs.rbi.org.in/rdocs/notification/PDFs/21DWR 010709_FULL.pdf.

[44] MATTHEW, *supra* note 10.

Clearly, the avenues for domestic Indian corporations to obtain funding to finance domestic acquisitions are limited. However, this does not in any way limit the ability of foreign corporations to assume positions in Indian corporations using overseas financing opportunities. Further, these restrictions do not apply to hostile acquisitions alone but also to friendly deals, which continue to take place despite these restrictions.

V. RESTRICTIONS ON FOREIGN DIRECT INVESTMENT

The inability to conduct a hostile takeover in India is also heightened in view of the general restrictions imposed by the Indian regulatory environment. This part shall preview some such restrictions and their repercussions, to substantiate the query at hand.

A. General Restrictions on FDI

The defining feature of India's liberalization oriented reforms in 1991 was the adoption of the New Economic Policy, which sought to achieve fiscal stabilization and structural adjustment of the Indian economy. Prior to 2006, the Government of India required a foreign investor to comply with two sets of requirements. *Firstly,* the Government of India had placed sector specific ceilings that restricted foreign investment in India.[45] *Secondly,* even if FDI sectoral restrictions did not inhibit a foreign entity's acquisition of control over an Indian company, the Government of India required FIPB and RBI

[45]Press Note 7 (2008), Ministry of Commerce and Industry, CONSOLIDATED POLICY ON FOREIGN DIRECT INVESTMENT, http://pib.nic.in/newsite/erelease.aspx?relid=39600. For instance, foreign entities may invest up to 100% in the production of alcohol-distillation and brewing industry, but investment in defense production is restricted to 26%.

approval for a foreign entity's acquisition of control over an Indian company through the acquisition of shares.[46]

Thereafter in 2006 India's foreign investment policy was significantly liberalized with the issuance of Press Note 4 (2006 Series) by the Department of Industrial Policy and Promotion which opened the retail sector subject to certain conditions.[47]Subsequently, almost all the sectors were opened for foreign investment under the automatic route. Presently, besides eight sectors in which foreign investment is prohibited;[48] foreign investment is permitted either under the automatic route or consequent to the prior approval of the Foreign Investment Promotion Board and the Reserve Bank of India.

Under the automatic route, no prior approvals are required from any governmental entity or the Reserve Bank of India, although there are some notification and filing obligations that must be complied with.[49] But the automatic route is subject to two exemptions. *Firstly*, prior

[46]See Secretariat for Industrial Assistance, Department of Industrial Policy And Promotion, Ministry Of Commerce And Industry, Govt Of India, MANUAL ON FOREIGN DIRECT INVESTMENT IN INDIA 11-12 (2003) (stating that "government approval . . . through the FIPB shall be necessary . . . [for] (iii) All proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor.").

[47] Press Note 4 (2006), Department of Industrial Policy and Promotion, RATIONALISATION OF THE FDI POLICY, § 2 (e). (The Indian Government permitted the transfer of shares from Indian residents to a foreign acquirer without any FIPB Approval and subject only to FDI sectoral caps).

[48]Press Note No. 7 (2008 Series), Department of Industrial Policy & Promotion, CONSOLIDATED POLICY ON FOREIGN DIRECT INVESTMENT, http://siadipp.nic.in/policy/changes/pn7_ 2008.pdf. (Retail trading which is not single-brand product retailing, atomic energy, the lottery business, gambling and betting, the business of chit funds, Nidhi companies, trade-in transferable development rights, and any sectors not open to private sector investment).

[49]CONSOLIDATED FDI POLICY, Department of Industrial Policy and Promotion, http://dipp.gov.in/English/Policies/FDI_Circular_02_2011.pdf.

government approval is required where more than 24% foreign equity is proposed to be inducted for the production of items reserved for the small scale sector.[50] *Secondly*, FDI under the automatic route is prohibited for investment in purely investing companies, i.e. companies that conduct only monetary operations,[51] even though their subsidiaries may be amenable to foreign investment without any prior governmental approval.

Let us now discuss the procedural requirements for sectors that are not open to foreign investment under the automatic route and thereby require the approval of the Foreign Investment Promotion Board and the Reserve Bank of India. The RBI approval is only a matter of technical compliance, which requires that the consideration paid meets the basic SEBI and RBI pricing guidelines.[52] On the other hand, the FIPB approval requires a foreign investor to submit a no objection certificate by obtaining a board resolution passed by the target company,[53] a resolution which would be impossible to obtain in the hostile context. Consequently, nationalist sentiment forms an invisible barrier to the hostile acquisition under the approval route.

After having analyzed the regulatory landscape governing the inflow of FDI into India, the author shall examine the sectors in the Indian economy, which are most amenable to inbound hostile acquisition. Theoretically, the sectors in which foreign investment exceeding 50%

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[50] *Id.*

[51] Press Note No. 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES, §4.2.3, http://siadipp.nic.in/policy/changes/pn4_2009.pdf.

[52] Although this formality at least technically provides the RBI with an opportunity to delay consummation of a transaction by a politically unpopular hostile foreign acquirer.

[53] CHECK LIST FOR FIPB PLAIN PAPER APPLICATION, Department of Industrial Policy and Promotion cl. 7(a)–(b), http://finmin.nic.in/fipbweb/fipb/fipb_index.html.

is permissible under the automatic route are most likely to be acquired by a foreign raider.[54] From this perspective, Indian companies in the IT, mining, non-banking financial company ("NBFC"), agriculture, pharmaceuticals, and power sectors, amongst others, would be viable targets.[55]

Those sectors which are not amenable to foreign hostile acquisition are as follows: tea, cigars and cigarettes, defense, asset reconstruction, single-brand product retailing, commodity exchanges, courier services, telecommunications, credit information companies, insurance, certain mining activities, investing in infrastructure or services, public sector petroleum companies, broadcasting, print media, trading, and satellites.[56] These sectors are identified as being shielded from inbound hostile acquisition for one of two reasons: either the permissible foreign investment may be capped at less than 50% or the prior approval of the FIPB would be required, an approval which may be difficult to obtain given the possibility of nationalist sentiment arguments.

B. Investment by Foreign Institutional Investors

FIIs can invest up to a maximum of 10% of the total issued capital of an Indian company.[57] The cumulative holdings of all the FIIs put

[54]The sectors amenable to foreign investment are set out in Press Note 7 (2008 Series).
[55]CONSOLIDATED FDI POLICY, *supra* note 49.
[56]*Id.*
[57]Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, §15(5)–(6), http://www.sebi.gov.in/acts/ForeignInstitutional.html.

together cannot exceed 24%.[58] This limit of 24% can be increased to the sectoral cap as applicable to the Indian company concerned, by passing a resolution of its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior approval from the Reserve Bank.[59]

C. Sale of Shares by Residents to Non-Residents

The transfer of shares by residents to non-residents by way of sale requires the approval of the RBI, when the transaction would attract the provisions of the Takeover Code.[60] Thus, the RBI may adopt protectionist strategies to thwart a potential inbound hostile acquisition.

But according to practitioners, this hurdle can be easily overcome. Per the Foreign Exchange Management Act, 1999, the term *resident* is inclusive of a corporation incorporated in India.[61] Accordingly, a foreign hostile acquirer that incorporates a wholly owned subsidiary in India can trigger the provisions of the Indian takeover law, without simultaneously conferring upon the RBI the authority to thwart its hostile acquisition attempt.[62]

D. The Defense under Press Note 2 and 4, 2009 Series

[58]RBI, Investment in Indian Companies by FIIs/NRIs/PIOs Regulations, Foreign Institutional Investors List, http://www.rbi.org.in/scripts/BS_FiiUSer.aspx.
[59]*Id.*
[60]RBI/2012-13/15 Master Circular No. 15/2012-13, MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/15MF010712FLS.pdf.
[61]The Foreign Exchange Management Act, § 2 (v)(ii), No. 42, Acts of Parliament, 1999 (India).
[62]CHANDRACHUD, *supra* note 32.

Press Note 2 and 4 (2009) allow Indian targets to devise interesting defensive strategies to ward off an enemy at the gate.[63] An understanding of the three kinds of companies, i.e. investing companies, operating companies and operating-cum-investing companies, can be instructive in understanding the scope of Press Note 2 and 4 (2009).

An investing company is one with no operations but only subsidiaries or investment. According to Press Note 4 (2009), foreign investment of pure holding or investing companies would require prior governmental approval.[64] Consequently, the nationalist sentiment underlying the decision making protocol of the FIPB may be detrimental to the interests of a potential raider.

An operating company is one with no subsidiary or investment in India. According to the renowned legal writer Mr. A Chandrachud companies that are conglomerates (i.e., companies with ingredients of business prohibited to foreign investment) pose an anomalous situation before a foreign raider.[65] For instance, when an operating company is functioning in both power and atomic energy, foreign investment would be allowed in the power sector under the automatic route, but investment in the atomic energy sector would be forbidden.

[63]Press Note 2 (2009 Series), Department of Industrial Policy and Promotion, GUIDELINES FOR CALCULATION OF TOTAL FOREIGN INVESTMENT I.E. DIRECT AND INDIRECT FOREIGN INVESTMENT IN INDIAN COMPANIES, *See also* Press Note 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES,§ 4.2.3.

[64]Press Note 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES,§ 4.2.3

[65]*Id.* 115 § 4.2.1.

Consequently, such an operating company would be protected from the foreign hostile takeover attempt.

Operating-cum-investing companies also pose a similar problem to the foreign acquirer. Investment exceeding 50% by a foreign investor in a holding company is deemed to be an indirect investment in its subsidiary.[66]The said investment is to the full extent of the holding company's investment in the subsidiary unless the subsidiary itself is wholly owned. According to Mr. A Chandrachud, this may constitute a violation of the FDI policy, without (or sometimes irrespective of) approval.[67] To substantiate his standpoint, he articulates the following hypothetical: Company A, a foreign acquirer, invests 50.1% in Company B, an Indian holding company, which has a 90% stake in Company C, a company engaged in the gambling/lottery business, a sector prohibited to foreign investment. The 90% stake of Company B in Company C is considered indirect investment by the Company A in

[66]Press Note 2 (2009 Series), Department of Industrial Policy and Promotion, GUIDELINES FOR CALCULATION OF TOTAL FOREIGN INVESTMENT I.E. DIRECT AND INDIRECT FOREIGN INVESTMENT IN INDIAN COMPANIES § 5.2.2.3. (To illustrate, if the indirect foreign investment is being calculated for Company A which has investment through an investing company B having foreign investment, the following would be the method of calculation:

(i**)** where Company B has foreign investment less than 50%- Company A would not be taken as having any indirect foreign investment through Company B.

(ii) where Company B has foreign investment of say 75% and:

a. invests 26% in Company A, the entire 26% investment by Company B would be treated as indirect foreign investment in Company A;

b. Invests 80% in Company A, the indirect foreign investment in Company A would be taken as 80%

c. where Company A is a wholly owned subsidiary of Company B (i.e. Company B owns 100% shares of Company A), then only 75% would be treated as indirect foreign equity and the balance 25% would be treated as resident held equity. The indirect foreign equity in Company A would be computed in the ratio of 75: 25 in the total investment of Company B in Company A).

[67]CHANDRACHUD, *supra* note 32.

Company C, thereby exposing the Company A to breach of foreign investment policy.[68]

VI. HOSTILE TAKEOVER UNDER THE TAKEOVER CODE, 2011

The Indian Takeover Code, 1997 was modelled on the U.K. City Code on Takeovers. Justice Bhagwati, the head of the panel empowered to develop the Code, envisaged the Code as a tool to enable promoters to consolidate holdings and better resist foreign takeovers. Nevertheless, the practitioners in the Indian corporate market are of the opinion that the 1997 Code did not present any direct barriers to hostile acquisition. No provision in the 1997 Code expressly required the acquiescence of the target company's board of directors for the successful operation of an open or conditional offer, which would be the route undertaken by a potential hostile acquirer.

In 2010, the Report of the Takeover Regulations Advisory Committee chaired by Mr.C. Achuthan, also did not frown upon or otherwise make recommendations against hostile acquisitions in its report.[69] Relying on the recommendations of the TRAC, SEBI eventually promulgated the Takeover Code, 2011. According to practitioners, the New Code has created impediments for acquirers in carrying out a hostile acquisition of a listed Indian company.

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[68] *Id.*

[69] Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achuthan* http://www.sebi.gov.in/commreport/tracreport.pdf.

The central inquiry of this part deals with the anti-acquirer nature of the Takeover Code, 2011, along with explaining how creative lawyering can enable a potential raider to surmount such regulatory barriers.

A. Early Warning Mechanism

Indian corporations are cautioned about the predatory attempts of a prospective raider because of the early warning mechanism, which is built into India's Takeover Code. According to Regulation 7 of the erstwhile Takeover Code of 1997, an acquirer had to make a public disclosure within two days when his holdings exceeded the 5%, 10%, 14%, 54%, and 74% thresholds.[70]

Thereafter, relying on the recommendation of the TRAC Report, the Takeover Code of 2011 altered the said regulation significantly.[71] Thus, currently Regulation 29 of the Takeover Code, 2011 mandates that in cases where the acquired shares and voting rights together with any existing shares or voting rights of the acquirer and PAC amount to 5% or more of the shareholding of the target company, then the acquirer shall make disclosures of their aggregate shareholding and voting rights in such target company.[72] The said disclosures shall be made to the target corporation at its registered office and every stock exchange where its shares are listed. After having crossed the 5% threshold, every acquisition or disposal of shares of such target company representing 2% or more of the shares or voting, shall also be disclosed by the acquirer.

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[70]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Gazette of India, § 7, http://www.sebi.gov.in/acts/act15a.pdf.
[71]CHANDRACHUD, *supra* note 32.
[72]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 29.

According to Mr. S.J. Mathew, this disclosure requirement serves as an early warning system to both the target corporation and its public shareholders. *Firstly*, the corporation is alerted about a potential threat from a raider and can avertibly issue shares to the shareholders under a pill plan. *Secondly*, the shareholders are signaled that in anticipation of a potential change of control they should demand a control premium for sales of their shares on the open market prior to any tender offer.[73]

Furthermore, the disclosure requirement under the present Takeover Code has to be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company. At this juncture, the author shall discuss the ramifications of the varying time-frames for filing the disclosures, prescribed under the Indian and American Takeover Codes. § 13(d)(1) of the American Securities Exchange Act, 1934 requires disclosure within ten days as opposed to two days under India's Takeover Code.[74] Thus, the American hostile acquirer benefits from ten days of permissible silence, as opposed to a meagre two days in India. In other words, after triggering the early warning scheme, a raider in America can make a mandatory public offering within the ten-day time frame granted for filing disclosures, and thereby diminish the capacity of the target's board to adopt reactive defensive measures. On the contrary, a raider in India gets an inadequate period of just two days, to this effect. This severely restricts the ability of an

[73]MATTHEW, *supra* note 10.
[74]See Laurie Smilan, David A. Becker & Dane A. Holbrook, *Preventing "Wolf Pack" Attacks,* NATIONAL LAW JOURNAL, http://www.lw.com/upload/pubContent/_pdf/pub1710_1.pdf.

Indian raider to circumvent the rigors of the early warning mechanism.

a) Disclosure Requirement

§ 25(3) of the Takeover Code, 2011 provides that the directors of the acquirer are responsible for the veracity of the information contained in the public statement, the letter of offer and the post-offer advertisement. These documents are circulated to the target shareholders in the context of a takeover. The practitioners criticize this provision by questioning why the acquirer should have to vouch for the publicly available information regarding the target or bear the liability for any false or misleading statements when that clearly should be the responsibility of the target directors. The stipulation of such an ambiguous requirement by SEBI imposes unnecessary due diligence requirement on the acquiring company and tends to regulate the hostile takeover activity in India in an opaque and indirect manner.[75]

b) Creeping Acquisition

Per the Takeover Code 2011, any Acquirer, holding 25% or more but less than the maximum permissible limit for non-public shareholding can purchase additional shares or voting rights of up to 5% every financial year, without requiring to make a public announcement for open offer. The Takeover Code, 2011 also lays down the manner of determination of the quantum of acquisition of such additional voting rights.[76]

[75]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 25 (3).
[76]*Id.* Regulation 11 (1) and 11 (2).

This would be beneficial for the investors as well as the promoters, and more so for the latter, who can increase their shareholding in the company without necessarily purchasing shares from the stock market.

c) Competitive Bidding

Regulation 20 of the Takeover Code, 2011 delineates the concept of competitive bids, which tend to stave off both friendly and hostile takeover bids. Competing bids (i.e. those following the bids of the initial acquirer), requires that a subsequent bidder at least match the total number of shares that a first bidder would own if its offer were successful. The second bid must be made within fifteen days of the public announcement of the first offer.[77]

Renowned legal writer, Mr. A. Chandrachud, provides a fitting illustration elucidating the hurdles created by competitive bids to a potential raider. He explains that if a potential acquirer who previously owned no stock in a company launched an open offer for 51% and was topped by a counteroffer from the promoter, who already held 35% of the stock, for a total of 75% of the common stock, the potential acquirer would also have to offer to purchase up to 75% of the stock. Since the promoter is only offering to buy 40% of the stock as compared to the acquirer's 75% he can usually afford to pay more. Therefore, the pro-promoter undertone of competitive bids is more pronounced in India's corporate environment due to the high level of share ownership by the Indian promoters.[78]

[77] *Id.* Regulation 20.
[78] *Supra* note 39.

Thus, it is fair to conclude that requiring a prospective raider to match the total potential holdings of the promoter works to the advantage of the promoter and makes bidding expensive for competitors.

d) Voluntary Open Offer

Taking a cue from the City Code on Takeovers and Mergers in the UK, the concept of *mandatory tender offer* or *open offer* was incorporated in the erstwhile Takeover Code of 1997.[79] The objective underlining the concept of *open offer* is to enable the minority shareholders to exit a corporation, after receiving the control premium from a predator who seeks to acquire their company. Accordingly, a shareholder or shareholder group on acquiring more than 15% of a company's shares was obligated to make a tender offer for at least an additional 20% of the target's shares.

The TRAC Report, 2002, which had articulated significant changes to the Takeover Code, 1997, had proposed to raise the open offer trigger from 15% to 25%. Moreover, the TRAC had recommended that the minimum tender offer size should be increased from 20% to the entire remaining share capital of the company (i.e. up to 100%).[80]

Furthermore, the Committee was of the opinion that increasing the mandatory open offer size to 100% would restrict the ability of substantial shareholders to consolidate their stake. Therefore, TRAC had proposed the concept of *voluntary open offer*, as an exception to the mandatory tender offer requirement. It is worth mentioning that in the Takeover Code, 1997, there was no distinct category as a

[79]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 14.
[80]Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee under the Chairmanship of C. Achuthan*, http://www.sebi.gov.in/commreport/tracreport.pdf.

voluntary tender offer. Under the proposed framework of the *voluntary open offer* route, the acquirers who collectively held shares entitling them to exercise 25% or more voting rights in the target company could voluntarily make an open offer with a minimum offer size of 10%.[81]

The Committee also observed that inasmuch as the *voluntary open offer* was permitted as an exception to the general rule on the offer size, the ability to voluntarily make an open offer was not be available if in the proximate past, any of such persons had acquired shares within the creeping acquisition limits. Similarly, such an acquirer was prohibited from making acquisitions outside the open offer during the offer period, and from making any further acquisitions for six months after the open offer. Also, such an offer had to conform to the maximum permissible non-public shareholding.[82]

The latest Takeover Code promulgated by SEBI in 2011, partially mirrors TRAC's recommendation as regards the introduction of a voluntary open offer, as an exception to the mandatory tender offer protocol. Under the Takeover Code, 2011, SEBI has increased the threshold for triggering the mandatory open offer requirement from 15% to 25%, along with increasing the open offer size from 20% to 26%. In addition to the mandatory tender offer route, the concept of voluntary tender offer has also been introduced. Regulation 6 of the new Takeover Code sets out the conditions for consummating a voluntary open offer, which can be summarized as follows:

[81] *Id.*
[82] *Id.*

1. A voluntary offer can be made only by a person who holds at least 25% shares in a company, but not more than 75% (taking account of the maximum permissible public shareholding).
2. A voluntary offer can be made only by a person who has not acquired any shares in the target company in the preceding 52 weeks prior to the offer. In other words, there is a 52-week moratorium on acquisitions before the acquirer can make a voluntary offer.
3. During the offer period, the acquirer cannot acquire shares other than through the voluntary offer.
4. Once the voluntary offer is completed, the acquirer shall not acquire further shares in the target company for 6 months after completion of the offer. However, this excludes acquisitions by making a competing offer.[83]

To take the discussion forward, the author shall now explain how Regulation 6 of the Takeover Code, 2011 has disregarded the context in which TRAC had imposed the conditions contingent to a voluntary open offer. It is submitted that the TRAC report had appended various conditions to a voluntary open offer, because a voluntary offer (with a size of only 10%) was considered as a lenient exception to the stringent general offer size of all the remaining shares of the company (i.e. up to 100%). While the final form in which the new Takeover Code was accepted makes significant deviations from the overall offer size requirements by limiting it to 26%, there was no attempt to address the consequential conditions for voluntary offer that were based on the general offer size being 100%. Although the purpose for the introduction of these conditions loses relevance with the non-acceptance of the 100% offer size requirement imposed by TRAC,

[83]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 6.

they have nevertheless found their way into the new Code leading to possible difficulties in effecting hostile takeovers.

Let us now examine the ramifications of Regulation 6 that make a classic hostile takeover almost impossible in the Indian context. *Firstly*, voluntary open offers can only be made by persons who already hold at least 25% stake in the target company. In other words, a hostile acquirer who does not hold any shares, or holds less than 25% shares, in the target cannot make a voluntary offer. He would first have to trigger the mandatory public offer requirement by crossing the 25% threshold, and only then can he float an open offer for an additional 10% shares under the voluntary open offer route. Consequently, deals like Mphasis (2006) are wholly implausible in the Indian context. In the instant deal, the US outsourcing major EDS had made a voluntary open offer to buy 52% of Jerry Rao promoted Mphasis. It is worth noting that EDS completed the Rs 1,750 croredeal by buying 83 million shares, even though it did not have any prior shareholding in Mphasis. But a similar deal cannot be orchestrated under the Indian Takeover Code.[84]

Secondly, the remaining conditions under Regulation 6 while arming the promoters with a provision to consolidate their holdings, puts in place time and shareholding restrictions on such offers; thereby, averting any nasty surprises from prospective raiders.

But through creative lawyering, a hostile bidder can circumvent the impediments erected by Regulation 6 of the Takeover Code, 2011. The requisites stated under Regulation 6 become applicable only

[84]*New Takeover Code will keep raiders away*, BUSINESS STANDARD (Sept. 30, 2011), http://www.business-standard.com/india/news/new-takeover-code-will-keep-raiders-away/450958/.

when a voluntary offer seeks to avail of the lower offer size of 10%, but not otherwise. In that sense, the voluntary offer mechanism is only an option that can be availed of by acquirers, but nothing in the Code prohibits them from making a full offer for all of the remaining shares of the company (or even the general offer size of 26% that has been now prescribed) without complying with these conditions. However, these matters are open to interpretation, and clarity from regulators would help create the certainty required of the legal environment on this essential aspect of takeovers under Indian law.[85]

VII. TAKEOVER DEFENSES

The lack of takeover defenses in the Indian regulatory framework places Indian firms in a precarious position. This part shall examine how Indian corporate law renders ineffective the traditional takeover defenses common in the United States, leaving target companies with few viable strategies to fend off hostile suitors.

A. Poison Pills

It is submitted that the in the U.S. context, the poison pill has proved a formidable defense, as no hostile bidder has ever triggered the modern poison pill[86] But the Indian regulatory framework has rendered ineffective the takeover defense of shareholder rights plan, or "poison pill" used by many U.S. corporations.

[85]UmakanthVarottil, *Hostile Takeovers under the New Code*, http://indiacorplaw.blogspot.in/2011/10/hostile-takeovers-under-new-code.html.
[86]Lucian A. Bebchuk, John C. Coates IV &Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STANFORD LAW REV. 887, 904 (2002).

In the United States a company with a traditional flip-in poison pill distributes special stock warrants or rights to its shareholders entitling them to purchase shares of the company at a substantial discount in the event of a hostile takeover attempt.[87] When a potential hostile acquirer crosses a threshold of share ownership (usually between 10% and 15%) without the permission of the company's board of directors, all target shareholders, with the important exception of the hostile bidder, become entitled to exercise these special rights and purchase the company's stock at a substantial discount.[88] Such a flip-in provision would dilute the value of the bidder's stake in the company substantially.[89]

It is imperative to note that a U.S. style shareholder rights plan would not function properly under Indian law. While an Indian company may be able to issue warrants that trigger when an acquiring person would cross a shareholding threshold to the exclusion of the acquiring person, these warrants cannot be exercised to buy shares at a substantial discount. In fact, per the ICDR Regulations, the exercise price of the warrant must not be lower than the average of the weekly high and low of the closing prices of the share on the stock exchange in the preceding six months or two weeks, whichever is higher.[90]

Thus, the pill mechanism is rendered ineffective as a takeover deterrent in India because without the ability to allow its shareholders to purchase discounted shares, an Indian company would not be able to dilute the stake of the acquiring person.

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[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] Security and Exchange Board of India (Disclosure and Investor Protection) Guidelines (2000), 13.1.2.1 [hereinafter DIP Guidelines].

B. Staggered Boards

Let us now discuss how the much sought after defense option of staggered boards in the US is also rendered impotent by India's regulatory regime.

In the United States, a company with a poison pill may nevertheless, still remain vulnerable to a takeover because of a hostile acquirer may run a proxy contest for the control of the target board of directors. If the acquirer wins control of the board, it can simply vote to redeem the poison pill and commence a tender offer for equity control of the corporation. To prevent this situation, companies install staggered boards. Accordingly, only one-third of a company's directors are elected per year. Hence, for taking control of the board and redeeming the pill, a hostile acquirer usually must win at least two consecutive proxy contests over a minimum period of one year.[91]

In India, § 256 of the Companies Act by default mandates companies to maintain staggered boards.[92] But the problem in using staggered board as defense strategy arises because in India all directors can be removed without cause at any time by a simple majority of voting shareholders. It is submitted that the right to remove directors as such is guaranteed by Indian Companies Act and cannot be revoked by amendment to the charter or bylaws of an Indian company.[93] Thus, the staggered nature of the board does not serve as a defense as it does in the United States.

C. Scorched Earth Tactics

[91]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 14.
[92]The Companies Act, 1956, § 256, No. 1, Acts of Parliament, 1956 (India).
[93]Saviprasad Rangaswamy, *An Effective Market for Corporate Control: Exploring its Practicability and Possible Benefits in India*, 49 LL.M THESIS, HARVARD LAW SCHOOL (on file with Harvard Law School library, Harvard University).

According to the renowned legal scholar, Shaun Mathew the only option before Indian target companies is to engage in tactics once prevalent in the United States before the advent of the poison pill. Scorched Earth tactics include threat to sell off crown jewel assets; raze factories or other measures intended purely to destroy the value of the target company in order to deter potential hostile suitors.

The Takeover Code, however, explicitly bars such behavior. § 23 provides that after the announcement of the tender offer the target company may not (i) sell, transfer, encumber or otherwise dispose of an asset outside of the ordinary course of business; (ii) issue or allot authorized but unissued securities carrying voting rights; or (iii) enter into any material contracts- without the approval of shareholders voting at a special meeting.[94]

According to Shaun Mathew creative advisors, however, may be able to circumvent the strict prohibitions of the Takeover Code. While the provision prohibits *entering* into material contracts, it does not enjoin *terminating* material contracts, actions that could quite significantly diminish the value of a target company.[95] Moreover, the Code permits the target company to encumber or sell its material assets if a simple majority of those voting at a special meeting acquiesce. In view of the historically low shareholder turnout at such meetings, most resolutions are very easy to pass given the typically high concentration of promoter holding.[96]

[94]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 23.
[95]MATTHEW, *supra* note 10.
[96]*Id.*

But it is worth noting that the Indian Companies Act has erected an inherent barrier to the exercise of the Scorched Earth tactics in India. It is submitted that calling a shareholder meeting to ratify such scorched earth tactics requires a minimum of twenty-one days' notice, which may not allow sufficient time for the target company to respond and call the meeting in the context of a pending open offer.[97] Additionally, according to practitioners, SEBI has indicated that it would take an extremely hard and fast line against a target company that acted inequitably in these settings.[98]

In nutshell it may be said that even the application of the scorched earth tactics in the context of deterring hostile takeover attempts in India also stands on tenuous grounds.

D. Embedded Defenses

Faced with the real prospect of being subject to hostile takeovers without adequate protective mechanisms such as the poison pill, and setting aside the putatively illegal scorched earth tactics described above, Indian companies seeking to protect themselves from foreign acquirers will undoubtedly seek out alternative defensive mechanisms.[99] A so-called "embedded defense" is a term in an agreement with a third party that has an antitakeover effect.[100]

For instance, Tata Sons, according to one practitioner, has put into place a so-called "brand pill", essentially a contractual term that

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[97]The Companies Act, 1956, § 171, No. 1, Acts of Parliament, 1956 (India).
[98]MATTHEW, *supra* note 10.
[99]This phenomenon is known in the United States corporate law literature as "defense substitution." See, e.g., Jennifer Arlen, *Regulating Post-Bid Embedded Defenses: Lessons from Oracle versus PeopleSoft* N.Y.U. LAW AND ECON. WORKING PAPER 64, 11 (2006) (discussing the "Problem of Defense Substitution").
[100]Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from Airline Pilots Ass'n, Intn'l v. UAL Corp*., 120 HARV. L. REV.1239 (2007).

prevents a hostile bidder who succeeds in taking control of a Tata company from using the Tata brand name.[101] One may also consider the example of Larsen&Tubro that has created trusts that guarantee lifetime chairmanship provisions and long term rights of the promoters to nominate a certain percentage of the board of directors.[102]

Another type of defense substitution involves embedding takeover defenses into ordinary commercial contracts. Change of control provisions are the most common examples of embedded defenses, for example the contract may provide for rights to termination or some monetary penalty upon a change of control by the other party.[103]

Confronted with a hostile bid, managers (in the case of Indian companies, often managers appointed by boards controlled heavily by promoters) could offer extremely generous change of control penalties in their ordinary business contracts that would make the company significantly more expensive for a hostile bidder. The most notable example of an embedded takeover defense in the United States is the People Soft Customer Assurance Plan, or CAP, which would have required a successful hostile bidder (Oracle) to make exorbitant payments to People Soft's existing customers if the level of customer service fell within the first four years of the customer's contract, thereby making a hostile takeover potentially more expensive and less attractive.[104]

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[101]RANGASWAMY, *supra* note 93.
[102]MATTHEW, *supra* note 10.
[103]Jennifer Arlen & Eric Talley, *UnregulableDefenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV.577 (2003).
[104]Subramanian, *Bargaining in the Shadow of PeopleSoft's (Defective) Poison Pill,* 12 HARV. NEGOT. LAW REV.41 (2007). (By August 2004, the potential liability

Note that for an Indian company contemplating installing an analogous embedded defense, these contractual provisions could be entered into long before the offer period and hence would not run afoul of any of the §23 Takeover Code restrictions.

VIII. CONCLUSION

The principle argument in favor of hostile takeovers is their ability to "*perform a desirable disciplinary function by replacing inefficient management, deterring fiduciary abuse and enforcing greater sensitivity on the part of management to the market's judgment"*. These benefits notwithstanding, Indian regulators are concerned over how foreign hostile acquisitions might discourage entrepreneurship by inhibiting the development of home-grown Indian companies.

Given the new potential for hostile takeover battles in India's future and the absence of takeover defenses such as the poison pill and staggered board, India must replicate Delaware's well-developed takeover jurisprudence is an illustrative model for India to replicate. In its *Unocal* line of cases, Delaware courts have extended the protection of the business judgment rule to directors defending against hostile takeovers who can demonstrate in good faith and after reasonable investigation that they perceived a threat to their corporate policy and effectiveness and that the defensive measures they authorized were reasonable in relation to the threat posed. A standard modelled after *Unocal* in India would effectuate *defense substitution* which is most likely to emerge once hostile takeovers in India become a reality.

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under the CAP was approximately $2billion, more than one-third of PeopleSoft's pre-bid market capitalization).

Finally, improved co-ordination between the RBI and the FIPB, would instil greater confidence in the Indian regulatory apparatus. Thus, Indian policymakers should ensure that their stance vis-à-vis encouraging or discouraging foreign hostile takeovers should be clear to potential foreign acquirers and investors.

INTERNATIONAL COMMERCIAL ARBITRATION: ROADMAP FOR A BRIGHTER FUTURE

Udai Singh[*] *and Apoorva Tapas*[**]

Abstract

Institutional arbitration posits a more secure environment for arbitration than that conducted on an ad hoc basis. The reputation of these institutions is gradually built up through sustained standards of integrity and can be tarnished by a single incident of favouritism/unfairness. While no institution (including the judiciary) is infallible, it would be pragmatic to trust arbitral institutions given the self-corrective and testing nature of the arbitration process, in which the onus of quality rests on the institution. With institutional arbitration being much more effective and dependable in practice, the overambitious invasion by the judiciary to take absolute control in the appointment of arbitrators has given a blow to the institutional arbitration. This needs to be urgently redressed and an attempt is made to

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delve into factors which place institutional arbitration at a higher pedestal.

I. THE BACKDROP

Spurred by the discontent with the incongruent standards of dispensation of justice and the dysfunctional condition of public courts across the world, Arbitration has evolved as the most effective mechanism for resolution of international commercial disputes. Judicial systems are plagued by endless delays, political influence, prohibitive costs and corruption, and are usually at the root of the malady of 'Misrule of law'. Notwithstanding the fact that the vast majority of states otherwise fulfil the formal requisites of statehood, their institutional capabilities are appalling, with justice being a luxury available only to the privileged few in the developed countries. The basic institutions in many states are grossly inadequate - without substantive legislative, judicial or law enforcement mechanism, which considerably hampers social and economic growth.

As global economy spawned disputes, an internationally uniform practice became a prerequisite to facilitate transnational economic exchanges, devoid of risks. Often huge amounts were held up due to lengthy litigation clogged in national adjudication systems. Liquidity being a critical factor, International Arbitration proved to be a convenient alternative being expeditious, cost-effective and confidential.[1]

[1]It protects the reputation and trade secrets of the parties by maintaining confidentiality of the whole process.

With India being a promising destination for foreign investment, it is essential that India's arbitration law is aligned with the contemporary international practice. This minimizes the fear of prolonged litigation in case of disputes. Such a response to the changing requirements will ensure a promising future for India as a favourable destination for arbitration, and can become a game changer for the progress of our economy as a developing nation. A robust arbitration regime in India would eliminate the possibility of investors having transactions in India to resort to arbitration elsewhere, since it would not only be convenient and time saving but also inexpensive. This is a strong contention to promote and market India as a world class facility for arbitration.

With judicial legislations increasingly sanctioning judicial intervention in the arbitral process, the growth of arbitration in India had been throttled. Evidenced by a plethora of decisions of the apex court, the objective behind arbitration seems to have evaporated into thin air. However, in the recent landmark judgment of *Bharat Aluminium Company v Kaiser Aluminium Technical Service*[2] *(*hereinafter referred to as "**BALCO**"), the Supreme Court has declared that Part I of the Arbitration and Conciliation Act, 1996[3] (hereinafter referred to as "**the 1996 Act**") is inapplicable to arbitrations held outside India. This is likely to have huge consequences, catalysing the flow of foreign investment into India.

[2]Bharat Aluminium Company v Kaiser Aluminium Technical Service (2012) 9 S.C.C. 552 [hereinafter BALCO].
[3]Arbitration and Conciliation Act, 1996 (India), Act 26 of 1996.

II. LEGITIMACY AND UNIVERSALITY

Propelled by the expansion of international private commercial relations, trans-border arbitrations have multiplied manifold, breeding a plethora of complexities including the claim of state sovereignty. It is important to neutralize such unrestrained defensive claims of state exclusivity, which have the potential to disrupt the greater legal order.

Law must ultimately be relevant to the social reality. A legal order is a set of norms acknowledged by a social order to be authoritative. Its existence may be independent and based on *rights* guaranteed by authorities other than the state.[4] Arbitration draws its legitimacy from its practical effectiveness and can be categorised as a private social institution.

Arbitration subjects private disputes to a separate regime[5] outside the operation of rules of law, which would have been applicable in the ordinary course. It affords to the parties the freedom to choose some of the procedural and the substantive law. Placing primacy on the consent of the parties to the contract, it postulates that social groups may create distinct legal orders, existing within a greater legal order which tolerates and nourishes them without imposing itself on the domain for which the sub-group has prescribed its own rules. Thus, 'arbitral order' does not trump the national order. It emerges out of the necessity of co-existence. It does not reject law but merely reproves certain facets of it, especially the apparatus.

[4]MAX WEBER, LAW IN ECONOMY AND SOCIETY 16, 17 (Harvard University Press).
[5]In cases of foreign players it is also a neutral fora, independent of their respective municipal laws, eg. The London Court of International Arbitration and the ICC International Court of Arbitration.

Paradoxically, arbitration relies on the cooperation of the very public authorities, from which it tries to disengage itself, seeking the power and authority of the state only to support arbitration, not to interfere in it. This makes it obligatory to connect the conduct of arbitral proceedings to a national legal system, which will support and supervise it and encompasses *inter alia* fixing of the permissible degree of party autonomy (curtailed by mandatory or non-derogable rules), assistance by grant of provisional measures and in collection of evidence by the court (especially in cases of procedural matters affecting the position of third parties who are not subject to the jurisdiction of the arbitrators).

In a short span of time, International Arbitration has become the norm for resolving international commercial disputes, and the success of UNCITRAL Model Law on International Arbitration (hereinafter "**Model Law**") bears witness to its claim of universality. The UN Commission on International Trade Law (hereinafter "**UNCITRAL**") adopted the Model Law in 1985 and the UN General Assembly subsequently recommended its incorporation in domestic legislations.[6]

The Arbitration and Conciliation Act, 1996 regulates the conduct of arbitration in India[7] and reproduces the model law almost verbatim with a few notable exceptions. It seeks to minimise the supervisory role of the courts to effect speedy disposal of disputes and provides finality to the arbitral awards by making them enforceable as a decree of a court.[8] The 1996 Act is divided into four parts with the first

[6]UNGA 40/72 (11th December, 1985).
[7]Earlier it was regulated by The Arbitration Act, 1940, The Arbitration (Protocol and Convention) Act (1937), and The Foreign Awards (Recognition and Enforcement) Act (1961).
[8]Statement of Objects and Reasons, The Arbitration and Conciliation Act (1996) No. 26, Acts of Parliament.

concerned with arbitration in India; second with Enforcement of 'certain' foreign awards (Arbitral awards given in countries signatories to New York Convention, Geneva Convention and Protocol); third with conciliation and the fourth lays down the supplementary provisions. It has consolidated within its scope domestic arbitration[9], international commercial arbitration and enforcement of foreign arbitral awards.

Till recently, the Indian judiciary had been perplexed by two competing and conflicting policy considerations of injustice, resulting from delay due to its review of the merits of arbitral awards, and that from a patent illegality in an award (genuine excesses or abuses by arbitrators, incapacity of the parties, invalidity of the agreement, etc.[10]). The arguments which had been advanced by it to justify its excessive paternalistic approach of interference were heavily misplaced. This became prominent especially in disputes involving high monetary stakes, with speedy justice being but a distant dream. The Supreme Court in BALCO has taken a step in the right direction for ensuring that Arbitration develops as an effective method of dispute resolution in India. Notably, the enforceability of awards without judicial review of the merits is what makes it an attractive alternative to litigation.

III. CONVOLUTED JURISDICTION

Modern arbitration thrives on a pluralistic environment and it is plausible to have overlapping legal orders giving effect to it. They

[9]UNCITRAL Model Law was designed to be applicable to international arbitrations and not domestic arbitrations.
[10]The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, § 34.

may regulate different aspects of arbitral relationship and may not be exclusively that of one state. They can be categorised as:[11]

a) Proper Law of the Arbitration Agreement

It governs the agreement to arbitrate and to honour the arbitral award. It determines the validity of the arbitration agreement, the question of arbitrability of dispute, validity of notice of arbitration, constitution of the arbitral tribunal, the question whether the award is within the jurisdiction of the arbitrator as well as the formal validity of the award. It is the source of authority of the arbitrators. It would apply to the filing of the award, to its enforcement and to its setting aside.

The arbitration clause embedded in a contract which creates the obligation to refer a dispute to arbitration is governed by a proper law of its own. It is recognised as independent of the contract, having a distinct life of its own and capable of surviving the termination of the substantive agreement.[12]

b) Curial or procedural law (lex arbitri)

It is the law applicable *to* arbitration and is operative during arbitration. It deals with 2 sets of issues[13]:

(i) *Internal:* It governs the conduct of the individual reference, procedural powers, appointment and duties of the arbitrator (e.g. whether they must hear oral evidence; questions of evidence; misconduct); the determination of the proper law of the contract.

[11]Sumitomo Heavy Industries Ltd. v. ONGC Ltd. and Ors., (1998) 1 S.C.C. 305.
[12]The Arbitration and Conciliation Act, 1996, § 16(a) & (b), No. 26, Acts of Parliament.
[13]DICEY, MORRIS & COLLINS, THE CONFLICT OF LAWS 722 (2007).

(ii) *External:* It is the source of authority to entertain applications for incidental reliefs and to ensure that the procedure adopted in the arbitral proceedings conforms to the requirements of the curial law. This power is discretionary in nature and lies with the courts administering the curial law. It determines court's power of supervision such as remedies available for challenging the award (lack of jurisdiction or serious irregularity) once it has been rendered but before its enforcement is sought. The power to remove arbitrators and to secure attendance of witnesses is also under its domain. It also specifies the circumstances in which such judicial remedies may be excluded by the parties. Curial law does not apply to the filing of an award in court since the enforcement process is subsequent to and independent of the proceedings before the arbitrator.

Pragmatism entails that parties choose curial law corresponding to the 'seat' of arbitration i.e. the place at which proceedings to be conducted. In the absence of agreement to the contrary, prima facie presumption exists that parties intend the curial law to be the law of the 'seat' of the arbitration, on the ground that it is most closely connected with the proceedings.[14]

In BALCO, the apex court pointed out the distinction between 'seat'/'place' and 'venue' of arbitration. The 'seat'/'place' is a juridical concept distinct from the 'physical seat' or 'venue' which can be a geographically convenient place[15] chosen to conduct

[14]MUSTILL & BOYD,COMMERCIAL ARBITRATION 64 (1989).

[15]As stipulated by Article 16(2) of UNCITRAL Arbitration Rules which state "The arbitral tribunal may determine the locale of the arbitration within the country agreed upon by the parties. It may hear witnesses and hold meetings for consultation among its members at any place it deems appropriate, having regard to the circumstances of the arbitration". Also, see § 20(3) of The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament.

particular hearings. There can be only one 'seat' of arbitration;[16] however, the tribunal is free to hold meetings or hearings at any other place for the sake of convenience. This is in consonance with its previous judgment in *Videocon Industries Limited* v. *Union of India and Anr*.,[17] wherein the arbitration as per the agreement was to be conducted at Kuala Lumpur, Malaysia, but was later shifted to London.[18] It was held that the mere change in physical venue of hearing from Kuala Lumpur to London did not amount to change in juridical seat of arbitration.

The law at the 'seat'/'place' of arbitration is the wellspring of the binding character of the arbitral award. The courts at the 'seat' are the sole supervisors and primary supportive functionaries of the proceedings, except where lex arbitri is different from law at the 'seat', wherein party autonomy will be restricted by mandatory rules (non-derogable) of the latter. In case of conflict between them and upon a subsequent failure to comply with the latter, the courts at the 'seat' can set aside the award. It also stipulates directionary rules or 'fall back provisions' which apply if the parties have not made their own arrangements. BALCO reaffirms this by positing that only if the 'seat'/'place' of Arbitration is in India, will Part I of the 1996 Act be applicable.[19]If the 'seat'/'place' is outside India, Part I would be inapplicable to the extent it is inconsistent with the arbitration law of the 'seat', even if the agreement purports to provide that the1996 Act shall govern the arbitration proceedings.[20]

[16]BALCO; Dozco India P. Ltd. v. Doosan Infracore Co. Ltd., (2011) 6 S.C.C. 179.
[17](2011) 6 S.C.C. 161.
[18]Due to outbreak of epidemic SARS.
[19]BALCO ¶ 100.
[20]*Id.*

c) Proper law of the contract or the Substantive law (lex causae)

It is the law applicable *in* arbitration and governs the contract. It is the source of the substantive rights of the parties, in respect of which the dispute has arisen, and determines the law to be followed in making the award. It forms the basis of the arbitrator's decision.

The determination of the applicable law was examined in *National Thermal Power Corporation* v. *The Singer Company and Ors.*[21], wherein it was affirmed that in absence of any express choice and any contrary indication, the presumption lies that the proper law of the contract and the law governing the arbitration agreement are same as the law of the 'seat'. If proper law of the contract is chosen by the parties, it must govern the arbitration agreement.

IV. ENFORCEMENT JURISDICTION & THE NEW YORK CONVENTION

The main loophole in arbitration is the enforcement mechanism, which is often beset by 'court intervention'. Arbitrations carry a significant risk that enforcement jurisdiction might not agree to recognise and enforce the award since it may be susceptible to manifold challenges. Most of the complexities in arbitration arise due to the unpredictability of the enforcement jurisdiction. Usually, these cannot be contemplated at the time of arbitration agreement or even at the time of commencement of arbitration. The attitude of the legal order of a country where the debtor has his assets is highly relevant to

[21](1992) 3 S.C.C. 551.

efficaciousness of the arbitration. However, uniformity has been possible largely due to increasing interdependence between states.

Judicial systems of countries are usually prepared to enforce an arbitral award if they are satisfied that it will be 'binding' either due to conventions or the principle of comity. The pervasive reach of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958[22] (hereinafter referred to as "**New York Convention**") exemplifies the former. With 146 signatory countries,[23] it is the dominant tool for recognition and enforcement of international arbitral awards made in signatory jurisdictions, without requiring prior approval of the courts at the seat of arbitration.[24] Its signatories cease to be bound by the predecessors of the convention:[25] Protocol on Arbitral Clauses, 1923,[26] and Convention of the Execution of Foreign Arbitral Awards, 1927, (hereinafter "**Geneva Convention**")[27] thereby rendering them archaic.[28] Only Myanmar, The Gambia, Guyana, Iraq and The Democratic Republic of Congo are parties to the earlier instrument and not to New York Convention.

The strength of the New York Convention lies in its relative simplicity and widespread adherence. While emphasising the integrity

[22]Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, June 10, 1958, 330 UNTS 38 [hereinafter New York Convention].
[23]*Id.*, Chapter XXII: Commercial Arbitration.
[24]*Id.*, Article III. "Awards are binding as per the rules and the procedure of the territory where the award is relied upon."
[25]*Id.*, Article VII.
[26]Protocol on Arbitration Clauses, Sept. 24, 1923, 27 L.N.T.S. 157.
[27]Convention on the Execution of Foreign Arbitral Awards, Sept. 26, 1927, 92 L.N.T.S. 301.
[28]This was due to the wide acceptability of the New York Convention and its superseding effect over them. These instruments were the results of the efforts to achieve uniformity under the auspices of the League of Nations.

of national order, it limits the grounds for refusal to enforce awards[29] to seven cases listed in Article V.[30] Thus, it negates any scope of concurrent jurisdiction to courts in the enforcing territory with respect to entertaining challenges as to the binding nature of the awards.[31] Significantly, certain states like Switzerland do recognise an agreement between the parties to opt out of judicial review of the arbitral awards.

The question of arbitrability is basic to the arbitral process. The New York Convention and the Model Law recognise this by referring to disputes that are 'capable of being resolved by arbitration', implicitly acknowledging that all disputes are not legally arbitrable.[32] Multi-territorial contracts yield a multitude of potentially relevant jurisdictional criteria e.g. place of signing, of residence/work of the parties, of its enforcement. The same set of facts can lead to different interpretations of obligations by legal systems of two countries. National orders are dissimilar and can impute different outcomes to the same event. However, it has been left to the enforcement forums to test the award against their conception of public policy and arbitrability.[33]

[29]The award cannot be set aside but can only be refused to be enforced.
[30]Incapacity of parties; Invalidity of arbitration agreement (including inarbitrability); Violation of principles of Natural Justice (sanctions the application of standards of due process of the enforcement forum); Excess of Jurisdiction (decisions beyond the scope of submission to the tribunal); Breach of Procedural law (including mandatory rules of the seat of arbitration); Award not binding; Public Policy.
[31]New York Convention, Article V. It lays down the grounds under which the Recognition & Enforcement of an award may be challenged or refused.
[32]New York Convention, Article V (2)(b).
[33]New York Convention, Article V (2).

V. JUDICIAL LEGISLATION: THE FIASCO

In *Bhatia International* v. *Bulk Trading S.A. and Anr.*[34], the court had drawn an absurd analogy between Part I & II of the 1996 Act. It had construed the absence of the word 'only' in Section 2(2) (in light of the non-obstante clause[35] in Section 45 and 54) to hold it only as 'an inclusive and Clarificatory provision'. It held that a conjoint reading of the 1996 Act makes Part-I applicable to offshore international commercial arbitrations wherein Indian law governed the contract, unless the parties, by agreement express or implied, excluded all or any of its provisions (including those non-derogable). However, in arbitrations held in India the non-derogable provisions would be mandatorily applicable.[36]

The court was concerned that exclusion of Part I to offshore International Commercial Arbitration would leave those parties remediless who secured arbitral awards in non-convention countries (which are not signatories of New York or Geneva Conventions), for such a construction would have left no provision for their enforcement under the 1996 Act. According to it, this would amount to holding that there was a lacuna in the law. The court did not consider that India had exercised both the *Reciprocity* and the *Commerciality* reservations.[37] There is a mandatory requirement of notification in the Official Gazette before offshore arbitral awards become enforceable. This also extends to a country acceding to the New York[38] and Geneva Convention.[39]Thus, the 1996 Act explicitly

[34](2002) 4 S.C.C. 105.
[35]It reads 'notwithstanding anything contained in Part I'.
[36]This view has been affirmed in Venture Global Engineering v. Satyam Computer Services Ltd. and Anr. (2008) 4 S.C.C. 190.
[37]New York Convention, Article 1(3).
[38]The Arbitration and Conciliation Act 1996, § 44, No. 26, Acts of Parliament.

excludes enforcement of awards obtained in non-convention jurisdictions as a decree and a suit has to be filed for their enforcement in India.

The decision in BALCO has prospectively overruled the aforesaid judgment. The constitutional bench in BALCO held that Part I of the 1996 Act, is inapplicable to arbitrations held outside India in so far as the arbitration agreements were entered into after September 9, 2012.[40]

VI. INTERVENTIONIST ROLE OF THE INDIAN JUDICIARY: THE ERA OF THE CONCURRENT JURISDICTIONS

Prior to BALCO, national courts whose laws govern the arbitration agreement were held to be the competent courts in respect of matters arising under the arbitration agreement, and the jurisdiction exercised by the courts at the 'seat' was merely concurrent, and not exclusive and strictly limited to matters of procedure.[41] Section 48(1)(e) of the 1996 Act states that for the enforcement of foreign awards, they need to be binding as per the law of the land where the 'challenging' jurisdiction rests. This evidently suggests a difference between 'challenging' jurisdiction and the 'enforcement' jurisdiction which was overlooked. Though ambiguously demarcated, they are not concurrent. Such judicial pronouncements asserting concurrent

[39]The Arbitration and Conciliation Act 1996, § 53, No. 26, Acts of Parliament.
[40]BALCO ¶ 200.
[41]National Thermal Power Corporation v. The Singer Company and Ors.,(1992) 3 S.C.C. 551.

jurisdictions rendered arbitration an expensive affair, negating the cost-effectiveness of arbitration which makes it an attractive alternative to traditional litigation.

In BALCO, the court categorised regulation of arbitration as comprising of the following four stages:

(a) the *commencement of* arbitration;
(b) the *conduct* of arbitration;
(c) the *challenge* to the award; and
(d) the *recognition or enforcement* of the award.

The court has held that though Part I of the 1996 Act regulates arbitrations at all the four stages, Part II regulates arbitration only in respect of commencement, and recognition or enforcement of the award.[42] While upholding the principle of territoriality, it drew a distinction between the 'challenging' jurisdiction and the 'enforcement' jurisdiction and held that challenge to an arbitral award could be done only by the courts of the country in which the arbitration is being conducted as only such courts possess the supervisory power to annul the award.[43] This is in consonance with the scheme of international instruments, such as the Geneva Convention and the New York Convention as well as the UNCITRAL Model Law.

The court stated that Section 48(1)(e) merely recognizes that the courts of two countries are competent to suspend or annul an award. It does not entail concurrent jurisdiction to them to annul an award. Such jurisdiction must be specifically provided in the national legislations of the countries. The corresponding section in Indian law

[42]BALCO ¶ 126.
[43]BALCO ¶ 128.

i.e. Section 34, does not apply to arbitrations conducted abroad.[44] Furthermore, it elucidated that "under the laws" in Section 48(1)(e) pertained to curial law and not the substantive law.[45]

VII. THE PUBLIC POLICY CONUNDRUM

During the *Bhatia* era, public policy had been a bone of contention as a ground for refusal to enforce or setting aside of foreign awards. Indian courts do have the right to refuse recognition to repugnant procedures. But where will the courts draw a line?

In *Renusagar Power Co. Ltd.* v. *General Electric Co.*[46] the SC gave a narrow inclusive construction to 'public policy' in the context of Section 34 of the 1996 Act, holding that an award could be set aside if it was contrary to[47]

(a) fundamental policy of Indian law, or *(b)* the interest of India, or *(c)* justice or morality.

This was given a wider connotation in *Oil & Natural Gas Corporation Ltd* v. *SAW Pipes Ltd*[48] with the inclusion of another expansive ground: 'patent illegality' of the award, encompassing within its scope an award contrary to (a) substantive provision of law, or (b) provisions of the Act, or (c) terms of the contract.

However, it cautioned that such illegality must go to the root of the matter and could not be trivial in nature. It affirmed that an award

[44]BALCO ¶ 138.
[45]BALCO ¶ 157.
[46](1994) A.I.R. SC 860.
[47]*Id.*at ¶ 64.
[48](2003) 5 S.C.C. 705.

could also be set aside if was unfair and unreasonable to the extent of shocking the conscience of the court.[49]

Post BALCO, a foreign award cannot be set aside under the provisions of Section 34 of the 1996 Act. Notably, the apex court in *Phulchand Exports Ltd. v. OOO Patriot*[50], has upheld indirectly the same "public policy test" under Section 34 as being applicable under Section 48 as well. Thus, a foreign award is still subject to the same scrutiny.

The possibility of abuse of the grounds of recourse by a dissatisfied party cannot be ruled out. In the pre-BALCO era the agony of the Arbitral award holder was further exacerbated by the automatic suspension of the execution of the Award upon filing of objections under Section 34 results.[51] It was suggested by many that the delay caused in review of arbitral award be neutralised by allowing enforcement of the award during the pendency of challenge, while providing courts discretion to stay such enforcement. Section 48(3) gives the court discretion to suspend the enforcement of the award in case of an application for setting aside or suspension of the award. This comes as a great relief for those struggling with delay in the over-stretched procedure for enforcement of award.

[49] *Id.*at ¶ 30.
[50] (2011) 10 S.C.C. 300.
[51] National Aluminium Co. Ltd. v. Pressteel and Fabrications Pvt. Ltd., (2004) 1 S.C.C. 540.

VIII. THE STING: INTERIM RELIEF

It is suggested that, as held by the Apex Court in Bhatia International[52], Section 9 should be made applicable for offshore International Commercial Arbitration. It is likely that by the time courts exercising jurisdiction over the seat of arbitration are petitioned for interim measures of protection, the assets of a party located in India will be transferred or removed. The only possible alternative a party has is to obtain an interim order from a foreign Court or the arbitral tribunal, and file a civil suit to enforce this right. However, the interim order would not be enforceable directly by filing an execution petition as it would not qualify as a "judgment" or "decree" for the purposes of Section 13 and 44A of the Code of Civil Procedure, 1908[53] (which chalk out the procedure for enforcement of foreign judgments). The efficacy of enforcement through such a mechanism is suspect. The party obtaining an arbitral award in its favour would more often than not find that the entity against which it has to enforce the award has been stripped of its assets, defeating the award.

It is suggested that since the courts of the 'seat' are the natural forum for granting interim relief, the onus should lie on the claimant to establish why Indian courts should be preferred over them. The discretionary equitable doctrine of *Forum non conveniens* should be applied by courts to decline jurisdiction owing to appropriateness of the other forum.

[52]Bhatia International v. Bulk Trading, (2002) 4 S.C.C. 105.
[53]Code of Civil Procedure, 1908, No. 5 of Acts of Parliament.

IX. NON-STATE ENFORCEMENT: A FEASIBLE ALTERNATIVE

Parties can choose arbitration to be conducted on an *ad hoc* basis or under the auspices of an arbitration institution. Usually, the enforcement of the tribunal's orders on interim measures or arbitral award is done with the assistance of the national courts. However, some arbitral institutions wield sufficient coercive power to enforce their award independent of the state.

The Court of Arbitration for Sports (CAS) has successfully enforced its awards without the assistance of states, since the sports federations accept them as binding. *Clube Atlético Mineiro v. Fédération Internationale de Football Association (FIFA)*[54] perfectly exemplifies a conflict of an international arbitral award with the national legal order, wherein the former triumphed. The award was enforced without the help of the state and against its mandate. A Brazilian footballer had violated his four-year contract with a Mexican Club after a year, for which the club had paid him a transfer fee of $1million. FIFA suspended him from playing worldwide, but a Brazilian court ruled in his favour, allowing him to pursue his career. He started playing for a Brazilian club. However, the FIFA Player's Committee ordered him to restore the amount, failing which the Brazilian club he was playing for would be liable. This was challenged before CAS which confirmed the decision of FIFA. The club could be counted upon to pay the amount since otherwise it would face sanctions from the Brazilian Federation which in turn would face sanctions from FIFA in case of non-compliance. This could even lead to disqualification of Brazil from the World Cup!

[54]CAS 2005/A/957.

This could be viewed as one of the many international non-state organisations having sufficient coercive power to ensure compliance. They legislate and establish adjudicatory bodies and enforce awards through an array of internal sanctions. Such systems draw legitimacy from being impersonal and intended to exclusively govern specific aspect of social life. It would do good to promote them in the larger common interest.

X. THE INTERNATIONAL COURT OF ARBITRATION

The International Court of Arbitration (hereinafter referred to as "**ICC Court**") is the arbitration body attached to the International Chamber of Commerce (hereinafter referred to as "**ICC**"). ICC has a wide reach with members and national committees in many countries, which assist in obtaining voluntary compliance from defiant parties.

The ICC Court, established in 1923, is an administrative body charged with the responsibility of overseeing the ICC arbitration process. Its members are chosen for a renewable term of three years by the ICC's World Council in which each National Committee is represented. [55]

The Court is unique both in its composition and its supervisory role. Among its many functions are appointment of arbitrators; reviewing and confirming the appointment of arbitrators; reviewing and confirming the appointment of arbitrators; reviewing and deciding allegations of arbitrator bias or misconduct; extending time limits;

[55]To uphold high standards of integrity, a member is barred from being appointed as arbitrator by the court but is free to be appointed by any party and can also appear as a counsel in any arbitration.

fixing fees of arbitrators; reviewing and approving (as to their form) the arbitral awards.

To ensure that the award addresses all the disputed issues, ICC requires Terms of Reference to be spelled out by the tribunal before the commencement of arbitration.[56] This includes the respective parties' claims, relief sought and a list of issues to be determined. Additionally, a provisional time-table is to be submitted, which though flexible, provides a broad framework and deadline for expeditious disposal by the tribunal. The Court also has the power to replace an arbitrator 'who does not fulfil his functions'[57] and has used it on several occasions.

It is mandatory for the ICC Court to approve the form of all arbitral awards[58] and while doing so it may also draw the tribunal's attention to points of substance. Despite being of non-binding nature, this does enhance the quality of the awards. Thus, the legitimacy of the award owes much to supervision of the Court, reinforced by its diverse composition and collective character of decisions. Though no arbitral institution can guarantee ultimate quality and efficacy, the ICC Court has counterbalanced the flexibility and autonomy in arbitration by a highly supervisory (yet not intrusive) set up.

XI. AD HOC VERSUS INSTITUTIONAL ARBITRATION

Institutional arbitration posits a more secure environment for arbitration than that conducted on ad hoc basis and is therefore a preferred mode due to cost-effectiveness if compared to a long drawn

[56]ICC Arbitration Rules (2012), Article 18,
[57]*Id.* Article 12(2).
[58]*Id.*, Article 27.

litigation, though institutional arbitration is generally more expensive than ad-hoc arbitration; pre-laid institutional procedural rules for conduct of arbitration; infrastructure facility; removal of arbitrators by institution; and scrutiny of awards.

Section 11 of the 1996 Act leaves it to the discretion of the Chief Justice to appoint the arbitrator or designate any person or institution to do so. However, in *S.B.P. and Co.* v. *Patel Engineering Ltd. and Anr.*[59] it was held that such delegation could only be to another Judge of the court who could seek the opinion of an institution in exercise of such duty, but the order had to be made only by Chief Justice or such designated judge.[60] This retrograde step is a severe blow to institutional form of arbitration which could be earlier recommended by judiciary.

Notably, the reputation of arbitral institutions is gradually built up over a period through sustained, impeccable standards of integrity and can be tarnished by a single incident of favouritism/unfairness. While no institution (including the judiciary) is infallible, it would be pragmatic to trust arbitral institutions due to the self-corrective and testing nature of the process in which the onus of quality rests on the institution. An institution upholding high standards of justice and transparency would be a natural consensus choice for arbitration.[61] With institutional arbitration being more effective and dependable in practice, this overambitious digression to take absolute control over appointment is required to be reviewed urgently by the judiciary or be rectified by legislative amendment. Such an approach would be

[59](2006) A.I.R. SC 450.

[60]It held that appointment of arbitrator is a judicial function and not an administrative function.

[61]The foundation of arbitration rests upon choice and the parties while selecting an institution will come to a consensus only upon only those, where they feel that they will get 'justice' through a fair and transparent procedure.

consistent with the international framework, appropriately catering to the forthcoming demands.

XII. CONCLUSION

The Commercial Division of High Courts Bill, 2009, which has been passed by the Lok Sabha lying pending before the Rajya Sabha heralds a much brighter future for speedier settlement of commercial disputes. It envisions the creation of a division within the High Courts carved out of its existing strength, having jurisdiction over commercial matters above a threshold limit of Rs.5 crore as well as appeals lying before the High Court under the 1996 Act. It would use a fast-track mechanism[62] and would bind judges to deliver the judgement within 30 days of the conclusion of arguments. Appeals would lie only before the Supreme Court. However appointment of judges as arbitrators poses the danger of render the environment and purpose of arbitration void since they tend to impose the procedural and substantive rules as followed in a formal court, without being formally trained as arbitrators.

It is of critical significance at this juncture to highlight the paternalistic stand of the judiciary which has a direct impact on arbitration. As the ultimate guardian of the rights of the people, the judiciary which adjudicates upon the finality of the arbitral award is already overburdened. A sizeable blame of the delay rests upon the Supreme Court collegium, which has appropriated the responsibility of appointment of Judges to the Higher Judiciary upon its shoulders.[63]

[62]Setting of specific time-limits for filing documents, delivering judgements etc.

[63]Of making mandatory binding recommendations for appointment to the Higher Judiciary to the President of India. SC Advocate-on-Record Association vs. UOI, (1993) 4 S.C.C. 441.

Thus, the onus of filling up the vacancies rests on them.[64] The distressing handicap[65] of the collegium to discharge this additional burden effectively calls for an urgent review of the appointment process. This will bring much needed respite to the judicial system and will also lubricate the wheels of the commercial division of the High Courts.[66]

It is evident that the problem is multi-axial, fraught with complexities of different dimensions. Arbitration assumes a significant role in providing a level playing field for robust trade and commerce. Therefore, it is imperative for the legal framework to rise to the occasion and equip the infrastructure with the requisite tools to tackle the forthcoming challenges with professionalism. Resetting the negative trend of judicial interference is sine qua non for achieving a conducive environment for healthy business in India. Speed and cost-efficiency are the hallmarks of arbitration, and the obstruction of either can adversely affect international trade, retarding our economic growth. Thus, it is important that the grounds for judicial intervention be construed narrowly, giving paramount consideration to the principle of party autonomy, to bring the arbitration regime at par with the global standards.

[64]In September 2009, 254 posts out of 886 sanctioned for judges of High Courts were lying vacant.

[65]The court, in absence of a secretariat is overburdened with administrative work. It lacks resources to investigate into competence, character and integrity of candidates, resorting to informal consultation with other judges or members of the bar. This is a poor substitute for intensive data collection. National Judicial Appointment Commission is the need of the hour.

[66]As provided for in the Commercial Division of High Courts Bill, 2009.

TESTS OF SIEC AND AAEC IN M&A: A COMPARATIVE STUDY OF COMPETITION ACT, 2002 AND EU COMPETITION LAW

Anish Jaipuriar[*] *and Sarita Rout*[**]

Abstract

In the European Union (EU), the substantive test for merger control is to ascertain whether a prospective merger would significantly impede effective competition (SIEC) in the common market, while under India's Competition Act, the substantive test for combinations is to determine whether there is an appreciable adverse effect on competition (AAEC) within the relevant market. The two tests therefore play a significant role in fulfilling what is called the aim of any competition law and being the sole criteria in each of the law a clear, definitive and market friendly scope has to be established. This paper therefore discusses and compares the two tests in terms of any similarity or differences and tries to establish a standard

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scope for achieving the objective of the competition law.

I. INTRODUCTION

In the wake of the economic liberalization and growing industrial and trade policies, foreign investment rules, capital controls, etc., a need was felt for a new and modern Competition Law in the place of the old Monopolies Restrictive Trade Practices Act, 1969 (hereinafter "**MRTP Act**").[1] The background to the enactment of the Competition Act was succinctly explained by the Supreme Court in the case of *Competition Commission of India v. Steel Authority of India Ltd*[2] that the main objective of competition law is:

> "*to promote economic efficiency using competition as one of the means of assisting the creation of market responsive to consumer preferences. The advantages of perfect competition are three fold: allocate efficiency which ensures effective allocation of resources, productive efficiency which ensures that costs of production are kept at a minimum and dynamic efficiency which promotes innovative practices.*"[3]

Mergers and acquisitions (*for simplicity* combinations, concentrations or M&A) legally and physically compound the corporate status of the merging company with which it has merged and the merging company's autonomy is lost in its entirety to the merged company. The main rationale behind pursuing such combinations is synergy i.e.

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[1]Ranjit Anantrao Shedge, *Need of Second Generation Economic Reform*, http://www.legalindia.in/need-of-second-generation-economic-reform.
[2](2010) 10 S.C.C. 744.
[3]*Id.*

to acquire the additional advantage of business operations that the merging firms separately could never have achieved. In India combinations are regulated under three different legislations viz. Companies Act, 1956, SEBI Act, 1992, Competition Act, 2002 (also referred to as "**CA**") which aim at fulfilling three different and mutually exclusive objectives. When on the one hand, the Companies Act, 1956 tries to protect the interests of the secured creditors the SEBI Act, 1992 tries to protect the interests of the investors. The Competition Act, 2002 is aimed at "*preventing practices having adverse effect on the competition, and to protect the interests of the consumer and to ensure fair trade carried out by other participants in the market in India and for matters connected therewith or incidental thereto.*"[4]

In the European Union (hereinafter "**EU**") mergers are mainly regulated through the European Council Merger Regulation, 2004[5] (hereinafter "**ECMR**") which replaced the earlier EC Merger Regulation 4064/89[6] ("**Old Merger Regulation**"). ECMR changed the test for prohibition from '*the creation or strengthening of a dominant position*' to a '*significant impediment to effective competition*'.[7] The test is a compromise between the concept of dominance as part of the substantive assessment (particularly Germany) and those who favoured the adoption of a '*substantial*

[4]*Id.*
[5]Council Regulation (EC) No.139/2004 on the control of concentrations between undertakings (2004) O.J. L24/1, http://www.wipo.int/wipolex/en/text.jsp?file_id=181665.
[6]Council Regulation (EEC) No.4064/89 on the control of concentrations between undertakings [1989] O.J. L395/1, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31989R4064:EN:HTML.
[7]Shearman and Sterling LLP, *The New European Merger Regulation*, 1 (April 2004), http://www.shearman.com/files/Publication/f2849061-ee0c-4352-ae1d-0fbdfbf3aadc/Presentation/PublicationAttachment/11539f1e-5e5c-4640-b1e6-22379dbc21bf/AT_0404.pdf.

lessening of competition test' (hereinafter "**SLC**"), used by the UK, Ireland and several other jurisdictions including the U.S.[8]

The purpose based study of the above stated legislations (mainly ECMR and CA for the sake of this paper) is significant so as to recognize the contrasting features of the Significant Impediment of Effective Competition (hereinafter "**SIEC**") under the ECMR and Appreciable Adverse Effect on the Competition (hereinafter "**AAEC**") under the CA.

This paper tries to compare the two tests. The purpose of the paper is to draw differences and thereby establish if there exists a need to modify the current law in India. The idea behind the comparative study is to ascertain the loopholes in the Indian legislation if any and thereby devise plans to overcome it. The paper will be divided into 3 basic subheads. Part I deals with detailed analysis of AAEC regulation in CA, 2002. Part II deals with detailed analysis of test of SIEC. Part III will contrast and compare the two tests in terms of what does each test tries to achieve and whether if the purpose of the tests are same then which test has ultimately served the purpose in a more efficient and effective manner. Thereafter the paper will proceed with the conclusion which will point out the summary of the analysis done in the whole paper with certain intelligible remarks.

[8]Neil Horner, *Unilateral Effects and the EC Merger Regulation – How the Commission Had its Cake and Ate it Too*, 2 HANSE. L. REV. 23, 24 (2006).

II. APPRECIABLE ADVERSE EFFECT ON THE COMPETITION

The phrase Appreciable Adverse Effect on the Competition appears around 23 times in the CA, 2002. However not even once has the legislation tried to define AAEC except in Sec 20 (4) of CA which provides nothing more than tools for the Competition Commission of India (hereinafter "**CCI**") to identify AAEC. The provisions to regulate combinations have been the subject of intense discussion in recent times.[9] The Act defines a "combination" as any M&A in which the firms' combined assets or turnover exceed Rs 1,000 crore (approximately $ 250 million) and Rs 3,000 crore (approximately $ 750 million) respectively in India or $ 500 million and $ 1,500 million worldwide, M&As that fall below these thresholds are not considered in the expression combinations and are outside the ambit of the Act.[10]

The legal debate encircling the provisions of combinations is mainly because of the lacking nexus between the threshold and the test of AAEC. Further, the *domestic nexus test* i.e. only those combinations where at least Rs 500 crore of the combined worldwide assets or at least Rs 1,500 crore of combined worldwide turnover of the merging parties is in India, would come under the purview of the Act has been highly criticized.[11]

The International Bar Association (hereinafter "**IBA**") and the American Bar Association (hereinafter "**ABA**") in their submissions to the government and the CCI have pointed out that a multi-national

[9]Manish Agarwal and Aditya Bhattacharjea, *Are Merger Regulations Diluting Parliamentary Intent?*,43 ECONOMIC AND POLITICAL WEEKLY 10 (2008).
[10]The Competition Act, 2002, § 5, No. 12, Acts of Parliament, 2003 (India).
[11]AGARWAL & BHATTACHARJEA, *supra* note 9, at 10.

firm whose Indian operations are substantial enough to satisfy the *domestic nexus test* would still have to notify its offshore acquisition of a firm with no Indian interests whatsoever, if the combined operations of the parties crossed the threshold for worldwide assets or turnover.[12] They argue that such combinations do not raise any competition concerns and should be kept out of merger review.

The above contention raised by the two international bodies is interesting as it points at an undefined area of law. The question is whether Sections 5 and 6 of the CA, 2002 are independent of each other or inter-dependant or there exists a unilateral dependence of the two sections on each other. The *prima facie* answer may be simple that only when a particular combination attracts Sec 5 can it be further examined as per Section 6.

The study of the correctness and practicality of the answer above is ancillary to the main purpose of this paper because the correct answer will help us in determining the opposite legislative intent behind the suitable scope of AAEC. *Prima facie* relying on the specific threshold limits in Section 5 an implication is deducible that those combinations that exceed the threshold are bound to have AAEC and therefore such combinations will necessarily have to go under the scrutiny laid down in Section 6. Section 5 states that any combination that exceeds the threshold limits specified in the Act in terms of value of assets or turnover can be scrutinized by the CCI to determine whether it will cause or is likely to cause an appreciable adverse effect on competition within the relevant market in India.[13]

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[12]*IBA Memoranda*, http://www.ibanet.org/legalpractice/AntitrustWGIndia.cfm; *ABA Letter*, http://www.abanet.org/antitrust/at-comments/2007/11-07/Comments-IndianCompetition.pdf.

[13]Subhadip Ghosh and Thomas W.Ross, *The Competition (Amendment) Bill 2007: A Review and Critique*, 43 ECONOMIC AND POLITICAL WEEKLY 35 (2008).

The above conclusion attaches an inherent restriction on the powers of CCI as only those combinations which trigger the provisions of Section 5 will stand reviewable under Section 6. In other words Section 6 cannot be triggered independently to review those combinations which first do not invoke Section 5. This conclusion ultimately defeats the purpose of the CA, 2002 which reads:

> "*An Act to provide, keeping in view of the economic development of the country for the establishment of a Commission to prevent practices having adverse effect on the competition…*"

Provisions of CA, 2002 relating to combinations seems to be based on the assumption that combinations with large turnovers/assets ownership can *only* adversely affect the competition. If this premise is true then the scope of the test of AAEC is automatically narrowed down. While if reliance is placed on purposive interpretation i.e. Section 6 can operate independently of Section 5 then the scope of AAEC widens to a great extent and calls for a deeper analysis in giving it a proper structure.

CA, 2002 being a relatively new legislation such questions has not been judicially scrutinized. Therefore this paper for simplicity will proceed on the second interpretation i.e. Section 6 can be triggered independently without application of Section 5 so to promote and safeguard the primary objects of the CA, 2002.

To support this view reliance is placed on the approach under the relevant competition law legislations of US and Canada. Here, *mandatory pre-notification* thresholds has been defined as simply a level at which reporting to the authority becomes an obligation, but this level does not have to limit the authority's ability to review any

combination that it feels might harm competition.[14] This approach realizes that in some markets, competition can be harmed even by the combination of relatively small firms.

Another reason for the reliance on the purposive interpretation is that throughout CA, 2002 there is *only* one specified competition test; it requires that, to be condemned, an action or agreement must have an AAEC. So, it will be against the interests of the consumers and will further restrict the powers of CCI if AAEC is narrowly defined.

The question of defining AAEC revolves around another question i.e., how large must an effect be to be deemed *appreciable*? For example, will it be any effect beyond a *de minimus effect* or will it be more like the '*Substantial Lessening of Competition*' tests of other countries (e.g., Canada, USA),[15] or beyond or equivalent to the opinions laid down for *dominance test* and its successor SIEC under the EU competition law.

There are various approaches which influence the scope and definition of AAEC. Few such factors include:

A. *Time centric*
B. *Money centric*
C. *Consumer centric*
D. *Market Centric*

A. Time Centric

Time as a factor plays a significant role in determining the scope of AAEC. The Act grants the CCI the power to investigate a combination only up to one year after "such combination has taken

[14] *Id.* at 39.
[15] *Id.* at 37.

effect".[16] This obviously limits the CCI's power to address concerns when a merger results in anti-competitive effects that show up gradually over a few years. In contrast, in Canada for example, the Competition Bureau may make an application to the Competition Tribunal regarding a merger up to three years after the merger has been "substantially completed".[17] Australia also has, in effect, a three-year limitation period.[18] There is no statutory limitation on the US government's authority to review mergers after they have been complete.[19]

So, if only one year limitation is available then the test of AAEC is to be narrowly construed in terms of application within a span of time. If a combination gradually turns out to have AAEC after a period of one year then the CCI's powers will be restricted to inquire into such combinations. This is an area which requires an immediate attention.

B. Money Centric

As have already been discussed the questionable threshold restricts the powers of the CCI to inquire, control and thereafter achieve the purposes of CA.

C. Consumer Centric

Consumers are the ultimate point of judgement of a particular combination. If a combination is adversely affecting the consumers in terms of unfair pricing strategy, deliberate creation of shortage of supply, abuse of the dominant position which the combination intends

[16]The Competition Act, 2002) § 20 (1), No. 12, Acts of Parliament, 2003 (India).
[17]The Competition Act 1985 (Canada), § 97.
[18]Trade Practices Act 1974 (Australia), § 81(2).
[19]GHOSH & ROSS, *supra* note 13, at 39.

to form etc. So, only a broad scope of AAEC can achieve what the consumers' desire.

D. Market Centric

When assessing the permissibility of horizontal mergers, one must first establish what the relevant market is. This requires a focus on the demand side to establish whether or not the products are close enough substitutes. On the supply side, it is important to identify the market shares of the firms. It is important to assess how the relevant market is likely to evolve in the near future. This would depend on whether entry is easy and whether there are potential entrants that could easily enter.[20]

Further another factor is whether the higher concentration in the market resulting from the merger will increase the possibility of collusive or unilaterally harmful behaviour. Collusion is more likely in industries producing relatively homogeneous products and characterised by small and frequent transactions, the terms of which cannot be kept secret. The merger is likely to be unilaterally harmful when the two merging firms produce similar products in a concentrated differentiated product market.[21] It has been noted that

[20]S. Chakravarthy, *India's New Competition Act 2002 - a Work Still in Progress*, 5 BUS. L. INT'L 240, 258 (2004).

[21]SVS Raghavan Committee, *Report of High Level Committee on Competition Policy Law*, http://rapidlibrary.com/source.php?file=ulzwbwmxnbi89on&url=http%3A%2F%2Fwww.globalcompetitionforum.org%2Fregions%2Fasia%2FIndia%2FReport_of_High_Level_Committee_on_Competition_Policy_Law_SVS_Raghavan_Committee29102007.pdf&sec=9e890c44eb0d4554.

the definition of market frequently determines whether a particular merger is judged anti-competitive and unlawful.[22]

The core component of any merger control regime is the assessment of proposed mergers to determine their possible effects on competition. Every system of merger control sets out a substantive test to determine whether or not a merger ought to be blocked and must decide upon a standard of proof required before a competition authority can block a merger.[23] A substantive test usually involves the examination of various factors such as:

a) Market Shares and Market Concentration

Market shares of firms are an important factor taken into account in the context of impacts on competition as they can indicate the market power of the firm. Market shares, prior and subsequent to the merger, are also used to determine the level of concentration in the market which in turn indicates the level of competition in the market.[24] Many jurisdictions today however employ the *Herfindahl-Hirshman Index* (HHI) to determine market concentration. This method involves the calculation of the sums of squares of individual market shares of all competitors in the market. A total less than 1000 indicates low concentration and one greater than 1800 indicates high concentration.[25]

[22]OECD/World Bank, *A Framework for the Design and Implementation of Competition Policy and Law* (1999), http://www.oecd.org/dataoecd/10/30/27122278.pdf.
[23]RICHARD WHISH, COMPETITION LAW 788 (2005).
[24]ALAN H GOLDBERG, COMPETITION LAW TODAY: CONCEPTS, ISSUES AND THE LAW IN PRACTICE100-101(1st ed, 2007).
[25]Neeraj Tiwari, *Merger Under The Regime of Competition Law: A Comparative Study of Indian Legal Framework With EC and UK,* 23 BOND LAW REV.117, 136 (2011).

b) Barriers To Entry

Barriers to entry, as the expression indicates, refers to a situation that makes the costs of a new entrant to the market higher than the cost of firms already in the market which creates a range within which firms in the market can raise their prices above the competitive level without attracting new entry.[26] 'Barriers to entry' finds place among the various factors to be taken into account by the CCI in determining whether a proposed combination has or is likely to have an appreciable adverse effect on competition.[27] The nature and extent of vertical integration in the relevant market is also to be considered by the CCI.[28]

c) Actual And Potential Competition

The determination of the effects of proposed mergers on competition involves the examination not only of the actual levels of competition in the relevant market and the likely consequences of the transaction but also the impacts of the transaction on potential competition.[29] Indian Competition law requires the consideration of 'actual or potential competition' but this is qualified by the words 'through imports'.[30] At the same time, another listed factor is the 'extent of effective competition likely to sustain in the market'.[31]

[26]*Id.* at 137.
[27]The Competition Act 2002, § 20 (4) (b), No. 12, Acts of Parliament, 2003 (India).
[28]*Id*. at § 20 (4) (j).
[29]TIWARI, *supra* note 25, at 137-138.
[30]The Competition Act, 2002, § 20 (4) (a), No. 12, Acts of Parliament, 2003 (India).
[31]T. RAMAPPA, COMPETITION LAW IN INDIA: POLICY, ISSUES AND DEVELOPMENTS 209(2006).

d) Welfare Objective And Benefits To The Customers

While competition law is essentially concerned with economic objectives, social welfare objectives and consumer benefit also constitute an important part thereof. The regulation of mergers may also involve the consideration of such objectives.[32] The CAincludes the nature and extent of innovation among the factors to be assessed in merger regulation and also mentions the benefits of the combination in general. Although as such consumer interest does not find a mention in the law, it is likely that in examining the benefits of the combination or its impact, the effects on consumers would also be taken into account.[33]

The emergence of globalisation and privatisation has increased the need to regulate M&As in a global market perspective. The existence of a sound regulatory mechanism increases the faith of incoming foreign investors.[34] The effect and the efficiency of the functioning of the Act although yet to see, a lot of literature seems to have developed with differing views. The scope and extent of application of AAEC is largely contested.

Appreciable has been defined as capable of being measured or perceived,[35] and adverse is defined as having an opposing or contrary interest, concern, or position.[36] So, in order to attract the CCI's attention a combination must have a negative impact on the free and fair competition. The problem which arises is the impact analysis as the impact can be both quantitative and qualitative. The quantitative

[32]TIWARI, *supra* note 25, at 139.
[33]The Competition Act 2002, §19(3), No. 12, Acts of Parliament, 2003 (India).
[34]Jitheesh Tilak, *Regulating M&As an Insight into Competition Laws in India*, 32 INT'L BUS. LAW. 161, 165 (2004)
[35]BLACK'S LAW DICTIONARY 117 (9th ed. 2009).
[36]*Id*. at 62.

aspect may still be measurable easily but qualitative aspects such as customer satisfaction, fairness of pricing structure etc. may prove to be difficult to measure and if somehow measured, the genuineness of the data will always be doubtful.

The CA has come a long way to establish a sound regulation as far as combination is concerned, but the prevalent ambiguous concepts and tests are preventing the statute from achieving an optimum level of enforcement.

III. SIGNIFICANT IMPEDIMENT ON EFFECTIVE COMPETITION

The Treaty of Rome established the European Economic Community in 1957. It has been known as the European Community (EC) since the Maastricht Treaty of 1992. The Treaty does not contain any specific provisions relating to mergers. Historically, mergers were dealt with by the application of Articles 81 and 82. However, this was considered to be an inadequate way of governing mergers and so, in 1989, the ECMR was introduced. The present rules are contained in Council Regulation (EC) 139/2004.[37]

In the last twenty years, the application of EC competition law by the Commission has been increasingly informed by economics.[38] In the field of merger control it has operated an economically enlightened

[37]George Metaxas and Hector Armengod, *EC Merger Regulation and the Status of Ancillary Restrictions: Evolution of the European Commission's Policy*, 9 E.C.L.R. 500 (2005).

[38]D.Neven, *Competition economics and antitrust in Europe*,21(48) ECONOMIC POLICY 741 (2006); See also, M. Monti, EUROPEAN COMPETITION FOR THE 21ST CENTURY 257 (B. Hawk ed., 2002).

regime as a whole, however its policy on conglomerate mergers and ambiguity over the role of efficiencies have received adverse comment.[39] The most significant reform that resulted from the review of the ECMR that took place between 2001 and 2004 was a change in the substantive test for analysing mergers, and is the focus of this essay.[40] Unlike the reforms noted above, it did not result from any significant criticism of the merger regime, so the need for a new test and its possible impact is uncertain and worth exploring, especially in light of some experience with the operation of the new ECMR.[41]

As originally drafted the ECMR prohibited a merger '*which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or a substantial part of it*' more commonly known as Dominance test.[42] During the review of the ECMR, economists and lawyers debated and raised issue whether the dominance test was sufficiently supple to apply to unilateral effects in oligopoly markets.[43]

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[39]D. E. Patterson and C. Shapiro, *Transatlantic Divergence in GE/Honeywell: Causes and Lessons*, 16 ANTITRUST 18 (2001).

[40]The process began with the *Green Paper on the Review of Council Regulation (EEC)*, No. 4064/89 COM (2001) 745, http://eur-lex.europa.eu/LexUriServ/site/en/com/2001/com2001_0745en01.pdf.

[41]Giorgio Monti, *The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?* 2 LSE LAW, SOCIETY AND ECONOMY WORKING PAPERS 10/2008,http://ssrn.com/abstract=1153661.

[42]Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings art.2(3) (1989) OJ L395/13, http://ec.europa.eu/comm/competition/mergers/legislation/regulation/consolidated/en.pdf.

[43]N. Horner, *Unilateral Effects and the EC Merger Regulation – How The Commission Had its Cake and Ate it Too*, 2(1) HANSE LAW REVIEW 23 (2006); S. Baxter and F. Dethmers, *Unilateral Effects Under the European Merger Regulation: How Big is the Gap?*,ECLR 380 (2005); C.D. Ehlermann, S. Volcker and G.A. Gutermuth, *Unilateral Effects: The Enforcement Gap under the old ECMR*, 28(2) WORLD COMPETITION 193(2005) ; J. Vickers, *How to Reform the EC*

Observing the insufficiency of the test, a need to change the regulation was brought to the fore which was then furthered in the case of *Volvo/Scania* where the EC Commission blocked a merger that would have created a dominant manufacturer of heavy goods vehicles in several Member States.[44] This case gave rise to the following questions: if the merged entity is not the biggest player on the market but it is able to raise price or restrict output unilaterally, how can we block these mergers with the 'dominance' test? Thereafter another concern arose that if the dominance test was to be altered then the EC might end up losing all the case laws, jurisprudence and literature developed in this regard, as the EC proposed to alter the dominance test to SLC test used in USA, UK and Australia.[45]

So a compromise was brought in the new ECMR provides that a merger would be blocked if 'it would significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.'[46]

Regulation 139/2004 introduces a new substantive test, according to which EC may block a transaction, which would significantly impede effective competition (SIEC), in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.

Merger Test?(G. Drauz and M. Reynolds (eds)), EC MERGER CONTROL: A MAJOR REFORM IN PROGRESS (2003).

[44]Volvo/Scania [2001] OJ L 143/74.

[45]Enterprise Act 2002 (UK), § 35; Trade Practices Act 1974 (Australia), § 50; Clayton Act 15 USC 18 (US),§ 7.

[46]Council Regulation (EC) No 139/2004, Art. 2(3) [2004] OJ L24/1. Recital 25 clarifies that the only reason for this is to fill the gap in horizontal merger cases.

The new substantive test will specifically allow the Commission to take into account so-called unilateral effects, that is, price increases arising because the transaction eliminates some existing competitive constraint that had been holding back the price level in the market. Adoption of the Significant Impediment Test will bring EC competition law more in line with standard applied in the USA and Canada.[47]

What exactly does SIEC mean? Is it the same as SLC? One interpretation is that they are synonymous. Another is that 'substantial lessening' relates to how much competition is *lost*, while 'impediment to effective competition' has to do with how much competition *remains* post-merger.[48] Another source to answer the above question can be that the notion of SIEC:

> *"should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned*".[49]

This says that SIEC extends, in a disciplined way, beyond dominance, and it makes clear that the new test covers non-coordinated effects, thus disposing of the problem of the gap. Thus the key question now relates to how a merger affects competition, not whether it reaches a threshold of dominance.[50]

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[47]Anniek van Zutven and Hans Urlus, *New EU Merger Regulation and Reform of EC Antitrust Enforcement EC Treaty* (Alert, June 2004).
[48]OLIGOPOLIES AND JOINT DOMINANCE IN COMMUNITY ANTITRUST LAW, FORDHAM CORPORATE LAW INSTITUTE(Barry Hawk ed.2001).
[49]*Supra* note 46 at recital 25.
[50]John Vickers, *Merger policy in Europe: retrospect and prospect,* http://oft.gov.uk/shared_oft/speeches/spe0104.pdf.

Dominance, as the Commission acknowledges will remain the main scenario, but the new test will clearly also encompass duopolies and oligopolies and beyond. It thus seems that the test to pass has become stricter and that this will lead to more prohibitions or approvals subject to conditions.[51] The new test is intended to fill a (perceived) gap by covering cases of "unilateral effects" i.e. where the fear is that the merged entity could raise prices even though it will not become the largest player (sole dominance) and without the need of any tacit coordination with other players (joint dominance).[52] It has also been observed that the change is mainly procedural and an attempt to make abundantly clear what was clearly inferred in the dominance test.

In a recent *Oracle/PeopleSoft* review, for example, any likely adverse finding would not easily fit into the dominance test. Oracle and PeopleSoft are the second and third largest competitors for high-end business software applications and the combined company would only have around 30% of the market. SAP, the market leader, has more than 50%. It is possible that such a transaction could be interpreted as constituting a SIEC but not creating or strengthening a dominant position.[53]

The EC has continued to apply an economics-focused approach to the assessment of mergers, indicating that its policy towards mergers has not changed as a result of the move to the SIEC test; however, it is generally perceived that the SIEC test gives a wider degree of discretion to the EC.[54] SIEC aims to fill the gaps under the old

[51]Stibbe, *New EU Merger Control Regulation*, http://www.stibbe.be/assets/publications/newsletters/new%20eu%20merger%20control%20regulation.pdf.
[52]*Supra* note 7, at 1.
[53]*Id.* at 1.
[54]Slaughter and May, *The EU Merger Regulation: An Overview of the European Merger Control Rules*,http://www.slaughterandmay.com/media/64572/the-eu-merger-regulation.pdf.

dominance test, in particular if a merger raised serious competition concerns but resulted neither in a firm enjoying a strong No. 1 position of say 40-50% or more in a market (indicative of single-firm dominance) nor in the creation or strengthening of an oligopolistic market structure conducive to tacit collusive between a small group of players (indicative of collective dominance). Some of these concerns were driven by the fact that in 2002 the court of first instance annulled 3 prohibition decisions on the basis that the Commission had failed to prove that the deals were caught by the old Merger Regulation's dominance test.[55]

Following are some of the important criteria taken into account in assessing mergers:

A. Market Shares And Market Concentration

In the EU, the Competition Commission would consider accretion of market power on the buying as well as selling sides. In determining whether a concentration might have adverse horizontal effects, the Commission will look predominantly at the increase in the combined entity's market share through other factors would also be taken into account as this alone would not provide any insight into the loss of potential competition that the concentration might entail.[56] An instance in which market shares were looked into by the commission is that of *Syngenta CP/Advanta*,[57] in which the parties which were engaged in crop protection, breeding, production and processing, etc. of seeds respectively. The Commission took into account the facts that the merged entity would have 15-80 per cent market share in various types of seeds to come to the finding that the operation would

[55]*Id.* at 21.
[56]RICHARD WHISH, COMPETITION LAW 838, 839 (2005).
[57]COMP/M.346 [2004] EC Comm. 53.

give rise to serious concerns of being likely to significantly impede effective competition.[58]

B. Barriers To Entry

In the EU, the EC considers whether the vertical effects of the concentration could foreclose access to markets. In *Skanska/Scancem*[59] where the merged entity would have a very powerful presence in the market for raw materials (cement), construction materials (concrete) and the construction industry, the EC directed Skanska to divest *Scancem's* cement business as well as its entire shareholding in *Scancem*.[60]Article 2 of the ECMR, which deals with the appraisal of concentrations and sets out the factors to be taken into account by the Commission in this process mentions, access to supplies and *'any legal or other barriers to entry'*.

C. Actual And Potential Competition

The Commission must, in making its assessment, look into actual and potential competition from both inside and outside the communities.[61] The EC in *Telia/Telenor*[62] expressed concern over the fact that the merged entity would have an increased ability and incentive to eliminate actual and potential competition from third parties.

D. Welfare Objectives And Benefits To Consumers

The ECMR gives importance to consumer welfare in the process of merger analysis, requiring the Commission to look into the interests of the intermediate and ultimate consumers as well as the

[58]*Id.* at 60.
[59]Case No. IV/. 1157, [2000] 5 CMLR 686.
[60]*Supra* note 57, 840.
[61]ECMR, art.2 (1) (a).
[62]COMP/M. 1439[2001] 4 CMLR 1226.

development of technical and economic progress, provided that it is to consumers′ advantage and does not form an obstacle to competition. Therefore, the above analysis establishes that the SIEC test is an attempt to fill the gaps the old dominance test had created. It was out of abundant caution that the reform was brought in.

IV. SIEC VIS-A-VIS AAEC

The SIEC test overall as discussed earlier in addition to filling the gap in the old dominance test it aims at achieving an effective competition, while the AAEC test aims to prevent any measurable adverse effect on the competition.

The SIEC test allows greater flexibility and gives more powers to the Commission: while it is still based on the concept of dominance, it is only by example and is no longer the primary criterion for assessing a concentration. It has been observed that the SIEC test is a much more powerful economic tool to analyse the costs and benefits of a proposed merger in terms of balancing its pro-competitive and anti-competitive effects.[63] On the other hand, The CA, however does not define or elucidate the meaning of the expression AAEC, merely enumerating various factors, all or any of which are to be taken into account to determine whether a combination has such an effect. It would be up to the CCI, the CAT and the Supreme Court to define how large an effect would qualify as an appreciable adverse effect and whether this term would include any term above the *de minimis*.[64]

[63]TIWARI, *supra* note 25, 136.
[64]*Id.* at 136.

The words '*significant*' and '*appreciable*' seem to be two sides of the same coin. But a close examination establishes a difference in terms of degree i.e. 'significant' applies in cases where the impact on the competition is larger in comparison to appreciable impact. If this is the case then scope of AAEC in contrast with SIEC is wider.

The two tests are equally new and have to undergo a lot of scrutiny to establish the effectiveness of the competition. The only advantage that SIEC has is the presence of abundant jurisprudence in terms of cases and literature due to the old dominance test, while AAEC is a new development under the CA post-MRTP and therefore no such jurisprudence is available.

It may also be interesting to note that in the report of the High Level Committee there is no reference to the dominance test of EC, also the UK and US competition law has been referred but not the SLC. It compels the deduction that the AAEC is an independent test established to regulate combinations in a way not being done by the other jurisdictions. So, a probable conclusion that SIEC and AAEC are one and the same thing is unacceptable at this juncture.

The ultimate purpose of any competition law legislation is the protection and preservation of an independent, effective and efficient market to protect the consumers. SIEC and AAEC are different tools for the same purpose. The question therefore is which of the two tests has done the job better. In order to compare the two tests on this point the differences in the market must be noted i.e. India and Europe. The two markets are absolutely different in terms of tastes, nature, consumer preferences, and market players. So a measure which might prove efficient in one market may fail utterly in the other market.

Emerging market consumers are rapidly becoming more like their affluent market counterparts, is true. But the rate of change is not as rapid as contended. In most emerging markets, the mass market will remain poor well beyond the current planning horizons of most

multinationals. And even as they grow more affluent, it is far from certain that Chinese and Indian consumers' preferences will converge with those of Europeans or Americans.[65] Market as that of Indian is mostly culture driven and as a result the style and pattern differ.

AAEC and SIEC are instruments for two different markets when on one hand the former is a completely new concept with its roots from Russia, US, UK as its source, while on the other hand the latter is merely an extension to a somewhat successful dominance test under the old EC merger code. If the market difference is to be kept constant then based on the available data such as case laws and literature SIEC is most likely to achieve the goals of a competition law more efficiently compared to AAEC. This deduction is mainly on the basis of absence of the judicial scrutiny of the test in India, which compels the author to point that the preliminary judicial examination whenever arises will ultimately first rely on jurisprudence available with regard to SIEC and Dominance test on a reference basis to reach any decision.

V. CONCLUSION

It is as a matter of fact that there appears to be much in common between the competition laws in the European Union and India. EU and Indian competition systems also have similar objectives. They all seek to advance the interests of consumers and protect the free flow of goods in a competitive economy as well as protect the rights of competitor's access to markets and protect to some extent consumer's

[65]Niraj Dawar and Amitava Chattopadhyay, *Rethinking Marketing Programs for Emerging Markets*, 3 Working Paper Number 320, http://deepblue.lib.umich.edu/bitstream/2027.42/39704/3/wp320.pdf.

freedom of choice and seller freedom from coercion to bring about the ultimate aim of total welfare.[66]

However, as discussed, there are also numerous differences in the provisions in the context of definitions, notification, time limits for review of notifications by the competition authorities, and the substantive test applied for determination of impacts on competition. The substantive assessment of mergers in all three jurisdictions involves the same basic steps, namely the identification of the relevant market, the assessment of the merger as per the substantive test set out in the respective laws, and in this process, the consideration of various factors including market shares, concentration, possibility of foreclosure and also welfare objectives.[67]

The basic substantive test for the analysis of mergers differs. EC law requires the determination of whether the merger causes significant impediments to the effective competition, which although it implies the distortion of competition, may not require the impediments caused to be 'substantial'. The test in Indian law requires the assessment of whether the merger is likely to cause 'appreciable adverse effects on competition' in a manner somewhat 'measurable'.

[66]Veena V. Rajes, *Competition Act, 2002 in comparison with the Antitrust/Competition Laws in force in the USA and European Union with Reference to Cartels*,http://cci.gov.in/images/media/ResearchReports/veenafeb12.
[67]TIWARI, *supra* note 25, at 140.

THE LAW ON INTERNATIONAL TELECOMMUNICATIONS AND BROADCASTING: NEED FOR DEVELOPMENT OF THE EXISTING REGIME?

Srinivasan Ramaswamy[*]

Abstract

The law on international telecommunications and broadcasting derives its substratum from international space law. However, at the time when the Outer Space Treaty was drafted, the involvement of private corporations in activities related to outer space was not envisaged. Therefore, with the rapid technological as well as commercial advancement, the doctrines envisaged by the five major space treaties and the related principles have become redundant in so far as their application to telecommunications and direct satellite broadcasting is concerned. Hence, there is a need to revisit Article VI of the Outer Space Treaty if the activities of autonomous bodies like INTELSAT are to be governed. In this regard, the provisions of the ITU Constitution appear to be an

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improvement over the Outer Space Treaty. The World Trade Organization also has a pivotal role in formulating and administering laws on telecommunications. However, the GATS Annex on Telecommunications and the Reference Paper are not devoid of ambiguities. Furthermore, the role of the UNCOPOUS and the International Telecommunication Union in the allocation of frequencies and orbital positions is questionable at best, since such a practice would tantamount to national appropriation. Professor Stephen Gorove's counter misses the point in the sense that he fails to take into account the use of nuclear powered satellites. In this regard, the author states that the International Telecommunication Union must be conferred with extensive powers to deregister or cancel a particular allotment in case a more efficient proposal is made by another state. This would check continued national appropriation as well as provide opportunities to developing states thereby justifying the statement that outer space is a "province of all mankind".

I. INTRODUCTION

As we stand at the threshold of the twenty-first century, we can admire the advancement made in field of telecommunications and the benefits accrued to mankind as a result of such progress. This development has catapulted the human society to an unprecedented

level of progress within a short span of time. With the advancement of research and exploration activities in the outer space, this new arena was gradually put to commercial use and one of the first such uses was the use of satellite technology to accentuate telecommunication mechanisms. With the successful launching of the Telstar I satellite and the establishment of the Communication Satellite Corporation (hereinafter referred to as "**COMSAT**") by the United States of America, several states at the European Conference in Satellite Communication (hereinafter referred to as "**CETS**") entered into talks with the United States to foster transnational cooperation for the purpose of the development of a commercial communication satellite system.[1] This resulted in the formation of the International Telecommunications Satellite Consortium (hereinafter referred to as "**INTELSAT**") and the subsequent launching of the Intelsat I or the *Early Bird* in the year 1965. This consortium was later converted into a corporate body responsible for providing fixed satellite services. By virtue of multilateral agreements administered by the International Telecommunication Union (hereinafter referred to as "ITU") and the INTELSAT, the market for communication services and technology had increased manifold to $ 550 billion by the end of 1988,[2] and $ 1.5 trillion by 2012.[3] Therefore, with the increase in the commercial uses of the outer space as well as the extensive participation of private space activities, it is imperative that the legal mechanism relating to telecommunications is efficient enough to deal with the recent developments.

[1]Council of Europe, *Consultative Assembly, Committee on Science and Technology Report on Long-Term Prospects of Space Exploration for Europe* (rapporteur: Mrs. Maxsein), Doc. 2517 at 34 (Jan. 16, 1969).

[2]PETER F. COWHEY, WHEN COUNTRIES TALK: INTERNATIONAL TRADE IN TELECOMMUNICATION SERVICE (Cambridge, Mass.: Ballinger Publishing Co., 1988).

[3]*Telecommunication Services*, http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm.

This paper shall firstly analyse the evolution of the international law on telecommunication. In this part, the constitution and the role of various intergovernmental bodies shall be discussed. Thereafter, I shall proceed to identify a number of legal issues pertaining to the international telecommunications regime. One of the major concerns pertains to Article VI of the Treaty on Principles Governing the Activities of States in the Exploration and Use of Outer Space, including the Moon and Other Celestial Bodies, 1967[4] (hereinafter referred to as "**Outer Space Treaty**") with regard to the responsibility borne by states for the activities carried out in outer space. However, with intergovernmental bodies like the INTERSPUTNIK and private entities like INTELSAT carrying out activities in outer space, the extent and scope of application of parts of Article VI of the Outer Space Treaty remains somewhat unclear.

The third part of this paper shall seek to analyse the interplay between the law on international telecommunications and world trade law, with special focus on the GATS Annex on Telecommunications and also the Agreement on Basic Telecommunication Services. Thereafter, this paper shall explicate the concept of the electromagnetic spectrum as a natural resource and the role of the WTO in this regard. Direct Satellite Broadcasting being an important segment of international telecommunication shall also form an area of discussion. The DBS Principles also ignore the responsibility of private players and Principle I despite its attempt to encourage international cooperation fails miserably as it merely reproduces the text of Article IX of the Outer Space Treaty thereby attracting the very issues facing Article IX. The paper also strives to resolve issues relating to national security involved in DBS by resorting to the object and spirit of international space law. This paper also strives to look into the problems of equitable allocation of spectrums and orbits

[4]UN Doc. 2222 (XXI) (1967).

considering that these resources are limited in nature, in view of the principles laid down in the ITU Constitution[5]. This area shall be dealt with keeping in mind the principles of the common heritage of mankind, since it espouses the sustainable use and conservation for meeting the needs of future generations. Last, but not the least the author shall also address the issues of exploitation of orbital resources, the interests of the developing countries in this regard and the problems with the text of the concerned laws. Towards the end, the paper shall conclude by arguing in favour of an inclusive system and a comprehensive regime of international telecommunications taking into account the needs of developing countries and also the future generations in the light of the Outer Space Treaty and other principles of international outer space law.

II. THE EVOLUTION OF THE LAW ON INTERNATIONAL TELECOMMUNICATION: A LOOK AT THE VARIOUS INTERGOVERNMENTAL BODIES

A. International Telegraph Union

The development of international laws governing outer space activities were for the first time started with the transnational discussions relating to radio frequencies in the year 1959, when the ITU Radio Regulations were amended to include frequency allocations for newly designated radio telecommunication services

[5]Constitution and Convention of the International Telecommunication Union, July 1, 1994, 1825 UNTS 1826 art. 44 [hereinafter I.T.U Constitution].

and the conditions on the use and exploitation of those frequencies.[6] The roots of these regulations of telecommunications can be traced back to the establishment of the International Telegraph Union in 1865. The International Telegraph Union was one of the earliest examples of international co-operation. The convention establishing this body provided *inter alia,* for the right of everyone to "correspond by means of international telegraph" and emphasized on the secrecy of such conversation and also the need to have a uniform set of tariffs and regulations.[7] Soon, the privileges under these regulations were accorded to private telegraph entities as well.[8]

B. The International Radiotelegraph Union

The International Radiotelegraph Union was another body which was born as a result of the multi-national interests,[9] to regulate practices of certain monopolistic entities in the radiotelegraph industry. This was a result of the International Radiotelegraph Conference held at Berlin in 1906.[10] One of the foremost agendas of the conference which was also adopted by this convention was Article 3 which required the coastal and ships stations to exchange wireless telegrams without any discrimination on the ground of the telegraph systems used by such stations. This was in response to the practices carried on by the Marconi Wireless Company which used its monopolistic presence in that particular market to enter into agreements with various shipping companies to provide them with radio operators and also conferred

[6]J. Henry Glazer, *The Law Making Treaties of the International Telecommunication Union through Time and in Space,* 60(3) MICH. L. REV. 292 (1962).
[7]*International Telegraph Convention of Paris*, 56 BRIT. & FOR. ST. PAPS. 294(1865).
[8]*Vienna Telegraph Convention*, 59 BRIT. & FOR. ST. PAPS. 322(1868).
[9]It is to be noted that the Berlin Radiotelegraph Conference of 1906 was attended by at least the representatives of twenty seven states across the world.
[10]International Radiotelegraph Convention Nov. 3, 1906 https://search.itu.int/history/HistoryDigitalCollectionDocLibrary/4.37.57.en.100.pd.

upon itself the right to refuse communication with any ship or station not using the patented devices. Such practices were found to be hampering the utility of telegraph communications, hence the aforesaid provision along the lines of Article 1 of the preliminary convention[11] sought to prevent the creation of monopoly in favour of a single entity. The Convention and the rules framed thereunder prescribed technical standards for the devices and the apparatus put to use with an aim to reduce interference. The Berlin Radiograph Convention was revised in 1912. Although, several attempts were made to make the use of radio sets in ships after the disaster of the RMS Titanic, such an agreement could be fructified only in the first Safety of Life at Sea Convention.[12] However, despite these amendments, the Convention was not comprehensive enough to deal with the emerging problems. Therefore, delegation from 30 countries across the world met in Washington in the year 1927 to discuss the possibilities of incorporating further amendments to the existing Convention. This Convention, *inter alia*, propounded the method of allocation of frequencies to telecommunication service providers rather than countries.[13] The Berlin and the London Radiotelegraph Regulations referred to the bands in terms of 'kilocycle'. Thus, after the conference at Washington, the channels from 10 to 100 kilocycles per second were reserved for long distance services, channels from 100 to 500 for ship and aircraft services and 500 to 1500 for broadcasting.[14]

C. The International Telecommunication Union

[11]*Preliminary Conference on Wireless Telegraphy 1903*, ITU, https://www.itu.int/en/history/Pages/RadioConferences.aspx?conf=4.35.
[12]*Safety of Life at Sea Convention*, 108 BRIT. AND & FOR ST. PAPS. 283.
[13]Stewart, *The International Radiotelegraph Conference at Washington*, 22 A. J. INTL. L. 28, 48 (1928).
[14]*Supra* note 7, at 279.

The subsequent meeting of the delegates at Madrid in 1932 resulted in the formation of the ITU as a result of the merger of the two pre-existing treaties- Telegraph Convention and the Radiotelegraph Convention. This was a comprehensive structure embodying rules relating to telegraph, radio and the telephone. The ITU later went on to become a specialized body of the United Nations Organization (hereinafter referred to as "UN") in the year 1949.[15] The ITU is itself structurally divided into various component organs which are as follows:

- The Plenipotentiary Conference which is an important body concerned with decision making and chalking out the strategic map of the ITU meets once every four years. The Plenipotentiary Conference is also actively involved in the election of the office bearers of the ITU. The next Plenipotentiary Conference is scheduled to be held at Busan in the Republic of Korea in 2014.
- Administrative Conferences, where member states of the ITU met to propose and discuss changes to the existing regulations.
- The Administrative Council which is associated with the administrative work of the ITU.
- There are four more permanent bodies: The general secretariat, the International Frequency Registration Board (hereinafter referred to as "**IFRB**"), the International Radio consultative Committee (hereinafter referred to as "**CCIR**"), the International Telegraph and Telephone Consultative Committee (hereinafter referred to as "**CCITT**").

[15]Agreement between the International Telecommunication Union and the United Nations, Apr. 26, 1949, 30 U.N.T.S. 315.

The IFBR has been entrusted with the responsibility of implementing frequency allocation plans and registering frequencies.[16] States assign particular wavelengths to various private entities for the purpose of carrying out broadcasting operations within the respective state. These assignments made by the states are registered with the IFRB. The objectives of the ITU are implemented by periodic ITU Conferences and also previously through its worldwide and regional World Administrative Radio Conferences (hereinafter referred to as "**WARC**"). One of the major and the most important conferences of the ITU has been the one held in 1979 at Geneva. The conference of 1979 whose decisions, having the force of an international treaty, still continue to have a decisive influence on the development of all types of radio communications and broadcasting to this day. This radio conference was the first one in twenty years to examine and completely modify the main document of the radio sector, the Radio Regulations, in order to meet new challenges of rapidly changing radio technology and to provide a better sharing of spectrum and orbit resources among developed and developing countries.

The WARC-79 resulted in the following outcome:

- There was a significant change in the allocation of frequencies and the procedures involved in the implementation of these modifications.
- New approaches were formulated for aiding the developing countries in accessing spectrum.
- It was decided to conduct conferences to discuss space activities and short wave broadcasting.
- Agreements were reached on the expansion of short wave spectrum allocated for broadcasting.

[16]Glazer, *Infelix ITU- The Need for Space Age Revisions to the International Telecommunication Convention,* 23 FED. B. J. 1 (1963).

Some of the decisions arrived at by the countries at the WARC-79 are valid to this date, such as the call for having a standard mechanism for regulating the radio spectrum and space activities connected thereto, framing standards for efficient operation of these technologies by means of international cooperation and working towards bridging the technological gap between the developed and the developing countries. However, in 1992 at the *Additional Plenipotentiary Conference* in Geneva the ITU was restructured and as a result from 1993 the conference became known as the World Radio communication Conference or simply the WRC.

D. The United Nations Education Scientific and Cultural Organization

The United Nations Education Scientific and Cultural Organization (hereinafter referred to as "**UNESCO**") also has been playing a pivotal role in the international telecommunications, with its first action in this regard dating back to 1948, when a resolution recognizing the right of the public to access broadcasts from across the world was recognized.[17] Subsequent resolutions in 1969 in favour of the use of space communications and the 1972 Declaration of Guiding Principles on the Use of Satellite Broadcasting for the Free Flow of Information, the Spread of Education and Greater Cultural Exchange[18]. However, the latter was subject to severe criticism on the grounds of loose wordings used therein and also as going against the general stand of the UNESCO which was in favour of free flow of information. One of the primary reasons for such a consideration was the requirement of consent of the receiving state to broadcasting of

[17]UNESCO, Records of the General Conference, 3rd Sess., Vol. 2 UNESCO Doc. 3C/Resolution 7.2221 (1959).
[18]UNESCO, Records of the General Conference, 17th Sess., Vol. 1 UNESCO Doc. 17C/Resolution 4.111 (1972).

data. This was however, supported by other superpowers like the Soviet Union and France.

III. LEGAL TEXTS OF THE ITU: THE CONSTITUTION & THE CONVENTION

In the light of the above discussion, it is clear that the ITU plays a pivotal role in the field of telecommunications. The composition and the functioning of the ITU are determined by the ITU Convention, the ITU Constitution, and the Administrative Regulations.[19] Article 4.2 of the Constitution stipulates that it shall remain the principal document of the Union and that the Convention shall be supplemental to the Constitution. In the event of any discrepancy or conflict between the provisions of the Constitution and the Convention, the provisions of the former shall prevail over the latter.[20] The Administrative Regulations on the other hand are the regulations of the ITU and are binding on the member states to the ITU.[21] Therefore, a state is also obliged to ensure the compliance of these rules by any agency which may be authorised by the state to conduct international activities in telecommunication.[22] However, the ITU Constitution creates an exception in relation to military installations, wherein the member states are not bound by the regulations of the ITU.[23] The ITU Constitution puts forth a very important principle in Article 12 which

[19]I.T.U. Constitution, art. 4.1.
[20]I.T.U. Constitution, art. 4.4.
[21]I.T.U. Constitution, art. 4.3.
[22]I.T.U. Constitution, art. 6.1.; Although it may be noted that by virtue of Article 51 of the Constitution, the supervision exercised by the states over the agencies may be subject to specific conditions fixed by the concerned state.
[23]I.T.U. Constitution, art. 48.

states that the functions of the Radio communication Sector shall be to ensure that all the radio spectrum resources are used efficiently, rationally and equitably by the services both in the geostationary orbit as well as in other orbits.

Another very significant issue presented by the ITU Constitution relates to usage of orbits. Article 44.2 of the Constitution envisages that the orbits must be used in an efficient manner, but taking into consideration the needs of the developing countries and the geographical position of certain countries. The reference to developing countries and the geographical situation was introduced by the ITU Nairobi Convention of 1982.[24] Various scholars on space law have previously contended that the indication about the situation of particular countries was not with a view to confer on any particular country preferential rights over others, but only to express a dissatisfaction towards the prevailing practice of *a priori* allocation.[25] However notwithstanding the emphasis on the needs of developing countries, orbital slots are allocated only on a 'first come, first served' basis with the exception of direct broadcasting satellites.[26] These inclusions by the convention were an aftermath of the claim made at the First Meeting of Equatorial States in Bogota in 1976, when Colombia claimed a specific part of the geostationary orbit above its territory, on the grounds that such an appropriation was alien to the scope of the Outer Space Treaty, 1967.[27] The concerned states claimed that "segments of [the] geostationary orbit [those over the

[24]International Telecommunication Convention, Nairobi, 6 November 1982, 1531 U.N.T.S 1.

[25]Stephen Gorove, *The Geostationary Orbit: Issues of Law and Policy*, 73 AM. J. INTL. L. 444 (1979), Ram Jakhu, *The Legal Status of Geostationary Orbit*, 7 AASL 333 (1982), G.O. Robinson, *Regulating International Airwaves: The 1979 WARC*,21 VIRG. J. INTL. L. 1 (1980).

[26]FRANCIS LYALL, SPACE LAW: A TREATISE 252 (Ashgate Publishing Co., 2009).

[27]Declaration of the First Meeting of the Equatorial States, Bogota, 1976, 6 J. SP. L. 193 (1978).

equator] are part of the territory over which the Equatorial States exercise their national sovereignty". A reason put forward by them was that the existence of the geostationary Orbit was a result of the gravitational pull emanating from their surface. This however, is nothing but a plain contradiction of the principle outlined by Article I and II of the Outer Space Treaty. The view of the countries was that the geostationary Orbit was being used contrary to the 'equitable use' principle enshrined by the ITU Convention and the developing countries were at a loss. In other words, an assertion of this kind would only highlight the failure of the Outer Space Treaty to define the limits of outer space.

IV. INTERNATIONAL TELECOMMUNICATIONS AND THE OUTER SPACE TREATY: A CASE OF THE PRIVATE ENTITIES

The Outer Space Treaty is the most comprehensive body of law concerning activities in outer space. However, one of the most significant problems in the Outer Space Treaty with regard to telecommunications is that of the principle of international responsibility enshrined under Article VI. The text of Article VI is as follows:

> "*States Parties to the Treaty shall bear international responsibility for national activities in outer space, including the Moon and other celestial bodies, whether such activities are carried on by governmental agencies or by non-governmental entities, and for assuring that national activities are carried out in conformity with the provisions set forth in the present Treaty. The activities of non-governmental entities in outer space,*

> *including the Moon and other celestial bodies, shall require authorization and continuing supervision by the appropriate State Party to the Treaty. When activities are carried on in outer space, including the Moon and other celestial bodies, by an international organization, responsibility for compliance with this Treaty shall be borne both by the international organization and by the States Parties to the Treaty participating in such organization.*"

One issue which may be pointed out in this regard is whether private bodies like the INTELSAT would be governed by the provisions of the Article VI. It is pertinent to note that although Article VI includes non-government entities and inter-governmental organizations into its ambit, but there is no mention about private bodies. The INTELSAT was an intergovernmental consortium until the year 2001, when few private equity firms took over and converted it into a private limited company, currently headquartered in Luxembourg and having offices across the world. Considering this proposition, it has been argued that non-governmental entities would include private bodies as well.[28] However, under Article VI, such bodies are required to be supervised by the 'appropriate party' to the Outer Space Treaty. In case of private body like the INTELSAT which has offices carrying out operations worldwide, the issue of appropriate country becomes a point of debate. Whether the country in which the company is headquartered shall be the supervising state or the country where the mission supervising office is situated or the country from whose territory the spacecraft is being launched is a matter of doubt. With regard to this problem, it is submitted that the countries in which all the offices involved in the space activity are situated may bear the

[28]J. FAWCETT, OUTER SPACE: NEW CHALLENGES TO LAW AND POLICY 51-79 (1984).

responsibility. This interpretation is in consonance with the nature and spirit of the provision as seen from the wordings applicable to intergovernmental bodies and this reading would also not impose unnecessary burden on a single state merely because of the fact that such a private body is headquartered in that particular state or because of the fact that such a country happens to be the launching state. In these circumstances, the text of Article VI of the Outer Space Treaty though laden with ambiguities becomes very crucial. The erstwhile INTELSAT would have squarely fallen within the meaning of Article VI, since it was an intergovernmental organization formed as a result of agreement between states without any independent corporate existence.

Furthermore the use of the term 'national activities' in Article VI only serves to compound the ambiguity. This is because a body like INTELSAT or INTERSPUTNIK would usually carry out activities in outer space on behalf of all the member countries. So, would 'national activities' only imply that such an organization be responsible only when it is involved in the sending or maintenance of a satellite of any particular country? Another question which props up is with regard to the applicability of this provision insofar as the sending or maintenance of a satellite in behalf of a private body is concerned. One view which is also shared by the Outer Space Act, 1986 of the United Kingdom implicitly points towards this interpretation by defining 'national activities' as activities carried out by that state or its nationals.[29] But, to put such an interpretation into the words of Article VI would again tend to leave an unfair result. Therefore, the most plausible interpretation of 'national activities' would be to interpret it as any activity carried on by or on behalf of any particular

[29]The Outer Space Act §2 (1986), See B. Cheng, *Whose Parking Space is it anyway? Mapping Out a legal Minefield in the Celestial Outlands*, The Times Higher Education Supplement 14 (30 May 1986, No. 789).

state or a number of states or any private entity. This would make all the member states responsible and would thus, fall in line with the principle of international responsibility envisaged by Article VI.

V. RECONCILING THE LAW ON INTERNATIONAL TELECOMMUNICATIONS WITH WORLD TRADE LAW

With the increasing participation of countries in this field, it could be seen that there has developed an intrinsic relationship between the law of international telecommunications and international trade law. The World Trade Organization (hereinafter referred to as "WTO") was a result of the Uruguay Round of Negotiations held in the year 1994. Prior to the birth of the WTO, a greater part of the international trade since 1948 had been administered by the General Agreement on Trades and Tariffs and the provisional secretariat. The General Agreement on Trades and Tariffs (hereinafter referred to as "**GATT**") is particularly relevant, owing to the trade in the equipment and terminals involved in relaying and conveying telecommunication signals. However, the General Agreement on Trade in Services (hereinafter referred to as "**GATS**") is more important in this respect, since it consists of certain obligations which are applicable to all the members of the WTO[30] as well as sector specific obligations applicable only to sectors liberalized by the member nations. The GATS came into operation in January 1995 as a result of the conclusion of the Uruguay Round of Negotiations. The GATS strives to protect the equality of opportunity for countries in world trade and seeks to foster liberalization of trade, albeit subject to the national

[30]General Agreement on Trade in Services, Jan. 1995, 1869 U.N.T.S. 183; 33 I.L.M. 1167 (1994), art. I [hereinafter GATS].

policy objectives of the WTO members.[31] The GATS comprises of general agreements, the annexes thereto and individual commitments listed in the schedules. Few of such horizontal obligations have been explicated hereunder:

- One of the primary obligations of members under the GATS is the Most Favoured Nation (hereinafter referred to as the "**MFN**") treatment which provides that a member state receiving foreign services must accord equal advantages to another state without any discrimination.[32] By virtue of this obligation, all states are prohibited from practising all forms of discrimination between services rendered by states.[33] However, Article II.2 provides that the member states may exempt themselves or refrain from undertaking these obligations in consonance with the Annex on Article II Exemptions. Therefore, several countries including the United States[34], Brazil[35], India[36] and Pakistan[37] have maintained exemptions concerning telecommunications. A more significant exemption in this regard is that of the European Union on audio visual services, implying no liberalization obligation on the members thereof.[38] However, it is pertinent to note that in instances where no specific commitments have

[31]GATS, Uruguay Round Final Act, Dec. 15, 1993, Annex 1B, GATT Doc. No. MTN/FA, 33 I.L.M. 1130 (1994).
[32]GATS, art. II.
[33]Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, 9 September 1997, WT/DS27/AB/R, para 234.
[34]WTO Doc. GATS EL/90/Suppl. 2.
[35]WTO Doc. GATS EL/13/Suppl. 1.
[36]WTO Doc. GATS EL/42/Suppl. 1.
[37]WTO Doc. GATS EL/67/Suppl. 1.
[38]European Communities and their Member States, Final List of Article II (MFN) Exemptions, WTO doc. GATS/EL/31 of 15 April 1994.

been undertaken, the MFN clause is a very significant obligation in this regard.

- Another very important obligation created by Article III under the GATS is the responsibility of maintaining transparency. Article III mandates all the member states of the WTO to publish all the domestic laws, rules and regulations which affect international trade in services to a great extent. The obligation of transparency is an essential aspect of international trade, since it permits market players to determine the regulations involved in this regard and also their applicability.[39] By the year 1997, all the member nations had created information sources to aid foreign market participants. This obligation has also found special mention in GATS Annex on Telecommunications.

The GATS also has provisions facilitating a multilateral system of settling disputes which may arise in connection to the compliance with obligations listed out in the annexes and the schedules. Although the earlier GATT had a system of dispute resolution, the orders could be blocked by countries losing the dispute and the dispute resolution process went on for a long period of time. Therefore, the GATS strives to redress these issues as well.

A. The GATS Annex on Telecommunications

Therefore, world trade law has also made deep inroads into the law of international telecommunications. The GATS Annex on telecommunications does not emphasize on the liberalization of the telecommunications market,[40] but merely adds generic obligations which apply to all the WTO member states. The main purpose of the

[39]Kern Alexander, *The GATS and Financial Services: The Role of Regulatory Transparency*, 20(1) CAMBRIDGE REVIEW OF INTERNATIONAL AFFAIRS (2007).
[40]GATS, Annex on Telecommunications, art. 1.

Annex was to bring to light the obligations of member states with regard to access and use of public telecommunications transport network. The definition of the term 'Telecommunications' as provided in the Annex, would attract any communication or the reception of signals with the involvement of an electromagnetic spectrum.[41] Therefore, scholars like David Luff have called for an explanation in this regard, since the transmission of signals by a cable also uses an electromagnetic spectrum.[42] The wordings used in the definition of "Public telecommunications transport network"[43] are also somewhat ambiguous considering the lack of clarity with regard to its applicability to cable networks.

An important aspect of the Annex on Telecommunications is that it creates an obligation on all member states to enable all service providers from other member states to have access to their public telecommunications infrastructure and permit the use of all public telecommunication services on a non-discriminatory basis.[44] Member states also are required to ensure that the service providers of other member nations have been permitted to purchase or take on lease equipment and also access cross border communications and information retained in databases.[45] However, it is to be noted that a member state has been given every right by virtue of Article 5(d) and Article 5(e) of the Annex, to impose conditions and measures on the access and use of public telecommunications network so as to inter

[41]GATS, Annex on Telecommunications, art. 3(1).
[42]DAVID LUFF, CURRENT INTERNATIONAL TRADE RULES RELEVANT TO COMMUNICATION SERVICES, THE WTO AND GLOBAL CONVERGENCE IN TELECOMMUNICATIONS AND AUDIO-VISUAL SERVICES 43 (Cambridge University Press, 2004).
[43]Article 3(c) defines "public telecommunications transport network" as 'the public telecommunications infrastructure which permits telecommunications between and among defined termination points.'
[44]GATS, Annex on Telecommunications, art. 5(a).
[45]GATS, Annex on Telecommunications, art. 5b(i), c.

alia, ensure the security and the secrecy of the messages and the technical integrity of the network.

The Annex on Telecommunications also outlines the principles of transparency and international cooperation. The Annex embodies the spirit of Article III of the GATS to a great extent, as it requires all information pertaining to access of public telecommunications network, tariffs and compliance requirements to be available.[46] Lastly, the Annex envisages vital cooperation between the developed and developing countries at the international as well as the regional level and mandates special preference to be given to suppliers from 'least developed' countries in this regard. The ITU and the International Organization for Standardization have thus been entrusted with the objective for fostering the objectives envisaged by the Annex.[47]

B. The Agreement on Basic Telecommunication Services

The Agreement on Basic Telecommunication Services was signed on February 15, 1997 between sixty nine countries of the world which sought to liberalize the global telecommunications sector which according to the then Director General of the WTO was more than $500 billion.[48] The agreement epitomizes nations undertaking additional obligations on scheduled sectors as provided in Article XVIII of the GATS. Therefore, the term "Agreement" has been said to be a misnomer, since this is essentially a list of specific commitment and exemptions submitted by the member countries.[49] As a Protocol, the commitments and exceptions listed here override

[46]GATS, Annex on Telecommunications, art. 4.
[47]GATS, Annex on Telecommunications, art. 7.
[48]WTO Press Release 67, *Rugiero Congratulates Governments on landmark Telecommunications Agreement* (Feb. 17, 1997).
[49]*Supra* note 43.

and amend any previous undertaking by the states. The agreement emphasizes on the inclusion of basic telecommunication services by the parties in their schedule of commitments. Explanatory notes issued on behalf of the Group on Basic Telecommunications define "Basic Telecommunication Service" as anything that

a. Encompasses local, long distance and international services for public and non-public use;
b. May be provided on a facilities-basis or by resale; and
c. May be provided through any means of technology.[50]

C. The Reference Paper

Towards the conclusion of the Uruguay Round in 1994, the member states formed a Negotiating Group on Basic Telecommunications (NGBT) to work towards the liberalization of the telecommunications market in consonance with the strategic framework of the GATS. A very significant development with regard to this agreement was the adoption of another separate set of commitments in the schedules known as the Reference Paper. The Reference Paper sets forth the definitions and the guidelines concerning the regulatory mechanism in basic telecommunication services, to be adopted by countries in transforming their respective telecommunication sectors to a competitive environment encouraging free market access to international players.[51] The obligations mentioned in the Reference Paper become binding on its members when the Reference Paper is included in its schedule of commitments.

[50]Note by Chairman, S/GBT/W/2Rev. 1, (16 Jan. 1997).
[51]Boutheina Guermazi, *Exploring the Reference Paper on Regulatory Principles*, The World Trade Organization, http://www.wto.org/English/tratop_e/serv_e/telecom_e/workshop_dec04_e/guermazi_referencepaper.doc.

One of the most prominent principles enshrined in the Reference Paper is the safeguard against anti-competitive practices.[52] The foremost reason behind the incorporation of this principle is to ensure that the commitments are not impaired by anti-competitive practices. Anti-competitive behaviour in this regard would include denial of access to network on commercial terms and also misuse of commercial information.[53] The terms of the Reference Paper with regard to antitrust policies govern only 'major' entities, since adoption of restrictive and abusive measures by these dominant service providers would hinder the principles of free market access of basic telecommunication services. The effort of the countries to negotiate a document to check anti-competitive practices is indeed commendable, since the Reference Paper is the first such document to coin a definition for the term 'major entities'. But at the same time, the scope of the definition is very general and loose in nature in the sense that it does not define the "power to effect the terms of participation". However, the Reference Paper has struck a balance as far as the definition of "essential facilities" is concerned. A very wide definition would have resulted in decreasing the efficiency of the market by allowing more number of firms and a restricted view of the concept would have hampered the competitive nature of the market and consumer welfare.[54]

The Reference Paper also throws light on the principles of transparency by virtue of Section 4, which inter alia, requires the publication of licensing criteria as well as the licensing conditions of individual permits be made available in the public domain. This

[52]Reference Paper, Negotiating Group on Basic Telecommunication Services, Art. 1, http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm.
[53]OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*33 (Paris 1997).
[54]Alexander Larson, William Kovacic and Douglas Mudd, *Competitive Access Issues and Telecommunications Regulatory Policy*, 20 J. CONTEMP. L. 423 (1994).

principle is subsequently accentuated by Section 6 which envisages that the allocation of scarce resources like spectrums, right of way must be done in a "*transparent and non-discriminatory manner*".

D. The WTO and the Electromagnetic Spectrum as a Natural Resource

The electromagnetic spectrum is as much a natural resources like any other, although the spectrum is not depletable like minerals or petroleum. Therefore, an analogy has been drawn to a river, since a river may be used for various purposes but may never be depleted.[55] Similarly, a spectrum is never in itself depleted, but it may not be put to favourable use in case of interferences of overcrowding and employing the present technology only a sizeable portion of the spectrum can be put to use.[56] The geostationary orbit like the electromagnetic spectrum is also a limited natural resource. Although there is no measure of the number of satellites, the geostationary orbit can accommodate, estimates indicate the number to be anywhere between 180-2400 depending on variety of factors.[57] Therefore, it is imperative that a reasonable distance between the satellites have to be maintained in order to avoid collision and harmful interference.[58]

The era of modernization has resulted in the frequent use of wireless networks in lieu of wired ones. Therefore, this has gradually increased the demand for frequencies in the radio-electric spectrum, since wireless networks use the radio-electric spectrum. Several

[55]Christian A. Herter, *The Electromagnetic Spectrum: A Critical Natural Resource*, 25 NAT. RESOURCES. J. 651 (1985).
[56]*Id.*
[57]S*upra* note 27.
[58]Rothblatt, *The Impact of International Satellite Communication Law upon Access to the Geostationary Orbit and the Electromagnetic Spectrum*, 16 TEX. INTL. L.J. 207, 207-11 (1981).

procedures are involved in the assignment of frequencies. The first procedure is the allocation of frequencies at the international under the patronage of the ITU at the World Radio-communication Conferences. Although, there seems not to be any direct link between the allocation of frequencies and international trade law, however a violation of the principles of world trade law may be established if a discriminatory treatment is meted out to a country during the course of the negotiations, resulting in an impingement of the MFN obligations under Article II of the GATS.

Another procedure is the allocation of frequencies at the national level, wherein the procedures involve the auctioning by the state of frequencies within the allocated frequency band. This assignment by the state is done to service providers within the country where the service is meant to be provided. Trade law become equally important in the case of domestic allocation, especially trade barriers arising from onerous and unfair trade practices. However, under such circumstances, the applicability rules of trade law are subject to the specific commitments of the particular nation under the GATS. Therefore, trade law under such circumstances fails to guarantee any protection against unfair practices.

VI. DIRECT SATELLITE BROADCASTING

Another prominent area in the field of international telecommunications is Direct Satellite Broadcasting (hereinafter referred to as "**Direct Broadcasting**"). Direct Broadcasting involves the transmission of signals from satellites placed in the geostationary orbit; therefore the need to track the signals by an antenna does not

arise.[59] The legal principles on Direct Broadcasting can be traced back to the year 1970s, with the adoption of Resolution 2916 (XXVII) of November 9, 1972 which sought to lay down general rules regarding the use of artificial satellites by member nations for the purpose of television broadcasting 'with a view to concluding international agreement or agreements'. However, there were various issues on which the Legal sub-committee of the UN Committee on Peaceful Use of the Outer Space (hereinafter referred to as "**COPUOS**") failed to reach a consensus. This lack of agreement was attributed to the conflict between the stance of states favouring free flow of information and nations concerned with security and integrity. This paved the way for the adoption of the Direct Broadcasting Principles in the year 1982.[60] The principle relating to state responsibility in direct broadcasting activities was a much debated issue. Principle F of the Direct Broadcasting Principles sought to hold a state responsible only in case of activities carried out by the state for its national and intergovernmental activities. However, these principles were also not devoid of ambiguities.

Principle F, unlike Article 6 of the Outer Space Treaty is silent about the responsibility of the state in case of private activities.[61] A possible solution in the absence of any such stipulation would be to apply the principles enshrined in Article VI of the Outer Space Treaty to the Direct Broadcasting Principles. But then, as we have noticed earlier, even Article VI is not free from ambiguities. Another point of contention between the nations was the degree of consultation envisaged by Principle J. Professor Stephen Gorove points out that

[59]A. Chayes and L. Chazen, *Policy Problems in Direct Broadcasting from Satellites*, 5 STAN J. INT. STUD. 4-20 (1970).

[60]Principles Governing the Use by States of Artificial Satellites for International Direct Television Broadcasting, G.A Res. 37/92 (Dec. 10, 1982).

[61]As a matter of fact, a proposal of this kind was presented by Canada and Sweden, only to be rejected by the Soviet Union.

the representation made by the Indian and Greek delegates that the activities be carried out in accordance with international law, if accepted would have solved the problem.[62] Principle I despite attempting to foster international co-operation leaves much to be desired, since the wordings are almost the same as Article XI of the Outer Space Treaty. The phrase "to the greatest extent possible" only invites more confusion.

Furthermore, there exist certain issues specifically in this field that are yet to be addressed. One such problem as Professor Francis Lyall points out is the access to the orbital positions along with radio frequencies and their use thereof.[63] Direct Broadcasting involves the use of electromagnetic spectrum and the allocation of frequencies thereof is usually done on an *a priori* basis. Concerns regarding exhaustion of the orbital resources were raised by several developing nations. Hence, in the ITU-WARC-ORB held in 1985-87, the debate of efficient use versus equitable use was sought to be reconciled and orbital allocations within 10 degrees on the geostationary arc for the purposes of Direct Broadcasting were made.[64] Another issue of utmost importance relates to the content of the broadcasts. Broadcast of certain forms of data may be unacceptable to a country and this may result in significant problems.[65] Therefore, in this regard it may be argued that the Preamble to the Outer Space Treaty, 1967 envisages the use of the outer space exclusively for peaceful purposes; hence the use of a satellite for spreading propaganda and disturbing the internal decorum of a country would violate the spirit

[62]S. GOROVE, DEVELOPMENTS IN SPACE LAW70 (1991).
[63]*Supra* note 27, at 257.
[64]Ram Jakhu, *The Evolution of ITU's Regulatory Regime Governing Space Radio Communication Services and the Geostationary Orbit*, 8 AASL 381(1983).
[65]J.T. Powell, *Towards a Negotiable Definition of Propaganda for International Agreements relating to Direct Broadcast Satellites*, 45 LAW AND CONTEMP. PROBS. 3 (1982).

of the Outer Space Treaty. Principle 4 of the Direct Broadcasting principles may also be taken into consideration, since it envisages Direct Broadcasting to be carried out in consonance with the principles of international law.

VII. CONCLUDING THOUGHTS: THINGS CAN ONLY GET BETTER?

Considering the analysis presented throughout the course of this paper, it could be observed that there are significant issues involved in the law relating to international telecommunications. As observed in the preceding paragraphs, activities in the telecommunications sector are not conducted particularly by governmental entities but also by intergovernmental consortiums and private entities, which probably was not contemplated by the drafters of the Outer Space Treaty. But then, Article VI though strives to bring non-governmental entities within its ambit, the scope of the provision remains unclear as it is merely a reproduction of the UN Declaration of 1963. The Outer Space Treaty therefore, is not adequately capable of addressing these issues and a comprehensive set of laws are required. The Outer Space Treaty thus remains an epitome of good intention but bad drafting. Similarly, Article 44.2 of the ITU Constitution encourages the efficient and economic use of radio and orbit resources. As a result, in the event of a private body accessing space, these rights and/or obligations which have been conferred on the states have to be licensed to that private organization. In the absence of any legislation governing such licensing activity on the part of the state, the outcome of the space activity in the event of a failure might be a rather risky one. Hence, there is a need for an efficient legal document if not now, at least in the near future.

Looking at the constitution and functioning of the ITU, one cannot but deny the omnipotent role of the body. The 'first come first served' principle of allocating frequencies although, fosters the idea of Article 44.2, a prolonged use of a specific frequency would be akin to claiming title over that particular frequency. The efforts of the ITU must however be commended in this regard as Resolution 4 of the WARC 1979 proscribed considering the allotment of a frequency as permanent, albeit allowing for extension of such period.[66] Coupled with this, the author would also advance suggestions in favour of conferring on the ITU powers to limit the duration or cancel such allotment in case a better use of that particular frequency is proposed in future, keeping in mind the interests of international telecommunications. There is an intrinsic relationship between the orbital positions and frequencies. It has been pointed out that an 'allocation' of positions would go against the spirit of free use contemplated by the various space treaties. To this effect, Stephen Gorove points out that the ban on national appropriation contemplated by Article 2 of the Outer Space Treaty would be effective only if there is "continued physical occupation of the same physical area of the GSO", which he says is practically not possible. However, it is respectfully submitted that Gorove in this regard ignores the point that with the advent of nuclear powered sources, satellites can stay in space for a greater length of time. Nuclear sources like Plutonium and Uranium have a high half-life and as such, a few kilograms of such a source would be enough to keep the satellite in orbit for many years to come. Therefore, I would submit that such an allocation is contrary to the principles of outer space law. However, for the sake of practical handling of all these activities, the international body must have the authority to de-register any orbital allocation if they remain unused or

[66]Period of Validity of Frequency Assignments to Space Stations using the Geostationary-satellite and other Satellite Orbits' RR RES. 4 (Rev. WRC-03).

are not put to efficient use, because the opposite would be a gross violation of Article 44 of the ITU Constitution.

Space activities are governed by a broad framework of laws adopted at the international level. International trade law and the WTO are involved in the supervising matters relating to market access and encouraging liberalization in the telecommunications sector. The Agreement on Basic Telecommunication Services has been a major effort in liberalizing trade services. The members to this agreement contribute to over 90 per cent of the international revenue in telecommunications.[67] International space laws administered by the five major treaties strive to govern issues involving responsibility, liability and use of space resources. However, the loopholes present in the treaty do not address the issues arising out of international telecommunication activities sufficiently. As far as the issues concerning private organisations are concerned, the ITU Constitution is an improvement over the Outer Space Treaty, as Article 6.1 of the ITU Constitution provides that the states must ensure compliance by the licensed parties of the ITU laws and regulations. Furthermore, with the involvement of bodies like the INTELSAT and the INTERSPUTNIK, it is evident that there has to be international cooperation in this regard. In fact, the ITU Constitution itself envisages international cooperation for the rational use of telecommunications and mutual benefits of all the members.[68] International cooperation here must not only include effective participation of all the countries but also looking at the need of the developing as well as underdeveloped countries and working towards a system of inclusive growth keeping in mind the basic tenets of 'common heritage of mankind' such as sustainable exploitation of

[67]Spector P.L., *The World Trade Organization Agreement on Telecommunications*, 32(2) The International Lawyer 217 (1998).
[68]I.T.U. Constitution, art. 1.

space based natural resources and increasing the access of knowledge and technology to developing states. Therefore, in the light of the above discussion, it is imperative that large scale reforms in international laws of outer space, trade and telecommunications are required to keep up with the pace of globalization and technological advancement.

DATA EXCLUSIVITY IN INDIA: A SAGA OF IGNORANCE AND ILLOGICALITY[1]

Kushank Sindhu[*] *and Abhishek K. Singh*[**]

Abstract

The central point of conflict between innovator and generic pharmaceutical companies is how generic companies circumvent drug authorization procedures for manufacturing products already invented by innovator companies. Governments rely on the post-screening data submitted by innovators to check the similarity of the generic's product with the innovator's product. Generics are able to reduce costs because of low trial and testing costs. This helps them market cheap and similar medicines but according to the innovators, there must be intellectual property protection given on the data that they have already submitted given its newness and expensive generation. Governments should not rely on them at least for a few years. The TRIPS

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Agreement is ambiguous on this issue leading to different interpretations. India interprets against such protection on the misplaced belief that imposing it would finally lead to delay and increase in medicine costs. This paper brings out the fallacy in the above line of thought by interpreting the TRIPS in a manner which clearly indicates towards a regime of data exclusivity as a means of intellectual property protection. Analysis of data from countries shows the benefits of such interpretation- encouraging critical research and development of cheaper and more effective medicines. It allows for foreign investment and collaboration opportunities. India's position on data exclusivity is incorrect and dangerous making the country lose out on crucial benefits. Concerns such as high prices of medicines can be remedied utilizing the provisions already there in Indian law. This plan of action will protect intellectual property towards better public healthcare conditions.

I. INTRODUCTION

The Indian pharmaceutical industry has high output and growth rates and is one of the top five in the world.[2] It is widely credited to have helped in controlling diseases, especially in poor countries, by marketing cheap drugs through its domestic generic industry.[3] The generic industry, unlike its counterpart innovators, is able to produce and market drugs already discovered and patented, at cheaper costs because it is allowed to circumvent all clinical trial processes for their medicines by submitting bioequivalence reports, without conducting full clinical trials of their medicines, to the designated government authority and the authority relies on the data submitted by the innovator to check the bioequivalence of the generic's product. This process deserves criticism because the generics are able to produce the same medicines without investing as much time and money.

In this context, this paper intends to look at the Agreement on Trade Related Aspects of Intellectual Property Rights and examines the kind of protection and incentives it envisages and whether and how the Indian legal system complies with its obligations.

The existing body of literature in the Indian context has interpreted the TRIPS to means that it does not refer to a regime of data exclusivity and having it would be against India's interests. It develops on the premise that protecting intellectual property rights in

[2]The industry was estimated to be US$ 10.76 billion in 2008 and grew at a high compound annual growth rate (CAGR) of 9.9 per cent till 2010 and has been estimated to grow at a CAGR of 9.5 per cent till 2015. It ranks 4th in volume terms and 13th in value terms. *Drugs and Pharmaceuticals,* CONFEDERATION OF INDIAN INDUSTRY, http://www.cii.in/Sectors.aspx?enc=prvePUj2bdMtgTmvPwvisYH+5EnGjyGXO9hLECvTuNtw8YL926EJfiCmU3ofN0YX

[3]*India is fittingly known as pharmacy of the developing world*, 14 MSF UNTANGLING THE WEB OF ANTIRETROVIRAL PRICE REDUCTIONS 6-7 (July 2011).

India would necessarily be against India's interest. This paper brings out the fallacy in this argument and presents an alternative argument that not only does TRIPS refer to a data exclusivity regime but with a whole basket of legal reform, such a regime can act in India's interests to promote public healthcare. It proposes that the existing *status quo* of not recognizing data exclusivity has only harmed India's interests and hence there is an urgent need to look at our legal structure

Part I of the paper is opened to the reader to describe the philosophical base and how the paper seeks to take the reader through the complex arguments to be put forth. Part II deals with the various entities, operations and universal issues in relation to data exclusivity. Part III discusses the various provisions of the TRIPS Agreement while the next part interprets them. The subsequent part discusses the Indian position and proposes changes in its legal regime. Part VI deals with miscellaneous concerns and benefits stemming from this discussion. The paper ends with a conclusion summarizing the various issues raised in the paper.

II. TYPICAL PHARMACEUTICAL INDUSTRY

A. Entities Operating

The general norms of how pharmaceutical industries operate in the world are consistent across countries.[4] A pharmaceutical product that is first authorized for marketing based on data submitted for proving its efficacy, safety and so on is called the innovator pharmaceutical

[4] *Infra* note 5, 43, 46 and 56.

product.[5] A lot of research, time and money is generally invested while conducting research on the product especially in clinical trials. The research and trials' data have to be submitted to the stipulated statutory authority for getting marketing approval.

Upon evaluation, if the authority deems it appropriate and if the test results and the medicine satisfy the authority, it will give permission to the innovator company for marketing the product.

Any company that also wants to market the product that the innovator company produces can do so by first manufacturing a product that is similar to the innovator's product and selling it subsequently but without putting its brand name on the package and only the generic name of the drug which basically means the chemical composition. The generic company need not make its product undergo clinical trials. It only has to show that its product is 'bioequivalent' to the innovator product of which it wants to produce a generic version. The government authority utilizes the innovator's clinical trial data produced to see whether or not a generic's product is bioequivalent to the innovator's product. The most obvious benefit that the generic company gets in this scenario is the fact that it does not have to pay the high costs nor spend the time that clinical trials would usually take. If the government authority gives its approval, the generic can sell the medicines at low prices albeit without its brand name and by including only the generic name of the medicine.

B. Common Concerns

[5] *Glossary*, WORLD PHARMACEUTICAL FRONTIERS, http://www.worldpharmaceuticals.net/glossary.htm. These definitions have been taken because the drug approval procedures in different countries are fundamentally and normatively same. Mayu Hirako provides an excellent comparison of the procedures in Mayu Hirako, *A Comparison of the Drug Review Process at Five International Regulatory Agencies*, 41 DRUGINFORMATIONJOURNAL291–308 (May 2007).

Several concerns are raised when an industry operates as described above. Innovators object to how generic companies are able to avoid clinical trials and still manufacture and market the innovator drugs.

It is trite to mention that clinical trials are very expensive and the costs of such data have exploded over time and even rough estimates are testament to their high costs. While launching a drug, the money spent on research constitutes a major portion of the total costs involved.[6] This percentage has only grown through the years.[7] This paragraph can be clubbed into one single line.

[6]According to objective estimates, the average cost has reason to almost 60% of the total development costs and that of pediatric trials has increased nearly eight fold from 2000 to 2006. Clinical Trial Facts and Figures, CENTRE FOR INFORMATION AND STUDY ON CLINICAL RESEARCH PARTICIPATION, http://www.ciscrp.org/professional/facts_pat.html. The total cost can reach $300–$600 million to implement, conduct, and monitor a large, multicenter trial to completion. INSTITUTE OF MEDICINE (US) FORUM ON DRUG DISCOVERY, DEVELOPMENT, AND TRANSLATION, TRANSFORMING CLINICAL RESEARCH IN THE UNITED STATES, CHALLENGES AND OPPORTUNITIES, WORKSHOP SUMMARY 26 (2010).

[7]Apart from the high cost of research, there is also the problem of drugs not succeeding even after research has been done. Matthew Herper, *The Truly Staggering Cost Of Inventing New Drugs*, FORBES,http://www.forbes.com/sites/matthewherper/2012/02/10/the-truly-staggering-cost-of-inventing-new-drugs/2/. Worldwide, research and clinical testing costs have risen to hundreds of millions of dollars per approved new molecule according to all kinds of estimates. Clinical success may be achieved at substantially lower cost with alternative models of pharmaceutical development and testing, but embracing those alternatives requires streamlined regulatory and organizational approaches and sacrifices in the richness of the evidence on the basis of which physicians must make subsequent prescription choices. F.M.Scherer, *R&D Costs and Productivity in Biopharmaceuticals*, HKS FACULTY RESEARCH WORKING PAPER SERIES RWP11-046, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY (December, 2011), http://dash.harvard.edu/bitstream/handle/1/5688848/RWP11-046_Scherer.pdf?sequence=1. Even when countries tried to reduce money spent on research, there was a drop seen in the effectiveness of drugs. According to studies conducted by a major Indian company, Wipro, in 2008-2010, there were fifty-five

With the costs involved, the time taken to get the regulatory approval by the governmental authority to grant permission to the innovator to manufacture the medicine, is also a cause for concern. It takes a long time to conduct research and get approval for pharmaceuticals.[8] According to Professor Carlos Correa,[9] it is the regulatory approval aspect of test data that makes them commercially important. In view of these cost and time concerns, innovators argue that it is unfair that generic companies are able to circumvent the clinical trial process. Supplying the same product at a cheaper price eats into the innovators' products. This acts as a disincentive to innovators and discourages them from investing in research and developing new medicines.[10]

Arguments in favour of such an industrial structure recognize the important of the very fundamental distinction between innovators and generics i.e. cheap medicines. Cheaper medicines allow more people to buy them, by and large improving the healthcare conditions of the country.[11] Governments are usually in a fix because while there are

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drug terminations in phase III which was much more than the number of terminations during the previous three year period. The number of drugs entering phase III clinical trials last year fell by a staggering 55 percent. Jennifer Zaino, *The State of Global Clinical Research Trials*, WIPRO AND UBM TECHWEB., http://www.wipro.com/Documents/TW_1108035_StofClinTrials_REV_v1.pdf

[8]For a comprehensive study of time and costs pattern in research and development, see Henry Grabowski, *Follow-on biologics: data exclusivity and the balance between innovation and competition*, 7 NAT. REV. DRUG DISCOV.479-488 (2008).

[9]Carlos M.Correa, *Protecting Test Data for Pharmaceutical and Agrochemical Products Under Free Trade Agreements*, UNCTAD-ICTSD, http://www.iprsonline.org/unctadictsd/bellagio/docs/Correa_Bellagio4.pdf

[10]Development Studies, *Medicine & Intellectual Property*, UNIVERSITY OF DUBLIN, TRINITY COLLEGE, http://www.tcd.ie/Economics/Development_Studies/link.php?id=87. See Harris G and Slater J., *Bitter pill: "Branded generics" eat into drug makers' profits*, WSJ, April 17, 2003, at A1.

[11]See for example the India government's attempts at increasing use of generic drugs at *infra*94.

cheap medicines on the one hand, on the other, there always is scope for research developing more effective medicines. The generic industry is also hit by massive quality concerns.[12]

A *via media* to this conundrum is protecting the data that the innovator submits to the authority and a restriction on government authorities relying on them. The restriction generally extends to a few years from the time the innovator company has received marketing approval. This system of protection is known as data exclusivity.[13]

Even with this solution, generics argue that a system of data exclusivity increases their costs because they have to conduct the trials again and high research costs increase cost of medicines. Developing countries like India do not want to take any chances of increase in medicine costs because of the battle against widespread, deadly diseases.

The above debate has found itself a place in international debates on the protection of intellectual property. In the following sections, the researcher intends to highlight how there indeed is a solution within the confines of international intellectual property instruments. The researcher further intend to show how India needs to reformulate its laws on the basis of its international intellectual property obligations if it has to even dream of guaranteeing the human right to healthcare.

[12]For a totality of the issues explained through the Indian context, see ¶ 5.4 of this paper.

[13]For a bird's eye view of the underlying notions and benefits of data exclusivity, see Henry Grabowski &Joseph DiMasi, *Biosimilars, Data Exclusivity, and the Incentives for Innovation: A Critique of Kotlikoff's White Paper*, DUKE UNIVERSITY DEPARTMENT OF ECONOMICS WORKING PAPER (February, 2009), http://www.cbpp.org/9-8-08sfp.pdf.

III. OBLIGATIONS UNDER THE AGREEMENT ON TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS

The globalizing economy has brought with itself issues of competitiveness which can be achieved only by innovation and product differentiation. This domain has high costs and high risks and must attract equally high rewards. Protection of intellectual property in this context is critical. It helps not only the developed countries but also developing countries in their transition to industrialization.[14]

The Agreement on Trade Related Aspects of Intellectual Property Rights[15] was framed in the year 1994 at the end of the Uruguay Round of the World Trade Organization.[16] The TRIPS was a major multilateral trade-intellectual property instrument in the series of multilateral trade agreements recognizing the importance of intellectual property in trade issues, signed in the late twentieth century.[17]

India has been a signatory to the TRIPS and Indian intellectual property laws have been known to be largely TRIPS compliant.[18] As

[14]L. Peter Farkas, *Trade-Related Aspects of Intellectual Property, What Problem with transition Rules What Changes to U.S. Law, How has Congress Salvaged 377?,in* THE WORLD TRADE ORGANIZATION, MULTILATERAL TRADE FRAMEWORK FOR THE 21ST CENTURY AND U.S. IMPLEMENTING LEGISLATION 463, (T. Stewart ed., 1996).

[15]Hereinafter, 'TRIPS' or 'the TRIPS Agreement'.

[16]Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, April 15, 1994, http://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm.

[17]GRAEME B. DINWOODIE AND ORS., LEADING INTERNATIONAL INSTITUTIONS AND ACTORS, INTERNATIONAL INTELLECTUAL PROPERTY LAW AND POLICY, 46 (2001).

[18]Jeffrey Colin, *Coming into Compliance with TRIPS: A Discussion of India's New Patent Laws*, 25 Cardozo Arts & Ent. L.J. 877 (2007).

a developing country[19], India had been given time till 2005 for aligning its laws with the TRIPS.[20]

IV. TRIPS' PROVISIONS

Article 39 is found in Section 7, Protection of Undisclosed Information, and is relevant to our discussion. According to Article 39.3

> "*3. Members, when requiring, as a condition of approving the marketing of pharmaceutical or of agricultural chemical products which utilize new chemical entities, the submission of undisclosed test or other data, the origination of which involves a considerable effort,* ***shall protect such data against unfair commercial use*** *(Emphasis supplied). In addition, Members shall protect such data against disclosure, except where necessary to protect the public or unless steps are taken*

[19]Members of developing countries announce on their own whether they are "developing" or "developed". A "developing country" status invites a number of advantages including longer transition periods under WTO Agreements. *Who are the Developing Countries in the WTO?*, WTO, http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm. The TRIPS as such provided a one-year transition period to all countries. [Art. 65(1): Subject to the provisions of paragraphs 2, 3 and 4, no Member shall be obliged to apply the provisions of this Agreement before the expiry of a general period of one year following the date of entry into force of the WTO Agreement.] Developing countries were provided a further period of four years. [Art. 65(2): A developing country Member is entitled to delay for a further period of four years the date of application, as defined in paragraph 1, of the provisions of this Agreement other than Articles 3, 4 and 5.] India has been a developing country since the time of the General Agreement on Tariffs and Trade, the predecessor of the WTO.

[20]Atsuko Kamiike and Takahiro Sato, *The TRIPs Agreement and the Pharmaceutical Industry: The Indian Experience*, CONFERENCE ON COMPARATIVE ASPECTS ON CULTURE AND RELIGION: INDIA, RUSSIA, CHINA", http://srch.slav.hokudai.ac.jp/rp/group_06/activities/files/20110915_16/20110916_KamiikeSato.pdf.

to ensure that the data are protected against unfair commercial use."

A. Interpreting the TRIPS

For the purposes of our discussion, the words 'shall protect such data against unfair commercial us' must be taken into considered.

The TRIPS can be interpreted using principles under the Vienna Convention on Law of Treaties, 1969. Under the general rule, any interpretation under this treaty starts with:-

(a) The ordinary meaning of the terms of the treaty
(b) In the context of such terms
(c) In light of the treaty's object and purpose.[21]

Hence, the starting point of interpretation is the elucidation of the meaning of the text and all the principles must be taken together and

[21]Article 31(1). HereinafterVCLOT. It is important to note that the rules have to be taken together and not individually or in bits. The WTO Appellate Body (AB) has laid down more specific principles for the interpretation of the TRIPS Agreement in the India- Patented Pharmaceuticals (Mailbox) Case. IWTO Appellate Body Report on India- Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R (Dec 19, 1997), http://www.wto.org/english/tratop_e/dispu_e/79r.pdf. Ironically, this was the first case to be filed and fought under the TRIPS and utilizing the Dispute Settlement mechanism. The United States was successfully able to argue that India had not yet set up the Patent Mailbox Mechanism for registering patent applications and had hence, violated the TRIPS. In the case, the Court held that for interpreting TRIPS, The rules of Article 31 of the Vienna Convention on the Law of Treaties apply. The panel and the AB began by examining the express terms of the TRIPS Agreement, giving them their ordinary meaning in their context, and light of the object and purpose of the agreement. The performance of the parties would be evidence of its intended meaning. Extracted version of these rules can be found at, FREDERICK M. ABBOTT, THE TRIPS-LEGALITY OF MEASURES TAKEN TO ADDRESS PUBLIC HEALTH CRISES,73 (1998).

not individually.[22] Further, the performance of the parties would be evidence of the intended meaning of the terms in the TRIPS.

B. Ordinary Meaning of the Terms

A dictionary and other sources of definitions help to ascertain the ordinary meaning of the terms.[23]

'*Shall'* is generally interpreted to mean a command or instruction.[24] 'Protect' refers to defend, protect or guard against.[25] 'Such' can refer to something that has already been said.[26] "Unfair" means to deprive of fairness while commercial refers to some activity engaged into for profit and use means[27] to put something to work. Such use can be both direct and indirect.[28]

In the construction of the sentence, when the words are taken together, it is evident that the words cast a duty on the government to protect the data that innovators submit against direct or indirect unfair commercial use.

However, because of the vagueness and subjectivity surrounding unfair commercial use, the treaty interpretation is not complete.

C. 'Context'

[22]Commentary to Article 27, VCLOT, paragraph 11, Yearbook of the International Law Commission, 1966, Vol. II, p. 220.
[23]RICHARDGARDINER, TREATYINTERPRETATION, 166 (2008).
[24]Oxford English Dictionary, http://www.oed.com/view/Entry/177350?rskey=J0wBOH&result=2#eid.
[25]*Id.*, http://www.oed.com/view/Entry/153127?redirectedFrom=protect#eid.
[26]*Id.*, http://www.oed.com/search?searchType=dictionary&q=such&_searchBtn=Search.
[27]*Id.*, http://www.oed.com/view/Entry/37081?redirectedFrom=commercial#eid.
[28]CHRISTIAN LENK, NILS HOPPE AND ROBERTO ANDORNO, ETHICS AND LAW OF INTELLECTUAL PROPERTY, CURRENT PROBLEMS IN POLITICS, SCIENCE AND TECHNOLOGY 188 (2007).

The context of the words occurring can be determined from the grammar and the syntax of the provision or phrase within which a word in issue is located.[29] Applying this rule, it can be seen that 'against unfair commercial use' actually describes the extent to which duty to protect such data exists. It is important to note that words occurring before or after clauses have been used as the immediate context to interpret the meaning of phrases in treaties.[30] Just before the clause being analyzed, there is a comma and before the comma, the undisclosed test or other datas described to mean any information that has been generated after investing a lot of time and money. Now, the context of the words can be understood also by the structure or scheme underlying a provision or the treaty *as a whole*.[31] Looking at this provision as a whole, the exact nature of "unfair commercial use" can be interpreted to mean use of the data that has been generated, without putting in the effort as described in the first clause, by any person, at a profit. This logical interpretation seems to clearly fit in

[29]*Id*. at 178. *Supra* note 24.

[30]*Id.*at 183. Joost Pauwelyn, *The Role Of Public International Law In The WTO: How Far Can We Go?,* 5 3 5 A J I L (2 0 0 1) . The author analyzed Article 3.2 of the World Trade Organization, Understanding on Rules and Procedures Governing the Settlement of Disputes, which reads "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." The author said that in exercising this judicial function of interpretation, WTO panels may clarify the meaning of WTO covered agreements, but they may not "add to or diminish the rights and obligations provided in the covered agreements. The immediate context of the relevant passage in Article 3.2 confirms this reading. The sentence directly follows the instruction for panels to clarify WTO covered agreements "in accordance with customary rules of interpretation of public international law." This is a clear indication that the last sentence of Article 3.2 also deals with the interpretive function of panels.

[31]*Id.*at 182. Also see, Dispute Concerning Filleting within the Gulf of St. Lawrence "La Bretagne" (Canada/France) (1986) 82 ILR591, 620-21.

the present context where a party i.e. the innovator, generates data i.e. clinical trial data, with a lot effort i.e. time and cost[32], submits it to the regulatory authority for approval of its product i.e. medicine and another party i.e. the generic, makes use of such data for profit use (i.e. the generic selling the medicines at reduced prices and making profits).

In summation, the above two sections intend to show that the TRIPS requires protection of expensive test data submitted by innovators from direct or indirect use by generics because if the generics were allowed to make use of such data without spending any costs or time, it would be very unfair for the innovators.

D. Objects and Purposes of the TRIPS and performance of parties

This section intends to substantiate upon the logical conclusion in the above paragraph by discussing whether or not, in light of the objects and purposes of the TRIPS, a system of data exclusivity is required. Because this discussion naturally intends to look at how generic industries and restrictions upon them, function across the world, by extension, this discussion would also satisfy a further tool of interpretation, specifically for the TRIPS that what the parties had intended to be included under the TRIPS can be deduced from the acts of parties itself.[33]

The object and purpose of the TRIPS Agreement is to fulfil the public health obligations and strike a balance with the intellectual property

[32] *Id.* at 6, 7, 8, 9 and 10.
[33] *Supra* at 21.

necessities.[34]The TRIPS built on the Paris Convention[35] but goes beyond it in terms of prescribing higher obligations and minimum standards on state parties.[36]

Ultimately, it is the defense of the common interests of mankind operates when it comes to multilateral treaties covering issues such as

[34]The Preamble of the TRIPS Agreement has been interpreted to highlight protection of intellectual property that needs to be undertaken keeping in view the social and economic necessities of the country. This view has been carried forward in Articles 7 and 8 that aim at prescribing a balance between protecting intellectual property and promoting the social, economic conditions of the country. See Peter K. Yu, *The Objectives and Principles of the TRIPS Agreement*, http://www.peteryu.com/correa.pdf.Even in India, the Madras High Court accepted this understanding and held that TRIPS gave enough flexibility to the government while adopting TRIPS in its provisions and highlighted the need to ensure access to health to all citizens including that of providing access to healthcare. See Linda L. Lee, *Trials and Trips-Ulations: Indian Patent Law And Novartis Ag V. Union Of India*, 23-1 BTLJ 281. Article 31, 3(a) of the Vienna Convention reads "Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions" shall be considered together with its context in the interpretation of a treaty. Only after the processes of negotiation and agreement were followed, was the Doha Declaration framed. Hence, it may be termed to be a 'subsequent agreement' to the Agreement on TRIPS. James Thuo Gathii, *The Legal Status of the Doha Declaration on TRIPS and Public Health under the Vienna Convention on the Law of Treaties*, 15-2 HJLT 291 (2002).

[35]Paris Convention for the Protection of Industrial Property of March 20, 1883, http://www.wipo.int/treaties/en/ip/paris/trtdocs_wo020.html.

[36]"Although it built on the Paris and Berne conventions of 1883 and 1886, respectively, TRIPS went well beyond the original anti-copying objectives of the drafters." J.H. Reichman, *The TRIPS Agreement Comes of Age: Conflict or Cooperation with the Developing Countries?*,32 Case W. Res. J. Int'l L. 441 (2000). "The international intellectual property system was recently strengthened and broadened by the Uruguay Round of multilateral trade negotiations whose intellectual property component, known as the "TRIPS Agreement," builds on the Paris and Berne Conventions. See Final Act Embodying the Results of the Uruguay Round of the Multilateral Negotiations, Marrakesh Agreement Establishing the World Trade Organization, signed at Marrakesh, Morocco, Apr. 15, 1994, Annex 1C, Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement"), in Results of the Uruguay Round 6-19, 365-403 (GATT Secretariat ed., 1994). Cited in J.H. Reichman & Anr., *Intellectual Property Rights in Data*? 50 Vand. L. Rev. 51.

health and artistic and scientific property.[37]In this backdrop, 'unfair commercial use' must be interpreted to mean any use that ultimately does not fulfill the public health objectives of enacting the Agreement on TRIPS.

E. 'Performance of the Parties':

In 1987, the United States proposed that that data exclusivity could be introduced under the concept of trade secrets. Business entities from the developed countries of the U.S., Japan and the E.U. jointly submitted that the Clinical Trial data generated took a lot of time and resources to generate.[38] After the TRIPS was enacted, developed countries like the United States and the European Union have interpreted Article 39.3 to be in favor of a regime of data exclusivity.[39] Even a developing country Argentina has been convinced about this interpretation.[40]

F. Furthering the American Dream

In the United States of America, a company that wants to manufacture an innovator drug has to file an application called a New Drug Application. Before 1984, a company that wanted manufacture

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[37]2 PAUL REUTER, INTRODUCTION TO THE LAW OF TREATIES 2 (1989).

[38]*Position Paper on Data Exclusivity*, THE INDIAN PHARMACEUTICAL ASSOCIATION, http://www.spicyip.com/ip-resources.html.

[39]Charles Clift, *Data Protection and Data Exclusivity in Pharmaceuticals and Agrochemicals*, HANDBOOK OF BEST PRACTICES, DATA PROTECTION AND DATA EXCLUSIVITY IN PHARMACEUTICALS AND AGROCHEMICALS 431-436 (Krattiger, RT Mahoney, L Nelsen, et al., 2007).

[40]This convincing was not without problems and the US invoked the WTO Dispute Settlement Mechanism against Argentina. The countries entered into an understanding via *Notification of Mutually Agreed Solution According to the Conditions Set Forth in the Agreement* (IP/D/18/Add.1, IP/D/22/Add.1) and Argentina finally passed laws requiring Data Exclusivity in 1996, http://www.eldis.org/assets/Docs/29224.html.

generic drugs of a product already approved by the FDA had to file another New Drug Application (hereinafter referred to as "**NDA**")[41] effectively duplicating the investments made in the first NDA and taking more time.[42]

The Drug Price Competition and Patent Term Restoration Act, 1984, commonly known as the Hatch-Waxman Act, amended the Federal Food, Drug, and Cosmetic Act, 1938.[43] The purpose of this Act was to facilitate the introduction ofgeneric drugs without undermining incentives for innovation.[44] It was designed to benefit makers of generic drugs, research-based pharmaceutical companies and the public.[45]

In the present regime, the generic drug manufacturer can submit an Abridged New Drug Application (hereinafter referred to as "**ANDA**") if the generic drug manufacturer's active ingredient is the "bioequivalent" of the listed drug. Regulatory authorities cannot rely on the originator's test data to approve subsequent applications for five years from the date of the FDA approval to the originator.[46]

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[41]The Court upheld this rule in the case of Roche Prods. v. Bolar Pharm. 733 F.2d 858 (Fed. Cir. 1984).

[42]Mylan Pharm. Inc. v. Henney, 94 F.Supp.2d 36, 39 (D.D.C.2000). In this case, the Court had granted Mylan's and Pharmachemies' claims for declaratory relief based on their dispute with the FDA regarding Barr's entitlement to the 180-day period of market exclusivity.

[43]For the process in the United States, THOMAS M. JACOBSEN, MODERN PHARMACEUTICAL INDUSTRY: A PRIMER 273 (2010).

[44]Bayer AG v. Elan Pharmaceutical Research Corp., 212 F.3d 1241 (Fed.Cir.2000).

[45]Glaxo, Inc. v. Novopharm, Ltd., 110 F.3d 1562, 1568 (Fed. Cir.1997). The Court had relied on the cases of Eli Lilly & Co. v. Medtronic, Inc., 496 U.S. 661, 669-74,; Telectronics Pacing Sys., Inc. v. Ventritex, Inc., 982 F.2d 1520, 1524-25, (Fed.Cir.1992) .

[46]Judit Rius Sanjuan, *U.S and E.U Protection of Pharmaceutical Test Data*, CONSUMER PROJECT ON TECHNOLOGY, http://www.cptech.org/publications/CPTechDPNo1TestData.pdf. The main condition is that the approved new drug application must contain a new active

There is also a 3-year period of marketing exclusivity granted which means that for the three year period, the FDA will not accept any application for the same drug and indication.[47] Under the recently passed Patient Protection and Affordable Care Act[48], data exclusivity for biologics has been extended to four years from the date of product approval of the innovator product.

When data exclusivity was first introduced, some originator brands lost half their market share in a year after generic medicine entry.[49] The regime evidently has not affected the spread of generic drugs market- generic drugs comprised 66% of the American market in 2009[50] and 80% in 2011.[51] The market is one of those that show the maximum potential for growth and have become increasingly competitive. The generic industry is growing at more than 7.8%, a pace that is faster than the world pharmaceutical market.[52]

G. The EU Aspects

ingredient that is a New Chemical Entity or new active moiety, never previously approved by the FDA alone or in combination.

[47]Steven, *It's 12 Years of Data Exclusivity*, THE GROSSMAN FDA REPORT, http://www.fdamatters.com/?p=883.

[48]The United States Supreme Court upheld the constitutionality of most of the PPACA in the case *National Federation of Independent Business v. Sebelius 567 U.S. (2012), Case No: 11-393*.

[49]Grabowski H and Vernon J. Brand, *Loyalty, Entry and Price Competition in Pharmaceutical after the 1984 Drug Act*, 35-2 JLE 331-350 (1992).

[50]Shrank WH, Cox ER, Fisher MA, Mehta J, Choudhry NK, *Patients' Perceptions of Generic Medications*, 28 *Health Aff*(Millwood) 546–556 (2009).

[51]*Generics grab 80% share of US market and fill 78% of prescriptions*, GENERICS AND BIOSIMILARS INITIATIVE ONLINE, http://www.gabionline.net/Reports/Generics-grab-80-share-of-US-market-and-fill-78-of-prescriptions .

[52]*The Pharmaceutical Industry in the United States*, SELECT USA, http://selectusa.commerce.gov/industry-snapshots/pharmaceutical-industry-united-states. *Facts at a Glance*, GENERIC PHARMACEUTICAL ASSOCIATION, http://www.gphaonline.org/about-gpha/about-generics/facts.

Data Exclusivity entered the European Union in 1987 through the 87/21/EEC Directive.[53] Applicants for medicinal products that showed that their product was "essentially similar" to a product already authorized could rely on the test data submitted by the first applicant for the product. Different exclusivity periods were specified for different categories of products. The new 2001/83/EC Directive amended in 2004, introduces a harmonized "8+2+1" formula for new drugs approved either through the centralized procedure or the mutual recognition procedure. It refers to an eight-year Data Exclusivity, starting with the initial approval of the "European reference medicinal product" and a two year Market Exclusivity while the total period of 10 years can be extended by an additional one year maximum if, during the first eight years of those ten years, the data originator obtains an authorization for one or more new therapeutic indications which, during the scientific evaluation prior to their authorization, are held to bring a significant clinical benefit in comparison with existing therapies.[54] Statistics have proven that the European Union had the highest generic penetration rates in 1994-2004.[55] Interestingly, the

[53]Council Directive 87/21/ECC of 22 December 1986, amending Council Directive 65/65/EEC on the approximation of provisions laid down by law, regulations or administrative action relating to proprietary medicinal products. The process in the European Union can be understood from http://www.ema.europa.eu/ema/.
The European Agency for the Evaluation of Medicinal Products regulates procedures throughout the European Economic Community. Since 2004, it has been known as the European Medicines Agency ("EMEA"). See b Adam R. Young, Generic Pharmaceutical Regulation in the United States with Comparison to Europe: Innovation and Competition 8 WASH. U. GLOBAL STUD. L. REV. 165 (2009). In the same paper, the authors provide an interesting comparison of the American and the EU regimes. The understanding of generic medicines is similar in the EU as it is in the USA. See European Generic Medicines Association, FAQ on Generic Medicines, http://www.egagenerics.com/index.php/generic-medicines/faq-on-generic-medicines.
[54]Judit Ruis Sanjuan, *U.S and E.U Protection of Pharmaceutical Test Data*, Judit Rius Sanjuan, CPTech Discussion Paper - No. 1 First Published: 3 April 2006 Revised: 12 April 2006.
[55]*Id.* at 37.

European Union comprises of countries with both market regulation as well as stricter control of prices and generic industries have grown across the board.

H. Chinese Perspectives

Adhering to the provisions of the TRIPS was one of the conditions laid down on China for accession to the WTO in 2001.[56] China introduced data exclusivity in its law through the enactment of the Regulations for Implementation of the Drug Administration Law.[57] In 2007, Amended Regulation on the Administration of Drug Registration (Amended Regulation) were promulgated. The Regulation uses the concepts of 'new' drug and 'generic' drug. A new drug is one that has not been previously marketed in China, whereas a generic drug is one that has an existing national drug standard, and was previously approved to be marketed by SFDA.[58] Data submitted to the SFDA[59] for the approval of a drug containing a new chemical entity is protected against improper commercial use for six years from the date of marketing approval.[60] Interestingly, this protection is enjoyed not only by new drugs but also generics that imitate products sold abroad.[61] Even with such a data exclusivity provision, pharmaceutical manufacturing is dominated by generics. Compared

[56]ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA**,** Decision of 10 November 2001, World Trade Organisation, WT/L/432, 23 November 2001.
[57]Article 35. Enacted on August 4, 2002. With effect from September 15, 2002.
[58]Steven Rizzi and Max Lin, *Generic Drug Approval Process in China*, FOLEY, July 2011, http://m.foley.com/files/Publication/e29262fa-55dc-4d12-9c90-d2bb07794ba7/Presentation/PublicationAttachment/4f0dcc1f-bd20-4ee2-a9c6-d36f62a9adcc/RizziLin_DrugApproval.pdf
[59]The State Food and Drug Administration, P.R. China
[60]Cheri Grace, *The Effect of Changing Intellectual Property on Pharmaceutical Industry Prospects in India and China Considerations for Access to Medicines*, June 2004, http://www.who.int/hiv/amds/Grace2China.pdf
[61]http://www.biolawgics.com/India/Guise%20Biogeneric%20regulatory.pdf

with patented prescription drugs, the generic industry has grown more in both absolute terms and as a percentage and this trend is expected to continue.[62] The industry is scheduled to grow at a CAGR of 12.9 percent to a value of USD 57.1 billion by 2014.[63] The government nurtures the emergence of large scale generic drug companies, partnerships with multinational corporations to enable investment in R&D and encourages the overall use of generic drugs among the population.[64]

V. TRANSNATIONAL LESSONS LEARNT FROM DATA EXCLUSIVITY REGIMES

From the above study, it is clear that generic industries are flourishing and growing even in countries that have a Data Exclusivity regime. Most times, innovator companies get patent protection for their drugs even before they get marketing approval. Data Exclusivity in such a situation helps in recouping costs. The benefits of data exclusivity are not restricted only to developed countries and their entities but even to domestic research companies. It provides incentives for research to identify new uses for existing unpatented products and for originator companies to introduce products into developing countries, since, in

[62] *China's pharmaceutical industry- Poised for the Giant Leap*, KPMG (2011).
[63] BioJobBlogger, Why Generic Drug Companies Will Dominate Future Pharmaceutical Markets, BioJOBBLOG, Feb. 2010, http://www.biojobblog.com/2010/02/articles/biobusiness/why-generic-drug-companies-will-dominate-future-pharmaceutical-markets/.
[64] Franck Le Deu, Rajesh Parekh et. al, *Health care in China: Entering 'uncharted waters*', MCKINSEY& COMPANY, Nov. 2012, http://www.mckinseychina.com/2012/09/03/healthcare-in-china-entering-uncharted-waters-2/

effect, exclusivity would protect the companies from generic competition.[65]

Even though many developing countries do not accept that the TRIPS mandates a Data Exclusivity regime, a number of them have entered into Free Trade Agreements (hereinafter referred to as "**FTAs**") which require them to have Data Exclusivity in their law.[66]

Data Exclusivity is necessary to provide a measure of certainty to the innovator that they will be provided with a period of protection for their efforts of testing a drug and ensuring its safety and effectiveness for patients no matter when, where or how long it takes to bring a drug to market. Patents are an important form of intellectual property, but are not themselves necessarily sufficient to create the favorable environment needed to support the development of medical advances.[67] Thus, by providing incentives for innovation through the system of data exclusivity, pharmaceutical industries have been able to flourish ensuring the good and satisfaction of all.

Concerns have been raised with regard to the system of compulsory licensing and that a regime of Data Exclusivity will go against it by delaying entry of generic medicines.[68] However, this concern is misplaced because the system of compulsory licenses works independent of the working of a generic industry. Further, experts

[65]CHARLES CLIFT, HANDBOOK OF BEST PRACTICES, DATA PROTECTION AND DATA EXCLUSIVITY IN PHARMACEUTICALS AND AGROCHEMICALS 434.

[66]The FTA's do not necessarily refer to the TRIPS but have a minimum period of five years of Data Exclusivity. Carlos M. CORREA, University of Buenos Aires UNCTAD-ICTSD Dialogue on Moving the pro-development IP agenda forward: Preserving Public Goods in health, education and learning.

[67]Data Exclusivity Periods and Next Generation Improvements to Innovator Biologics: Key IssuesDuke University Department of Economics Working Paper, No. 2009-05, Apr. 29, 2009, http://www.ifpma.org/innovation/ip-rights/data-exclusivity.html

[68]WHO Drug Information Vol 19, No. 3, 2005, p. 239.

have argued that given the few instances when compulsory licenses have been granted all over the world, it is unlikely the issue is of any major importance.[69]

The fact that the TRIPS does not lay down specific aspects about length of data exclusivity, nature of it and so on enables countries to introduce them using different mechanisms. Generic Industries are able to capture their market share and ensure more citizens are able to access medicine through smart marketing initiatives including strategic tie-ups, high quality products and synched supply chain management[70] with different policy initiatives[71].

It has also been proposed that such a regime would hugely be in favor of small biotech firms and a data protection regime would be built into it. Hence, it must be seen that not only have a variety of countries recognized Article 39.3 referring to a Data Exclusivity regime but also in view of their public health status, the objectives of entering into intellectual property instruments have been largely fulfilled.

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[69]Clifford Chance, Newsletter, May 2012, Patent Law Series- Compulsory License- *A growing threat to patent holders?*, http://www.cliffordchance.com/publicationviews/publications/2012/05/client_briefing_patentlawseriescompulsor.html.

[70]SOHM, Inc., *Entering the Huge USA Generic Pharmaceutical Market*, Mar., 2012, http://www.sohm.com/2012/03/16/sohm-inc-entering-the-huge-usa-generic-pharmaceutical-market/.

[71]*Strategies to Increase Generic Drug Utilization and Associated Savings*, AARP PUBLIC POLICY INSTITUTE, http://assets.aarp.org/rgcenter/health/i16_generics.pdf. A White Paper release by Thomson Reuters in December 2010 provided interesting insights into transnational deals that led to generic countries expanding their markets. See David Harding, *Gaining Market Share in the Generic Drug Industry through Acquisitions and Partnerships*, THOMSON REUTERS, http://thomsonreuters.com/content/science/pdf/ls/newport-deals.pdf.

VI. THE INDIAN SCENARIO

A. Generic Manufacturers and the Patent Regime

India restricted product patents in pharmaceuticals through its principal patent legislation, the India Patents Act, 1970[72] and allowed only for process patents to encourage generic pharmaceutical industries. The absence of product patents allowed generic industries to flourish because they were able to 'reverse engineer' the medicine and manufacture the same using their own process.[73] After India became a signatory to the TRIPS in 2005, it has introduced product patents,[74] which allows generic versions to be introduced after the patent period is over.[75]

B. Pharmaceutical Industry in India- The Legislative Framework:

[72]India Patents Act, 1970, Act 39 of 1970.

[73]Ajay D'souza, *Future Of Indian Pharma Lies Beyond Generics*, THE HINDU, April 22, 2012,http://www.thehindu.com/business/future-of-indian-pharma-lies-beyond-generics/article3339963.ece.

[74]For an understanding of industry response to this move, see Lorandos Joshi, *Changes in India's Patent Law and its Repercussions on the Global Drug Industry,* http://www.lorandoslaw.com/Publications/Changes-in-Indias-Patent-Law.shtml.
"As a result, many MNCs exited India in the 1970s. They began to come back after 2005, launching their drugs, filing for patents, and filing lawsuits against infringement." E. KUMAR SHARMA, Pill Talk, Pharma companies need to do more to cure the country of its health care ills, April 15, 2012, Business Today. The parent legislation, amendment act and the amended version of the parent legislation can be found at http://www.wipo.int/wipolex/en/details.jsp?id=2407.

[75]Waning et al. Journal of the International AIDS Society 2010, A lifeline to treatment: the role of Indian generic manufacturers in supplying antiretroviral medicines to developing countries.

The principal legislation that regulates the pharmaceutical industry in India is the Drugs and Cosmetics Act, 1940.[76] It was enacted to regulate the import, manufacture, sale and distribution of drugs.[77] The Drugs and Cosmetics Rules were made in the year 1945.[78] The importer who wants to import a new drug[79] or manufacture it in India must be approved by the Licensing Authority[80] under the prescribed procedure.[81] When applying for permission, all entities have to submit data including the results of local clinical trials.[82] The norms for conducting clinical trials and the format and nature of the data submitted can be found in Schedule Y to the Rules.[83]

[76]Drugs and Cosmetics Act, 1940, Act 23 of 1940.

[77]Cadila Pharmaceuticals Ltd. Vs. State of Kerala and Ors., A.I.R. 2002Ker 357. For Statement of Object and Reasons, *see* Gazette of India, 1940, Pt. V, p. 34; for the Report of the Select Committee, see *id*. at 143. It was later extended to cosmetics too via Act 21 of 1962. According to the Madhya Pradesh High Court, "…the Legislatures of all the Provinces passed resolutions in terms of Section 103 of the Government of India Act, 1935, authorizing the Central Legislature to legislate for regulating the import, manufacture, distribution and sale of drugs and cosmetics to the extent the above matters fell within List II of the Seventh Schedule to the Government of India Act." See Dr. Prakash Chandra Tiwari v. The State of Madhya Pradesh and Ors., I.L.R. [1980]MP628.

[78]Via notification No. F. 28-10/45-H(1). The notification came out in exercise of the powers conferred by sections 6(2), 12, 33 and 33N of the Drugs and Cosmetics Act.

[79]Defined in Rule 122 E.

[80]Defined in Rule 21(b). The Drugs Controller General of India is the nodal authority for licensing of certain drugs including blood, blood products, I.V. Fluids, Vaccine and Sera. See http://cdsco.nic.in/html/CDSCO%20Contact%2025-9-08.htm. Different state-level authorities regulate different aspects of drug control. For details about the Drug Control Administration working in the State of Andhra Pradesh, see http://www.apdca.net/.

[81]Rule 122-A describes the procedure for importing while Rule 122-B describes the procedure for manufacture.

[82]Rule 122-A (2) and Rule 122-B(2).

[83]Reports of such clinical trials have to be submitted in the same format as given in Appendix II to the Schedule.

The clinical trials are conducted in the following phases: Human Pharmacology Phase, Therapeutic Exploratory Phase, Therapeutic Confirmatory Phase and Post Marketing Surveillance.[84]

Schedule Y supports the growth of the generic Indian pharmaceutical industry[85] especially with the inclusion of Appendix 1-A which governs application for grant of permission to import or manufacture an already approved new drug having much lesser requirements than those for new drugs manufactured.[86] With this schedule, generic drug manufacturers usually adhere to the Guidelines for Bioavailability and Bioequivalence Studies framed in March 2005 by the Central Drugs Standard Control Organization.[87] However, by and large, there is little clarity on what kind of laws apply and companies usually go by past experience while requesting registration of their medicine.[88] India does not have a system of data exclusivity[89] and clearly, it is hence, violating the TRIPS Agreement.

C. Studies and Changes Made by the Government

[84]Section 122-DA of the Act. Read Y. Madhavi's short but comprehensive piece on the dimensions of regulatory issues around clinical trials. http://www.nistads.res.in/indiasnt2010-11/T3_Industry/Regulation%20of%20Vaccine%20Clinical%20Trials%20in%20India.pdf. Dr. Sundeep Mishra presents other regulatory problems in his piece. He also talks about the advantages of conducting clinical trials in India and the concerns. See http://www.usibc.com/sites/default/files/members/files/ficcidrsmishraaiims.pdf.

[85]Perspect Clin Res. 2010 Jan-Mar; 1(1): 6–10. PMCID: PMC3149409, Evolution of Clinical Research: A History Before and Beyond James Lind**,** Dr Arun Bhatt .

[86]Animesh Sharma, *Data Exclusivity with Regard to Clinical Data*, 3 IJLT 82-104 (2007).

[87]http://cdsco.nic.in/html/be%20guidelines%20draft%20ver10%20march%2016,%2005.pdf. For a technical, comparative understanding of regulatory standards around the world, see The basic regulatory considerations and prospects for conducting bioavailability/ bioequivalence (BA/BE) studies – an overview, Comparative Effectiveness Research, Mar., 2011.

[88]http://www.biolawgics.com/India/Guise%20Biogeneric%20regulatory.pdf

[89]*Supra* note2 and 77.

The Government of India in February, 2004 constituted a Committee known as the Satwant Reddy Committee with the task of interpreting Article 39.3. The Committee interpreted Article 39.3 to require data exclusivity for insecticides but not in the case of pharmaceuticals.[90] The Government introduced the Pesticide Management Bill, 2008 to make the required amendments however, the bill has not been brought up for consideration even till this date.[91] The changes have been introduced through government notifications under the Insecticides Act, 1968.[92]

There has been no judicial interpretation of Article 39.3 *per* se. The High Court of Delhi had been moved to enforce the above notifications in *Syngenta India Ltd. v. Union of India* but there was no interpretation of TRIPS.[93]

D. State of Indian Industry and the Need for Data Exclusivity

India's success story as a growing world superpower and its pharmaceutical success is marred by its pathetic healthcare conditions.[94]

[90]The whole report can be accessed at http://chemicals.nic.in/DPBooklet.pdf.
[91]It is still pending discussion in the Rajya Sabha i.e. the Upper House of the Parliament. See http://mpa.nic.in/preb12.pdf. Also see the Ministry of Parliamentary Affair's circular including it in the list of bills to be considered http://mpa.nic.in/preb12.pdf.
[92]No.17-2/2006-PP.I dated October 30, 2007 and F.No.17-2/2006-PP.I dated, February 18, 2008.
[93]W.P. (C) 8123/2008, Delhi High Court. The Court in ¶ 39 did refer to the fact that the statute does not prescribe this kind of exclusivity but since neither of the notifications were in questions, it did not go further.
[94]There is wide urban-rural disparity from childhood to about 5 years. Beyond that age, the disparity is compounded by social ills such as female foeticide and discrimination against women. Accessibility to cheap and effective healthcare remains a distant dream. See PLANNING COMMISSION OF INDIA: Health Care

India is at a stage of crossing over from being a pirating nation to one strongly protecting intellectual property rights through a TRIPS compliant regime.[95] Lack of a Data Exclusivity has made India lose out on gains on other trade agreements which would have helped it offset the rising prices of drugs, if any.[96]

There are real quality concerns with the generic medicines today in the drug approval process.[97] The regulations governing generic drugs

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in India- Vision 2020, R. Srinivasan. http://planningcommission.nic.in/reports/genrep/bkpap2020/26_bg2020.pdf

[95]http://www.wipo.int/about-wipo/en/wipo_journal/pdf/wipo_journal_1_1.pdf, http://www.ey.com/Publication/vwLUAssets/Doing_business_in_India_2011/$FILE/Doing_business_in_India_2011.pdf. There are major concerns about enforcement as well. See http://www.ipo.gov.uk/ipr-guide-india.pdf

[96]Upon demands from countries like Switzerland for data exclusivity in the India-EU Free Trade Agreement, India vociferously voiced concerns against it and refused to include it. *India fights back over its generics*, ALLIANCE SUD NEWS, April 1 2012. The issue of data exclusivity in the India-EU FTA was still in consideration in the year 2012. EU-India FTA: Ska Keller, April 30, 2012, http://www.theparliament.com/latest-news/article/newsarticle/eu-india-fta-ska-keller/. This is particularly unfortunate because it has been recognized that the agreement is for mutual benefit. For India, what is in the reckoning is the free flow of much needed capital, technology and personnel from countries such as Luxembourg. Luxembourg for early conclusion of India-EUFTA, Oct, 16,2012,The Economic Times, http://articles.economictimes.indiatimes.com/2012-10-16/news/34498965_1_india-gaston-stronck-luxembourg-ambassador-luxembourg-stock-exchange.

[97]Doctors are concerned about the poorly staffed drug regulatory authority that checks generic drug quality, *What ails the generic drug*?, Times of India, July 29, 2012, http://articles.timesofindia.indiatimes.com/2012-07-29/special-report/32923254_1_generic-drugs-quality-and-efficacy-pioneer-drug .See Chaudhuri, Sudip and others; Mackintosh, Maureen and Mujinja, Phares G M (2010). Indian generics producers, access to essential medicines and local production in Africa: an argument with reference to Tanzania. European Journal of Development Research 22(4), 451–468. Foot note The author has argued that branded drug manufacturers have withdrawn from Tanzania making way for generic drugs which are decisively lower in quality or not much concerned about it. See Heather Timmons, *India Expands Role As Drug Producer*, The New

themselves have been attacked on the ground that they are insufficient.[98]

The government has given several advantages to the generic industry. There are several initiatives aimed at boosting their sale. The government gives them preference while prescribing medicines in government hospitals.[99]

The ready market has ensured a sense of security to the generic industry. There is hardly any concern about research and development further. Most Indian companies do not have enough resources or the incentive to invent better quality drugs.[100]

YorkTimes,July6,2010. The US FDA had directed action against an Indian generic drug manufacturer citing quality issues.

[98]The author argues that quality issues in Indian drugs arise because the Bioequivalence regulations do not require showing toxicity of the drug. Mercurio, Brya, *Northwestern University Journal of International Human Rights*, Vol. 5, Issue 1 (Fall 2006), 1-40 Mercurio, Bryan 5 Nw. Univ. J. Int'l Hum. Rts. 1 (2006-2007).

[99]Not only do more doctors in government hospitals prescribe them than in private ones. See Nirmalya Dutta, *Genericdrugs- What You Need To Know*, Sept 26, 2012, http://health.india.com/diseases- conditions/generic-drugs-what-you-need-to-know/, but the Government has also setup special stores outside government hospitals that dispense generic medicines. The stores are called 'JanAusadhi'. See Jan Ausadhi, Department of Pharmaceuticals, Government of India,http://janaushadhi.gov.in/foradescriptionoftheirstyleoffunctioningandideological basis.

[100]Research and development have traditionally been major investments undertaken by governments as opposed
to the private sector putting huge costs on the public exchequer. See the Government of India report, *Research and Development in industry: An Overview*, November, 2007
http://www.dsir.gov.in/tpdup/irdpp/07rndoverview.pdf. In July 2012, the Government agreed to set up a 20 billion rupees venture capital fund for pharmaceuticals. See http://www.thehindu.com/business/Industry/govt-to-set-up-rs2000crore-venture-fund-for-rd-in- pharma/article3599041.ece.

It is high time these hand outs by the government were stopped and an economically sensible interpretation of TRIPS was carried out.

E. Package of Reforms Required:

A system of Data Exclusivity can also be introduced with exception such as protection only to undisclosed data and not to data that has already been published and protection only for the data relied upon.[101]

F. Price Controls

Concerns about costs of the medicines are very valid but the same can be remedied through India's home grown model of drug price regulation. The Drug Price Control Order, 1995 (hereinafter referred to as "**DPCO**")[102] was formulated under section 3 of the Essential Commodities Act, 1995[103] And fixes prices of drugs in the market. The Government while fixing prices is only guided by the Drug Price Control Order and is given enough flexibility to undertake whatever kinds of investigations it deems fit while fixing the prices.[104]

Under the DPCO price control is to be based on sales turnover, market monopoly and market competition. The current tally of number of drugs subject to this regulation is 74.[105] The Indian Government has been fairly active in favor of controlling prices. It

[101] *Supra* note 31.
[102] Standing Order 18(E) looks incomplete.
[103] Drug Price Control Order, 1995 Act 10 of 1995.
[104] Drug Price Control Order, 1995, §3(1), Act 10 of 1995.
[105] *India Looks to Expand Drug-Price Control*, THE WALL STREET JOURNAL, http://online.wsj.com/article/SB10000872396390443819404577633070809995582.html .

has recently allowed price control even in the case of patented medicines.[106]

Today, only one-tenth of the drug market is price controlled as against nearly 90 percent during the late 1970's.[107] Even with this extensive protection, the Price Control mechanism seems to have been a failure. It must be urgently strengthened because it will be a crucial component while fulfilling India's needs.[108]

The government can look at[109] having a more participatory model of price regulation where industry concerns are brought on board while

[106]Narayan Kulkarni, *Side effects of the New Drug-Pricing Policy*, Oct. 5, 2012, http://biospectrumindia.ciol.com/content/newsAnalysis/11210053.asp.
[107]Govt. of India (2005b), Report of the Task Force to Explore Options Other Than Price Control for Achieving the Objective of Making Available Life-Saving Drugs at Reasonable Prices", September, 20, pp.17.
[108]In spite of the very powerful drug price control mechanism we have, from 1994 through 2004, price has increased enormously across therapeutic groups. Between 1981 and 2001, drug companies in India registered super-normal profits consistently as compared to other commodity sectors. *Id.* The Supreme Court has been very concerned with rising drug prices. In response to a petition brought in by All India Drug Action Network, on Oct. 11, 2011, the Supreme Courtdirected the secretaries of ministry of health and ministry of chemical and fertilizer to file affidavits in four weeks stating whether the Union government wanted to bring the essential medicines under the ambit of price control. There are concerns such as those around the absence of controls for substitute medicines. Nidhi Chauhan, COMPETITION ASSESSMENT OF PHARMACEUTICAL SECTOR IN INDIA, COMPETITION COMMISSION OF INDIA, NEW DELHI, http://cci.gov.in/images/media/ResearchReports/nidhifeb12.pdf.
[109]It is interesting that while the researcher had started working on this paper, there were indications that the National Pharmaceutical Policy would include a weighted average method of determining drug prices i.e. by taking into account what the average market prices of drugs in the segment being considered are but while concluding the research, a news item has reported that at the last moment, the Finance Ministry placed objections over the drug price determination mechanism. See Pharma GoM finalises pricing policy, to cover 348 drugs,Press Trust of India, September 28, 2012, http://profit.ndtv.com/news/economy/article-pharma-gom-finalises-pricing-policy-to-cover-348-drugs-311396 and http://www.business-standard.com/india/news/decisionpharma-policy-deferred/492163/.

discussing prices. The government can also try looking at a more systematic mechanism of periodical drug price control like the mechanism present for regulating electricity tariff.[110]

VII. MISCELLANEOUS CONCERNS AND BENEFITS

With more research and development, there will be more opportunities, more employment and people would be able to afford more and better medicines. This growth can be capitalized upon by the government to enhance the healthcare standards among the poorest of the poor. There will be more clinical trials where people will be able to earn more. India is already growing as a destination for conducting clinical trials. Any form of data exclusivity will increase research and development sectors leading to more trials and more economic benefits.[111]

Article IV.5 of the WTO Agreement establishes a Council for Trade-Related Aspects of Intellectual Property (TRIPS Council). The Council meets in regular session to oversee the implementation of the TRIPS Agreement and conduct other business, including negotiation further to an agenda ''built in'' to the TRIPS Agreement, and on

[110]The Electricity Policy is far more commercially relevant than the Pharmaceutical Policy. For instance, under the Tariff Policy, tariff for electricity is to be fixed keeping in mind the financial viability of the sector and the ability to attract investments and promoting competition. There is an extensive system of electricity regulatory commissions that look into tariff control among other issues. For an overview of Indian electricity laws see Regulatory and Policy Environment, India's Energy Sector, Dun & Bradstreet India, http://www.dnb.co.in/IndiasEnergySector/Regu_Power.asp.

[111]Clinical trials can be conducted in India at a fraction of the costs involved in other countries which attracts many pharmaceutical companies. Antal K. Hajos, Conducting Clinical Trials in India- A Case Study, SIBF Symposium- Re-shaping the Pharmaceutical Industry.

proposals put forward by the Members. The TRIPS Council according to its rules of procedure acts only by consensus which makes it very difficult for it to reach decisions.[112] Hence, witnessing a successful resolution of conflicting interpretations and demands around Article 39.3 might be difficult.

Under Article 64 of the TRIPS, disputes about respect to the Agreement's obligations respect have been made subject to the WTO's dispute settlement procedure. Ironically, India's track record in this respect has been particularly bad. This mechanism in the TRIPS' context was first used against India by the USA for failure of India's obligations to set up the patent mailbox system.[113] Because absence of a data exclusivity regime violates the TRIPS, we can expect a complaint being filed with the WTO. In view of India's track record thus far, any negative decision by the WTO will only add to a negative image of India in terms of protecting Intellectual Property.

It may always be argued that the WTO can be moved against domestic price controls imposed by India on pharmaceuticals. However, the fact that India has had a robust price control mechanism functioning till now and that price controls are in place even in developed countries, trumps any such claim.

VIII. CONCLUSION

In this paper, the authors have tried to show that interpreting the TRIPS Agreement requires introducing data exclusivity which would

[112]World Trade Organization, *Whose WTO is it anyway*?, "*Reaching decisions by consensus among some 150members can be difficult."*http://www.wto.org/english/thewto_e/whatis_e/tif_e/org1_e.htm.
[113]*Supra* note 18.

help research, development and an overall improvement in the quality of medicines and thus, fulfil the public health objectives for which the TRIPS has been enacted. It looked at systems around the world to show how the system had worked which allowed for data exclusivity in a manner that achieved better access to health care. India requires a serious relook at its pharmaceutical laws to ensure that the rhetoric flow medicines does not wrongly take policy measures away from the ideal track. Different ways of introducing amendments were also discussed.

The Indian status quo of refusing to acknowledge its obligation of data exclusivity, in the long run, will not only lead to a prolonged TRIPS' violation, but a plain derogatory effect on the Indian healthcare system. The only solution is to interpret TRIPS in a manner that aims at the common interests of mankind: protect intellectual property to achieve better public health.

GENERAL ANTI-AVOIDANCE RULE (GAAR): AN INDIAN AND INTERNATIONAL PERSPECTIVE

Arshu John[*] *and Linesh Lalwani*[**]

Abstract

Internationally, tax avoidance has been recognized as an area of concern and several countries have expressed concern over tax evasion and avoidance. This is also evident from the fact that either nations are legislating the doctrine of General Anti-Avoidance Regulations in their tax code or strengthening their existing code. In India, the proposed Direct Tax Code seeks to address the issues relating to tax avoidance and evasion by bringing in General Anti-Avoidance Rules (GAAR). This paper firstly lays down the essential features of the proposed GAAR provisions. It gives a brief history as to the introduction of GAAR in India which is necessary because the introduction of such a provision is an important step for a fast growing economy of a developing country such as India. Recently, the implementation of GAAR was deferred yet

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again which only points to the magnitude of the implications of such a step. It is the opinion of the authors that despite such deferment, the issue of GAAR is nonetheless very relevant, and one that deserves discussion. The paper has for this reason covered the entire debate that surrounds the implementation of GAAR. The potential concerns that arise from it, the advantages that would be borne from it, and the alternatives to GAAR which could allow the exploitation of such advantages without the risk of these concerns. The paper also compares the proposed GAAR of the Direct Tax Code with provisions of GAAR established in five other countries, namely, United Kingdom, United States of America, South Africa, Canada and Australia and how these GAAR provisions have shaped and influences the Indian GAAR provisions. Lastly, the paper also explores the effect it will have on international law and treaty obligations. In conclusion, the authors submit that GAAR presents itself as the necessary solution to check tax evasion and tax avoidance.

I. INTRODUCTION

The aforementioned quotes provide an ideal curtain raiser for the core themes which this paper seeks to address. In the near future the

Companies, advisors, investors and consultants will frequently think of transactions as "GAAR-able." The Indian Government is the latest jurisdiction in the ever increasing line of jurisdictions to consider a wide catch-all measure that would ban tax-driven transactions. The act reflects a situation in which the Government is tired of seeing legal loopholes exploited by taxpayers and hence has come up with a provision which shall prevent such fiscal loss.

General Anti Avoidance Rules are not a novel idea; they have existed in many jurisdictions for many years. However, it is difficult to find a jurisdiction which has attained stability with its anti-avoidance rules. This loss is primarily due to the fact that the demarcation between "avoidance" and "evasion". Both the terms with respect to tax have some widely accepted traditional definitions[1] but the lack of acceptance across jurisdictions has led some of the commentators to use the term "avosion" in order to imply close and unresolved ties between the two terms.[2] The variations of this demarcation and the difference in laws in both letter and spirit add to the complexity of the subject at hand.

Almost twenty years ago, the OECD, with its Committee on Fiscal Affairs, prescribed three substantial features of avoidance schemes, which should be combated, i.e. artificiality, taking advantage of

[1]S. PICCIOTTO, INTERNATIONAL BUSINESS TAXATION: A STUDY IN INTERNATIONALIZATION OF BUSINESS REGULATION94 (Weidelfeld and Nicoloson 1992); Dr.Dionisios& D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 34(2004).

[2]B PETERS, THE POLITICS OF TAXATION: A COMPARATIVE PERSPECTIVE 192(Cambridge, Oxford, Blackwell, 1991); Dr.Dionisios& D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 31, (2004).

loopholes in the law and secrecy.[3] Further, the Committee added that the revenue loss considerations and aspects of fairness among taxpayers establish a strong position against schemes involving the aforementioned components.

II. UNDERSTANDING TAX AVOIDANCE: PRACTICES, BELIEFS AND CAUSES

Some consider the practice of tax avoidance to be a reaction against the constraints imposed by tax. It has been considered an inevitable consequence of the very existence of taxes.[4] However, Sovereign states tend to look at tax avoidance as a serious budgetary problem and hence take measures to curb the practice. In most cases, tax avoidance for the citizen is a 'tax expenditure' for the government.[5]The term refers to the decision made by the government to forego taxation, when an individual spends money for a particular purpose or earns money in a particular way, as if it was making a direct public expenditure.[6] Such expenditures may generally be invisible to the public eye, they nevertheless, create uncertainty and complexity, since these are largely uncontrollable by the Government and moreover there may be difficulties in monitoring who actually

[3]20 OECD, WORK ON TAX AVOIDANCE AND EVASION: SUMMARY OF THE WORK OF THE OECD'S COMMITTEE ON FISCAL AFFAIRS ON COMBATING TAX AVOIDANCE AND EVASION139-144 (European Taxation 3rd ed.1980).

[4]G Trixier, *Definition, Scope, and Importance of International Tax Avoidance*, COUNCIL OF EUROPE, COLLOQUY ON INTERNATIONAL TAX AVOIDANCE AND EVASION 1, (1980).

[5]Dr.Dionisios& D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 8 (2004).

[6]B. PETERS, THE POLITICS OF TAXATION: A COMPARATIVE PERSPECTIVE 194 (Cambridge, Oxford, Blackwell1991).

receives the benefits.[7] From a legal point of view, the primary argument runs that avoidance undermines equity irrespective of whether it loads and extra burden on non-avoiders or not, it does cause citizens who should be taxed similarly to be taxed differently.[8]

Any attempt at an analysis of tax avoidance must pay heed to the fact that a legal method based on strict or literal interpretation is the essential prop that sustains tax avoidance.[9] The Revenue authorities, legislature and administrators are faced with a stern challenge of facing and responding to an ever shifting landscape of taxpayer responses to taxation. The judicial response to the legislative and even judicial anti avoidance has been that they are dealing with an extraordinary situation and as a remedy that should be used sparingly because of an essential element of arbitrariness which always borders on opening Pandora's Box.[10] The famous line of judicial decisions in the United Kingdom[11] stands testimony to this fact. Similarly, the question as to whether a transaction amounts to tax avoidance or tax evasion, and the debate regarding substance over form is one that has plagued the Indian Tax regime and judiciary for many years now.[12] The tax authorities as a result have in various instances attempted to tax transactions which are subject to such debate, but have not been

[7] *Id.*

[8] A. SHENFIELD, THE POLITICAL ECONOMY OF TAX AVOIDANCE 19 (London, LEA 1968).

[9] William B. Barker, *The Ideology of Tax Avoidance*, 40 LOY. U. CHI. L.J.229 (2008).

[10] YURI GRBICH, DOES SPOTLESS EXORCISE BARWICK'S GHOST? - TAX CATCH UPS: A PROSPECT INTELLIGENCE REPORT88, 105-12(Robert L. Deutsch ed.1997).

[11] Duke of Westminister v. IRC, (1935) All E.R 259 (HL), Ramsay v. IRC, (1981) All E.R. 865 (HL); Furniss v. Dawson, (1984) All E.R. 965 (HL), Craven v White, (1988) 3 All. E.R. 495 (HL).

[12] Union of India v Azadi Bachao Andolan, (2003) 263 I.T.R. 707 (SC); Vodafone International Holdings B.V. v Union of India, (2012) MANU/SC/0219/2012 (SC); McDowell & Co. Ltd. v Commercial Tax Officer, (1986) A.I.R. 649 (SC); Aditya Birla Nuvo Ltd. v DDIT, (2011) 242 C.T.R. 561.

successful because these transactions fall outside their jurisdiction on a strict interpretation of the law.[13]

India's tryst with codification is not unique or novel in any manner. Codification or discussions of codifications have been fairly common in the recent years. In the Unites States, codification of the economic substance doctrine has been proposed numerous times over the past decade, with its supporters lauding greater certainty and democratic legitimacy and the critics remarking at the lack of flexibility and difficulty of administration associated with such codification.[14] Further, both Australia and Canada, for example, have GAARs, which have been met with both qualified success and significant criticism.[15]

Thus, as the latest means to bell the cat, the Income Tax Act, 1961 has been proposed to be replaced by the Direct Taxes Code (DTC). The DTC greatly increased the scope of jurisdiction of the tax authorities empowering them to tax these transactions. One of the fundamental, salient changes proposed which would allow for the increase of jurisdiction was the introduction of General Anti Avoidance Rules (GAAR) in India. Although the DTC has not yet been implemented, the GAAR provisions[16] have been introduced by the Finance Act, 2012 which amended the Income Tax Act, 1961.[17]

[13]Vodafone International Holdings B.V. v Union of India, (MANU/SC/0219/2012); Union of India v Azadi Bachao Andolan, (2003) 263 I.T.R. 707 (SC).
[14]EX: NEW YORK STATE BAR ASSOCIATION, NYSB TAX SECTION COMMENTS ON TREASURY'S PROPOSAL TO CODIFY THE ECONOMIC SUBSTANCE DOCTRINE 19 (July 25, 2000)
[15]Julie Cassidy, *To GAAR or Not to GAAR - That is the Question*, 36 OTTAWA L. REV. 259 (2004).
[16]Direct Taxes Code 2011,§ 23, Bill No. 110 of 2010 (India).
[17]Finance Act 2012, § 95-102 (India).

III. APPLICATION OF GAAR: AN ANALYSIS OF SECTION 95- SECTION 102 OF THE INCOME TAX ACT, 1961

A. Statutory Provisions

Sections 95- 102 of the Income Tax Act, 1961, as amended by the Finance Act, 2012, are the General Anti Avoidance Rules provisions of the Act. The first condition for the application of the rule is that the main purpose or one of the main purposes of the arrangement is to obtain a '*tax benefit'* which has been defined under Section 102(11) as:

> a. A reduction in avoidance or deferral of tax or amount payable under the Act
> b. An increase in the refund of tax or other amount under this Act
> c. A reduction or avoidance of deferral of tax or other amount that would be payable under this Act, as a result of tax treaty.
> d. An increase in the refund of tax or other amount under this Act, as a result of a tax treaty
> e. A reduction in the total income including the increase in loss, in relevant previous year or any other previous year.

For an arrangement to be termed as an "impermissible avoidance arrangement", it must be a combination of tax benefit and one of the following four conditions[18]:

> 1. It creates rights or obligations, which are ordinarily not created by persons dealing at arm's length.

[18]Income Tax Act 1961, § 96(1) No. 43 of 1961 (India).

2. It results, directly or indirectly, in the misuse or abuse, of the provisions of the Act.

3. It lacks commercial substance or is deemed to lack commercial substance under S. 97 in whole or in part, or

4. It is entered into, or carried out, by means, or in manner, which are not ordinarily employed for *bona fide* purposes.

While the Act clearly lays down the conditions for an impermissible avoidance arrangement, it does not substantiate or define the conditions further. Thus, for an understanding of these terms, we must refer to other jurisdictions having GAAR.

B. Main Purpose

The discussion paper on GAAR in South Africa[19] as well as the Information Circular on GAAR released by the Canada Revenue Agency[20] states that 'main' must be determined objectively by reference to the relevant facts and circumstances. As per the Act, an arrangement can be deemed to be an impermissible avoidance arrangement where the main purpose or '*one of the main purposes'* is to obtain a tax benefit. Further, as per the Act, even if the main purpose of only one of the steps of the arrangement is of a tax benefit, there is a presumption that the main purpose behind the entire arrangement is of tax benefit[21], thus significantly widening the scope of GAAR.

C. Misuse or Abuse

[19]*Discussion Paper on Tax Avoidance*, South African Revenue Service, 49, 81 (2005).
[20]IC 88-2 – General Anti-avoidance Rule: Income Tax Act § 245 (21 October, 1988).
[21]Income Tax Act 1961,§ 96(3), No. 43 of 1961 (India).

In the Canada Trustco case[22] the Supreme Court of Canada held that, "the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear." It further held that a single, unified approach to the textual, contextual, and purposive interpretation of the specific provisions of the Income Tax Act must be relied upon to determine abuse of the provisions. In the Copthorne Holdings case[23] the Court has taken the view that the misuse and abuse must be connected to a specific provision of law and that such misuse will be upheld only:

- Where the transaction achieves and outcome which the statutory provision was intended to prevent.
- Where the transaction defeats the underlying rationale of the provision
- Where the transactions circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose.

D. Bona fide Purpose

The objective circumstances[24] and overall result[25] of the transaction must be considered. A test would be to determine whether the taxpayer would have incurred taxation but for the transaction.[26] This test was substantiated by Courts holding that the test encompasses an objective[27] comparison between the transactions and a hypothetical

[22]Canada Trustco Mortgage Co. v. Canada, (2011) S.C.C. 36 (SC).
[23]Copthorne Holdings Ltd. v. Canada, (2011) S.C.C. 63 (SC).
[24]Cadbury Schweppes PLS v. Inland Revenue CommissionersC-196/04 (2007); Wallschutzky IG, *Towards a Definition of the Term 'Tax Avoidance*, AUSTRALIAN TAX REVIEW48-58 (Mar. 1985).
[25]COPTHORNE, *supra* note 23.
[26]ITC 1625 (1996) 59 SATC 383.
[27]Commissioner of Inland Revenue v Challenge Corporation Limited, (1986) 8 NZTC 5 (CA).

enquiry of how the transaction should have taken place.[28]. The standards are strict as the law does not require the whole arrangement to be designed in such a way so as to avoid payment of taxes as stated above.

E. Lacking Commercial Substance

This provision is a codification of the sham doctrine. The sham transaction doctrine states if the transaction is merely a charade in order to reap tax benefits with no other motivation, then the transaction will be ignored.[29] A transaction lacks commercial substance if the purpose is to obtain a fiscal advantage[30] or tax benefit[31] which cannot be accepted for taxation purpose.[32]. Further, the Act provides under Section 97 that a transaction shall deem to lack commercial substance in the following cases:[33]

> 1. The substance or effect of the arrangement as a whole is inconsistent with or differs significantly from, the form of its individuals steps or part
>
> 2. It involves or includes, (i) round trip financing (ii) an accommodating party (iii) elements that have the effect of offsetting or cancelling each other; or (iv) a transaction which is conducted through one or more persons and disguises the

[28]ITC 1712 (2000) 63 SATC 499; FCT v. Peabody, (1994) 181 CLR 359 (HC).
[29]Knetch v. United States, (1960) 364 U.S. 361 (SC).
[30]Lupton v. F.A. and A.B. Ltd.,(1972) AC 634 (HL); Coates v. Arundale Properties Ltd., (1984) 1 WLR 1328; Overseas Containers (Finance) Ltd. v. Stoker (Inspector of taxes), (1991) 188 ITR 383 (CA).
[31]ACM Partnership v. Comm., (1998) 157 F.3d 231 (3rd Cir.);Compaq Computer v. Comm., (1999) 113 T.C. 214.
[32]Lerman v. Commissioner, (1991) 939 F.2d 44, 45 (3d Cir.); Aiken Industries v. Commissioner, (1971) 56.T.C. 925.
[33]*Expert Committee Final Report on General Anti Avoidance Rules (GAAR) in Income-tax Act,1961 (2012)*, http://finmin.nic.in/reports/report_gaar_itact1961.pdf.

value, location, source, ownership or control of funds which affects the subject matter of such transaction

3. It involves the location of an asset or a transaction or of the place of residence of any party which would not have been located for any substantial commercial purpose other than obtaining tax benefit (but for GAAR provisions) for a party.

F. Consequences of Impermissible Avoidance Arrangement

Once a transaction is characterized as an impermissible avoidance arrangement, the tax authorities are given wide powers over the arrangement which include, but are not limited to - [34]

- Disregard , combine or recharacterise any step, part or whole of a transaction;
- Treat the transaction as if it had not been entered into or carried out;
- Disregard any accommodating party or treating any accommodating party and any other party as one and the same person;
- Deeming connected persons in relation to each other as one;
- Reallocating receipts, expenditure, deduction, relief or rebate, amongst the parties to the arrangement;
- Relocating place of residence of a party or location of a transaction or situs of an asset to a place other than provided in the arrangement; and
- Considering or looking through an arrangement by disregarding any corporate structure

[34]Income Tax Act 1961, § 98, No. 43 of 1961 (India).

IV. GUIDELINES FOR IMPLEMENTATION

It is clearly apparent that the income tax authorities were given sweeping powers by virtue of the GAAR principles. The effect of the advancement of the GAAR provisions ahead of the implementation of the DTC was felt hard and adversely by the markets as the FIIs sought to withdraw their investments leading to a slump in the stock market and adding to the pressure on the already down sliding rupee.[35] In order to mitigate the situation and reduce the possibility of abuse, the following critical amendments were made to the Finance Bill, 2012 when it was passed[36] –

- Implementation of GAAR was deferred by one year to the fiscal year 2013-14.
- Onus of proof to prove that GAAR provisions are applicable was shifted to the tax authorities thereby greatly reducing their potential abuse of power by the tax authorities.
- Taxpayers can approach the Authority of Advanced Ruling to determine whether the GAAR provisions are applicable to them, further reducing scope of abuse of power.
- Special Committee constituted for formulating rules and guidelines for implementation of GAAR.
- GAAR panel is to have an independent member, to give approvals for invoking GAAR and to ensure objectivity and transparency.

[35] *All eyes on Pranab as Lok Sabha takes up Finance Bill today*, THE HINDU, May 7, 2012, http://www.thehindu.com/todays-paper/tp-national/article3392168.ece.
[36] Circular 3/2012, Central Board of Direct Taxes, Government of India, dated 12-06-2012.

V. THE SPECIAL COMMITTEE REPORT

The Special Committee was constituted to give recommendations and guidelines for proper implementation of GAAR and suggest safeguards so that it is not indiscriminately used in every case.[37] After deliberations and discussions, the Committee submitted the following recommendations –

> 1. Setting of a monetary threshold in order to prevent indiscriminate application of GAAR provisions and to provide relief to small tax payers.
> 2. Prescription of statutory forms so as to ensure that consistency is maintained which is essential in procedures in invoking GAAR Provisions requiring the tax authorities to give a detailed description as to the applicability of GAAR provisions in that instant case.
> 3. Prescription of time limits so that there is minimal hindrance to business transactions.
> 4. Setting up of the Approving Panel

Further, the Committee also suggested the issuance of a circular on GAAR explaining the provisions of GAAR, providing special provisions for FIIs, and dealing with the situation of interplay of GAAR and SAARs. The Guidelines also contained a list of illustrations as to when the GAAR provisions may and may not be invoked.[38] While these examples do provide a certain amount of clarity, it does not completely remove the ambiguity as to the imposition of these principles.

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[37]GAAR Committee Constituted under the Chairmanship of Director General of the Income Tax (International Taxation) by the Chairman, CBDT, vide OM F. NO. 500/111/2009-FTD -1.
[38]*Id.* at 20.

VI. SHOME COMMITTEE REPORT

After the Draft GAAR Guidelines were released, the PM constituted another Expert Committee under the chairmanship of Dr.ParthasarthyShome to rework the guidelines based on comments from various stakeholders and the general public. The Shome Committee was setup with the term of reference to conduct consultations and dialogues with various stakeholders and the general public in order to provide a second draft of guidelines and a roadmap for the implementation of the GAAR provisions. The salient recommendations of the Report, submitted on August 31st, were[39] –

- **Main Purpose**– Only arrangements which have the main purpose of obtaining tax benefit, and not 'one of the main purposes' should be covered under GAAR. It also recommended that where the purpose of only a step of the arrangement is to obtain a tax benefit, then the tax consequences of an impermissible avoidance arrangement should be limited to that portion of the arrangement and not the whole arrangement as stated under Section 96(2) of the Act.
- **Procedural Requirements** –It prescribed the procedure that the Assessing Officer (AO) must make a reference to the Commissioner of Income Tax (CIT) for invoking GAAR, who shall then hear the taxpayer, and if he still wishes to invoke GAAR, then refer the matter to a five member Approving Panel (AP). The AP must declare the arrangement as impermissible or permissible on further inquiry and the final order shall be given by the AO, against

[39]Report on General Anti-Avoidance Rules in Income Tax Act, 1961, Expert Committee, (2012).

which an appeal would lie to the Appellate Tribunal. It further prescribed that the tax authorities must follow prescribed statutory forms within the prescribed time to ensure that principles of natural justice are followed and ensure transparency in the process.

- **Overarching Principle for Applicability of GAAR** – Important need to distinguish between tax mitigation and tax avoidance before invoking principles of GAAR, and that the GAAR should be invoked only in cases of 'abusive, contrived and artificial arrangements.'
- **Deferring Implementation of GAAR** –It stated that GAAR is an extremely advanced instrument of tax administration for which intensive training of tax officers is required, and that it should be deferred by three years so that the principles are better understood by both tax authorities and taxpayers, to remove ambiguities in the law, and so that there is a more conducive economic environment for the imposition of the principles.
- **Grandfathering of Existing Investments** – All investments, not the arrangement itself, made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on sale of such investments on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit.
- **GAAR and SAAR**– In cases where a Specific Anti Avoidance Rule (SAAR) is applicable, the GAAR provisions should not be invoked.
- **Treaty Override and Limitation of Benefit** – In cases where a Double Tax Avoidance Agreement (DTAA) has a specific anti avoidance provision such as a limitation of benefits clause, then the GAAR shall not be applicable to such treaties.

- **Circular 789 of 2000 w.r.t. Mauritius DTAA** –Tax Residency Certificate issued by the Tax Authorities of Mauritius shall be sufficient proof for accepting status of resident of Mauritius and to avail the benefits of the DTAA[40], and that the GAAR provisions may not be invoked for such purpose.
- **Monetary Threshold** – A monetary threshold of Rs 3 crores tax benefit to a taxpayer in a year should be used for the applicability of the GAAR provisions.
- **Foreign Institutional Investors** – The GAAR provisions should not be applicable to FIIs who choose to not take benefits under any DTAA and subject themselves to the domestic law provisions, and that GAAR provisions will not apply to non-residents investing directly or indirectly in an FII having underlying Indian assets, irrespective of whether the FII chooses to take a DTAA benefit.
- **Capital Gains Tax** – Abolition of capital gains tax on the transfer of listed securities, whether in the nature of capital gains or business income.

VII. EFFICACY OF GAAR IN INDIA

The introduction of GAAR in India initially met with a very unwelcoming response. This was followed by the amendments in the Finance Bill, 2012 when passed in the Lok Sabha, then by the draft guidelines, and then finally by the guidelines and recommendations of the Shome Committee. While these changes from the original proposition of GAAR were much needed, and many were significant,

[40]Central Board of Direct Taxes, Circular 789 of 2000, issued on 13th April 2000.

critical changes without which GAAR would never work in India, the recommendations had both hits and misses which need to be analyzed.

A. Hits

- One of the most significant developments to have come out after the GAAR was first introduced is that the onus of taxation has been shifted to the tax department saving taxpayers from the creation of an unfair tax regime.
- A very important suggestion which has been unanimously put forth by both the committees is that GAAR should be introduced with a monetary threshold. This would prevent the indiscriminate application of GAAR provisions and would at the same time prevent the harassment of small investors.
- Another suggestion which holds prime value in terms of the eventual application of GAAR is the constitution of the Approving Panel. The recommendation of the Shome Committee, if followed would lead to the creation of a body which would have at least two non tax department members and a retired High Court judge as its chairman. Furthest, its decisions would also be binding on the tax authority. This could turn out to be one of the biggest achievements of the whole process and shall assist in providing confidence to the investors.
- The provision with regard to the time frame of invoking GAAR is also one which has been well received by the business community. Under this provision no action can be taken by the commissioner against the taxpayer after a period of 6 months from the date of receiving the report. Further, the actions of the commissioner have also been put in a reasonable time frame. The recommendation provides that if

the commissioner is not satisfied with the objections of the tax payer, he must make a reference to the Approving Panel within 60 days from the receipt of such objections. Alternatively if the commissioner is satisfied with the objections raised by the tax payer, he must communicate the same within 60 days from the receipt of such objections.

- The illustrations provided by the Expert Committee if approved, shall be helpful in achieving a standard of certainty in application of GAAR.

B. Misses

- The timing of the move has been questioned by many. In a scenario where the global economies are facing huge contingencies in terms of economic stability and India itself does not have a fiscal or current account deficit to boast of, it could do with higher investment.
- The time frame required by the Authority for Advanced Rulings is too long to help gain any confidence. Provisions must be made to allow rulings to be obtained within six months.
- There has been a lot of debate with regard to the "grandfathering clause". The authors agree with the line of opinion that 'grandfathering' of arrangements as existing on the date of introduction of GAAR would confer protection in perpetuity which is not desirable. Instead, all 'investments' rather than 'arrangements' made by a resident or non-resident should be grandfathered so that on exit of such investments, GAAR provisions are not invoked to deny tax benefits.

VIII. INTERNATIONAL PERSPECTIVES ON GAAR

While GAAR features in a wide host of jurisdictions as diverse as Sweden, Germany, and Hong Kong, in this paper, the authors shall be limiting their study of international application of GAAR to five countries – United Kingdom, United States of America, Canada, South Africa, and Australia.

A. United Kingdom

The UK does not have a codified GAAR and Anti-Avoidance principles in UK are laid down through judicial decisions and Targeted Anti Avoidance Rules[41], which are specific legislations against perceived unacceptable tax avoidance. While this sort of tax system is effective to an extent, it does not have the capability to deal with the unpredictability and complications of the more complex situations.

In 2010, the government constituted a study group to determine whether UK needed a GAAR system. The study group in its report submitted that a broad spectrum general anti avoidance rule would not be beneficial for the UK tax system as it would 'carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning.' Instead, it proposed a narrowly focussed GAAR targeted at 'abusive arrangements' only[42] and such a GAAR has been proposed for 2013.

B. United States of America

[41]Antony Seely, *Tax Avoidance: A General Anti-Avoidance Rule – Commons Library Standard Note*, http://www.parliament.uk/briefing-papers/SN06265.
[42]HC Deb 21 November 2011 cc2-3WS; HM Treasury press notice 130/11.

The United States does not have a codified GAAR. However, it recently codified its economic substance doctrine in order to bring uniformity to tax law[43]. The US tax code contains a set of broad mini-GAAR statutory rules as well as targeted anti-avoidance legislative fixes. For tackling avoidance transactions there are a variety of common law doctrines that are laid down by courts which are applied for the purpose of Anti Avoidance, such as Sham Transaction, Economic Substance, Business Purpose, Substance over Form, and Step Transaction Doctrine.[44]

C. Canada

The GAAR principles in the Canadian Tax Code are laid down in Section 245 of the Income Tax Act which came into effect in 1988. The Explanatory Note listed out for the purpose of GAAR stated that - *"New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions."*[45]

In the case of Copthorne Holdings Ltd. v Canada[46], the Supreme Court of Canada held that there are three questions that need to be answered to determine whether the GAAR principles are to be invoked – i) Whether there was a tax benefit arising from the transaction, ii) Whether the transaction was an avoidance transaction, i.e. 'arranged primarily for bona fide purposes other than to obtain the tax benefit', and iii) Whether the avoidance transaction giving rise to the tax benefit was abusive. Section 245 of the Income Tax Act

[43]The Health Care and Education Reconciliation Act 2010, § 1409(a).
[44]Penrod v. Commissioner, (1987) 88 T.C. 1415, 1428.
[45]The Explanatory Notes to Legislation Relating to Income Tax issued by the Honourable Michael H. Wilson, Minister of Finance (June 1988).
[46]*Supra* note 23.

further defines the relevant terms such as 'tax benefit', 'transaction', and 'avoidance transaction' but does not define misuse or abuse either.

In the Canada Trustco case,[47] the Supreme Court laid down the procedural requirements regarding onus of proof. It held that it shall be a split burden, where the taxpayer needs to refute there is a tax benefit arising from a transaction and that the transaction is an avoidance transaction. The tax authority, on the other hand, needs to prove there was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

In 1982 the Canada Revenue Agency released an Information Circular with reference to the application of GAAR.[48] The highlights of the Circular are summarized below -

- The Circular in paragraph 2 states that the CRA will issue advance rulings with respect to the application of the GAAR to proposed transactions and will publish summaries of the facts and rulings in those cases that will provide further guidance.
- In paragraph 4, it explained an avoidance transaction as a single transaction carried out primarily to obtain a tax benefit. Where a transaction, which is primarily tax motivated, forms part of a series of bona fide transactions that is carried out primarily for non-tax purpose, the single transaction will nevertheless be an avoidance transaction.

[47] *Supra* note 22.
[48] Information Circular 88-2 – General Anti Avoidance Rules issued under Section 245, Income Tax Act, Canada Revenue Agency, (1988).

- If it can be inferred from all the circumstances that the primary or principal purpose in undertaking the transaction is other than to obtain a tax benefit, for example, a bona fide business, investment, or family purpose, then the transaction is not an avoidance transaction.
- In paragraph 5 it gave a list of examples to explain the principles of misuse and abuse.

D. South Africa

GAAR in South Africa was introduced in 2006[49] and is codified under Section 80A-80L of the South Africa Income Tax Act, 1962 subsequent to the amendment to S. 103 which contained the General Anti Avoidance Rule. The Indian GAAR is heavily influenced by the GAAR in South Africa, and as a result, the provisions for application of GAAR are practically identical.

The SARS recently released a Draft Comprehensive Guide to the General Anti Avoidance Rule as a reference and guide to the application of the GAAR principles. In paragraph 7.3, the guideline provides that a tax benefit may be denied under the GAAR 'if such tax benefit would misuse or abuse the object, spirit or purpose of the provisions of the Income Tax Act that are relied upon for the tax benefit.[50]

E. Australia

Australia's GAAR was introduced in 1981 and is in part IVA of the Income Tax Assessment Act, 1936. There are three conditions for the Australian GAAR to be applicable – i) There must be a 'scheme'; ii)

[49]Amended by Revenue Laws Amendment Act, No. 20 of 2006.
[50]Draft Comprehensive Guide to the General Anti-Avoidance Rule, South Africa Revenue Service, released on 14-02-2011.

There must be a tax benefit obtained in connection with the scheme; and iii) It must be reasonable to conclude that at least one person entering into the scheme did so for the 'sole or dominant purpose' of obtaining a tax benefit.[51]

The definitions for 'scheme'[52] and 'tax benefit'[53] given under the Income Tax Assessment Act are very similar to the definitions for 'arrangement' and 'tax benefit' given under the Income Tax Act, 1961 in India. However, the Australian GAAR, unlike the GAAR of all other countries analyzed in this paper including India, has a list of eight criteria to determine 'sole or dominant purpose.'[54]

1. The manner in which the scheme was entered into or carried out;
2. The form and substance of the scheme;
3. The time at which the scheme was entered into and the length of the period during which the scheme was carried out;
4. The income tax result that, but for Part IVA, would be achieved by the scheme;
5. Any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
6. Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;

[51]Julie Cassidy, *The Holy Grail – The Search for the Optimal GAAR*, 126 SOUTH AFRICAN LAW JOURNAL 740 (2009).
[52]Income Tax Assessment Act 1936, § 177A (Australia).
[53]Income Tax Assessment Act 1936, § 177C(1) (Australia).
[54]Income Tax Assessment Act 1936,§ 177D (Australia).

7. Any other consequence for the relevant taxpayer or for any person referred to in (6), of the scheme having been entered into or carried out; and

8. The nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in (6).

The procedure for applying the GAAR provisions has been explained in detail in the Practice Statement released by the Commissioner of Taxation.[55] Another stark difference from all the GAAR provisions is that as per the Australian GAAR provisions, the onus of proof lies on the taxpayer. However, this deviation from the commonly applied principle may be rationalized taking into consideration the fact that the application of GAAR is very strict and rare in Australia and it is considered a method of last resort. The application is reviewed by an independent panel comprising of senior tax officers and business and professional people chosen for their ability to give expert advice.

F. Concluding remarks on International Perspectives

On an overall perspective of the GAAR provisions in all these countries, it is clear that there are a lot of points of similarity with regards to what amounts to a tax benefit, what amounts to tax avoidance, the scope of the arrangements that it has jurisdiction over, and the consequences of being treated as an impermissible avoidance arrangement. Another point of similarity in all these countries is that there were separate guidelines released for the implementation of the GAAR provisions after the introduction of the provisions. Thus it is clear that the GAAR provisions have a tendency to be sweeping in its power and nature, and that there is a universal need to keep such powers under check. However, in all these countries, despite such

[55]Application of General Anti-avoidance Rule, PS LA 2005/24.

guidelines being released, there still remain ambiguities in scope due to the vast complexities of the transactions it covers. Thus, while these provisions still have a scope of abuse, the responsibility lies, firstly, with the tax authority to ensure that these provisions are implemented only in cases of clear impermissible tax avoidance, and secondly, with the judiciary, to ensure that the application of the GAAR provisions is not arbitrary or abusive and it is not used as a revenue generating scheme by carefully analysing the facts of the situation, the intention of the parties and the intention of the legislature.

IX. MAJOR CONCERNS AND SOLUTIONS

In this part the authors aim to address the major surrounding GAAR and provide an analysis of the solutions to the same.

A. Uncertainty

If one were to rationally look at the issue it is not only a problem for the government; rather it is a problem for the society as a whole. The first principle of horizontal equity states that people in the same economic position should be taxed at the same rate.[56] Tax avoidance makes it more difficult for tax systems to be economically neutral. Economic neutrality requires the tax systems should cause minimum disruption to the workings of the market. However, the existence of avoidance opportunities frustrates this requirement as it leads to a person organising his business in a particular manner, only because

[56]RICHARD E. KREVER, STRUCTURE AND POLICY OF AUSTRALIAN INCOME TAXATION, AUSTRALIAN TAXATION: PRINCIPLES AND PRACTICE, (Richard E. Krever ed.) (1987).

that option grants him a tax benefit. However, such transactions are attractive not because of their intrinsic value but rather for their tax advantages. For example: A Company owns a wholly owned subsidiary based in Cayman Islands not because it sees at a business opportunity but rather because it sees it as trampoline for growth in areas where it can obtain a tax benefit due to this particular route.

One must with all due regard, consider the fact that the very prevalence of General Anti Avoidance Rules, in any form, indicates that an authority of a particular jurisdiction is of the view that the negative results from the absence of such provisions outweigh the breaches of rule.[57]

Hart was of the view that all laws admit of "core" situations, where the laws will definitely apply, and "penumbra", where it is less certain whether the law will apply.[58] The biggest concern with regard to GAAR is that of vagueness and has always been said to cause grave breaches of the rule of law[59] but to criticize GAAR because of the their application appears to subject them to higher standard than we demand of law in general.[60] If the concern is with regard to the size of the penumbra which GAAR brings along with it, the process initiated by the Government shall help everyone reach a balanced an acceptable situation.

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[57]Rebecca Prebble & John Prebble, *Does the Use of General Anti Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*, 55 ST. LOUIS U.L.J. 21 (2010-2011).
[58]H.L.A Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593 (1958).
[59]GREAME COOPER, CONFLICTS CHALLENGES AND CHOICES - THE RULE OF LAW AND ANTI AVOIDANCE RULES, TAX AVOIDANCE AND THE RULE OF LAW (Greame Cooper ed.1997); Rebecca Prebble & John Prebble, *Does the Use of General Anti Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*, 55 ST. LOUIS U.L.J. 21 (2010-2011).
[60]*Supra* note 57.

X. TREATY OVERRIDE: UNILATERAL MEASURES AGAINST TREATY SHOPPING

Internationalisation of movements of capital, people and services and interaction between economies has become a salient feature of today's world.[61] All these practices often give rise to a situation where the effects of actions extend beyond the limits of one country. This encourages the need for cooperation and assistance among states. The matters in this regard vary from basic fiscal jurisdictional matters to non discrimination concerns.[62] However, the problem of double taxation and its relief is of utmost importance, since it carries with it huge concerns regarding both over and under taxation.[63] Further, the effect of such actions tends to have a direct impact on investment and flow of gains and losses. In the absence of such cooperation, a State is compelled to take unilateral measures in order to protect its fiscal interests.

A. Status of unilateral measures under International Law

The Vienna Convention on the Law of Treaties[64] (VCLT) requires the States to fulfil their treaty obligations in accordance with the principle of *Pacta Sunt Servanda*[65]. Some are of the opinion that when a DTAA is signed states agree to provide tax benefits to the residents of the

[61]M PIRES, INTERNATIONAL JURIDICAL DOUBLE TAXATION OF INCOME, (Deventer, Boston, Kluwer Law & Taxation Publishers, 1989).
[62]R MARTHA, JURISDICTION TO TAX IN INTERNATIONAL LAW: THEORY AND PRACTICE OF LEGISLATIVE FISCAL JURISDICTION, (Deventer, Boston, Kluwer Law & Taxation Publishers1989).
[63]S. JAMES & C. NOBES, THE ECONOMICS OF TAXATION,(Oxford, New Jersey, Philip Allan Publishers, 3rd ed.1988); 28 V TANZI& H ZEE, TAXATION IN A BORDERLESS WORLD: THE ROLE OF INFORMATION EXCHANGE, (Intertax, 2nded. 2000).
[64]Vienna Convention on Law of Treaties, May 23, 1969, 1155 U.N.T.S. 33
[65]*Id.* art 26.

treaty partner and for this reason unilateral measures may result in a treaty breach.[66].To justify the same a state cannot rely on domestic law.[67] It necessarily has to rely on norms derived from sources of International Law such as Treaties,[68]customary international law[69] and general principles of law[70]

Several canons of treaty interpretations support the contention that such unilateral measures are consistent with a state's obligation under a DTAA by arguing for a liberal interpretation of treaties[71]. Such canons look to the text of the treaty, treaty's object and purpose. Further, they also look at the signatories' subsequent practice.[72]

The VCLT provides for interpretation of treaties by giving effect to the ordinary meaning of their text and "in context and in the light of"[73] their object and purpose. Herein, lies the essential argument that a DTAA's purpose is both to avoid double taxation and prevent fiscal evasion. Purposive" interpretation of the DTAA's with reference to

[66]Detlev F. Vagts, *The United States and Its Treaties; Observance and Breach*, 95 AM. J. INTL L. 313(2001).
[67]*Supra* note 64, art. 26-27.
[68]*Supra* note 64, art. 11-19.
[69]Customary international law encompasses the rules adopted by the States in their practice or a "tacit agreement" of certain States to such rule, from which, nevertheless, other States may derogate. ANTONIO CASSESE, INTERNATIONAL LAW 153-154 (2nd ed.2005).
[70]The general principles of law are commonly understood as "the principles endorsed by the developed domestic legal systems of different states," for example, the principle of good faith. DAVID BEDERMAN ET AL., INTERNATIONAL LAW: A HANDBOOK FOR JUDGES 32 (2003); BINGCHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS 105-158 (1987); G.M. DANILENKO, LAW-MAKING IN THE INTERNATIONAL COMMUNITY 175 (1993).
[71]Nathalie Goyette, *Tax Treaty Abuse: A Second Look*, 51 CANADIAN TAX J. 764, 778 (2003).
[72]*Id.*
[73]*Supra* note 64, art. 26-27.

their object and purpose[74] of the treaty shall at least lead to a situation where unilateral measures are consistent with the pledge of the parties to prevent fiscal evasion

Even where anti-abuse measures do not merely complement or interpret a treaty, to constitute a violation of international law, such measures must "materially" breach a treaty. The VCLT distinguishes "material breach" from other acts of non-compliance by holding that a "material breach" is a "repudiation of the treaty" or a violation of a provision essential to the accomplishment of the object and purpose of the treaty.[75]

B. Status of conduits under International Law

Another argument which goes in favour of a state is one which states that conduits should not be considered to have the nationality of the treaty partner. While interpreting these treaties one must also keep in mind the status of conduits under International Law. Generally, a state may assert their claims only on behalf of their constituents or nationals.[76] "Nationality" under international law is not based on the act of a formal grant of citizenship by one state, but also on the basis of all relevant circumstances. In its *Liechtenstein v. Guatemala* decision[77] the International Court of Justice reasoned that "nationality *is a legal bond having as its basis a social fact of attachment , a*

[74]Maurice Cashmere, *GAAR for the United Kingdom? The Australian Experience*, 2 BRITISH TAX R. 125 (2008).
[75]*Supra* note 64, art. 60(3).
[76]Barcelona Traction Case (Belg. v. Spain), 1970 I.C.J. 3 (Feb. 5) 33-36 (the case found that Belgium may not assert a claim against Spain for an injury to a Canadian corporation owned by Belgian nationals and operating in Spain because the injured corporation, was not a Belgian constituent; the case did not implicate an *ergaomnes* obligation - obligation owed to the international community as a whole, to refrain from aggression or genocide).
[77]Nottebohm Case (Liech. v. Guat.), 1955 I.C.J. 4 (Apr. 6).

genuine connection of existence, interests and sentiments, together with the existence of rights and duties".[78]As a conduit's existence is generally limited to a single desk or even less[79], their ties with the treaty country are tenuous under International Law and hence, in such cases there should be no breach of duty owed to the treaty partner in the DTAA.

XI. OECD MODEL CONVENTION: ILLUSTRATIVE OF SUPPORT FOR UNILATERAL MEASURES

Amongst the countries which are members of the OECD, it is generally agreed that the OECD Model Convention[80] and its commentary are very important for interpretation of tax treaties as they provide a source from which courts of different states can seek a common interpretation.[81]

The 2010 Rome Congress of the International Fiscal Association provided a forum to analyse the relationship between treaties and the GAAR in a number of different tax jurisdictions. The General Reporter, Stef Van Weeghel, concluded in his summary of these reports that the vast majority of the 44 country reporters determined that their GAARs can be reconciled with their treaty obligations. By this he meant that, while most countries have statutory or judge made anti-avoidance rules (although there are a considerable number of

[78]*Id.*
[79]Lee A. Sheppard, *News Headlines: Preventing Corporate Inversions*, 26 TAX NOTES INT'L 8, 11 (2002).
[80]OECD, *Tax Treaty Override*, 1989, No.7, Oct. 2, 1989.
[81]KLAUS VOGEL, *ON DOUBLE TAX CONVENTIONS* (The Netherlands: Kluwer Law International, 3rd ed. 1997)

differences in the which these rules are applied),[82] these GAARs can, and do, apply to cross-border transactions. Van Weeghel concluded.[83]:

> *"Without exception the GAARs can have international effect and there is no distinction in their application depending on the national or international effect."*

Paragraph 7.1 of the 2003 Commentary discusses the temptation of the taxpayers might experience to "abuse the tax laws of a State by exploiting differences between various countries' laws." The latter Commentary acknowledges such attempts at abuse may be countered by provisions or jurisprudential rules that are a part of the domestic law and suggests that the State would be unlikely to agree to the provisions of a tax treaty that would allow transactions when domestic law would counteract the tax benefit.

The brief comment which can be placed on the status of the 2003 commentary is that the nature of the changes brought about was clarifying changes rather than fundamental changes. This is because more significant changes with regard to the issue had been made in 1992. When the new paragraph was introduced in the Commentary in 1992, which picked up the viewpoint of a large majority of the Committee of Fiscal Affairs that there is no problem in applying anti-avoidance rules to double tax treaties expressed in the 1996 Base Companies Report.[84]

[82] *Id.*
[83] *Id.*
[84] Committee of Fiscal Affairs, *Double Taxation Conventions and the Use of Base Companies* (November, 1986).

XII. EFFECT ON FOREIGN INVESTMENT

The greatest concern with the introduction of GAAR was that it would curb foreign investments. It is widely recognised that a state's economic growth within an international open trading system is dependent on two basic factors, namely, promotion of exports and foreign borrowing.[85] Factors relating to the "host" country viz. where the investment is taking place are considered the most important while considering a Multi-National Corporation's decision to invest abroad.[86] A state's tax framework which comprises of relevant legislative, administrative or judicial developments is one of the essential components of the factors relating to the "host" country. The taxation policy may be classified as open or restrictive.

Some work under an assumption that there is a gap in the real world between international growth and worldwide efficiency in the allocation of resources, since the hypothetical standards of efficiency criteria, including perfect competition are not always fulfilled.[87] Tax incentives in their opinion help bridge the existing gap. This argument is however flawed as tax incentives do not lead to better competition rather they lead to mutually disadvantageous competition among the states, hence creating distortion in economic activity. Secondly, these

[85]B BRACEWELL MILNES & J HUSICAMP, INVESTMENT INCENTIVES: A COMPARATIVE ANALYSIS OF THE SYSTEMS IN EEC, USA AND SWEDEN, at 23 (Deventer, Kluwer, 1997).

[86]R ANTHONIE, TAX INCENTIVES FOR PRIVATE INVESTMENT IN DEVELOPING COUNTRIES: A STUDY OF THE INTERNATIONAL BAR ASSOCIATION, SECTION OF BUSINESS LAW, TAX COMMITTEE 3(Kluwer, 1979).

[87]Dr.Dionisios & D Stathis, *The Role and Effects of Tax Avoidance on Worldwide Investment Flows and its Interaction with Tax Incentives*, 1 MANCHESTER J. INT'L ECON. L. 21(2004).

incentives are in themselves responsible for triggering the vicious circle which inevitably leads to tax avoidance or evasion.[88]

Hence, the solution to the problem of trade inflow is the one suggested by the Business and Advisory Committee which has at all stages maintained that the foreign investors would be better off without any incentives granted, and accordingly, without any restrictions from either host or home countries.[89] In their opinion a stable, low and simple tax regime is preferred to one with special tax incentives.[90]

XIII. SUGGESTIVE ALTERNATIVES TO GAAR

A. Judicial Anti-Avoidance doctrines

Many doctrinal or overriding GAAR principles are noticeable in the judicial decisions on anti-avoidance cases in common law countries.[91] These doctrines use two main rules to prevent avoidance. Firstly, the motive test which is applied using the business purpose rule and Secondly the artificiality test which is applied using the substance over form rule.

B. Movement towards Limitation of Benefits and other functional clauses

[88] *Id.*
[89] BIAC, TAX OBSTACLES TO INTERNATIONAL ROLE OF CAPITAL 195(BIFD 4th ed.1990).
[90] F. Ho, *Foreign Direct Investments into the DAE's: Tax Incentives versus Tax Neutrality*, (Paris, OECD, 1995).
[91] John Tiley, *Judicial Anti Avoidance Doctrines*, BRITISH TAX REVIEW (1991); John Ward, *Judicial Responses to Tax Avoidance*, EUROPEAN TAXATION (1995).

A Limitation of Benefits clause is the most popular suggestion as an alternative to GAAR. However, the biggest hindrance in such alternatives is that they require the cooperation of the partner treaty nation. There are various other clauses which would serve the purpose such as an express "savings clause" or a "gap filling clause" may also justify the adoption of anti-abuse rules. A typical savings clause will provide that nothing in the DTAA shall prevent the State from imposing tax on its residents and citizens, as if the tax was not in effect.[92] A gap filling clause would usually provide that terms which have not been expressly defined in the treaty shall be interpreted by reference to domestic laws as interpreted from time to time.[93] However, even at such instances the commentators are quick to caution that such clauses cannot be expanded indefinitely to provide blanket authorizations to domestic anti-abuse laws.[94] Herein exists a tension viz. the conflict between the dual objectives of providing relief from double taxation and preventing fiscal evasion that can only by the scope and nature of the anti-abuse measure.

C. Imposing a 'qualified resident' test

In one of the early alleged treaty overrides, the US congress under the Tax Reforms Act, 1986[95] imposed a new tax on foreign corporations with branches in the United States. The statute acknowledged that the users of the DTAA could avail of the benefit of the same but such

[92]U.S. Model Income Tax Convention of Nov. 15, 2006, [1 IRS Forms] Tax Treaties (CCH) P 209 (2007), http://www.ustreas.gov/press/releases/reports/hp16801.pdf.
[93]United Nations, Economic and Social Council, Committee of Experts on International Cooperation in Tax Matters; Treaty Abuse and Treaty Shopping, 21-24, U.N. Doc. E/C.18/2006/2 (2006).
[94]*Id.*
[95]Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

benefits would be denied in instances of "treaty shopping".[96] The rationale was to prevent non- residents of a treaty country from gaining benefits of the treaty commitments. To distinguish such non-residents the legislation provided for a test for "qualified residents".[97]

The "qualified resident" uses corporate ownership as a proxy for nexus with the treaty jurisdiction, with the intent of ensuring the entity claiming treaty benefits is not a conduit. Under this test, a foreign corporation does not qualify for treaty benefits if fifty percent or more is owned by non-residents of treaty jurisdiction or the United States, or if fifty percent or more of the corporation's income is directly or indirectly used to meet the liabilities of non-residents of such treaty jurisdiction or the United States.[98] However, the statute stated that Corporations publicly traded in the treaty jurisdiction or wholly owned by a U.S. Corporation also fall under the definition of "qualified resident".[99] The result of placing such a limitation was that it set an objective criterion which provided certainty to parties on both the sides of the bargain with regard to who shall be granted benefits and who won't. This test is efficient and effective as it works like a unilateral limitation of benefits clause and at the same time portrays a strong sovereign stance against treaty shopping

XIV. CONCLUSION

From an international perspective, even where unilateral anti-abuse measures are consistent with States obligations under DTAA's and

[96] *Id.*
[97] Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), § 884.
[98] Tax Reform Act 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), § 884(e)(4).
[99] *Id.*

where remedies for breach are available, unilateral measures as opposed to collective action are limited in a number of ways. Several states have adopted unilateral anti-abuse rules seeking to curb and combat treaty shopping. Moreover a comparative analysis on anti-abuse laws in different jurisdictions, such as Canada, United States, and the European Union demonstrate that States differ in views of the appropriate scope of anti abuse provisions. This highlights the dire need to raise the issue of anti-abuse provisions in the course of treaty negotiations which will lead to the development of mutually acceptable anti-abuse measures such as the Limitation of Benefits clause. Hence, the authors are of the opinion that a collaborative approach is better than an isolated one.

The complexity and diversification of the current international tax order has made the search for certainty and unified goals, the need of the hour. Technological improvements in new communications and transportation have made the global climate rife with international trade and investment. The direction of International Taxation should be based on the pillars of fairness and neutrality; it must strive to act as a facilitator and if not a facilitator at least not a distorter of trade and investment.[100] This is more of a concern with respect to India because historically our tax laws have been criticised for frequent amendments, lack of clarity which has led to excessive litigation.

India's tryst with codification is not unique or novel in any manner. Codification or discussions of codifications have been fairly common in the recent years. In the Unites States, codification of the economic substance doctrine has been proposed numerous times over the past decade, with its supporters lauding greater certainty and democratic

[100]RDOERENBERG, INTERNATIONAL TAXATION IN A NUTSHELL (4th ed.1999).

legitimacy and the critics remarking at the lack of flexibility and difficulty of administration associated with such codification.[101]

Keeping in view that one of the major criticisms of the Indian regime has been the frequent changes which are brought about in every year's financial bill. Such criticism is valid as the Government keeps on tackling symptom after symptom as they emerge rather than addressing the underlying cause which is the lack of clarity and consistency in the tax base. The presence of GAAR would enable the revenue authorities to tax most avoidance and evasion activities which would lessen the incentive for the taxpayers to attempt evasion in one form or other as the provision would be wide enough to cover for them. This would ensure that India presents a consistent system that is clear as well as forceful against tax evasion activities. Hence, on balance GAAR presents itself as the necessary solution to check tax evasion and tax avoidance.

The fact that still pervades over everything else is that every mature economy like Canada, Australia or China, has enshrined GAAR in its taxing statue. Hence, even if the country does decide to invoke GAAR, it will leave our tax laws richer on theory and principle; however, the application of the same would be the act one should watch out for.

[101]Ex: New York State Bar Association, *NYSB Tax Section Comments on Treasury's Proposal To Codify The Economic Substance Doctrine* 19 (July 25, 2000).

RIGHT TO LIE: EXTENDING THE GUARANTEE OF FREE SPEECH TO PROTECT FALSITY

Chanan Parwani[*] *and Akash Nagar*[**]

Abstract

The extent of the guarantee of freedom of speech and expression in any constitution is symbolic of the liberty enjoyed by its citizens. The Supreme Court of India has taken a strong stand in upholding the fundamental rights of the citizens of India. Article 19(1) guarantees certain fundamental rights, subject to the power of the state to impose restrictions on the exercise of those rights.[1] *These restrictions have been laid down in Article 19, Clause (2) to (6) but for the purpose of this analysis, we are focusing only on Article 19(1)(a), which enunciates that "All citizens shall have the right to freedom of speech and expression", subject to the specific restrictions in Article 19(2). And on the other hand, the First Amendment of the United States Constitution states that the US Congress shall make no law abridging the freedom of speech and by subsequent*

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[1] Samdasani P.D. v. Central Bank of India, A.I.R. 1952 SC 59.

interpretations the ambit of First Amendment it has been held to restrict the power of the state legislature as well.

The purpose of this comparative study is analyze the Freedom of Speech and Expression in the Indian Constitution and the Freedom of Speech in the Bill of Rights incorporated in the United States Constitution by the First Amendment in light of the United States v. Alvarez[2] case, which held that an Act which criminalizes false statements is unconstitutional since the Act infringes upon freedom of speech protected by the First Amendment of the US Constitution.

I. RELATIONSHIP BETWEEN LAW AND MORALS

The evolution of a society at any stage is attributed to the existence of a social order or the lack of it. This order stems from the understanding and inculcation of certain principles which govern the lives of individual units. Historically, law and morals have been intertwined in their existence whether as a recognized framework of rules or as a conduct of living a life based on good conscience. Various jurists and theorists have propounded theories and detailed studies on the relationship between law and morals and have attempted to characterize this relationship in terms of their differences, extent of their impact in maintaining social order as well as their dependence on each other in being the basis of, or the force

[2]132 S. CT. 2537.

behind their mutual existence. One such theory that highlights the distinction between law and morals is based on the view that laws regulate the external relations of men while morality governs their inner life and motivations.[3] This implies that while law is the set of rules or codes that regulates the relationship of men in their interaction with other men or institutions in society, morals are those values or ideas that govern the mind or the conscience of man.

Another characterization of this relationship in a normative sense is that what is required by or permissible under law may be prohibited by morality and conversely, what the law prohibits, morality may require or permit. Therefore what is legal may be immoral[4]. This view is referred to as the 'separation thesis.'[5] This separation thesis stands distinguished from the separation doctrine according to which 'the concept of law has no moral connotations whatsoever'[6] except in the making of law. The process of making of a law, according to Justice Homes, involves infusion of the basic tenets of morality into the body of law almost inevitably and hence the making of law is recognized as an exception to the separation doctrine.

Despite this larger blurring of boundaries between the manner in which laws and morals percolate society and exist simultaneously, it is noteworthy that certain moral principles remain outside the operation of law. This does not reduce the validity of the moral obligation; it simply remains outside the sphere of being a legal obligation. For example, the law does not recognize any legal obligation of a person to help another who may be in grave danger;

[3]Immanuel Kant, THE METAPHYSICAL ELEMENTS OF JUSTICE (Hackett Publishing, 1999).
[4]S. Khushboo v. Kanniammal & Anr., A.I.R. 2010 SC 3196.
[5]HLA HART, THE CONCEPT OF LAW (Oxford University Press 2012).
[6]HANS KELSEN, GENERAL THEORY OF LAW AND STATE (The Lawbook Exchange Ltd. 1945).

however this does not cease to be a moral obligation which contributes towards a good conscience and facilitates healthy way of living in society. This promotes social order (based on good conscience) which is in fact the desired goal of a legal establishment. While law and morality have their own spheres of operation in a manner that these spheres may overlap on occasion, both strive towards the common goal of maintaining social order that is conducive to the development of society.

While conceptually morality in itself is not unambiguous territory, the act of making a statement which one knows to be false with the intent to deceive or the act of lying swings between morality and immorality based on various aspects which include the outcome of such a lie. The commonly understood notion that the act of lying is immoral stems from the Divine Command Theory of right and wrong which bases its claim on God's command through Testaments and largely religious texts thus holding the act absolutely immoral. Similarly the Natural Law theory assumes 'everything has a function/purpose and "the good" for a thing is whatever helps realize that function, while "the bad" is what hinders or thwarts the fulfilment of that function'. It holds lying as morally wrong in the sense that it is contrary to human speech, the purpose of which is to communicate ideas of the mind. Both these theories hold lying as morally wrong (regardless of the consequence of the act) mainly because of the intrinsic nature of the act. This absolute approach in qualifying lying as morally wrong falls on the premise of the consequences being positive. When the outcome of a lie is to protect a greater evil from occurring or for the benefit of another person such an approach is limiting. Contrary to these theories the Act Utilitarianism theory makes room for the evaluation of the consequence of a lie. The theory states that an act is morally right if it produces more total happiness (not just for oneself, but all of society) than any other act that one could have performed in the circumstances. This effectively implies that if a lie maximizes 'utility' or provides happiness in the long run it is morally correct.

Supposedly, if a murderer came knocking at the door of a person and the servant of the house lied about the whereabouts of his master with the intention to deceive the murderer, the Divine command theory and the Natural law theory would hold it immoral on the part of the servant to have lied. However from the point of view of the Utilitarian approach since the lie contributed to the 'well-being' of the master or to his 'happiness' (since his death would in no way be a happy outcome) the servant's act would pass the test of being morally correct.

This act of lying, as a means of deceiving another may not always result in harm, it may on occasion prevent a greater evil, result in benefit to the listener or protect him from harm or simply provide happiness or benefit to the person who utters the lie. Legally, when a person lies with the intent to cause harm to another such an action is punishable on charges of fraud, cheating, breach of trust as the case maybe. But there exists a domain of lies which benefits the liar where there is no intent to harm another and neither is harm caused as a consequence. This domain while not punishable legally, cannot be categorized as absolutely immoral.

While a lie of the nature that results in benefit to the liar without causing harm is not prima facie within the ambit of immorality, whether such a lie stands protected by law is a question to be determined on further analysis of legal statutes independent of its characterization as being morally correct or incorrect.

II. THE FIRST AMENDMENT

A solid foundation for the guarantee of free speech has been laid down in the Constitution of the United States of America by the enactment of the First Amendment which prohibits the 'Congress' from enacting any law that restricts the freedoms mentioned therein.

While the text of the First Amendment reads that the 'Congress shall make no law…..abridging the freedom of speech, or of the press' it prohibits any prior restraint but has also been subsequently interpreted as not absolute in its application. While the 'congress' was interpreted as the federal government the passage of the Fourteenth Amendment made the First Amendment binding upon governments below the federal government. Therefore, the states could no longer impose their own censorship and hindrance of speech standards on the protections guaranteed by the First Amendment.

Prior restraint[7] implies government action that prohibits speech or any other expression before it can take place. This restraint can be exercised by means of a statute or regulation that requires a speaker to acquire a permit or license before speaking, or in the form of a judicial injunction that prohibits certain speech. In the context of the First Amendment both these forms of restraint are (subject to some exceptions) unconstitutional[8].

While the First amendment restricts the power of the Congress to make any law that curbs the freedom of speech this guarantee as interpreted by the Supreme Court is not absolute. Laying down the test of "clear and present danger" in *Schenck* v. *United States*[9]*(1919)*, Justice Oliver Wendell Holmes stated that when words are used in such circumstances and are of such a nature as to create a clear and present danger that they will bring about the substantive evils that Congress has the right to prevent do not stand protected by the First Amendment. The famous aphorism of falsely shouting "Fire!" in a theatre and causing panic thereof was used to enunciate that the guarantee would not extend to such speech. Later in *Brandenburg* v.

[7]Near v. Minnesota, 283 U.S. 697 (1931).
[8]New York Times Company v. United States, 403 U.S. 713 (1971).
[9]249 U.S. 47 (1919).

Ohio[10] the Supreme Court established the modern version of the "clear and present danger" doctrine, holding that states only could restrict speech that "is directed to inciting or producing imminent lawless action, and is likely to incite or produce such action." This came to be known as the Brandenburg test.

Further, the narrow domain of unprotected speech extends to that of obscene and indecent speech. The Supreme Court mapped out a cohesive three-part definition of obscenity in *Miller* v. *California*[11]*;* first, the average person applying contemporary community standards, must find that the work taken as a whole appealing to prurient interests; second, that it depicts or describes in a patently offensive way sexual conduct as defined by state law; and third, that the work, taken as a whole lacks serious literary, artistic, political, or scientific value. Similarly other categories of speech excluded from protection include child pornography, defamation, incitement, and "fighting words".[12]

The philosophy behind framing the First Amendment was largely to promote dialogue and expression of ideas in society in a manner that allows values of truth to triumph over oppressive policies and structures. James Madison, as a champion of the Bill of Rights, was of the view that only when truth and falsehood are allowed to grapple freely can the voice of truth be expected to win over.[13] It was with the view to uphold this ideal of freedom that the Blackstonian[14] concept of no prior restraint was incorporated. Further Justice Louis D.

[10]395 U.S. 444 (1969).
[11]413 U.S. 15 (1973).
[12]New York v. Ferber, 458 U.S. 747 (1982).
[13]RALPH LOUIS KETCHAM, JAMES MADISON: A BIOGRAPHY (University of Virginia Press, 1971).
[14]WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND (University of Chicago Press1979).

Brandeis' invaluable opinion expressed in *Whitney* v. *California* [15] further reiterated these views:

> "*Those who won our independence believed that the final end of the State was to make men free to develop their faculties; and that in its government the deliberative forces should prevail over the arbitrary. They valued liberty both as an end and as a means....They believed that freedom to think as you will and to speak as you think are means indispensable to the discovery and spread of political truth; that without free speech and assembly discussion would be futile; that with them, discussion affords ordinarily adequate protection against the dissemination of noxious doctrine; that the greatest menace to freedom is an inert people*."

From the discussion above it is evident that the framers of the First Amendment as well as the commentaries that have developed subsequently were of the view that in order that truth finds its way in the expression of people it is essential to provide that space within which such discourse can take place notwithstanding the fact that falsity may be a part of such expression.

[15] 274 U. S. 357 (1927).

III. UNITED STATES V. ALVAREZ: UPHOLDING THE RIGHT TO FALSITY

The *Alvarez*[16] case struck down the Stolen Valor Act of 2005 since the act makes it a crime to falsely claim receipt of military decorations or medals and provides an enhanced penalty if the Congressional Medal of Honor is involved. The statute intends to criminalize false factual statements made with knowledge of their falsity and with the intent that they be taken as true. The Unites States Supreme Court held this act to be violating the Freedom of Speech under the First Amendment and it is, thus, unconstitutional.

The accused in the case, Xavier Alvarez, lied when he said that he played hockey for the Detroit Red Wings and that he once married a starlet from Mexico. In 2007, respondent attended his first public meeting as a board member of the Three Valley Water District Board. The board is a governmental entity with headquarters in Claremont, California. He introduced himself as follows: "I'm a retired marine of 25 years. I retired in the year 2001. Back in 1987, I was awarded the Congressional Medal of Honor. I got wounded many times by the same guy." None of this was true. For all the record shows, respondent's statements were but a pathetic attempt to gain respect that eluded him. The statements do not seem to have been made to secure employment or financial benefits or admission to privileges reserved for those who had earned the Medal.

So the issue before the Supreme Court was that whether a person has a right to lie under the Freedom of Speech incorporated by the First Amendment, when the liar does not intend to deceive neither cause any wrongful gain or any wrongful loss to anybody.

[16]132 S. Ct. 2537.

The plurality opinion by Justice Kennedy explained that although this act of 2005 was intended to safeguard the honor of the brave soldiers but it still has to be consistent with the Constitution.

In the case of *Ashcroft* v. *American Civil Liberties Union,*[17] the US Supreme Court has held that the First Amendment means that the government has no power to restrict expression because of its message, its ideas, its subject matter, or its content. As a result, the Constitution demands that content-based restrictions on speech be presumed invalid and that the Government bear the burden of showing their constitutionality. Further, the content-based restrictions on speech have been permitted, only when confined to the few 'historic and traditional categories of expression long familiar to the bar'[18], which include inciting imminent lawless action,[19] obscenity,[20] defamation,[21] fraud,[22] child pornography[23] as well as speech presenting some grave and imminent threat the government has the power to prevent.[24]

The Supreme Court also felt that some false statements are inevitable if there is to be an open and vigorous expression of views in public and private conversation, the kind of expression the First Amendment seeks to guarantee. This was earlier talked about in the *New York Times Co.* v. *Sullivan*[25] case the sweeping, quite unprecedented reach of the statute puts it in conflict with the First Amendment. Here the

[17]535 U.S. 564 (2002).
[18]United States v. Stevens, 130 S.Ct. 1577 (2010).
[19]Brandenburg v. Ohio, 395 U. S. 444 (1969).
[20]Miller v. California, 413 U. S. 15 (1973).
[21]New York Times Co. v. Sullivan, 376 U. S. 254 (1964).
[22]Virginia Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U. S. 748, 771 (1976)
[23]FERBER, *supra* note 12.
[24]Near v. Minnesota ex rel. Olson, 283 U. S. 697 (1931).
[25]376 U. S. 254 (1964).

lie was made in a public meeting, but the statute would apply with equal force to personal, whispered conversations within a home. The statute seeks to control and suppress all false statements on this one subject in almost limitless times and settings. And it does so entirely without regard to whether the lie was made for the purpose of material gain.

Permitting the government to decree this speech to be a criminal offense, whether shouted from the rooftops or made in a barely audible whisper, would endorse government authority to compile a list of subjects about which false statements are punishable. That governmental power has no clear limiting principle. If this law is to be sustained, there could be an endless list of subjects the National Government or the States could single out. Where false claims are made to affect a fraud or secure moneys or other valuable considerations, say offers of employment, it is well established that the Government may restrict speech without affronting the First Amendment. But the Stolen Valor Act is not so limited in its reach. The Court went on to hold that the interest in truthful discourse alone is sufficient to sustain a ban on speech, absent any evidence that the speech was used to gain a material advantage, it would give the government a broad censorial power unprecedented in this Court's cases or in our constitutional tradition. The mere potential for the exercise of that power casts a chill the First Amendment cannot permit if free speech, thought, and discourse are to remain a foundation of our freedom.

Freedom of speech and thought flows not from the kindness of the state but from the inalienable rights of the person. And suppression of speech by the government can make exposure of falsity more difficult, not less so. Society has the right and civic duty to engage in open, dynamic, rational discourse. These ends are not well served when the government seeks to orchestrate public discussion through content-based mandates.

The concurring opinion delivered by Justice Breyer held that the fear of prosecution due to false statements can inhibit the speaker from making true statements where one can accidently incur such liability of a false statement, in cases of absence of mens rea.

More so, false factual statements can serve useful human objectives, for example: in social contexts, where they may prevent embarrassment, protect privacy, shield a person from prejudice, provide the sick with comfort, or preserve a child's innocence; in public contexts, where they may stop a panic or otherwise preserve calm in the face of danger; and even in technical, philosophical, and scientific contexts, where examination of a false statement (even if made deliberately to mislead) can promote a form of thought that ultimately helps realize the truth.

It was also held that many statutes and common law doctrines make the utterance of certain kinds of false statements unlawful. Those prohibitions, however, tend to be narrower than the Stolen Valor Act, in that they limit the scope of their application, sometimes by requiring proof of specific harm to identifiable victims; sometimes by specifying that the lies be made in contexts in which a tangible harm to others is especially likely to occur; and sometimes by limiting the prohibited lies to those that are particularly likely to produce harm but the same cannot be said for the Stolen Valor Act.

Fraud statutes, for example, typically require proof of a misrepresentation that is the material, upon which the victim relied, and which caused actual injury. Defamation statutes focus upon statements of a kind that harm the reputation of another or deter third parties from association or dealing with the victim due to such statements.

Perjury statutes prohibit a particular set of false statements, those made under oath, while requiring a showing of materiality. Statutes forbidding lying to a government official (not under oath) are

typically limited to circumstances where a lie is likely to work particular and specific harm by interfering with the functioning of a government department.

Statutes prohibiting false claims of terrorist attacks, or other lies about the commission of crimes or catastrophes, require proof that substantial public harm be directly foreseeable, or, if not, involve false statements that are very likely to bring about that harm.

Statutes forbidding impersonation typically focus on acts of impersonation, not mere speech, and may require a showing that, for example, someone was deceived into following a course of action he would not have pursued but for the deceitful conduct.

Statutes prohibiting trademark infringement present, perhaps, the closest analogy to the present statute, Stolen Valor Act. Trademarks identify the source of a good and infringement causes harm by causing confusion among potential customers (about the source) and thereby diluting the value of the mark to its owner, to consumers, and to the economy. Similarly, a false claim of possession of a medal or other honor creates confusion about who is entitled to wear it, thus diluting its value to those who have earned it, to their families, and to their country. But trademark statutes are focused upon commercial and promotional activities that are likely to dilute the value of a mark. Indeed, they typically require a showing of likely confusion, a showing that tends to assure that the feared harm will in fact take place due to the trademark violation.

While this list is not exhaustive, what can be seen is that in virtually all these instances; limitations of context, requirements of proof of injury and the like, narrow the statute to a subset of lies where specific harm is more likely to occur. The limitations help to make certain that the statute does not allow its threat of liability or criminal punishment to roam at large, discouraging or forbidding the telling of the lie in contexts where harm is unlikely or the need for the

prohibition is small. As written, it applies in family, social, or other private contexts, where lies will often cause little or no harm. These considerations lead the Court to believe that the statute as written risks significant harm to the First Amendment.

IV. EVALUATING FREEDOM OF SPEECH IN THE INDIAN CONSTITUTION

Article 19(1)(a) of the Indian Constitution states that all citizens of India shall have the right to freedom of speech and expression except for the restrictions laid down in Article 19(2). The freedom enunciated in Art. 19(1)(a) means the right to express one's convictions and opinions freely, by word of mouth, writing, printing, picture, or electronic media[26] or in any other manner (addressed to the eyes or the ears). It would also include expression of one's ideas by any visible representation, such as by gestures and the like. Freedom of speech also includes the freedom of propagation of ideas.[27]

Clause (1)(a) of Art. 19 refers to the common law right of freedom of expression and does not apply to any right created by a statute,[28] if the right is created by a statute then the right would seek approval from the statute and in case of any ambiguity the help Cl. (1)(a) could be sought.

[26]LIC v. Manubhai D. Shah, A.I.R. 1993 SC 171.
[27]Ramesh Thapar v. State of Madras, A.I.R. 1950 SC 124.
[28]Jamuna Prasad Mukharia v. Lachmi Ram, A.I.R. 1954 SC 686.

Any restriction imposed upon the above freedom is prima facie unconstitutional, unless it can be justified under the limitation clause, i.e., Cl. (2) of Article 19.[29]

In order to be justified as a valid restriction upon any of the rights guaranteed by Cl. (1), not only should such restriction be related to any of the permissible grounds enumerated in the relevant limitation clause[30] but it must further be reasonable.[31]

Clause (2) enables the legislature to impose restrictions upon the freedom of speech and expression; (i) to maintain the sovereignty and integrity of India, (ii) in the interest of the security of the State, (iii) to maintain friendly relations with foreign states, (iv) to maintain public order, (v) to ensure decency or morality, (vi) to punish for contempt of court, (vii) to prohibit defamation and (viii) to prohibit incitement to an offence

But the restrictions imposed by the above-mentioned grounds have to be reasonable within the ambit of Article 19(2).

V. CHARACTERIZING THE 'RIGHT TO LIE' & ITS STATUS UNDER ARTICLE 19(1)(A)

The premise of this study is to ascertain whether intentionally stating a false statement, without the intention to cause harm and thereby causing no harm would be protected by the guarantee of free speech and expression.

[29]Rangarajan S. v. Jagjivan Ram P., (1989) 2 S.C.C. 574.
[30]Kedar Nath Singh v. State of Bihar, A.I.R. 1962 SC 955.
[31]Virendra v. State of Punjab, A.I.R. 1957 SC 896.

When the intention to lie exists and a person lies to another he may do so either with the intent to cause harm to the other person or without the intent to cause harm. In the event that such harm is caused he may be prosecuted under relevant statutes of cheating, fraud, perjury, forgery, criminal breach of trust, dishonest misappropriation of property and so on. However the question arises when a person knowing that what he states is false does so without intending any harm and thereby causes none, has in fact overstepped his limit of free speech or has instead enjoyed the protection of it. An instance of such a situation is as follows:

(i) 'A' is a student who is not academically bright and has in fact passed his exams by a narrow margin. However when asked by his peers about his performance 'A' states that he has done extremely well.

(ii) At a social gathering of businessmen where Mr. X states that his son is an extremely successful entrepreneur when he knows that his son is actually a struggling entrepreneur who suffered losses in his last enterprise.

(iii) A lawyer who in conversation with his friends mentions that he has won several high profile cases in his career and names some of these when actually he has won none of the stated.

(iv) A guest speaker at a conference on religion states that he has seen and interacted with ghosts and spirits when actually he has had no such rendezvous.

(v) A retired colonel who shows off his scars to his friends or family as battle scars when actually the scars were caused by a road accident.

In all the above cases a lie has been told with the intent to make the listener(s) believe in what is not true. Further the liar is aware that

what he states is false. And finally, while stating the lie he has no intention to cause any harm to the listener(s). While the outcome of such a lie causes no harm it may bring a benefit to the liar in the form of increased self esteem, prestige or shield him from shame. It may enhance the social status for the liar and create positive or improved perceptions of him in the minds of the listener. Despite the fact these statements are far from the truth, do they stand protected by the guarantee of free speech in the Indian constitution? Or would such false statements fall within the ambit of clause 2 of Article 19? The following analysis attempts to provide an answer to these questions.

Article 19(1) contains specific rights which are protected by the Constitution but these rights are not at all exhaustive. A view recently gaining ground is that even though a right is not specifically mentioned in Art. 19(1), it may still be regarded as a fundamental right if it can be regarded as 'an integral part' of any of the fundamental rights specifically mentioned in Art 19(1), as distinguished from the ordinary incidents of a specifically enumerated right.

The test of evaluating whether an action is permitted under Art 19(1)(a) is to see whether any restriction has been put on it by virtue of Art. 19(2) and further, that restriction must be reasonable.

Clause (2) enables the legislature to impose restrictions upon the freedom of speech and expression, in the interests of the sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order, decency or morality, or in relation to contempt of court, defamation or incitement of an offence

'Sovereignty and integrity of India' was added as a ground of restriction on the freedom of expression by the 16th Amendment to the Constitution to enable the State to combat the crises which might not possibly be brought within the fold of the expression 'security of state'. The next ground for restriction is 'security of state'; which

means the absence of serious and aggravated forms of public disorder, as distinguished from ordinary breaches of public safety or public order which may not involve any danger to the state itself. Thus, security of the state is endangered by crimes of violence intended to overthrow the government,[32] levying of war and rebellion against the government, external aggression or war, but not by minor breaches of public order or tranquility, such as unlawful assembly, riot, rash driving, promoting enmity between classes and the like.[33] So the interpretation laid in the restrictive grounds of 'sovereignty and integrity of India' and 'security of state' excludes false statements from their ambit.

The object of putting 'friendly relations with foreign states' as an exception the freedom under Article 19(1)(a) is to prevent the citizens from speaking out against the foreign state which may adversely affect the relations between the two states. Thereby, the aforesaid premise does not infringe on the friendly relations of India with the foreign states.

While interpreting 'public order', the Supreme Court has held that the scope of the several grounds in Cl. (2) may sometimes overlap, they must ordinarily be intended to exclude each other. So 'public order' was interpreted to be synonymous with public peace, safety and tranquility[34] but, nevertheless, this does not infringe upon the extent of harmless false statements.

The question whether an utterance is likely to undermine 'decency or morality' is to be determined with reference to the probable effects it may have upon the audience to which it is addressed.[35] But it has

[32]Santokh Singh v. Delhi Administration, A.I.R. 1973 SC 1091.
[33]Romesh Thappar v. State of Madras, A.I.R. 1950 SC 124.
[34]Madhu Limaye vs Sub-Divisional Magistrate, Monghyr, A.I.R. 1971 SC 2486.
[35]Ranjit D Udeshi v. State of Maharashtra, A.I.R. 1965 SC 881.

been established in the earlier sections of this study that lying is not necessarily immoral and even when certain theories criticizing lying as immoral have been propounded with their own fundamental flaws, it is impossible to hold that what is morally wrong is liable to be held legally wrong.[36] Further the question of immorality maybe determined by the court based on the circumstances of a case. However, based on theories of morality discussed earlier in this study in context of the act of lying, the consequences of which are not harmful, is not immoral.

The fundamental idea behind the restriction of 'contempt of court' is that one has to keep in mind that in the exercise of one's right to freedom and speech and expression, nobody can be allowed to interfere with the due course of justice or to lower the prestige or authority of the court.[37] This type of false statements is most certainly punishable but they exclude from their cover the cases of a false statement which doesn't intend to cause any harm and in the process, no harm is caused.

Just as every person possesses the freedom of speech and expression, every person also possess a right to his reputation which is regarded a property. Hence, nobody can so use his freedom of speech or expression so as to injure another's reputation. Laws penalizing defamation do not; therefore constitute infringement of the freedom of speech.[38]

The next restrictive ground of 'incitement to an offence' will permit legislation not only to punish or prevent incitement to commit serious offences like murder which lead to breach in the interest of public order, but also any other offence. Hence, it is not permissible to

[36]*Supra* note 4.
[37]D.C. Saxena (Dr.) v. Hon'ble Chief Justice of India, A.I.R. 1996 SC 2481.
[38]Baradakanta Mishra v. The Registrar of Orissa High Court, A.I.R. 1974 SC 710.

instigate another to do any act which is prohibited and penalized in law[39]. The objective of imposing such restrictions is to not curb the freedom of speech and expression and yet legislate in the interest of public peace and tranquility.

VI. CONCLUSION

From the detailed discussion above, the premise, whether intentionally stating a false statement, without the intention to cause harm and thereby causing no harm, would be protected by the ambit of free speech and expression within the Indian Constitution. It has been explicitly held by the Supreme Court that it must strike down any law which imposes a restriction upon the freedom of speech and expression unless it falls within the ground specified in Cl. (2) of Article 19.[40] This aforementioned premise does not fall within any of the eight restrictive grounds of Clause (2). Erroneous ideas are necessary to encourage free and open debate in society; the flow of ideas should not be curbed by restricted statements, which might be although false yet harmless. Also, such a restriction on false statements would be a great deterrent to individuals from making true statements because any law-abiding citizen would run the risk of prosecution from incurring liability by mistakenly stating a false statement and the fear of stating the truth in the minds of the people would be hazardous for the society. Further, it is not imperative for a right to be enumerated unequivocally in Article 19, if it can still be interpreted within the boundaries of the Constitution by the courts it will be upheld.

[39]Kedar Nath Singh v. State of Bihar, A.I.R. 1962 SC 955.
[40]Kameshwar Prasad v. State of Bihar, A.I.R. 1962 SC 1166.

The Constitution of India has borrowed numerous features from other countries and the concept of Fundamental Rights has been borrowed in parts from Bill of Rights in the Constitution of United Kingdom, the France's Declaration of the Rights of Man and the Citizen which bears constitutional value and the United States Bill of Rights in the their Constitution. Article 19(1)(a) has been derived from First Amendment of the Bill of Rights by the framers of the Constitution of India. Thus, the First Amendment is a valuable source of understanding the extent of free speech in the Indian Constitution. Moreover, the difference between the First Amendment and Article 19(1)(a) is that the former was incorporated absolutely and the restrictions have been read into the First Amendment by the Courts while the latter has certain explicit restrictions mentioned in the Constitution itself but these restrictions have been excluded by the their interpretation in the course of this study. Hence, an executive or legislative action which prohibits an individual from making false statements, which neither intends to cause harm nor do they cause any harm, shall be unconstitutional to that extent, within the law of the land.

DIGITAL RIGHTS MANAGEMENT AND FAIR USE

Amoha Sharma[*] *and Jahnavi Mitra*[**]

Abstract

Through the advent of globalization, an exponential increase in digitization has been experienced all over the world. Newer and better technologies have spurred the creation of intellectual works that are afforded legal protection. At the same time, the change in the medium of the work affects its dissemination and alters the mode of its protection. Opposing demands with regard to protection have been made by creators and users, which has led to the polarisation of the debate between rights of content creators and public interest in the created works. Concerns range from the protection of economic interests of creators and apprehension of over-appropriation of their works on one hand, and the rhetoric of dissemination of knowledge and public policy on the other. The doctrine of fair use emerged to quell the protests from both sides and envisaged an arrangement where certain uses of copyrighted works are excluded from the purview of infringement of copyrights. However, the introduction of

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digital rights management regimes enables copyright holders to restrict the right of use to an unprecedented extent, thereby reducing the scope of applicability of the doctrine of fair use. This paper seeks to examine the altered scope of the doctrine, and provides suggestions to harmonize the opposing interests of content creators and users, creating a secure digital environment that encourages innovation without compromising the right to information.

I. INTRODUCTION

The first part of this article traces the development of copyright law identifying its key features. It also provides an introduction to the doctrine of fair use explaining its applicability as a defence in copyright law.

The second part provides an introduction to the notion of digital rights management. Critically analysing the problems associated with the implementation of the doctrine of fair use in the digital world, it seeks to determine the fate of fair use in this digital era.

The third part focuses on the emerging need to create a balance between the rights of the content providers and the rights of users. The researchers look into the alternatives that exist to copyright, such a Creative Commons licenses, and analyse various statutory provisions to identify a model that would balance all conflicting interests. Finally, the conclusions of the researchers are presented.

II. BACKGROUND

Historically in India, *dharma*[1]is the basic ethos of Indian civilisation. Society and creators of intellectual works have mutual obligations and understanding. Not only the State but the people as well had a duty to look after the authors. Event of one side straying from its obligations was not considered justification enough for the other to give up his duty.[2]

In Europe, with the advent of Enlightenment, the idea of legal protection for the same came to develop. The thinkers of the period pleaded for the recognition of intellectual property in order to preserve for the author the fruit of his works.[3] The same was pursued not just on a strictly individual basis, but also as a social ideal i.e. the dissemination of Enlightenment ideas. The author was to be encouraged to create new works and thereby contribute to the dissemination of new ideas.[4]

The honourable Supreme Court of India has held that copyright owners have the freedom to enjoy the fruits of their work, but such freedom is not absolute and should not be allowed to stifle the dissemination of information of knowledge.[5] The Delhi High Court

[1]There can be no one meaning for this Hindi word when translated. However way of life, duty, righteousness come close.
[2]Mira T Sundara Rajan, *Moral Rights in Developing Countries: The Example Of India – Part I*, 8 JOURNAL OF INTELLECTUAL PROPERTY RIGHTS 357, 361 (2003).
[3]5,24,30 Christophe Geiger, *Author's Right, Copyright and the Public's Right to Information: A complex relationship (Rethinking copyright in the light of Fundamental Rights)*,THE NEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW, (Fiona Macmillan ed., 2005).
[4]*Id.* at 13.
[5]Entertainment Network (India) Ltd. v. Super-Casette Industries Ltd., 2008 (9) S.C.A.L.E. 69. The court observed that, "The right to property, therefore, is not dealt with its subject to restrict when a right to property creates a monopoly to which public must have access. Withholding the same from public may amount to

made similar observations, explaining that the exemptions to copyright law are rooted in the need to promote creativity and to disseminate information.[6]

That is not to say copyright exists only in order to ensure dissemination of information. Copyrights 'protect the public from itself'[7] – an extremely liberal regime with no restrictions on communication of works that lawfully come into their position would lead to a shortage of creation of copyrighted works. We cannot allow for the rights of the content creator to be subjugated as Justice Holmes says that 'copyright restrains the spontaneity of men where but for it there would be nothing of any kind to hinder them from doing as they saw fit'[8] and encouraging individual effort through provision of private gains is imperative to advance public welfare through talents of authors and inventors in sciences and useful arts.[9]In India, a copyright is granted under the Copyright Act which finds its groundings in Article 19(1)(g)[10] and Article 300A[11] of the Constitution of India.

A. Justifications for Copyright in the Digital Media

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unfair trade practice. In our constitutional Scheme of statute monopoly is not encouraged. Knowledge must be allowed to be disseminated. An artistic work if made public should be made available subject of course to reasonable terms and grant of reasonable compensation to the public at large."

[6]The Chancellor Masters and Scholars of the University of Oxford v. Narendra Publishing House.,2008 (106) D.R.J. 482 ¶ 23.

[7]1 Joost Smiers, *Creative Improper Property: Copyright and the Non-Western World*,NEW DIRECTIONS IN COPYRIGHT LAW1, 6 (Fiona MacMillan ed., 2005).

[8]White Music Publishing Co. v. Apollo Co, 209 U.S. 1(1908).

[9]Mazer v. Stein, 347 U.S. 201(1954).

[10]Fundamental Right: Freedom to practice any profession, or carry on any occupation, trade or business. The Constitution doesn't grant this as right absolutely, and it is subject to *reasonable* restrictions in public interest.

[11]No person shall be deprived of his property save in accordance with law. The term property includes corporeal as well as incorporeal property.

We feel the same is increasingly relevant in this media since the information is literally a click away.

a) Incentive Rationale

Bentham and Mill's utilitarian proposition[12] can be used to support the argument that as Intellectual Property Rights (IPR) provide *'the prospect of reward'*, this in turn encourages creative advance by providing increased incentives to invent, invest in, and develop further new creative expressions and that without such incentives the invention inducement would be weakened.[13] The same has relevance in a highly digitised world as well. The opportunities to profit from copyright protection have increased with the development of information and communication technology. With increased user-producer interaction enabled by digital TV, internet etc., inventers and investors are better able to invest in the creative expressions that the critical mass of consumers wants.[14]

[12]John Cahir, *The Moral Preference for DRM Oriented Markets in the Digitally Networked Environment*, NEW DIRECTIONS IN COPYRIGHT LAW 26-27 (Fiona MacMillan ed., 2005) (Utilitarian consideration, though not the sole animating theme of copyright jurisprudence, have continued to dominate theoretical debates.)

[13]Birgitte Andersen, *How technology changes the scope, strength and usefulness of copyright: Revisiting the 'Economic Rationales' underpinning copyright law,* 5THE NEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW, 138, 141 (Fiona Macmillan ed. 2005). Also see Tanya Aplin, COPYRIGHT LAW IN THE DIGITAL SOCIETY; THE CHALLENGES OF MULTIMEDIA 19 (2005) where the author mentions the free rider problem as a consequence of easy copying of digital works. The same would result in market price of such works being brought down due to marginal cost of copying. Thus, the author would be disincentivised from creating the work in the first place. Keeping the same in mind, not only reward but limited control over work makes sense.

[14]Birgitte Andersen, *How technology changes the scope, strength and* usefulness *of copyright: Revisiting the 'Economic Rationales' underpinning copyright law,* 5 THE NEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW138, 143 (Fiona Macmillan ed., 2005) where the author feels that globalization has increased the size of the

b) Social welfare

What is pertinent here is that if authors cease to produce multimedia works, overall social welfare will be harmed. Society is enriched if such works are created, as the whole in digital works is greater than the sum of its parts i.e. the value flows from diverse inputs being brought together in one work with which a user can interact.[15]

c) Natural Law Rationale

The same is linked to two justifications

a) Personality theory: If we are to look at Kant's personality theory, the crux is that work is not a commodity but an expression or embodiment of the author's personality. To enable the author to control his/her personality, control over his work must be enabled.[16] Though it might seem that digital works would only include highly technological works and there would be no scope for the expression of one's personality, however, keeping in mind the visual layout, inputs involved – can it not be said that such a work would be an intersection of technological, economic and artistic considerations?[17]

b) Labour theory: According to Locke's theory of property, every person has property in their own person and therefore their own labour. Hence, a person may appropriate objects by mixing their own labour with something from the commons.[18] Pertinent here is the *labour desert* theory put forward by Hughes i.e. labour is an activity

market which in turn brings about increase in economic incentives for catering to the markets of digital TV, internet etc. and broadcasting via the same.

[15]TANYA APLIN, COPYRIGHT LAW IN THE DIGITAL SOCIETY; THE CHALLENGES OF MULTIMEDIA 19 (2005).

[16]*Id.* at 25.

[17]*Id.* at 28.

[18]*Id.* at 31.

which creates social value and it is this production of social value that deserves reward. Thus, people should be rewarded for how much value they add to other people's lives. Applying Locke's theory of property to intangible property, it can be said that every person has property in their intellectual labour and that whenever a person mixes their intellectual labour with something from the commons (here the same could mean ideas), they make it their own property.[19]

B. Fair Use

Though justified, protection of content creator's rights should not be at the cost of public interest. Thus, a balance between private rights and public interest is what is required i.e. creative work must be encouraged and rewarded but private motivation must ultimately serve the course of promoting broad public availability of literature, music, arts etc.[20] The same bring us to the concept of fair use.

The doctrine of fair use has been codified under Section 107 of the Copyright Act, 1976[21] in USA. The reason for codification of this

[19]*Id.* at 32.
[20]Twentieth Century Music Corp. v. Aiken 422 US 156 (1975).
[21]Notwithstanding the provisions of section 106, the fair use of a copyrighted work, including such use by reproduction in copies and phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use, the factors to be considered shall include:
(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
(2) the nature of the copyrighted work;
(3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
(4) the effect of the use upon the potential market for or value of the copyrighted work.
The fact that a work is unpublished shall not itself bar a finding of fair use if such finding is made upon consideration of all the above factors.

doctrine which till then had only been propounded by judges[22] was to protect the public interest and at the same time ensure protection of the freedom of speech and expression. Exceptions and limitations to the rights of copyright holder have been provided under Section 52, Indian Copyright Act, 1957[23] in India and Article 5 of the EU Copyright Directive.[24]

III. REQUIREMENT OF DRM

The insufficiency of the traditional forms of protection has brought about a requirement of increased protection and the same brings us to the next part of our paper. Traditionally copyright law was physically secure, however, with the advent of the internet, the physical limitations that supported implementation of copyright law have begun to wither away.[25] The emergence and growth of the internet

[22]The same is made clear by a number of cases. An example in point – In Fisher v. Dees 794 F.2d 435 (9th Cir. 1986), the Court stated that the doctrine of fair defense was initially developed by courts as an *equitable* defense to copyright infringement.

[23](1) The following acts shall not constitute an infringement of copyright, namely:
(a) a fair dealing with a literary, dramatic, musical or artistic work [not being a computer
programme] for the purposes of-
(i) private use, including research;
(2) The provisions of sub-section (1) shall apply to the doing of any act in relation to the translation of a literary, dramatic or musical work or the adaptation of a literary, dramatic, musical or artistic work as they apply in relation to the work itself.

[24]Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society.

[25]James Bessen& Eric Maskin, *Intellectual Property on the Internet: What's Wrong with Conventional Wisdom?*,Research on Innovation, Working Paper, 2004, http://researchoninnovation.org/iippap2.pdf.

weakens[26] copyright law's 'one-size-fits-all' approach.[27] The rapid innovation in technology has threatened the economic interests of information and entertainment industries and led to the introduction of new copyright laws[28] that affirm this threat and aim to protect the interests of copyright holders.[29]

Widespread digitization accompanied with piracy has been taking place worldwide and the Indian situation provides an example of this. Amendments[30] are being proposed to the Indian legislation to introduce DRM to protect the growth of music and film industries

[26]Christophe Geiger, *Author's Right, Copyright and the Public's Right to Information: A complex relationship (Rethinking copyright in the light of Fundamental Rights)*,5 THE NEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW24, 34 (Fiona Macmillan ed., 2005) (If theoretically the principles of copyright could adapt quite easily, the enforcement of the right has proven difficult. As a result, right owners have turned to other means of protection, like the technical measures of cryptography or anti copy mechanisms.)

[27]Michael Carroll, *Creative Commons as Conversational Copyright*,1INTELLECTUAL PROPERTY AND INFORMATION WEALTH: ISSUES AND PRACTICES IN THE DIGITAL AGE445, 447(Peter K. Yu ed., 2006).

[28]WIPO Internets Treaties; The Digital Millennium Copyright Act, 1998; Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society (EU Copyright Directive); Even India has moved to introduce provisions that protect the interests of copyright holders against new technology in the Copyrights Bill which has recently been passed by the Indian Parliament.

[29]John Cahir, *The Moral Preference for DRM Oriented Markets in the Digitally Networked Environment*,1 NEW DIRECTIONS IN COPYRIGHT LAW24, 26-27 (Fiona MacMillan ed., 2005) It must be noted that arguments against the utilitarian theory do exist. For instance, Rawls has criticised it on account of its failure to consider the distinction between persons, as long as the "common good" is maximised. Nozick disagreed with both lines of thought, arguing that individuals/groups are free to pursue their own goals, provided that they don't violate rights of others. Cahir himself opposes the utilitarian theory, basing his arguments on the libertarian theory laid down by Nozick.

[30]Copyright Bill 2012, § 2(xa), 65A and 65B.

against the ills of piracy. The following table will help make the position clearer:[31]

[31]All figures are approximate.

Name of Industry[32]	Revenue in INR billion (2010)[33]	Growth of industry in INR billion[34] (from 2006 to 2010)[35]	Impact of piracy[36]
Internet	7.7	1.6 to 7.7	-
Films[37]	87.5	84.5 to 87.5	US$959 million[38]
Music[39]	9.5	7.3 to 9.5[40]	US$52.7

[32]Link to DRM becomes clearer when we understand that with the advent of computers and internet, transformation from physical to digital format i.e. ripping and vice versa is now widespread. Thus, concerns of content producers need to be understood.

[33]Figures courtesy,*India Entertainment and Media Outlook, 2011*, http://www.pwc.se/sv_SE/se/media/assets/india-entertainment-and-media-outlook-2011.pdf.

[34]*Id.*

[35]The same is relevant keeping in mind the reach of the industries and the impact of globalization which has furthered the pace of growth. What is relevant here is the role of the internet in increased access to digitized version of films and music. The interface now being made clear, the choice of only these three industries for purpose of this paper becomes clear.

[36]The same is relevant in order to figure out the losses suffered by these industries as a result of easy online access. The same helps make a case for DRM easier.

[37]The film industry is witnessing advancements in areas of technology, marketing and rampant digitalization can be seen across the chain. Thus, understanding current revenue in order to prepare for wide scale digitalization and hence impact for purposes of this paper is important.

[38]According to the 2008 report on *The effects of counterfeiting and piracy on India's entertainment industry* published by the US India business Council and Ernst & Young, figures accessed in news release – *Film industry launches coalition to protect content in India*, http://www.usibc.com/sites/default/files/committees/files/mpaapressreleases.pdf.

			million[41]

When it comes to television, there are approximately 37 million digital homes and new digital mediums are emerging – such as DTH, Digital Cable, IPTV. Industry reports estimate the digital market in India to be the fifth largest in the world by 2015.[42] On the other hand, India has been ranked among the top ten countries in the world when it comes to internet piracy. Due to increased internet piracy with sites offering unauthorized copies of software for download,[43] the entertainment industry has been bearing the brunt of it. For example, it is felt that internet piracy in the music industry has grown and approximately 95% of all such uses are unauthorized.[44]Thus,

[39]The ratio for digital to physical sale for film music is estimated to be 70:30 and veering towards 80:20. Courtesy – *Digital music sales up, but labels continue making CDs to publicise films,* http://articles.timesofindia.indiatimes.com/2011-11-11/chennai/30386726_1_cds-sony-music-shridhar-subramaniam.

[40]On the other hand, if we are to look at solely digital music then forecasts for the same in 2014 are estimated at $4.25 billion. Courtesy – *India Digital Music Forecast for online, mobile and subscription channels, 2010-2014*,http://www.researchandmarkets.com/reports/1368870/india_digital_music_forecast_for_online_mobile.

[41]*International Intellectual Property Alliance, Special 301 Report, 2007,* http://www.iipa.com/rbc/2007/2007SPEC301INDIA.pdf. The figures here are losses caused due to internet piracy.

[42]*Media and Entertainment in India; Digital road ahead,* September 2011, http://www.deloitte.com/assets/Dcom-India/Local%20Assets/Documents/ME%20-20Whitepaper%20for%20Assocham.pdf.

[43]*Is music industry losing battle against piracy?*,http://ibnlive.in.com/news/is-music-industry-losing-battle-against-piracy/137547-45-75.html. Popular Indian singer, Shaan, puts the position quite succinctly "It's an easy and convenient thing for people to just download any music they like from the internet free of cost. Then obviously they don't take the pain to buy CDs."

[44]*International Intellectual Property Alliance, Special 301 Report, 2011,* http://www.iipa.com/rbc/2011/2011SPEC301INDIA.pdf.

copyright protection in the form of DRM is required to compensate industries for losses caused by piracy.

IV. FAIR USE IN THE DIGITAL WORLD AND ASSOCIATED PROBLEMS

The DMCA is indicative of a sharp shift from what copyright legislations have aimed to do historically. While historically these legislations sought to regulate the use of information, the DMCA steps into the arena of information technology that is used for transmitting, storing and using such information.[45]Anti-circumvention measures were first recommended by the WIPO Copyright Treaty's requirement that effective legal remedies be provided to prevent circumvention where it interferes with the rights of the copyright owner.[46] This interest of the copyright holder was required to be balanced with the concerns of fair use and the tendency of such a ban to stifle innovation.[47]

Concurrent to the advent of anti-circumvention provisions, one observes a growing acceptance of the trend to sue facilitators, rather than direct infringers.[48] While this is prompted by the cost

[45]David Nimmer, *A Riff on Fair Use*, 148(3) U. PA. L. REV.673, 682 (2000).
[46]Article 11, WIPO Copyright Treaty makes this provision, and it was incorporated in the DMCA under Section 1201.
[47]Julie E. Cohen, *WIPO Copyright Treaty Implementation in the United States: Will Fair Use Survive?*,21 EUROPEAN INTELLECTUAL PROPERTY REVIEW 236, 236-237 (1999).
[48]A&M Records v. Napster, Inc., 239 F.3d 1004 (Ninth Cir. 2001) (noted that a direct facilitator may be sued for infringing the rights of the copyright holder); In Re Aimster Copyright Litigation, 334 F.3d 643 (7th Cir. 2003) (making available software that allows file sharing infringes upon rights of the copyright holder);

effectiveness of suing facilitators rather than identifying infringers and suing them independently for their infringements,[49] such a move likely to stifle affect innovation by greatly deterring technological innovators.[50]

With the explosion of digital technology and keeping in mind the incentives in converting to the same,[51] we need to consider the applicability of the traditional fair use doctrine to an increasingly digitised world. But first we need to understand the protections in place, then only can we move on to understanding whether the defence of fair use is available for violation of the same.

The protections provided to copyright holders in the digital world can be understood through three layers. TPMs are technical means available to copyright holders in order to protect their works. Therefore, TPMs can be said to be a *second*, technical layer which protects the subject matter in addition to the *first* layer of say

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Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 545 US 913 (2005) (held that P2P file sharing companies can be sued for copyright infringement.)

[49]However, there are stray incidents wherever individuals are directly targeted. For instance, David Bryrne, a musician, sued Charlie Crist, former Governor of Florida, for using a song sung by him in his campaign advertisement. The dispute was settled by mediation, and resulted in a public apology posted on YouTube by Crist, http://www.youtube.com/watch?gl=US&v=s4k13LmlcUE.

[50]Mark A. Lemley and R. Anthony Reese, *Reducing Digital Copyright Infringement without Restricting Innovation*, 56 STANFORD LAW REV.1345 (2004) (Arguing that the liability attached to facilitators and the growing rate of successful suits against them would lead to a reduction in innovation, and that such foregone innovation would lead to a situation where the benefits of copyright law would not outweigh the costs imposed by its implementation.)

[51]Denis T Brogan, *Fair use no longer: How the Digital Millennium Copyright Act bars fair use of digitally stored copyrighted works*, 16 JOURNAL OF CIVIL RIGHTS AND ECONOMIC DEVELOPMENT 691,695 (2002) – massive number of copyrighted works are bound to develop since electronic storage saves cost, paper. Also, a digital copy stays true to the original whereas every subsequent physical copy deteriorates in quality. For example – A photostatted copy.

copyright or related rights.[52] An example of the same would be DRM.[53] The *third* layer is one of legal protections and entails anti circumvention provisions. The same has been incorporated through Article 6(1)[54] of the EU Copyright Directive, Section 1201(a)(1)(A)[55] of the DMCA in the US whereas in India the same is being incorporated under Section 65A[56] of the Copyright Bill, 2012 which has recently been enacted by the Parliament.

Such protections against circumvention can be extremely broad and can even go to the extent of encompassing *any act*[57] not authorised by the right holder.[58]

The problem of considering this third type of protection as a new type of violation[59] is clear. Applicability of fair use to such anti

[52]ESTELLE DERCLAYE, THE LEGAL PROTECTION OF DATABASES; A COMPARATIVE ANALYSIS 196 (2008).
[53]For example – the user could be denied the ability to copy the content.
[54]Obligations as to technological measures - Member States shall provide adequate legal protection against the circumvention of any effective technological measures, which the person concerned carries out in the knowledge, or with reasonable grounds to know, that he or she is pursuing that objective.
[55]"No person shall circumvent a technological measure that effectively controls access to a work protected under this title…"
[56]Any person who circumvents an effective technological measure applied for the purpose of protecting any of the rights conferred by this Act, with the intention of infringing such rights, shall be punishable with imprisonment which may extend to two years and shall also be liable to fine.
[57]See Article 6.3 of the Copyright Directive of Europe.
[58]ESTELLE DERCLAYE, THE LEGAL PROTECTION OF DATABASES; A COMPARATIVE ANALYSIS197 (2008).
[59]In Universal City Studios, Inc. v. Reimerdes,111 F. Supp.2d 294 (SDNY 2000) the Court held that the DMCA creates a new type of violation i.e. that of anti-circumvention provisions and not of copyright. Thus, applicability of fair use is restricted to copyright and not extended to anti circumvention provisions.
Further see Section 1201(c)(1), Copyright Act, 1976, Title 17 of the US Code. It can be said a distinction between copyright infringement and circumvention has been created.

circumvention provisions[60] is felt to be greatly restricted[61] and the same poses certain problems for the users, some of which shall be analysed here.[62] Proponents of the restrictions placed by the Act consider its provisions to be wisely placed necessary restraints on the violation of copyright law, especially due to the protection afforded to fair use.[63] However, one line of view is that the scope of fair use has been greatly narrowed under the DMCA as non-commercial use is no longer presumed to be fair, requiring a declaration of fairness by the library.[64] Further, it is difficult to protect technologies that facilitate fair use, as they don't comply with the norm of having a 'significant commercial purpose, other than circumvention'.[65]

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[60] A threefold anti circumvention ban was introduced by Section 1201 of the DMCA:

i. Basic Provision: No person shall circumvent a technological measure that has been installed to effectively control the access to copyright protected work.
ii. Trafficking Ban: No technology shall be manufactured, imported and offered to the public to if it is primarily designed to circumvent any technology that effectively controls the access to copyright protected work.
iii. Additional Violation: No technology shall be manufactured, imported and offered to the public, or otherwise trafficked, to if it is primarily designed to circumvent any technology that effectively controls the access to copyright protected work.

[61] If we are to look at the exemptions granted under Section 1201 (d) to (j), it can be seen that fair use is not safeguarded. Fair uses such as research, teaching, criticism, review have not been listed.

[62] ESTELLE DERCLAYE, THE LEGAL PROTECTION OF DATABASES; A COMPARATIVE ANALYSIS 241 (2008).

[63] Kenneth W. Dam, *Self-Help in the Digital Jungle*, 28 JOURNAL OF LEGAL STUDIES 393 (1999), at p. 401, "(allowing self-help, restricted by fair use, may be in the interest of copyright holders. Dam supports 'self-help' as a mode of rights management as it would reduce copyright violations and increase electronic commerce.)"

[64] Julie E. Cohen, *WIPO Copyright Treaty Implementation in the United States: Will Fair Use Survive?*,21 EUROPEAN INTELLECTUAL PROPERTY REVIEW 236, 242 (1999).

[65] As required by Section 1201, DMCA.

In order to avail of exceptions to TPMs, most of the users do not possess the technical knowhow to circumvent TPMs. The problem[66] is that the manufacture and distribution of these circumventing devices has been specifically prohibited. Further, there are very few devices available that allow for circumvention for non-infringement purposes. Thus, it can be said that the user's freedom to lawfully circumvent a TPM is practically *non-existent*.[67] In other words, access of encrypted works for making fair use of the same is not available. Though under Section 1201(c)(1),[68] it would seem that fair use has not been denied as a defence, the reality is such that consumers will have neither the ability nor the need to invoke such defences as the decision about when, where and how the copies will be made rests solely on the copyright holder.[69] Further, fair use can be used as a defence in case there has been copyright infringement and as mentioned earlier, this is not the case in case there is violation of anti-circumvention provisions.[70]

Thus, DRM technology cannot go through Section 107's four-factor balancing test for fair use. Any copying whatsoever is prohibited, even copying fragments of text or images that would clearly be seen as fair use. DRM also controls acts that weren't previously within the

[66]In order to gain access to digitally stored works, one would require the aid of technological measures that would in turn circumvent the protections barring access.

[67]ESTELLE DERCLAYE, THE LEGAL PROTECTION OF DATABASES; A COMPARATIVE ANALYSIS 242 (2008).

[68]"Nothing in this section shall affect rights, remedies, limitations, or defenses to copyright infringement, including fair use..."

[69]Ben Fernandez, *Digital content protection and fair use: What's the use?*, 3 JOURNAL ON TELECOMMUNICATIONS AND HIGH TECHNOLOGY LAW 425, 427 (2005).

[70]WenckeBaesler, *Technological Protection Measures in the United States, the European Union and Germany: How much fair use do we need in the "Digital World?"*, 8 VIRGINIA JOURNAL OF LAW AND TECHNOLOGY 1, 8 (2003).

copyright owner's control, such as private performance in the home by restricting the number of times a file can be played.[71]

A. Rationale for non-extension of fair use to digital world

1) *Best Interest:* It is felt that the whole taking of CDs and DVD movies is what led to the legal actions by some of the largest American and overseas corporations. What is relevant here is the fourth factor[72] under fair use and apprehensions of over appropriation over the Internet. The same can be noted in *Sony Corp. of America v. Universal City Studios, Inc*.[73] where Universal feared the market for its movies would dry up as a result of the videocassette recorder sold by Sony. However, the trend has now reversed with the success of video stores and the home viewing market. More recently, in *UMG Recordings, Inc. v. MP3.com, Inc.,*[74] the Court denied the defense of fair use to the defendant for facilitation of CD recordings over the Internet as indefensible and one that must be denied as a matter of law.[75] But the researchers would like to put forward the point that 'best interest' is not constant and we can go so far as to say it is relative. Once the large corporations manage to derive profits from the new technology by figuring out a way for decryption of digitally stored books and movies in a manner that would not allow for mass appropriation, then it wouldn't be surprising if we

[71]*Fair Use since the Digital Millenium Copyright Act of 1998* http://correctingcourse.columbia.edu/paper_tushnet.pdf.
[72]The effect of the use upon the potential market for or value of the copyrighted work.
[73]464 US 456 (1984).
[74]92 F. Supp. 2d 349 (SDNY 2000).
[75]Denis T Brogan, *Fair use no longer: How the Digital Millenium Copyright Act bars fair use of digitally stored copyrighted works*, 16 JOURNAL OF CIVIL RIGHTS AND ECONOMIC DEVELOPMENT 691,708 (2002).

indeed witness reverse lobbying of sorts.[76] Thus, looking out for the best interests of corporations and using the same as a justification for not extending fair use to DRM seems to be a short-sighted move.

2) *Widespread Use:* Another factor for the stringent rights granted by users of digital medium, seems to be the possibility of over appropriation or widespread use and the effect of the same on the potential market of the content creator. The case of *Princeton University Press v. Michigan Document Services, Inc.*[77]comes to mind. Though the concern is valid, the same does not take away from the facts that where, say, only a few articles for educational or research purposes need to be taken, then the fair use of the same is not possible without violation of Section 1201.[78]

B. Reasons for Extension of Fair Use to the Digital World

1) *Information as public good:* Information as a value cannot be said to be appropriable as such. It belongs to everyone, say, like air and fire. Thus, it can be said to be a public good or *res communes.* Under this view, the public's right to information would be the right for everybody to use freely a piece of information and to exercise the freedom guaranteed by law. Thus, in this conception, the right is

[76]*Id.* at 709.
[77]99 F. 3d 1381 (6th Cir. 1996). The defendant reproduced substantial parts of copyrighted textbooks etc., bound them into coursepacks in order to sell them to students at a University. The Court held that the same was an exploitation of the copyrighted works and not a fair use.
[78]Denis T Brogan, *Fair use no longer: How the Digital Millennium Copyright Act bars fair use of digitally stored copyrighted works*, 16 JOURNAL OF CIVIL RIGHTS AND ECONOMIC DEVELOPMENT 691,710 (2002).

closely linked to freedom of expression.[79] Article 19, Universal Declaration of Human Rights (UDHR), 1948[80]and Article 19(2), International Covenant on Civil and Political Rights (ICCPR), 1996[81] reinforce the same.

Thus, the constitutional justification for fair use comes from the freedom of speech and expression. The relevant provisions would be Article 19(1)(a)[82] under the Indian Constitution and the First Amendment[83] in the US. Further, the right to information is an inalienable component of the freedom of speech and expression.[84] Keeping the same in mind, it would be difficult and in fact a violation of these Constitutional provisions if rights envisaged under fair use are not extended to the digital media as well.

2) Underlying rationale for copyright: The same also brings us to our second constitutional justification. Firstly, if we are to look at the underlying rationale for copyright, then apart from the primarily negative approach i.e. prevention of theft, we can understand that it has a role to play in promotion of *learning* and in order to *encourage*

[79]Christophe Geiger, *Author's Right, Copyright and the Public's Right to Information: A complex relationship (Rethinking copyright in the light of Fundamental Rights)*,5THENEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW24, 25 (Fiona Macmillan ed., 2005).

[80]Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless of frontiers.

[81]Everyone shall have the right to freedom of expression; this right shall include freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice.

[82]Protection of certain rights regarding freedom of speech, etc. – All citizens shall have the right to freedom of speech and expression.

[83]Protecting the freedom of speech, the press.

[84]Bennett Coleman v. UOI, A.I.R. 1973 SC 106, SP Gupta v. UOI A.I.R. 1982 SC 149.

writing. Clearly, fair use developed to preserve the same.[85] The spirit of the same can be seen in the Indian Constitution under Article 51A(h).[86] The same being a Fundamental Duty, it can be said that the onus lies on both the user and the creator of content. Thus, there is a duty upon the creator to not stifle the spirit of inquiry, reform and scientific temper of the users. On this reasoning, non-extension of fair use to the digital world doesn't hold true.

3) Social justifications of fair use: If the user requires the information for the purpose of say criticism or parody, then it is quite likely that the copyright holder would restrict use of the work for the said purposes. In such cases, there is a requirement for the extension of fair use to the digital medium.[87]

V. NEED FOR BALANCE

It seems that in the recent past, it seems impossible to discuss these issues without being immediately categorised as being 'pro' or 'contra' copyright. The middle ground, sadly, seems to be disappearing entirely.[88] One is either "one of us" or "one of them."[89]

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[85]Denis T Brogan, *Fair use no longer: How the Digital Millenium Copyright Act bars fair use of digitally stored copyrighted works*, 16 JOURNAL OF CIVIL RIGHTS AND ECONOMIC DEVELOPMENT 691,704 (2002).

[86]Fundamental Duties – It shall be the duty of every citizen of India to develop the scientific temper, humanism and the spirit of inquiry and reform.

[87]WenckeBaesler, *Technological Protection Measures in the United States, the European Union and Germany: How much fair use do we need in the "Digital World?"*, 8 VIRGINIA JOURNAL OF LAW AND TECHNOLOGY 1, 10 (2003).

[88]Jane Ginsburg, *How Copyright Got a Bad Name for Itself*, 26 COLUM. J.L. & ARTS61 (2002) (holding copyright holders and consumers equally responsible for the current problems with copyright law); Cynthia M. Ho, *Attacking the Copyright Evildoers in Cyberspace*, 55 SMU L. REV. 1561 (2002) (arguing that both the sides tend to shift the entire blame on the other); Mark A. Lemley and R. Anthony Reese,

It has been argued that one way to reach such middle ground is by targeting direct infringers of copyrights rather than facilitators.[90] However, such a proposal seems infeasible due to the anonymity[91] and internationality[92] that characterises the internet.

Thus, copyright protection is required but at the same time, we need to keep in mind that exclusive rights result in corresponding decreased access to works. Thus, Landes and Posner argue that copyright law must, at least approximately, maximise the benefits from creating additional works minus both the losses from limiting access and the costs of administering copyright protection.[93] Balance can be struck when a model accounts for not only economic aspects, but also moral rights and utilitarian considerations.[94]

Reducing Digital Copyright Infringement without Restricting Innovation, 56 STAN. L. REV.1345, 1350-1351 (2004) (observing that when courts pass judgments regarding copyright infringement, the social benefits and harms caused by the actions are not reconciled, but either permitted in entirety or rejected in entirety.)

[89]Christophe Geiger, *Author's Right, Copyright and the Public's Right to Information: A complex relationship (Rethinking copyright in the light of Fundamental Rights)*,5 THE NEW ECONOMY IN NEW DIRECTIONS IN COPYRIGHT LAW24, 24 (Fiona Macmillan ed. 2005).

[90]Mark A. Lemley and R. Anthony Reese, *Reducing Digital Copyright Infringement without Restricting Innovation*,56 STAN. L. REV.1345, 1350-1351 (2004).

[91]David Nimmer, *A Riff on Fair Use*, 148(3) UNIVERSITY OF PENNSYLVANIA LAW REVIEW 673, 682 (2000) (noting that during deliberations on the DMCA, the House Commerce Committee added 'user privacy' to section 1201 by allowing them to disable 'cookies' which can be used to identify the location of users.); Doug Lichtman and David Jacobson, *Anonymity: A Double Edged Sword for Pirates Online*, The Chicago Tribune, April 13, 2000, http://www.law.uchicago.edu/news/lichtman041300. Further, there is no dearth of technology that enables a user to conceal their I.P. Address. For instance, the Tor Project which provides a free software to enable users to conceal their location or browsing habits, www.torproject.org.

[92]Justice S. Muralidhar, *Jurisdictional Issues in Cyberspace*, 6 IJLT 1 (2010).

[93]TANYA APLIN, COPYRIGHT LAW IN THE DIGITAL SOCIETY; THE CHALLENGES OF MULTIMEDIA 24 (2005).

[94]*Id.*at 25.

In an adequate protection model, the over protective aspects of the right should be at a minimal. Exceptions should include extraction for teaching, research, criticism or review. Further, the exceptions should keep in mind the public's right to information as well as public interest.[95] Due to strong lobbying for public interest by a coalition of educational, consumer and scientific groups[96], the statute makers were compelled to attempt to harmonize the interests of copyright holders with public interest[97] and the judicial extension of fair use to reverse engineering[98] was also preserved.[99]

A. Possible Solutions

Towards a Balanced Model: Moral rights[100] are the personal link between the author and his creation[101]. It includes[102]:

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[95]ESTELLE DERCLAYE, THE LEGAL PROTECTION OF DATABASES; A COMPARATIVE ANALYSIS 279 (2008).

[96]The Digital Future Coalition was the result of the collaboration between the different groups. Such representation of public interest was largely unprecedented, http://www.copyright.gov/reports/studies/dmca/comments/Init009.pdf. Julie E. Cohen raised questions about the sustainability of the coalition.

[97]Julie E. Cohen, *WIPO Copyright Treaty Implementation in the United States: Will Fair Use Survive?*,21 EUROPEAN INTELLECTUAL PROPERTY REVIEW 236, 239 (1999); Seealso Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417, 442(1984) (the Supreme Court observed that the aim of copyright law is to "strike a balance between a copyright holder's legitimate demand for effective - not merely symbolic - protection of the statutory monopoly, and the rights of others freely to engage in substantially unrelated areas of commerce.".

[98]Sony Corp. Of America v. Universal City Studios, Inc., 464 U.S. 417, 454-55 (decided that home time shifting fell within the purview of fair use.)

[99]17 U.S.C § 1201(f).

[100]Moral rights are not mentioned the Universal Copyright Convention. The Berne Convention recognizes these rights in Article 6bis. Article 9 of the TRIPS Agreement states that all member nations are required to comply with the provisions of the Berne Convention except Article 6bis. The decision by the Arbitrators on *EC — Bananas (Ecuador)* (Article 22.6 — EC), explained that parties are not exonerated from respecting moral rights simply because Article 9 of TRIPS excludes Article 6bis, Berne Convention.

i. Paternity right:[103] the inalienable right to claim authorship of the work.[104]

ii. Integrity right:[105] the right to object to any derogation or mutilation of the work, which tends to lower the reputation of the author.[106]

These rights can be justified on economic grounds and grounds of public policy.[107] Being a species of 'personality' rights, they protect literary and artistic property, protect personality, offer power to performers, and uphold their human rights.[108] Essentially, these rights pertain to the right of the authors to control the ascription of authorship in cases of copying and distribution of their creations.[109]

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[101] Follow up to the Green Paper on Copyright and Related Rights in the Information Society, Communication from the Commission of European Countries, 20 Nov., 1996, 27,http://aei.pitt.edu/939/1/copyright_gp_follow_COM_96_568.pdf;ELIZABETH ADENY, THE MORAL RIGHTS OF AUTHORS AND PERFORMERS 2 (6th ed. 2006).

[102]Article 6bis, Berne Convention, 1914

[103]Copyright Bill 2012, § 38B (a).

[104]The absoluteness of this right is disputed. *See* Joost Smiers, *Creative Improper Property: Copyright and the Non-Western World*, 1NEW DIRECTIONS IN COPYRIGHT LAW1, 6-8 (Fiona MacMillan ed., 2005) (Claims that the creator himself cannot be titled the true author as he has proceeded with the work of predecessors, relying on the common knowledge base of the community.)

[105]Copyright Bill 2012, § 38B (b).

[106]Follow up to the Green Paper on Copyright and Related Rights in the Information Society, Communication from the Commission of European Countries, 20 Nov., 1996, 27,http://aei.pitt.edu/939/1/copyright_gp_follow_COM_96_568.pdf; Has been incorporated in the Berne Convention in Art 6; SIMON STROKES, DIGITAL COPYRIGHT: LAW AND PRACTICE72,(3rd ed. Hart Publishing, 2009) (different view in authors' rights countries such as France and Germany, where authors have a right to prevent destruction – greater right of integrity.)

[107]*Id.*

[108]ELIZABETH ADENY, THE MORAL RIGHTS OF AUTHORS AND PERFORMERS 3 (6th ed. 2006); SIMON STROKES, DIGITAL COPYRIGHT: LAW AND PRACTICE 72 (3rd ed. 2000) (In countries such as France and Germany, it includes right to decide upon first publication)

[109]SIMON STROKES, DIGITAL COPYRIGHT: LAW AND PRACTICE 71 (3rd ed. 2009)

Given the effects of the internet on implementation of copyright law[110], and the tendency of anti-circumvention provisions to override fair use and adversely impact the dissemination of knowledge,[111] it is apparent that a customized regime needs to be adopted to regulate copyright laws on the internet. One possible solution is to incorporate a hybrid of a 'copyleft' model,[112] such as the Creative Commons (CC) license, along with certain economic rights of authors, to reach a balance between the rights of users and copyright holders.

CC offers a set of "some rights reserved" (as opposed to the "all rights reserved" form under copyright law) licenses designed primarily for authors and artists.[113] Essentially it seeks to create a solution by assembling 'a layer of reasonable copyright' on top of the existing law.[114]

Moral rights may also include the right to withdraw a work from the public domain or the right of access to the work – right of retraction (publishers are generally indemnified for exercise of such rights). For instance, in Fox Film Corp. V. Doyal,286 US SC 123 (1932), 127the SCOTUS recognized a similar right observing that, "the owner of the copyright, if he pleases, may refrain from vending or licensing, and content himself with simply exercising the right to exclude others from using his property." But such a right is not recognized in India, or under the Berne Convention.

[110]James Bessen& Eric Maskin, *Intellectual Property on the Internet: What's Wrong with Conventional Wisdom? Research on Innovation, Working Paper*, 2004,http://researchoninnovation.org/iippap2.pdf.

[111] The Chancellor Masters and Scholars of the University of Oxford v. Narendra Publishing House., 2008 (106) D.R.J. 482 at para 23; Entertainment Network (India) Ltd. v. Super-Cassette Industries Ltd.,2008 (9) S.C.A.L.E. 69

[112]Copyleft is a general method for making an item of work free, and requiring all modified and extended versions of the program to be free as well.

[113]CREATIVE COMMONS, www.creativecommons.org; Adrienne K. Goss, *Codifying a Commons: Copyright, Copyleft, and the Creative Commons Project*,82 CHICAGO-KENT LAW REVIEW 963, 965 (2007).

[114]LAWRENCE LESSING, FREE CULTURE, 282-283 (2004), http://www.free-culture.cc/freeculture.pdf.

The primary terms provided by CC licenses[115] are:

i. Attribution: right to copy, distribute, display, or transform a work done by one after giving due credit to the author.

ii. Non-Commercial use: right to copy, distribute, display or transform a work under a CC license for non-commercial purposes

iii. Share alike: once a derivative work is created after using a work under a CC license, the derived work should be placed under similar licensing

iv. No Derivative Works: right to copy, distribute or display are restricted only the original work.[116]

The terms of license that are selected by the author are displayed along with the work itself. It is interesting that some concerns raised in the European Copyright Directive,[117] such as the need to "identify better the work" and to "provide information about the terms and conditions of the work" are satisfied by CC licenses, as all this information is attached to the work itself. CC harmonises the needs of creators as well as users in a satisfactory manner, inculcating a spirit of creativity,[118] bearing no ill effects on innovation. Such a system would also satisfy the demands of those who feel that copyright law is

[115]A similar set of licenses is a French system known as Artlibre. It is essentially a 'free art license' that protects the moral rights of creators, http://artlibre.org/licence/lal/en/.

[116]CREATIVE COMMONS, www.creativecommons.org.

[117]Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society (EU Copyright Directive), 2001 O.J. (L 167) 10.

[118]William Patry, *Limitations and Exceptions in the Digital Era*, 7 INDIAN JOURNAL OF LAW AND TECHNOLOGY 1, 5-7 (2011) (arguing that copyright law ideally evolved to promote creativity, and this not only requires acceptance of the fair use doctrine, but alignment of copyright laws to the current digital environment.)

leading to a monopolistic exclusivity for cultural industries.[119] However, to suggest that no economic compensation need be provided to authors would be a faux pas – the absence of remuneration would discourage creation of copyrighted works, which in its turn would adversely affect dissemination of knowledge.

B. Broader Exceptions in Legislations

The notion that fair use rights apply only when no licensing market exists[120] can be said to be a viewpoint in opposition to *good public policy*. Not only free speech but public interest functions are also ignored by such a view.[121] Control of creator should not come at the cost of public access.

Keeping in mind the above mentioned factors, there seems to be no reason for excluding the applicability of fair use when it comes to TPMs and anti-circumvention provisions. Thus, a broad fair use doctrine, similar to the one under Section 107 of the US Copyright Act should be made applicable. Further, we can take inspiration from the European Copyright Directive. Article 6(4) refers to exceptions

[119]Joost Smiers, *Creative Improper Property: Copyright and the Non-Western Worldin,*1 NEW DIRECTIONS IN COPYRIGHT LAW1-5 (Fiona MacMillan ed., 2005) (argues that monopolistic exclusivity of cultural industries which is eternal in nature, can be reduced by providing restricted ownership rights. This would lead to *normalization* of the industry, thereby allowing smaller players and artists to enter the market and compete fairly.)

[120]This is in opposition to claims that fair use exists only in order to compensate for market failure. In the digital world, with the copyright holder having complete control over the license, such a situation would not arise. Thus, fair use would be made redundant. See Jonathan Dowell, *Bytes and Pieces: Fragmented copies, Licensing and Fair use in a digital world*, 86 CAL. L. REV. 843,843 (1998).

[121]Jonathan Dowell, *Bytes and Pieces: Fragmented copies, Licensing and Fair use in a digital world*, 86 CAL. L. REV.843,846 (1998).

and limitations provided for in Article 5[122]of the Directive and partially allows and partially mandates "appropriate measures to be taken by member states to ensure that right holders make available to the beneficiary of an exception or limitation...the means of benefiting from that exception or limitation, to the extent necessary to benefit from that exception or limitation and where the beneficiary has legal access to the protected work or subject-matter concerned." Thus, it can be seen that the Copyright Directive tips the balance in favour of the user at an earlier stage of the exercise of the exception constrained by a technological measure (as opposed to at the stage of sanctions against circumvention).[123]

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[122]1. Temporary acts of reproduction referred to in Article 2, which are transient or incidental and an integral and essential part of a technological process and whose sole purpose is to enable:
(a) a transmission in a network between third parties by an intermediary, or
(b) a lawful use of a work or other subject-matter to be made, and which have no independent economic significance, shall be exempted from the reproduction right provided for in Article 2.
2. Member States may provide for exceptions or limitations to the reproduction right provided for in Article 2 in the following cases:
(a) in respect of reproductions on paper or any similar medium, effected by the use of any kind of photographic technique or by some other process having similar effects, with the exception of sheet music, provided that the right holders receive fair compensation;
(b) in respect of reproductions on any medium made by a natural person for private use and for ends that are neither directly nor indirectly commercial, on condition that the right holders receive fair compensation which takes account of the application or non-application of technological measures referred to in Article 6 to the work or subject-matter concerned;
(c) in respect of specific acts of reproduction made by publicly accessible libraries, educational establishments or museums, or by archives, which are not for direct or indirect economic or commercial advantage; 5. The exceptions and limitations provided for in paragraphs 1, 2, 3 and 4 shall only be applied in certain special cases which do not conflict with a normal exploitation of the work or other subject-matter and do not unreasonably prejudice the legitimate interests of the right holder.

[123]WenckeBaesler, *Technological Protection Measures in the United States, the European Union and Germany: How much fair use do we need in the "Digital World?"*, 8 VA. J.L. & TECH. 1, 13 (2003).

The aforementioned principles seem to be reasonable and would go a long way in ensuring a balance between the copyright holder and user's rights. However, the user must have legal access to the work in order to make use of the exceptions.[124] Under the Copyright Directive, though the user is not permitted to circumvent the technological measures, he however does have a claim against the copyright holder to furnish him with the means to exercise his rights.[125]

A solution could be in the form of a technology which would be capable of distinguishing between lawful circumvention for fair use and one that results in copyright infringement. The same would help users exercise their rights in a lawful manner.[126]

An important aspect of the exceptions and limitations provided under the Copyright Directive is that the user has to pay reasonable compensation for most of the fair uses. The same seems to be reasonable as not only the users' rights are being protected by allowing for fair use but the copyright holders' rights are also protected by compensating him for his efforts. The same is not very different from fair use in the analog world. Even if one wants to copy a certain passage from a book, one has to either buy it or make use of it from a library.[127]

DRM is being introduced in India, but a pertinent difference lies between the Indian and American provisions. The Indian provision does *not* seek to punish facilitators for creating technology for circumvention, but only those who directly infringe copyright law by

[124] *Id.* at 13.
[125] *Id.* at 28.
[126] *Id.* at 9.
[127] *Id.* at 27.

using a technology for the purpose of circumvention.[128] Further, it is provided that utilisation of circumvention technology, for the purpose of circumvention research, lawful investigation etc.[129] is lawful. Thus, the process of innovation is not discouraged by the Indian system, as facilitators are not held liable for creation of technology.[130] Further, the Indian system surpasses the objection that fair use isn't achieved in practice because, unlike America, India does not prohibit the production of circumvention technologies. Further, there is no requirement to prove that the technology itself was not created for the purpose of circumvention.[131]

In *Emerson v. Davies*[132], Justice Story stated that every book in literature, science and art, borrows, and must necessarily borrow, and use much which was well known and used before.[133] The researchers feel there is no difference why the same should not hold true in the digital world as well. Having said the same, it is difficult to insist that the rights envisaged by traditional fair use should not be granted to the users.

[128]Copyright Bill 2012, § 65A(1).
[129]Copyright Bill 2012, § 65A(2). This Section also exempts necessary and authorised action taken for testing the security of a system, actions taken as an operator, actions taken in national interest, and any action not expressly prohibited by the Act.
[130]Julie E. Cohen, *WIPO Copyright Treaty Implementation in the United States: Will Fair Use Survive?*,21 EUROPEAN INTELLECTUAL PROPERTY REVIEW 236, 236-237 (1999) (argued that the legal ban on such technology, due to section 1201, DMCA, is likely to deter innovation, even for lawful purposes such as reverse engineering or encryption research.)
[131]Unlike Section 1201, DMCA, 1998.
[132]8 F. Cas. 615 (CCD Mass 1845).
[133]Denis T Brogan, *Fair use no longer: How the Digital Millennium Copyright Act bars fair use of digitally stored copyrighted works*, 16 JOURNAL OF CIVIL RIGHTS AND ECONOMIC DEVELOPMENT 691,703 (2002).

VI. CONCLUSION

The impact of restrictive DRM regimes on fair use creates a serious cause for concern. There is an urgent need to address the same. This not only adversely affects competition, but also leads to a great deal of consumer frustration.[134] The leading software producer, Apple, did away with DRM restrictions[135] due to the large amount of customer dissatisfaction with the same. Technology is in a state of flux and it is almost impossible to clearly identify or recognize the shape it may take in future years. This may render a lot of programs unreadable in the future.

In this paper, we have highlighted how the excessive extension of copyright has often not been counter balanced by an extension of its limitations. On the contrary, the limitations are still confined very strictly and the leeway for the users has been reduced to a minimum. Efforts need to be made to bring about a change in policies to harmonize interests of all involved. Since problems are created due to the 'blind' nature of technology, there is much reason to invest in technologies that are capable of distinguishing fair uses from unlawful ones.

It is increasingly felt that DRM cannot be successful in its current form due to its restrictions on fair use. After all, 'an unexamined life

[134]Keeping in mind problems of interoperability that have arisen where DRM has been imposed.

[135]https://www.apple.com/fr/hotnews/thoughtsonmusic/(These restrictions disallowed users from playing any songs or videos that were not purchased on iTunes on any Apple gadgets, including iPods. Interestingly, Steve Jobs, in an open letter entitled 'Thoughts on Music', encouraged music industries to do away with DRM.).

is not worth living'[136] and overly restrictive DRM regime, impeding dissemination of knowledge, leads to just that.

[136] Plato, THE APOLOGY (attributing the statement to Socrates).