Arbitration or Courts in Financial and Corporate Agreements?

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Arbitration as a mode of dispute resolution privatises law in terms of the freedom that it provides as an alternative to the courts. Due to its inherent advantages and widespread acceptance, arbitration has increasingly emerged as the preferred mode of dispute resolution in the field of commercial law. However, while arbitration has been a stable feature of plain vanilla sale and finance agreements, its usage in more complex corporate transaction documents such as securitisation and asset management agreement is contentious. The suitability of arbitration or courts as the contractually-preferred mode of dispute resolution depends on a host of factors such as enforcement, sovereign immunity, insulation from local law and courts, and exclusivity of the forum among others, from the perspective of creditors. Furthermore, it depends on the class of the agreement under consideration and the prevailing market practice. This paper explores the factors that ought to be considered when determining the appropriate dispute resolution mechanism for international financial and corporate agreements. Additionally, a supplemental note appended to this article comments on the peculiar issues created by this question in the context of the Indian market practice.[**]

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INTRODUCTION

Arbitration is one of the most astonishing things which has happened in the field of commercial law, a field which is pre-eminently dominated by the ruling power sovereign state.

Astonishing because arbitration derogates from sovereignty and the iron grasp of the law, because it privatises the law, because it allows freedom from the main institutions of the law – the courts. Astonishing because the state then lends its powers to enforce the outcome of private arbitration and because in the international sphere, the acceptance of the freedom of arbitration amongst the nations of this world has been so virtually universal that practically every state has agreed under the New York Arbitration Convention of 1958 to enforce arbitration awards of other states, subject only to the most basic protections.

The law is a system of restriction with the most basic objective of ensuring our survival and the survival of our societies. But freedom and the spirit of liberty are also major objectives and so arbitration is a symbol of one of the values we cherish the most.

There are profound things happening in this context. The demands of the law are that the law should be open and transparent and that the reasons for court decisions should be available to the public so that the law which governs our conduct can be understood and explained. This is lost in the case of arbitration.

On the other hand, the demands of the privatisation of dispute resolution are that the organs of the state should stand aside when court rituals, the disciplines of the law, the delays of the law and sometimes the unsuitability of courts in specialised fields, or in rarer cases the corruptibility of courts, should give citizens the right to appoint their own tribunal.

So what we have now in almost all commercial jurisdictions in the world is a choice between courts and arbitration when it comes to dispute resolution. This paper discusses that choice in relation to a major segment of the market – wholesale financial and corporate agreements which are international.

Lawyers can legitimately differ on how the right of choice should be exercised in particular circumstances and can have differing views about how you weigh up subjectively the large number of factors involved in the choice. In addition, circumstances vary so widely that generalisations are unsafe and nuanced qualifications are often necessary. The views I express below are my own.

Why has this issue re-emerged?

The question of whether arbitration should be used in wholesale international corporate and financial documentation has never gone away and has recently been revived in earnest. This revival of interest has arisen for a number of reasons. Firms are now conducting more and more business in emerging countries with weak judicial systems or where judgments of foreign courts may not be enforceable. Further, the financial crisis has focused parties' attention on how any disputes might be resolved should things go wrong and on how issues of jurisdiction can be used strategically by sophisticated parties. The collisions flowing from globalisation have enlarged the number of disputes about which country has jurisdiction, as parties battle to win the court they think is most favourable to their case.

What transactions are relevant here?

The field of corporate and financial documents in relation to which the question of courts or arbitration arises is large. The main documents I am concerned with are large international contracts of the following classes:

- syndicated bank credit agreements and loan transfer documents;
- bond issue documents and their accompanying launch agreements (subscription agreements, formal agency agreements, trust deeds and the like);

- derivatives agreements, usually based on the International Swaps and Derivatives Association (ISDA) master agreement, foreign exchange contracts and netting agreements;
- securitisation documents, including transfers of the securitised receivables, servicing agreements and liquidity agreements;
- investment banking agreements, prime brokerage agreements, client agreements, corporate finance advisory mandates, investment advisory agreements and dealing agreements;
- asset management documents, such as fund and portfolio management agreements and custodian agreements;
- specialised contracts relating to securities settlement systems, payment systems and central counterparties;
- agreements documenting security interests, repos and financial leases;
- in the corporate sphere, equity capital-raising documents, sale and purchase agreements for the sale of private companies, takeover offers, merger and demerger documents, and joint venture agreements; and
- host government concessions, off-take contracts and other contracts involved in project finance.

Arbitration has been a feature of old economy agreements for at least a century, e.g. sale of goods, ship charter-parties and construction. This widespread exit from the courts is now well established for some of these contracts. So what about other financial and corporate agreements?

I approach the issues from the point of view of creditors, not debtors – for example, lenders, not borrowers; bondholders, not the issuer; and sellers of an interest swap, not buyers.

I deal with international contracts, not contracts which are wholly domestic. Most, but not all of the points are also relevant to domestic contracts.

I. Summary of Conclusions

I examine below the 20 or so factors which are relevant to the choice and of course each case may be different. A colour-coded rating of these factors for credit contracts is set out at the end of this paper.

In my view, the main determinant of whether arbitration or courts are most suitable depends on the class of the agreement. If the agreement covers

a debtor-creditor relationship, such as a syndicated bank loan agreement or a bond issue, then in most cases arbitration is not suitable and courts are preferable. But there may be special cases. The courts will usually be the better choice in the case of substantial international bank syndicated credit agreements and international bond issues involving major corporations or sovereigns and especially if it is agreed to use English or New York law or some acceptable system of law, such as the law of Singapore or Hong Kong plus the related courts of the governing law.

This would, in my view, also be the recommendation in the case of bilateral loan agreements between a bank and a customer if they are international, again especially if an acceptable court is available. If an acceptable court is not available, e.g. a court in a third country jurisdiction or in the jurisdiction of the lender, some would argue that the scales are more evenly divided, but even in that case, my money is on courts, not arbitration.

In the case of these debtor-creditor contracts, I believe that the main argument often mentioned favouring arbitration – which is enforcement of an award locally under the New York Arbitration Convention of 1958 - is overrated for reasons which I give later.

There are other reasons too, apart from the New York Convention, including the fact that generally arbitration is not suitable for debt-collecting and typically there is nothing to arbitrate in these cases. Disclosure is not likely to be onerous and the privacy of arbitration can be disadvantageous.

If the loan is to a sovereign, the case in favour of courts is even stronger. This is because sovereigns are generally above the law in any case because their domestic assets are almost invariably immune to creditor attachments and their foreign assets are in practice immune, notwithstanding wide waivers of sovereign immunity. The reason for this de facto immunity is that sovereigns usually hold their foreign assets through central banks or state-owned companies which are separate legal entities and which are not liable for the debts of the sovereign. In that situation, if a sovereign defaults or repudiates, the need to go off and appoint three arbitrators to arbitrate nothing could significantly worsen the bargaining position of creditors. Although actual enforcement actions against sovereigns are rare, bargaining position is crucial in the case of sovereign financial difficulties since it is bargaining position that determines the outcome, in the absence of a statutory framework.

The further one gets away from the simple debtor-creditor relationship, the more arbitration could be considered on its merits if the circumstances

require this. For example, arbitration could be considered for joint venture agreements and sale and purchase agreements for companies. In each case, the relative merits of the choice should be weighed up, having regard to the practical circumstances.

For example, consideration should be given to whether there is likely to be a complicated dispute about the facts, whether court disclosure is or is not desirable, whether enforcement under the New York Convention is crucial and whether there are any privacy objectives, all as discussed below.

There can be hybrid agreements where one party is substantially expected to be a creditor or where a seller sells a company but leaving most of the price to be paid off after closing or where a bank sells a derivative and expects to be the creditor. These hybrids should take into account the above factors.

The above principles tend to apply even if an agreement is not international, such as a domestic loan by a bank to a domestic borrower. Arbitration may not be desirable as a first choice even in these cases because the document still sets up a debtor-creditor relationship. In addition, if you do business locally you take the local risk. It is hard to escape the real world. In addition, we think there is a strong case for building the expertise and independence of those local courts which at present do not enjoy the confidence of significant banks and corporates. This would not happen if major institutions dropped out into arbitration for domestic deals.

If the borrower or issuer or other counterparty is located in or has assets in European countries, then the effect of European law is that judgments of participating states are recognised and enforced in other participating states anyway. So there would be no need to opt for arbitration to permit enforcement.

If the chosen jurisdiction is English, and if the counterparty is located in one of the countries with whom the United Kingdom has an international reciprocal enforcement treaty, again there is less need to use arbitration because a judgment of the English courts will be recognised and enforced in those countries under the relevant treaty. The countries concerned comprise most of the British Commonwealth. See the map below.

The United States does not have any reciprocal enforcement treaties for judgments, probably because of the international hostility to US tort judgments, e.g. punitive damages, jury trials and class actions. Hence, the New York Convention arguments in favour of easier enforcement theoretically might have greater weight in the case of New York agreements. But we still do not think that this possible weakness of US judgments abroad materially

affects our conclusions in the case of New York contracts. Also, if a counterparty has extensive assets in the United States, then the courts in the United States are very ready to recognise final foreign money judgments notwithstanding the absence of formal reciprocal arrangements.

There are special cases, such as host government concessions in project finance, where external arbitration is preferable to local courts.

II. Market Practice

In the 1970s, when the euro-market was in its infancy, some Latin American countries, such as Brazil, Venezuela and Colombia, sought to insist on arbitration in their syndicated credit agreements with international banks. They said that their constitutions prohibited a submission to foreign law and courts. This reflected the Calvo doctrine, named after an Argentinean statesman and developed mainly as a result of the interference by European powers in South American states during the 19th century by gun-boat diplomacy, allegedly to enforce the claims of foreign bondholders. In the early years of the euro-market, the international banking community refused arbitration clauses in sovereign syndicated bank credits, although a few did get through. Proposing arbitration was treated as showing a lack of good faith and commitment. The South American insistence on arbitration waned somewhat when the countries concerned were advised that if they continued to take this line, access to international banking and capital markets would be closed to them.

That set a pattern. But history does not stop and that pattern has been challenged.

The current London and New York market practice is that arbitration is very unusual in major international bank syndications, rare in international bond instruments and probably non-existent in insolvency reorganisation plans. Market practice is of great importance in negotiations.

Apart from international issues, the public bond debt of many sovereign states is typically governed by local law and usually does not contain either a submission to local courts or an arbitration clause.

Arbitration is still unusual in derivative master agreements (despite the fact that ISDA has recently produced model clauses) in London and in New York markets but more common in other markets, e.g. in the Asia Pacific region. It is rare in bank custodian agreements. It is not found in the interbank deposit market (where there is typically hardly any documentation

anyway) or in the wholesale foreign exchange market. It is probably rare in prime broker documentation between banks and hedge funds. Hence, as a general rule, jurisdiction clauses referring to courts predominate.

Retail bank overdraft documents typically do not contain arbitration clauses in developed countries. Arbitration between members of a stock or other exchange, partly as an expression of their club-like autonomy, seems common. Arbitration is also common in relation to the nets of commercial contracts underlying international project finance, especially the host government concessions but not the finance documents.

Arbitration is more common for sale and purchase agreements for companies. A recent study carried out by Allen & Overy showed that English law joint venture agreements often chose arbitration, not courts. Courts had a lead in M&A cases.[1]

The use of arbitration in bank syndicated credits was resuscitated episodically in special cases in the early 1990s after the collapse of the Soviet empire. Some lawyers thought that the enforceability of arbitration awards under the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards was an improvement on the enforcement of foreign judgments in central and eastern European countries. Commonly, the clause was framed as a creditor right to elect for arbitration. The preferred practice subsequently has sometimes been to choose arbitration, but to give the creditor an election to choose court jurisdiction.

Although these optional clauses have been cleared in the English courts, the Russian Supreme Arbitrazh Court held in 2012 that an optional clause was invalid on the basis that it violated principles of equality, judicial protection and justice. The efficacy of an optional clause has also been called into question, or simply has not been settled, in many other countries. There may be problems in, for example, China, Bulgaria, the UAE and Poland, potentially on the basis that this is not a straight selection of arbitration or that it gives unequal rights to the parties.

That is considered to be the market practice in the London and New York financial and corporate markets. These jurisdictions have highly developed legal systems alongside, namely English or New York law and the English or New York federal courts. The position elsewhere may be different, especially in emerging countries. There is thought to be a higher incidence of arbitration in financial and corporate contracts in, for example, some Asian countries, such as India, Indonesia and Vietnam.

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The World Bank and some (but not all) of the other multinational financial institutions often use arbitration in their loan agreements, but these institutions do not expect ever to have to enforce their loan agreements. IMF agreements with member countries, e.g. standby documents, do not have governing law and forum provisions. The WTO has its own bespoke panels whose decisions are binding by international treaty.

III. What are the Main Choices?

There is a difference between the governing law of a contract and the place where disputes are heard. Most courts and arbitration tribunals will apply the law chosen by the parties, subject to various qualifications. The choices are between permutations of:

- external or local governing law;
- courts or arbitration as the forum for disputes; and
- external or local forum.

If it is decided to choose arbitration instead of courts, external or local, then the fundamental choices are:

- whose arbitration rules (if any) will be used;
- where the seat of the arbitration will be;
- will parties seek to exclude rights of appeal;
- how the arbitrators will be selected; and
- what will be the language of the arbitration.

It is common for arbitration clauses to apply the rules of an arbitration institution. These arbitration boards have a framework of rules which will apply to arbitrations conducted under their auspices. There are a number of well respected arbitration institutions, such as the International Chamber of Commerce, the London Court of International Arbitration, the American Arbitration Association, the Singapore International Arbitration Centre, the Hong Kong International Arbitration Centre and the Swiss and Stockholm Chambers of Commerce. Arbitral institutions do not decide the dispute. They generally act as a fall-back in certain circumstances, for example, on the appointment of the arbitrators where a party does not exercise its right to appoint an arbitrator or the parties are unable to agree. They also administer the proceedings. For example, they may be able to take deposits on account of the arbitration costs, fix the arbitrators' fees and deal with the logistics of hearings.

Arbitrations are also available under the UNCITRAL rules, although UNCITRAL is not an arbitration institution so it will not administer an arbitration conducted under its rules.

The seat can be in a different jurisdiction from the country where any chosen arbitral institution is based. Thus you can have an arbitration in Paris under the Stockholm Chamber of Commerce Rules. The choice of seat is perhaps the most important choice the parties need to make when negotiating an arbitration clause. It is wise to choose a seat in a country which is sympathetic to arbitration and has a suitable arbitration statute. This is because the local courts of the seat will have supervisory powers and because the seat may ultimately decide the procedural law, such as the right of appeal. London, Geneva, Paris, Hong Kong, Singapore and New York are generally regarded as satisfactory seats, amongst many others.

Arbitration is different from mediation or expert determination. Arbitration awards are binding and enforceable pursuant to international treaty. The determination of an expert is only contractually binding. A mediation will not give rise to a determination or award at all, although it may of course lead to a consensual settlement.

IV. Courts or Arbitration? – the Main Points

What then are the main points which affect the decision as to whether to choose arbitration as opposed to the normal courts and which courts or seat of arbitration to choose? Some of the principal factors to consider are set out below.

A. Enforcement

The main reason that arbitration is often favoured over courts for international contracts is said to be the ease of recognition and enforcement of awards under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 which has been ratified by so many countries as to be almost universal – about 150 contracting states out of nearly 200 states. (See the attached map (which may not be comprehensive.)) Arbitration is often held in a neutral country where neither party is situate or has assets. Indeed, neutrality is often seen as an advantage of arbitration, but it may still be necessary to implement an arbitral award from a neutral country by further proceedings for enforcement in other jurisdictions, particularly in the country where the defendant is domiciled or has most of its

assets. So it is important to understand whether any award will be enforceable in those jurisdictions.

Under the New York Convention a contracting state can refuse recognition or enforcement of an award rendered in another contracting state only on a very limited number of grounds listed in Article V of the Convention. These do not include a review of the merits. The creditor is not deprived of the option to enforce in several states at once.

I think that this enforcement advantage is typically given more prominence than it deserves in the case of debtor-creditor contracts, such as bank loans. In the first place, in the case of large international counterparties, e.g. borrowers under syndicated bank credits or issuers of bonds, situations where a creditor gets a judgment for an unpaid loan in one court abroad and then seeks to enforce it in the courts of the debtor's domicile are rare. This is because the action is almost invariably overtaken by a private work-out or by insolvency proceedings. Other creditors do not permit one creditor to levy execution ahead of them and thereby obtain priority. Enforcement and execution is a feature of debt collection from individuals and small businesses locally. In the rare cases where creditors do pursue enforcement and execution, e.g. against repudiating sovereign issuers, the last thing they want is arbitration.

In the second place, as we shall see, simple money judgments of senior foreign courts are widely enforceable elsewhere. This is true of English judgments, although less true of New York judgments.

In the third place, because actual enforcement through the courts is relatively uncommon in the case of international loans and bond issues, the bargaining position of the creditor is maintained by the ability to obtain a judgment in the main court, such as the English, New York, Singapore or Hong Kong courts. It is the fact of being able to get a judgment that matters because an unsatisfied judgment is usually damaging to the credit of a corporation or a sovereign, e.g. with rating agencies and because of disclosure in future offering circulars for capital issues.

Other relevant points are:

1. *Convention not applied*: There have been problems with enforcement in some states which have adopted the New York Convention, e.g. India and the Philippines. The presence of the Convention does not mean that there are no practical enforcement problems, especially in the countries where the need is greatest. Enforcement may be more

likely against external assets of the debtor located in a Convention country.

2. *Enforcement of court judgments*: As mentioned, many countries routinely recognise and enforce final non-penal money judgments of foreign courts to which the parties have submitted without re-examination of the merits, though sometimes subject to reciprocity (which is often easy to prove). There are many reciprocal enforcement treaties as well. Hence the gap between the Convention and normal foreign judgment enforcement is not as great as is often imagined.

   You do not necessarily need a treaty to recognise and enforce a foreign court judgment, although a treaty is preferable. The main advantages of treaties are that:

   a. it may not be necessary for the enforcing court to have jurisdiction over the defendant under the normal court rules: normally all that is required is that the judgment is registered in the enforcing court and notice sent to the defendant in accordance with the statute; in the absence of a treaty, the enforcing court usually has to have jurisdiction over the defendant in accordance with its jurisdictional rules (although those rules may in fact confer a wide enforcement jurisdiction on the court);

   b. recognition may be a simple operation such as a simple registration process (with orders for enforcement following on the back of recognition) as opposed to obtaining a formal judgment of the enforcing court;

   c. the reciprocal enforcement treaty usually limits the ability of the court to review the foreign judgment on its merits and may exclude other defences available to the defendant, e.g. that there was no fair trial; and

   d. treaties avoid the need to show reciprocity, which is often required in relation to the recognition and enforcement of ordinary judgments outside the treaty.

Note that it may well not be possible to go into one jurisdiction to get a foreign judgment recognised and then to leap-frog into other countries on the basis of that jurisdiction's treaties, e.g. to get an order in England recognising a Japanese judgment and then use the UK's treaties to enforce the English order in the numerous countries with which the UK has a treaty. This is certainly not permitted under the EU judgment recognition rules.

The countries that do not generally recognise foreign judgments (English or otherwise) include Indonesia and Thailand, as well as some Arabian Gulf countries. Recognition may also be difficult in other jurisdictions, including Russia and China.

In many jurisdictions, only money judgments are enforceable, although there are exceptions. Non-money arbitration awards are generally enforceable under the New York Convention (though these are less important in our context).

A number of surveys of the recognition and enforcement of foreign money judgments in the absence of a treaty are available. The usual conditions of recognition and enforcement of a foreign money judgment are: (1) jurisdiction of the foreign court, e.g. submission to jurisdiction, (2) (sometimes) reciprocity (not usually problematic for England or New York), (3) due process (easy to satisfy), (4) no conflict with local public policy (can be a problem if conflicts rules differ or if the judgment conflicts with, say, local moratorium or exchange control laws), (5) the foreign judgment was for a liquidated money sum (usually is in loan contracts), (6) the foreign judgment was not for foreign taxes or penalties (usually irrelevant), (7) the foreign judgment was final and conclusive (can be a problem), and (8) the foreign judgment does not conflict with a local judgment on the same cause of action (usual). If the local court reviews the merits of the foreign judgment, this is effectively not recognition.

3) *Writing requirements*: The New York Convention requires an agreement in writing or by exchange of letters or telegrams (this was 1958, after all). There can therefore be problems where a clause is assigned or novated or where an agreement was signed only by one party, such as a unilateral guarantee, deed poll or security agreement. Consider cases where an agreement is signed under a power of attorney. This writing requirement is one of the factors which has influenced reservations about arbitration in debt issues.

4) *Enforcement rate*: Most arbitration awards are complied with voluntarily. Enforcement seems to run at the rate of about ten per cent. Enforcement actions in relation to judgments for unpaid international bonds and large bank syndicated credits against assets of multinational borrowers seem rare.

5) *Credibility*: Court judgments normally have more weight and are more authoritative.

6) *Delays*: Resort to arbitration can be used as a delaying tactic by a debtor who is clearly liable.

The Hague Convention of 20 June 2005 on Choice of Court Agreements, which sets out a series of rules on jurisdiction and the recognition and enforcement of judgments, including very limited grounds on which contracting states may refuse to enforce judgments given by other contracting states, might in the future provide an effective regime for judgment enforcement equivalent to the New York Convention, provided the judgment is given under an exclusive jurisdiction clause in favour of a contracting state. But at present, only Mexico has ratified the Convention and it is not yet in force. However, the EU is in the process of ratifying the Convention in the near future.

B. Sovereign immunity

Arbitration is not a court, so immunity is less likely to apply to a sovereign entity in relation to the arbitration itself. Further, as a matter of English law, if a state has agreed to arbitration it will not generally be immune from proceedings in the English courts in support of the arbitration or in relation to proceedings to recognise an arbitral award. The state may still be immune in relation to enforcement, absent an express waiver. In practice, the contracts concerned typically contain wide express waivers of immunity so the differences between courts and arbitration do not seem material.

C. Insulation from local law

The governing law and the location of the court or arbitral tribunal are crucial for the protection of the contract obligations from local changes of law. Under the private international law rules of many countries, if a counterparty's home system of law is chosen for a credit agreement, then a moratorium decree or exchange control of the counterparty's country will almost always be recognised locally and will often also be recognised in foreign courts, subject to some very basic mandatory or public policy rules of the foreign court. This is not generally so if the contract is governed by an external system of law or (in the US) is "located" externally (subject to certain exceptions). Both English and New York law are public utilities in the sense that they are widely used for financial contracts, such as syndicated credits, international bond issues and derivatives. In both cases, there does not have to be any connection with the jurisdiction.

If there is an external system of law, then it has to be backed by an external forum because otherwise local courts must almost always simply apply their own mandatory laws, including a moratorium or other interference in a contract. It is important in this context to choose an external forum with conflict of laws rules which limit the circumstances in which regard may be had to the counterparty's system of law.

The English and New York courts are commonly chosen by parties as external forums. In both cases, the insulation against local changes is strong. The English insulation rule is more predictable because it is based on governing law, not a bundle of variable contracts pointing to the location of the claim.

A suitable arbitration tribunal under suitable rules should give similar effect to the virtues of these governing laws. The judiciary in England and New York may be more predictable in this respect as the approach taken by arbitral tribunals in practice can vary.

It follows that if the right external law and forum are chosen, the contract is insulated from adverse changes of law introduced by the debtor's country but is not insulated if the contract is governed by local law or has to be enforced locally.

D. Insulation from local courts

As with a choice of foreign courts, one of the main purposes of arbitration clauses is to escape the defects and weaknesses of local courts, including delays, bureaucracy and inefficiency, inexperience and, in the worst case, bias or corruption or total breakdown. The idea is to escape free from the dysfunctional earth with all its mess and mud to some pure utopia where perfect justice is dispensed. It is not just emerging countries where the courts are typically weak or dangerous. The system of justice in some highly developed countries can be heavily weighted against foreign defendants. There can also be practical difficulties in using local courts, for example, geographical inconvenience or an inconvenient language. Insulation is achieved through a choice of external courts or arbitration.

On the other hand, enforcement ultimately has to be through the local courts in the absence of foreign assets. So in the end one has to come down to earth – at least if one ever gets to enforcement. Security interests generally have to be enforced where the assets are located. And even if the parties agree to arbitrate, there may still be a risk of bias or other weaknesses

in the tribunal, not least because parties often have the right to nominate arbitrators.

E. Exclusivity of the forum

When negotiating jurisdiction clauses, banks generally prefer a clause which limits a borrower or issuer to an exclusive forum, such as the courts of England or New York, but which allows the creditors to take proceedings anywhere if there is jurisdiction (although the agreement typically chooses one jurisdiction as the main jurisdiction, e.g. England or New York). This reflects the relative exposures of the parties in financing agreements – banks will always want to be able to seek to recover their money in the debtor's home jurisdiction or where it has assets. However, it is certainly open to the parties to agree on an exclusive forum for court litigation and such clauses will, save in certain limited circumstances, be effective. Conversely, on derivatives deals, where exposures are more equal, the starting point is often a mutually non-exclusive jurisdiction clause. In the corporate context the dispute resolution clause also tends to be less one-sided than in the banking context, and parties often agree on an exclusive forum.

In the case of arbitration, there is only one forum which is exclusive unless an option (usually for the banks only) to litigate in the chosen courts is included. These options have, however, became increasingly common in recent years notwithstanding issues as to enforceability in some jurisdictions.

F. Choice of forum certainty

There is probably not much difference between the English or New York courts and English or New York seated arbitration in terms of jurisdictional certainty and the absence of jurisdictional disputes. In the courts the dispute is often about whether another forum is more appropriate on grounds of convenience of witnesses and the centre of gravity of the dispute. Jurisdiction disputes in arbitration are different, but still prevalent.

There can be an initial dispute as to the validity and interpretation of the arbitration clause and as to whether the tribunal has jurisdiction at all. Further, certain matters may not be arbitrable. Court jurisdiction clauses, which do not have to develop the methods of choosing the arbitral tribunal or the matters which may be subject to proceedings, are perhaps less susceptible to this difficulty. However, there are some circumstances in which a jurisdiction clause may be trumped, for example if the dispute is principally about a matter of company law, in which case it may have to be heard by the courts of the seat of the company.

There does not appear to be too much difference as regards pre-emptive proceedings especially in view of EU changes in force in January 2015, making pre-emptive strikes more difficult.

There are usually no special problems as regards service of process in arbitration.

As with court selection clauses, arbitration clauses are usually valid even if the main agreement is alleged to be void.

In common with court selection clauses, arbitration clauses can cover torts arising in connection with the main claim. This neuters a frequent strategy of debtors to claim in some non-agreed court that they have an action in tort against the creditor, e.g. for misrepresentation, which is not covered by the dispute resolution clause. This is just a matter of drafting.

G. Is expert adjudication required?

Where a contract involves complicated technical or factual matters, it may be an advantage for disputes to be heard by experts who do not have to be educated in the field concerned. Parties including an arbitration clause can provide that their arbitrators should have experience in a particular field (or a particular governing law) or can nominate arbitrators with such experience, whereas parties to court litigation can have no influence over the identity of a judge.

Disputes on financial agreements do not generally involve technical questions and the proceedings are commonly brought to enforce payment or to decide the law rather than to resolve factual matters. In the case of credit contracts, there is typically nothing to arbitrate. Further, the commercial courts of internationally-orientated jurisdictions are well-equipped to settle complex investment contests.

Hence, an advantage of arbitration – that you can choose an experienced tribunal – is of less relevance in the case of straight credits, as opposed to, say, a complex derivative, at least if the alternative of, say, the English, New York or Singapore courts is available. Also if the parties do not specify the expertise required of their arbitrators, they may find their tribunal has much less expertise than, for example, the English court.

One test is whether the relationship is really debtor-creditor as opposed to a trading contract between equals. If it is really debtor-creditor, then arbitration is sometimes just an excuse for delay by the debtor.

One problem is that debtors can sometimes deliberately complicate disputes, e.g. by allegations of mis-selling, absence of corporate power or authorisations or non-compliance with some technicality. As a result a simple dispute becomes obfuscated. Arbitral tribunals may be more reticent than the court to dismiss such arguments without a full hearing.

H. Neutrality

Arbitration allows the parties to choose a non-national forum which is neutral to both sides. Lack of neutrality can be a sticking point with sovereign counterparties: arbitration in an external forum is often easier for a sovereign party to agree to than external courts. On the other hand, some courts are so internationalised that they are effectively neutral, e.g. the English, New York or Singapore courts, and a choice of one of the main external systems of law is a universally established market practice for international bank syndications and international bond issues.

Arbitration may be considered less confrontational at the time of the negotiation of the contract and is therefore more likely to be acceptable where the parties consider themselves equals or as members of the same club, such as an exchange.

I. Language

The parties can choose the language of the arbitral proceedings so as to escape the expense of translations or the incomprehension of proceedings in the language of the local courts. This seems less of a point in the case of an international commercial language, like English.

J. Finality

A general feature of arbitration laws is to exclude appeals from the arbitrator's award except on very limited grounds such as absence of jurisdiction or fraud or absence of due process, as opposed to the fact that the decision was wrong on the merits. Finality depends on the seat. The principle of finality is espoused by arbitration statutes in the United States, many continental European countries and in Japan. In England, appeals are permitted on the basis of lack of jurisdiction or serious procedural irregularity (as is the case in many other countries) and beyond that finality is at the option of the parties: Section 69 of the Arbitration Act 1996 permits appeals on points of law but the parties can exclude this right.

Finality can be important in, say, construction contracts where it is desirable that a decision be handed down one way or the other so that the work can proceed. Such considerations do not generally apply to financial contracts.

The absence of an appeal may be ameliorated if the parties choose an experienced arbitral panel of three arbitrators who are likely to arrive at the correct conclusion. But this increases the expense.

As to finality outside England:

(1) Arbitration awards made in New York are presumptively binding with only limited grounds for judicial review, such as where the award was procured by corruption on fraud, where there was evident partiality or corruption in the arbitrators, where the arbitrators were guilty of misconduct, or where the arbitrators exceeded their powers.

(2) In Hong Kong, international arbitration awards are not subject to appeal unless the parties have agreed to adopt the domestic arbitration regime. For domestic arbitrations, an appeal on a question of law concerning an award is allowed only with the leave of the court.

(3) In Singapore, an international arbitral award may only be set aside in limited circumstances such as where the arbitration agreement is not valid or the dispute did not fall within the terms of the arbitration agreement or where the making of the award was affected by fraud or corruption or where there was a breach of natural justice in connection with the rendering of the award.

K. Privacy

The privacy and confidentiality of English-seated arbitration may be inimical to the interests of a non-defaulting party since arbitration weakens the sanction of adverse publicity, which a defaulting party might wish to avoid. On the other hand, parties may wish to maintain confidentiality for relationship reasons and may prefer not to be embarrassed by careless employee emails brazened around in the public media. A public court dispute may attract unwelcome attention and political pressure on a foreign party. Unlike court proceedings, in arbitration proceedings documents disclosed in the pre-hearing disclosure period will remain confidential. Hence, arbitration can protect against reputational risk, but these are considered special cases which are not mainstream.

Confidentiality is not expressly provided for in the English Arbitration Act but it is implied as a matter of English law. As to confidentiality rules more widely:

(1) In New York, the Federal Arbitration Act does not expressly address the confidentiality of arbitration proceedings and there is no implied duty of confidentiality in arbitration proceedings.

(2) In Hong Kong, arbitration proceedings and arbitral awards are confidential pursuant to Section 18 of the Hong Kong Arbitration Ordinance.

(3) In Singapore, a duty of confidentiality in respect of arbitral proceedings is not expressly contained within the International Arbitration Act, although a duty is implied under the common law.

Privacy or confidentiality (where they exist) may well be lost if an application is made to court, for example for interim relief or at the enforcement stage. Further, under English law, arbitration appeals are generally public.

L. Summary and default judgments

A quick summary judgment is generally not available in arbitration. In view of the time which it can take to set up the arbitral tribunal and complete the arbitration process, the inability of a party (in particular a lender) to proceed to a summary award where there is nothing seriously in dispute can be a significant disadvantage. A defendant also has more flexibility to raise defences which have no merit and take longer to defend than in the case of courts. Even where parties agree in their arbitration clause that disputes may be resolved summarily by the tribunal, in practice tribunals can be reticent to do this.

It is also not possible to obtain a default judgment in arbitration, *i.e.* where the other side does not appear at all and the tribunal gives an award in the claimant's favour without any consideration of the merits of the claim. Nevertheless, it may be possible in arbitrations to get interim injunctions to stop the other party doing something pending a decision on the merits. It may also be possible to obtain prejudgment freezes in the courts in support of the arbitration to prevent the debtor disposing of assets beyond the reach of the creditor.

M. Insolvency stays

Litigation may be stayed by insolvency proceedings with the effect that the creditor may be returned to the home forum where the insolvency proceedings have been opened. This is also generally true of arbitration. In effect, once insolvency proceedings commence, litigation and arbitration are reduced to disputes with the insolvency administrator about the amount of creditor claims.

N. Pre-award freezes

As mentioned, it is often possible to obtain a pre-award freeze or injunction from the local courts preventing a debtor from spiriting its assets out of the jurisdiction to evade enforcement. This kind of interim relief can also be ordered by a tribunal or by the English court acting in support of arbitration.

O. Procedure

Generally speaking, the rules of evidence and procedure established by arbitration tribunals and institutions are (often intentionally) less developed than court procedures. The arbitrators have more discretion. The result is that the course of arbitration can be unpredictable and rapid resolution blocked if one of the parties is not prepared to co-operate. The absence of formal procedures confers a useful flexibility in certain disputes but at the risk of creating uncertain uncertainty and delays.

P. Document disclosure and evidence

The rules of evidence applied by arbitral tribunals are generally less strict than those applied by the court. The scope of pre-trial disclosure or production or discovery of documents is generally decided by the arbitrators subject to any specific agreement between the parties or relevant institutional rules. The mainstream rules do not generally deal with disclosure in detail although some parties agree to apply the IBA Rules on the Taking of Evidence in International Arbitration. Disclosure is generally restricted and fishing expeditions are generally not allowed. Arbitration can therefore be an escape from disproportionate US-style discovery. An argument against arbitration is that the sanctions against non-disclosure of documents and the fibbing, e.g. perjury or contempt of court, are weak or absent. It seems likely under English law that parties could, in a court jurisdiction clause, agree to restrict disclosure, although the court could retain discretion to override the agreement.

Q. Joinder and consolidation

Arbitration proceedings involving many parties with similar causes of action cannot be consolidated in one hearing without the agreement of all the parties. This can be a problem where multiple parties to a deal are signing different deal documents or where there is a contributing tort-feasor. It can be important to harmonise arbitration clauses in related documents and to have specific joinder and consolidation clauses but this will still not bind true non-parties to the documents (e.g. a party's accountant). This is not generally a problem for disputes referred to the courts, as courts often have inherent powers to join parties and to consolidate disputes, even when the parties do not agree.

R. Remedies

There do not seem to be any particular advantages either way as regards fiscal remedies. Arbitration may be an escape from US-style punitive or other excessive damages awards.

S. Public contracts

In some countries the arbitration of state or public contracts may be subject to restrictions which might avoid the arbitration clause altogether to prevent effect being given to an arbitration award when enforcement is sought in the prohibiting country.

T. Consumer contracts

Arbitration agreements are prohibited or subject to restrictions in some types of consumer contracts in some countries, e.g. the United States.

U. Expense and delay

It is not the case that arbitration is speedier and less expensive than litigating in commercially-orientated courts, not least because, unlike judges, arbitrators and arbitral institutions have to be paid and, where the tribunal comprises three arbitrators, it can be difficult to synchronise diaries. A venue also has to be arranged and paid for. Parties can agree to expedite fast-track proceedings in the arbitration agreement, for what it is worth, but it is often possible for parties to delay the process (perhaps more so than in the context of an expedited court process). There may also be delays constituting the tribunal, for example because a party challenges the appointment of another

party's nominated arbitrator. Where one party is substantially a creditor, arbitration can more easily be used by a debtor to delay and prevaricate.

V. Predictability of outcome

It is sometimes the case that arbitrators are more inclined to make compromise awards or to apply general equitable principles than to determine the matter in accordance with strict principles of law. This is not necessarily a disadvantage in, say, construction contracts where compromise solutions may be acceptable, but in financial contracts predictability is vital. The other side may appoint a non-lawyer commercial arbitrator who decides on the merits. The potential lack of predictability can make settlements more difficult.

Issues such as the approach to interpretation and to whether judicial precedent is binding should generally be decided by the governing law of the contract.

W. Precedent value

Arbitration awards do not have any precedent value. This can be a disadvantage if, for example, a party has a number of identical contracts in place with different counterparties and wants to rely on an award given against one counterparty in a dispute with a different counterparty. Conversely it can be an advantage if a decision is unfavourable or if a party acts in different capacities in different contexts and may wish to run conflicting arguments depending on the capacity in which it is acting (e.g. insurer/reinsurer).

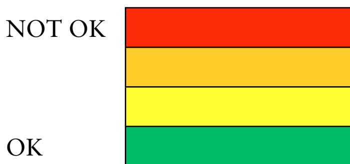
A wide move to arbitration would diminish the judicial precedents available on important agreements, such as the ISDA Master. This would be destructive of case-based law. Justice should be open, especially as the courts may be called upon to enforce awards.

X. Likelihood of settlement

Anecdotal evidence suggests that parties may be more willing to settle court litigation than arbitration.

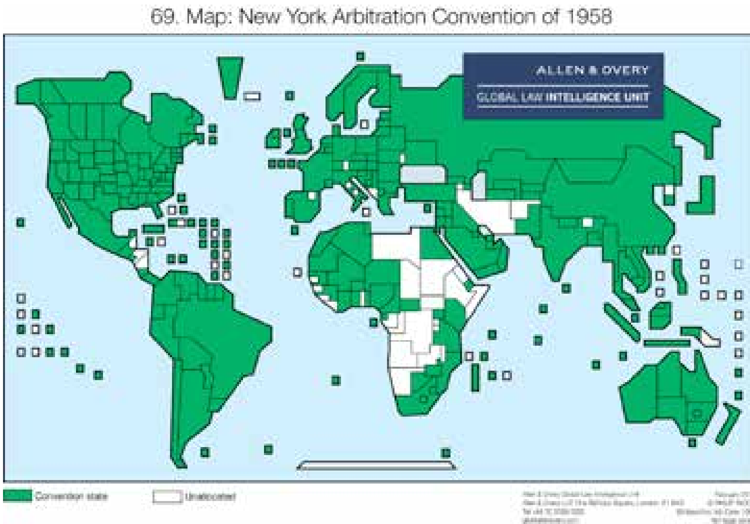
V. Colour-Coded Rating of Arbitration or Courts for Credit Contracts (Loans, Bonds and the Like)

	English court	**English seated arbitration**
Foreign enforcement		
Sovereign immunity		
Insulation from local law		
Insulation from local courts		
Exclusivity of forum		
Forum certainty		
Special expertise		
Neutrality		
Language		
Finality		
Publicity		
Summary judgment		
Insolvency stays		
Pre-award freeze		
Procedural flexibility/rigidity		
Document disclosure		
Joinder/consolidation		
Remedies		
Public contracts		
Consumer contracts		
Delays and expense		
Predictability of outcome		
Precedent value		
Likelihood of settlement		



This table is based on the creditor view for financial contracts.

VI. New York Arbitration Convention 1958 – World Map



This map may not be comprehensive

VII. Treaty Enforcement of Foreign Money Judgments in England

This map shows the jurisdictions where court judgments are enforceable in England pursuant to international treaty. English judgments should similarly be enforceable in each of these jurisdictions pursuant to these treaties.

Arbitration or Courts: A Note on the Indian Scenario*

The market practice with respect to the choice between arbitration and courts in the Indian scenario is heavily influenced by the law on the jurisdiction of courts over agreements which contain an arbitration clause, as provided for in the Arbitration and Conciliation Act, 1996 ("the Act").

The repeal of the erstwhile Arbitration and Conciliation Act, 1940 – which was based on a mistrust of the arbitral process – and consequent enactment of the Arbitration and Conciliation Act, 1996 (based on UNCITRAL Model Law on International Commercial Arbitration 1985) was intended to create a speedy and effective mechanism for arbitration in India based on minimal court intervention that would substantially reduce transaction costs for parties entering into agreements by reducing the likelihood of judicial delay. However, in practice, the choice between arbitration and courts often presents no real choice to parties seeking to avail the benefits of a non-judicial process, on account of various provisions of the Act coupled with case law that mandate arbitration in matters that would otherwise fall within the exclusive jurisdiction of the court.

In this note, we take the examples of two such provisions of the Act, *i.e.* Sections 8 and 45, which have given rise to the controversy in this regard. Section 8 of the Act provides for a judicial authority (before which an action is brought in a matter which is the subject of an arbitration agreement), on the application of one of the parties, to refer the parties to arbitration.[2] Section 45 of the Act, which vests power to refer disputes to arbitration with the relevant judicial authority, also provides discretion to such authority to adjudicate over matters such as the existence of the arbitration agreement itself.[3] It is our submission that such ambiguity surrounding the resolution

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* Supplied by the Editorial Board. We are indebted to Mr. Murali Neelakantan for his invaluable guidance and comments.

2 S. 8, Arbitration & Conciliation Act, 1996 states:
"Power to refer parties to arbitration where there is an arbitration agreement-
(1) A judicial authority before which an action is brought in a matter which is the subject matter of an arbitration agreement shall, if a party so applies not later than when submitting his first statement on the substance of the dispute refer the parties to arbitration.
(2) The application referred to in Sub-section (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof.
(3) Notwithstanding that an application has been made under subsection (1) and that the issue is pending before the judicial authority, an arbitration may be commenced or continued and an arbitral award made."

3 S. 45, Arbitration and Conciliation Act, 1996 states:
"Notwithstanding anything contained in Part I or in the Code of Civil Procedure, 1908 (5 of 1908), a judicial authority, when seized of an action in a matter in respect of which

of disputes which are both within the exclusive jurisdiction of a particular judicial authority and arising from or in connection with an arbitration agreement, frustrates the very purpose of the arbitration agreement.

Take, for instance, the scenario of a joint venture agreement between two Indian parties which stipulates that disputes arising under it be resolved by arbitration in accordance with the London Center for International Arbitration (LCIA) Rules. In the event of an allegation of oppression and/or mismanagement (such as a fraud on the minority), the Company Law Board,[4] which is specifically conferred jurisdiction to adjudicate such matters, decides instead to refer the matter to arbitration under Section 8 (or Section 45 if the seat is outside India). Such a situation creates a conundrum for the parties to the arbitration agreement and raises several issues on which the law is silent.

First, a strict interpretation of Sections 8 and 45 of the Act indicates that when the subject matter of a dispute before a judicial authority falls squarely within the ambit of an arbitration agreement, it must be mandatorily referred to arbitration.[5] In fact, the mandatory nature of Section 8 (use of "*shall*") has been the subject of much controversy, particularly in respect of allegations of oppression and/or mismanagement in the joint venture, which may arise without any breach of the agreement. Although Section 7[6] of the Act (which is identical to Article 7 of the UNCITRAL Model Law) provides that *matters beyond the contract*, "*whether contractual or not*," may be included within the ambit of matters arbitrable under the arbitration agreement, certain matters such as winding up and insolvency, divorce proceedings, etc. are not arbitrable and can only be resolved by the appropriate judicial authority.

Second, there is lack of clarity on whether the jurisdiction to determine the arbitrability of the dispute vests with the judicial authority or the arbitral tribunal in such cases. Recently, in *Rakesh Malhotra v. Rajinder Kumar*

the parties have made an agreement referred to in section 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is mill and void, inoperative or incapable of being performed."

[4] The National Company Law Tribunal which was envisaged to adjudicate such matters has not yet come into existence. Consequently, the provisions of the Companies Act, 2013 dealing with corporate restructuring (schemes of arrangement and dissolution by winding up) are yet to be notified. As a result, disputes arising in respect of such agreements fall squarely within the jurisdiction of the Company Law Board.

[5] Hindustan Petroleum Corpn. Ltd. v. Pinkcity Midway Petroleums, (2003) 6 SCC 503: AIR 2003 SC 2881; P. Anand Gajapathi Raju v. P.V.G. Raju, (2000) 4 SCC 539; Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee, (2014) 6 SCC 677.

[6] *See also*, Section 44, Arbitration and Conciliation Act, 1996.

Malhotra[7], the Bombay High Court examined whether the maintainability of such claims under Sections 241 r/w Section 242 of the Companies Act, 2013 (*i.e.* Sections 397-398 r/w Section 402 of the Companies Act, 1956) is affected by the existence of an arbitration clause. Relying on the dicta laid down in *Booz Allen*[8] (on test for arbitrability), *Sukanya Holdings*[9] (on severability of arbitrable disputes), and *Haryana Telecom*[10] (on adjudicating actions *in rem*), the Court held that disputes in oppression and mismanagement, having some flavour of actions *in rem*[11], invoke the wider powers of the Company Law Board (under Section 402, Companies Act, 1956) which cannot be exercised by an arbitral tribunal or even a civil court. The Court reasoned that no arbitration agreement could vest an arbitral tribunal with the powers comparable to those of the Company Law Board, to grant reliefs against oppression and mismanagement. As a result, the Court ruled that the mere existence of the arbitration agreement would not be sufficient to supersede the Company Law Board's exclusive jurisdiction to adjudicate oppression and mismanagement disputes and to grant the broad reliefs available in such cases, provided that the petitions invoking the vast plenary powers of the Company Law Board are not *mala fide*, vexatious, or "*dressed up*" to evade an arbitration clause. Consequently, the Company Law Board would retain the power to refer mischievous, vexatious, and *mala fide* petitions intended solely to circumvent arbitral proceedings to arbitration. However, the judgement nowhere offers so much as an explanation or mention of sources on which reliance is placed for this portion of the ruling. Additionally, the Court failed to examine whether the inclusion of matters beyond the arbitration agreement within the scope of 'arbitrable disputes,' by virtue of Section 7 of the Arbitration and Conciliation Act, 1996, would operate as a waiver of these rights and remedies.

Third, considering that there is no appeal from an order of the Company Law Board under Section 8, the statute offers no guidance as to what remedy will be available to a party in the event that the arbitral tribunal determines that the issue is not arbitrable. Indeed, if the petitioner is told by the arbitrators that his claim is not arbitrable (yet referred by the Company Law Board under Section 8), he may find himself with no remedy and no forum. The

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7 Rakesh Malhotra v. Rajinder Kumar Malhotra, 2014 SCC OnLine Bom 1146: (2015) 53 Taxmann 135 (Bom).

8 Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532.

9 Sukanya Holdings (P) Ltd. v. Jayesh H. Pandya, (2003) 5 SCC 531.

10 Haryana Telecom Ltd. v. Sterlite Industries (India) Ltd., (1999) 5 SCC 688: AIR 1999 SC 2354.

11 The Bombay High Court cited the example of the power of the Company Law Board to pass orders against parties not present before it as an instance of such wider powers granted under Section 402, Companies Act, 1956.

Act merely allows an appeal under Section 50 if an application for reference to arbitration is denied, not against the decision to refer the parties to arbitration. Parties may make an application under Section 34 to set aside the award of the arbitral tribunal on the ground that the same deals with or contains decisions on matters not contemplated by or beyond the scope of the terms of submission to arbitration[12] but not in this case where the arbitrators decided that they did not have jurisdiction to decide the dispute. However, as setting aside the arbitral award does not confer jurisdiction on the Company Law Board or compel it in any way to reverse its decision to refer the matter to arbitration, this creates a peculiar situation where the parties are left with no remedy. As a result, parties may find it prudent to look to drafting solutions to save themselves from this quandary – for instance, by restricting the availability of arbitration as a method of dispute resolution only for breach of the joint venture agreement or by incorporating the arbitration clause in the articles of association (thereby binding the company).

Thus, the power of the courts to adjudicate on matters relating to the management of companies in the interest of stakeholders (actions *in rem*) cannot be restricted due to the mere existence of an arbitration agreement. As a result, the mandatory nature of the language employed in Sections 8 and 45 causes confusion and has contributed to the virtual stalemate in the Indian context. Ultimately, these ambiguities in the law have significant adverse ramifications for arbitration as a viable alternative to the courts, and consequently, for India's investment climate.

[12] Section 34(iv), Arbitration and Conciliation Act, 1996; *See also*, Sections 48(1)(c) and 48(2)(a) of the Arbitration and Conciliation Act, 1996.

The Interplay between Competition Law and Intellectual Property Rights in the Indian Healthcare Sector

Murali Neelakantan[*]

There has been very little research published on the effect of brands, design, and trade dress on extension of patent monopolies. This paper explores how brand names, design, and trade dress have the effect of creating barriers to competition in the Indian healthcare market. Another consequence of the combination of brands and patents is the compliance risk for doctors to whom these drugs are being marketed. The paper concludes with some recommendations to address these issues and a call for deeper research into the Indian healthcare market, primarily from a competition law standpoint.

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Introduction

Competition law advocates the necessity for free markets, detests monopolies, and aspires to create a perfectly competitive playground that benefits consumer choice. It aims to create an ecosystem oriented towards consumer rights, free trade, and efficient resource allocation. Intellectual property legislation, in essence, creates monopolies. There is therefore a dichotomy between Intellectual Property Rights ("IPR") and competition policy. The former endangers competition and the latter engenders competition.[1] This paper is focused on certain activities of players in the Indian healthcare sector which highlight the conflict between IPR and competition law. While there is a good basis for looking to the rest of the world to understand certain fundamental aspects of IPR and competition law, the Indian healthcare sector operates in a completely different manner from that in the US and Europe, and we should therefore be sceptical of applying the jurisprudence from those jurisdictions to identify and address India's problems.

I. Historical Tension between IPR and Competition Law Continues

The discussion on the interplay between patents and competition law is not recent.

> "The granting [of] patents 'inflames cupidity', excites fraud, stimulates men to run after schemes that may enable them to levy a tax on the public, begets disputes and quarrels betwixt inventors, provokes endless lawsuits...The principle of the law from which such consequences flow cannot be just. The Economist may have put it rather strongly in 1851, but its disapproval of patents represented conventional wisdom at the time. A century earlier, Adam Smith had described them as necessary evils, to be handed out sparingly, and many other economists have since echoed his reservations. Patents amount to temporary monopolies on useful new inventions."[2]

More recently, after the Singapore Ministerial Declaration of 1996,[3] a Working Group on the Interaction between Trade and Competition Policy

[1] Report of High Level Committee on Competition Policy & Law – Raghavan Committee (Government of India, 2000), available at https://theindiancompetitionlaw.files.wordpress.com/2013/02/report_of_high_level_committee_on_competition_policy_law_svs_raghavan_committee.pdf [hereinafter "Raghavan Committee"].

[2] *Patent Sense*, The Economist, (October 20, 2005), available at http://www.economist.com/node/5015083.

[3] World Trade Organisation, Ministerial Declaration of 13 December 1996, WT/MIN(96)/16 (Dec. 13, 1996) available at http://www.wto.org/english/thewto_e/minist_e/

was created in 1997. This working group discussed competition-related provisions of all existing World Trade Organisation ("WTO") agreements. On the subject of the relation between IPR and competition policy, the view was expressed that the system of protecting technology through IPR could stimulate research and development ("R&D"). However, members were directed to consider the introduction of rules that could control anti-competitive practices related to the use of IPR.[4] The Parliamentary Standing Committee stated that all forms of IPR have the potential to raise competition policy issues.

> "Intellectual Property provides exclusive rights to the holders to perform a productive or commercial activity, but this does not include the right to exert restrictive or monopoly power in a market or society. Undoubtedly, it is desirable that in the interest of human creativity, which needs to be encouraged and rewarded, intellectual property rights need to be provided. This right enables the holder (creator) to prevent others from using his/her inventions, designs or other creations. But at the same time, there is a need to curb and prevent anti-competition behaviour that may surface in the exercise of the intellectual property rights."[5]

During the exercise of a right, if any anti-competitive trade practice or conduct is visible to the detriment of consumer interest or public interest, it ought to be assailed under the competition policy/law.[6] Despite this, when the Competition Act was drafted, this conflict between IPR and competition law was, arguably, not addressed in a comprehensive manner. On the other hand, it may be contended that the omission of exclusions for IPR was deliberate and the only intended protection was clearly set out in Section 3 of the Competition Act, 2002.

II. Indian Competition Act and its Uncertain Interplay with IPR

As one pharma industry expert lamented, "*owing to the blanket exemption under Section 3(5), the square peg of any anti-competitive practise tethered*

min96_e/min96_e.htm.

4 World Trade Organisation, *Report of the Working Group on the Interaction between Trade and Competition Policy to the General Council* (WT/WGTCP/4, Nov. 30, 2000).

5 Department-Related Parliamentary Standing Committee on Home Affairs, Ninety-Third Report on the Competition Bill, 2001 available at http://www.prsindia.org/uploads/media/1167471748/bill73_2007050873_Standing_Committee_Report_on_Competition_Bill__2001.pdf (Last visited on Jun. 25, 2015).

6 Raghavan Committee, *supra* note 1.

to the use of IPRs must now be brought through the round hole of "abuse of dominant position" under Section 4."[7] While one can sympathise with the emotion, this is perhaps a very narrow and cynical view since the exemption for IPR from the application of Section 3 applies only to agreements. It is a common misconception that IPR has a blanket exemption from all the provisions of the Competition Act. "*Thus, if there is an instance of an abuse of dominant position enjoyed by an IPR holder, the Competition Commission of India ("CCI") would have jurisdiction to inquire into such abuse.*"[8] Exclusions from the applicability of Section 3 have been provided to persons seeking to protect their intellectual property rights as well as agreements for the export of goods. However, the CCI would still be empowered to look into the reasonableness of the restraint while exercising intellectual property rights.[9]

The relationship between IPR and competition policy has been complex and widely debated, and various models exist in different countries to address potential conflicts.[10] The complexity of IPR has deepened since the adoption of legislative reforms in many developing countries as a part of their commitment under the WTO Agreement on Trade Related Intellectual Property Rights ("TRIPS") in 1995. While the importance of IPR in stimulating inventions is widely advocated, by providing legal monopoly it also raises competition concerns, and in certain areas like food and healthcare, it is widely believed that diffusion of intellectual property should have precedence over an incentive to invent.[11] It is noticeable that the discussion about IPR and competition law has remained focussed on patents[12] with very little thought about how other IPR like copyright, trademarks and design can give rise to competition law issues. This paper is an attempt to look at how

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7 Debolina Partap, *Intellectual Competition*, 5(9) LEGAL ERA (November 2014).

8 Vinod Dall, *Injunctions Sought By SEP Holders – Abuse of Dominance or Protection of IPRs?*, 5(9) LEGAL ERA (Nov. 2014).

9 Government of India Report on Competition Policy (Planning Commission, 2007), available at http://planningcommission.nic.in/aboutus/committee/wrkgrp11/wg11_cpolicy.pdf [hereinafter "Planning Commission"].

10 Remedies for abuse of IPR could exist in IPR legislation and/or in competition law. In the United Kingdom, competition law issues are addressed by the Office of Fair Trading but also by specific industry regulators like Ofcom for the telecoms and broadcasting sector, Ofwat for the water industry and Ofgem for the electricity sector. In the United States, it is the Department of Justice, the Federal Trade Commission and even the State Attorney General.

11 This is evidenced in the Doha Declaration which seeks to explain and elaborate on the nexus between IPR and national interest. *See* World Trade Organisation, Ministerial Declaration on the TRIPS Agreement and Public Health of 14 November 2001 (WT/MIN(01)/DEC/W/2), available at http://www.who.int/medicines/areas/policy/doha_declaration/en/.

12 Raghavan Committee, *supra* note 1; Planning Commission, *supra* note 9.

the Indian healthcare industry uses IPR, and to identify the competition law issues that arise from it.

III. Are IPR Statutes Self-Contained Codes and Immune from Competition Law?

We have recently noticed a move by IPR owners to resist the application of Indian competition law to IPR[13] on the ground that each IPR statute is a "*self-contained code*" and competition law may not be the appropriate remedy for a right created by each of them.[14] The Supreme Court of India has discussed the term 'self-contained code' in several judgments and held that the following conditions need to be established for a self-contained code:

1. It is a complete legislation for the purpose for which it was enacted;[15]
2. It provides for all possible situations that may arise in relation to that purpose;[16]
3. It contains an adjudicatory machinery;[17]
4. It provides for an appeal;[18]

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[13] Micromax Informatics Ltd., In re, [2013] CCI 77; the suit was filed in relation to refusal by Ericsson to license standard essential patents for GSM technology to Micromax. The CCI rejected this contention and directed the Director General to commence investigation. Ericsson appealed this CCI order and the Delhi High Court granted an interim injunction against the investigation.

[14] *See infra* note 58 for examples. The United States uses antitrust legislation as the basis for measures like compulsory licenses to address patent abuse. *See*, for example, Federal Trade Commission order in Intel Corporation, FTC Docket no. 9288, Final Agency Decision (Mar. 24, 1999), and notification by the Department of Justice in the case of *United States v. A.K. Steel Corpn.*, E.D. Mich. 15-cv-11804. For more examples, *see*, James Love & Michael Palmedo, *Examples of Compulsory Licensing of Intellectual Property in the United States*, CPTech Background paper 1 (Sep. 2001), available at http://www.cptech.org/ip/health/cl/us-cl.html. It may well be argued that compulsory licenses and other remedies for abuse of a patent are contained in the Patent Act thereby excluding other legislation from providing measures to counter abuse of IPR. *See supra* note14.

[15] Offshore Holdings (P) Ltd. v. Bangalore Development Authority, (2011) 4 Bom CR 212; Bondu Ramaswamy v. Bangalore Development Authority, (2010) 7 SCC 129.

[16] Offshore Holdings (P) Ltd. v. Bangalore Development Authority, (2011) 4 Bom CR 212; Bondu Ramaswamy v. Bangalore Development Authority, (2010) 7 SCC 129.

[17] The Patent Office can revoke a patent under a post-grant opposition. Similarly the High Court and the IPAB have specific powers of revocation. *See Girnar Traders v. State of Maharashtra*, (2004) 8 SCC 505.

[18] *See* for example, S. 115 of the Patents Act, No. 39, Acts of Parliament, 1970 (India) [hereinafter "Patents Act 1970"]; S. 91 of the Trade Marks Act, No. 47, Acts of Parliament, 1999 (India) [hereinafter "Trade Marks Act 1999"]; and S. 36 of the Designs Act 2000, No. 16, Acts of Parliament, 2000 (India) [hereinafter "Designs Act 2000"]. *See also Girnar Traders v. State of Maharashtra*, (2004) 8 SCC 505.

5. It contains provisions for offences;[19]
6. It contains comprehensive provisions pertaining to investigation,[20] inquiry, and trial for offences;[21] and
7. It gives power to duly authorized officers to search, recover and arrest, and record statements of witnesses.[22]

The literal meaning of a self-contained code is a law that is complete and exhaustive. While some of the criteria set out by the Supreme Court of India are met by various provisions of India's IPR laws, it is clear that the Patents Act, 1970, the Trade Marks Act, 1999 and the Designs Act, 2000 have not fulfilled all the conditions set out above. Such legislation, though dealing with the creation and maintenance of IP rights, fails to tackle the existence of such rights in the market, where they must co-exist with other rights and the economics of supply and demand.[23]

There is no common theme that runs through all IPR legislation and despite being conceptualised, practiced, and taught as one subject, they have fundamental differences in the jurisprudential and economic basis for their existence and how they are meant to work. For example, if a patent is not worked, the Government can force the patent holder to license it.[24] While a similar provision exists in the Copyright Act,[25] no corresponding provisions exist in the Designs Act. Similarly, if a trademark is not used, its registration lapses[26] but that does not prevent its continued use.

If the IPR laws do not exclude the application of competition law, does the Competition Act, as some apprehend,[27] provide immunity to IPR from com-

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[19] CBI v. State of Rajasthan, (1996) 9 SCC 735.

[20] *See* for example, S. 13, Patents Act, 1970.

[21] CBI v. State of Rajasthan, (1996) 9 SCC 735. *See* for example, Ss. 123, 124, Patents Act, 1970; Chapter XII, Trade Marks Act, 1999.

[22] CBI v. State of Rajasthan, (1996) 9 SCC 735; Moti Lal v. CBI, (2002) 4 SCC 713 : (2002) 2 ACR 1192 (SC). See for example, S. 115(4), Trade Marks Act, 1999.

[23] One could argue that S. 84 of the Patents Act, 1970 providing a simplified procedure for issuing a compulsory license if the patentee indulges in anti-competitive practices specifically allowing a competition law test refutes this. This is also supported by S. 62 of the Competition Act, No. 12, Acts of Parliament, 2002 (India) [hereinafter "Competition Act 2002"] which specifically states that the remedies provided in the Competition Act are in addition to other laws and remedies. On the other hand, those who advocate the "*self contained code*" theory could argue that by making specific reference to competition law in just one provision, the Patents Act, by deliberate omission, excludes the application of competition law except in S. 84.

[24] S. 85, Patents Act, 1970.

[25] S. 31, Copyright Act, No. 14, Acts of Parliament, 1957 (India) [hereinafter "Copyright Act, 1957"].

[26] S. 47, Trade Marks Act, 1999.

[27] *See* Debolina Partap, *supra* note 7.

petition law? The working group[28] discussed examples of anti-competitive behavior indicating to us that it was contemplated that IPR does have an inherent quality of adversely affecting a competitive market or distorting competition in a market.

A patent cross-licensing agreement that included mutual restrictions on the pricing and output of the patented product, and substantially lessened competition in the market for this product, would constitute an unreasonable restraint of trade (as any other agreement fixing prices and limiting output) and would therefore be illegal under competition law. Similarly, bundling, predatory pricing, and other similar unfair trade practices should be investigated where there is a dominance caused by a patent or other IPR. There are other examples in real life[29] that remind us that this possibility is real and not just the imagination of the working group and academics.

IV. Market is the Starting Point for a Competition Law Analysis

The Competition Act requires that the relevant market be identified in terms of (*a*) relevant geographical market;[30] and (*b*) relevant product market.[31] A relevant product market is assessed on the basis of the following factors:

(*a*) Physical characteristics or end-use of goods;

(*b*) Price of goods or services;

(*c*) Consumer preferences;

(*d*) Exclusion of in-house production;

(*e*) Existence of specialised producers; and

(*f*) Classification of industrial products.[32]

A. Physical Characteristics or End-use of the Goods

Aerospatiale, a French company active in the aerospace sector had a product range that included civil and military aircraft and helicopters, missiles, satellites, space systems and avionics. Alenia was an Italian company also predominantly active in the aerospace sector. Its product range included

[28] World Trade Organisation, *Report of the Working Group on the Interaction between Trade and Competition Policy to the General Council* (WT/WGTCP/4, Nov. 30, 2000).

[29] *See AZ*, *infra* note 54 and *Actavis*, *infra* note 58.

[30] S. 2(s), Competition Act, 2002.

[31] S. 2(t), Competition Act, 2002.

[32] S. 19(7), Competition Act, 2002.

civil and military aircraft, satellites, space systems, avionics, and air and maritime traffic control systems. A concentrative joint venture within the meaning of Article 3 of the European Commission's Merger Regulation was notified. In determining the 'relevant market', the EC decided that aircrafts which have less than 20 seats, 20 - 39 seats, 40 - 59 seats and 60 or more seats are subject to different type certification standards. The certification security requirements such as crash-worthiness, systems reliability, fatigue resistance, damage tolerance and heat release of cabin materials in case of fire differ greatly. It was held that a 60-seat commuter is not interchangeable or substitutable with a 30-seat commuter. Both are used on routes with a significantly different density and their prices vary significantly. The segmentation was made on the basis of physical characteristics, nature and end use of the products.[33]

In *Cellophane*[34] case, the decisions of the Delaware District Court in 1953 and the U.S. Supreme Court in 1956 seemed to attract much comment. The case was about whether Du Pont exercised market power over cellophane. The courts found that cellophane was in a market with other flexible wrapping materials. More specifically the Supreme Court found that there existed a substantial cross-elasticity between cellophane and other flexible wrappings, and that cellophane and these other wrappings had reasonable interchangeability. This seemed to suggest that if two products are not interchangeable or substitutable because of their physical characteristics, they do not compete in the same relevant market.

B. Price of Goods or Services

The Indian automobile industry has major vehicle segments according to the brand and the market positioning of vehicles in different regions. The premium segment (representing highest prices and margins) comprises 10% of the market. The value segment is the mid-price range; this comprises the vast majority of vehicles sold in all markets (70%). The entry segment refers to the least expensive vehicles in the different vehicle classes, making up the other 20%.[35] Creating such differentiation is vital to maintaining a premium perception. Inside the car, premium Original Equipment Manufacturers

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[33] Case No. IV/M053 – Aerospatiale-Alenia/de Havilland, Council Regulation (EEC) No. 4064/89.

[34] United States v. E.I. Du Pont De Nemours & Co., 118 F Supp 41-233; United States v. E.I. Du Pont De Nemours & Co., 100 L Ed 1264 : 351 US 377 (1956).

[35] Mohr, D., N. Müller, and A. Krieg, *The road to 2020 and beyond: What's driving the global automotive industry?* (McKinsey & Company, 2013), available at http://www.mckinsey.com/~/media/McKinsey/dotcom/client_service/Automotive%20and%20Assembly/PDFs/McK_The_road_to_2020_and_beyond.ashx.

could differentiate themselves with the help of design elements, new features in infotainment, and innovations directed at safety and comfort.[36] Even a specific segment in the automobile sector is clearly bifurcated. The electric vehicles category, for example, can be further divided in four types: battery electric vehicles, plug-in hybrids, range extenders and fuel cell vehicles. On the other hand, non-rechargeable Full Hybrid Electric Vehicles tend to belong to the segment of vehicles with internal combustion engines where they play a role in improvement of fuel economy.[37]

Therefore, if a customer wishes to purchase a car, he would normally be interested in one of the distinct segments. For a customer interested in purchasing a Maruti 800, a Maruti Alto or a Tata Nano would be a likely option. It is unlikely that a Bentley would be a viable alternative. Interchangeability of products is therefore primarily based on the price, which may be a proxy for the various features of the product segment and consequently, the market. As a result, products that have a vast price difference do not usually comprise the same relevant market as they are not viable substitutes.

In *Belaire*[38], the Commission stated that there is a distinction between "*high-end*" and "*economy*" or "*low-end*" residential units. "*High end*" is a complex mix of factors such as size, reputation of the location, characteristics of neighbours, quality of construction inter alia. Residential accommodation for Lower Income Group, Middle Income Group and Higher Income Group are standard descriptions adopted by several public sector builders such as Delhi Development Authority and Ghaziabad Development Authority.

> "Apart from the physical attributes, these categorizations also take into account the income or expenditure levels of the customer base. Together, these factors create a distinctly identifiable residential unit that is not substitutable in an economic sense. In other words, a small but significant non-transitional increase in price of a unit in one category [termed SSNIP test often applied in abuse of dominance cases] would not make the customer shift to another category. A 5% increase in the price of a villa would not make the intending customer choose a multi-storey apartment. The purchase may be deferred briefly or the choice may shift to a slightly less comfortable villa but a person who

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36 *Ibid.*

37 *See* Heike Proff and Dominik Kilian, *Competitiveness of the EU Automotive Industry in Electric Vehicles: Final Report* (University of Duisburg-Essen, Dec. 19, 2012), available at http://ec.europa.eu/enterprise/sectors/automotive/files/projects/report-duisburg-essen-electric-vehicles_en.pdf.

38 Belaire Owners' Assn. v. DLF Ltd., (2011) 104 CLA 398 (CCI).

> has made a final consumer choice of preferring a villa for the reasons of family size, need for privacy, demonstration effect etc. would not switch to an apartment for a small increase in price."[39]

In this case, prices create a clearly segmented market. Hence, the Commission was able to identify Belair Housing as high-end housing. For the consumer of such a market, a marginal change in price will not affect his shift to a different category of housing. Hence, due to its inherent quality of not being substitutable with a different category of housing, "*high end*" housing forms its own relevant market. A similar, neatly segmented market is the mobile phone market where price is a distinguishing factor. For an iPhone user, the only likely substitutes would be a high end Android phone. An iPhone user is very unlikely to consider a phone which sells at an 80% discount.

> "It is sometimes argued that two products cannot be reasonably substitutable if they have substantially different prices. Price differences have therefore been used to distinguish between products which may be 'functionally substitutable,' but are not 'substitutable' from a competition assessment perspective. Therefore, defining relevant market solely on the basis of differences in price will be flawed if price differences reflect quality differences (actual or perceived). When such quality differences appear, defining relevant market merely on the basis of absolute price levels, will ignore the possibility of consumers making a trade-off between price and quality. (sic)"[40]

It now seems that price is not the definitive criterion for establishing a relevant market. There are also non-price factors that are considered when a customer buys products. This is particularly significant when we discuss pharmaceutical products and healthcare services where customer choice is very limited because the decision making process for these is complex, with the doctor, pharmacist, and often the hospital,[41] exerting significant influence and excluding competing drugs that are qualitative substitutes. It may

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[39] Geeta Gouri, *Making Markets Work Effectively in India*, *Experience of the Competition Commission*, (Competition Commission of India), available at http://www.cci.gov.in/images/media/speeches/DrGG.pdf.

[40] Ramakant Kini v. L.H. Hiranandani Hospital, 2014 Comp LR 263 (CCI).

[41] Hospital chains often have pharmacies on their premises and patients are forced to buy drugs and other medical supplies from these "*in house*" pharmacies. Patients are not allowed to buy in drugs or other supplies from external sources. *See* Snehlata Shrivastav, *Hospitals Force Patients to Buy From In-House Pharmacies*, Times of India (Apr. 24, 2015), available at http://timesofindia.indiatimes.com/city/nagpur/Hospitals-force-patients-to-buy-from-in-house-pharmacies/articleshow/47032880.cms.

well be time for the application of the rationale in *Hiranandani*[42] to sales of drugs and other consumables in hospitals to conclude that each hospital and its "*in-house*" pharmacy is effectively a monopolistic market for patients who have no choice of products.

C. Consumer Preferences

In *Belaire*, the Commission cited the example of a consumer who intends to purchase a villa. For such a consumer, the independence, space and privacy are factors in purchasing a place of residence. While consumer preferences, social tastes, and behavioural trends of individuals could govern the demand elasticity of a product, they are relevant only where there is a legitimate choice to make. As seen in *Chemistree, Actavis, AZ* and *Hiranandani*, IPR in the healthcare sector by its very nature may well be monopolistic and may not, give the consumer a choice within that relevant market.

D. Existence of Specialized Producers

Where the producer is required to have highly sophisticated machinery to manufacture the product, or manufacturing techniques are protected as IPR, or that sector has high sunk costs, barriers to entry and competition are high and viable substitutes may well be extremely limited. This is a feature of the pharmaceutical sector where multinational pharmaceutical companies have focussed on certain therapies, creating an oligopoly of sorts.[43]

E. Classification of Products

In the pharmaceutical sector, an important distinction must be drawn between a molecule comprising its own market, and an entire therapy area. In the case of Kaletra, the manner of identifying the relevant market determined that AbbVie did not hold a dominant position and there were several competing products in the same market as Kaletra. A simple example could be of acetylsalicylic acid, more commonly known as Aspirin, an analgesic.

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[42] *Supra* note 40. Surprisingly, the Competition Commission of India had previously held in *Consumers Guidance Society v. Hindustan Coca Cola Beverages (P) Ltd.*, [2011] CCI 25 that a multiplex chain that served only one brand of beverages was not a relevant market even though customers could neither bring their own beverages nor leave during a show to buy beverages from outside. No mention is made of this case in the CCI's order in *Ramakant Kini v. L.H. Hiranandani Hospital*, 2014 Comp LR 263 (CCI).

[43] *See Evaluate Pharma World Preview 2014 Outlook to 2020,* Evaluate Group (Jun. 1 2014), available at info.evaluategroup.com/rs/evaluatepharmaltd/images/EP240614.pdf, on the projected market share of pharmaceutical companies in the global oncology market, the fastest growing of all therapies. Roche had a market share in 2013 of 34.3%, followed by Novartis with 10.8% and the top 10 companies had a market share of almost 78%.

If these are the only facts, then Aspirin has several well-known substitutes such as paracetamol and ibuprofen. However, if Aspirin is prescribed to help prevent unwanted blood clots from forming within the body, then its substitute may be clopidropel.[44]

The Anatomical Therapeutic Chemical Classification System with Defined Daily Doses ("ATC/DDD") is used for the classification of active ingredients of drugs according to the organ or system on which they act, and their therapeutic, pharmacological and chemical properties. It is controlled by the World Health Organisation Collaborating Centre for Drug Statistics Methodology ("WHOCC"), and was first published in 1976.[45] The Competition Commission of India was of the view that "*in generics markets, competition primarily takes place between different brands based on the same molecule. Accordingly, it is appropriate to define the relevant product market at the molecule level,* i.e., *medicines/formulations based on the same API may be considered to constitute a separate relevant product market*."[46] The CCI relied on sales data provided by the All India Association of Chemists and Druggists, a national body representing most of the retail chemists, and ignored the sales to millions of patients who are treated by hospital chains who procure directly from manufacturers, public sector undertakings, railways and defense services, all of whom provide free healthcare but procure drugs either directly from manufacturers or their selling agents. The CCI also ignored substitutes for a drug which may comprise other molecules which may be effective in the treatment of the same disease or indication – for example, paracetamol and ibuprofen for Aspirin. In the case of *Actavis*, the decision to grant an injunction was based on the monopoly of a single patented molecule dominating a market.[47]

In the United Kingdom, the approach of the Office of Fair Trading to market definition is provided in the competition law guideline market definition which follows a similar approach to that of the European Commission ("EC"). In order to establish which products or geographic areas are included

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[44] *See infra* note 74.

[45] History, WHO Collaborating Centre for Drug Statistics Methodology (Nov. 19, 2011), available at http://www.whocc.no/atc_ddd_methodology/history/.

[46] CCI Order in the matter of the combination of Sun and Ranbaxy, Combination Registration No. C-2014/05/170, ¶ 14 (Dec. 05, 2014), available at http://www.cci.gov.in/May2011/OrderOfCommission/CombinationOrders/C-2014-05-170.pdf. For an example of an ATC-3 therapeutic classification like antiepileptics, *see* Case No COMP/M.4402-UCB/Schwarz Pharma, available at http://ec.europa.eu/competition/mergers/cases/decisions/m4402_20061121_20310_en.pdf. *See also* Case No. COMP/M.7275- Novartis/GlaxoSmithKline Oncology Business, available at http://ec.europa.eu/competition/mergers/cases/decisions/m7275_20150128_20212_4158734_EN.pdf. Here, treatment of ovarian cancer was held to be a relevant market.

[47] *See infra* note 59.

in the relevant market, a conceptual framework known as the hypothetical monopolist test is usually employed.[48] Products are differentiated into different markets primarily on the basis of the relevant product market and the relevant geographical market.

In the United States, market definition focuses on demand-side substitutability, and supply-side substitutability is considered later when the regulator examines existing and potential participants in the market and barriers to entry. Demand-side substitutability focuses on customers' willingness and ability to substitute other products for the products in question. Supply-side substitutability focuses on other firms' willingness and abilities to defeat an attempted price increase by shifting production from one product to the product in question. In contrast to the United States, the EC considers both demand-side and supply-side substitutability when defining the relevant product and geographic markets. It is unclear if the two approaches lead to different results.[49]

V. Competition Law Remedies for Abuse of Patent Monopoly

The Court of Justice of the European Union ("CJEU") upheld the judgment of the General Court, which found that AstraZeneca ("AZ") had abused its dominant position by misleading patent offices and misusing the patent system in order to prevent generic competition against its anti-ulcer medicine, Losec.[50] The EC had established that AZ had provided misleading information to several national patent offices[51] in the EU, resulting in AZ gaining extended patent protection for Losec, and that it had selectively deregistered market authorisations[52] for Losec capsules in certain member

[48] The Office of Fair Trading Competition Law Guideline on the Definition of Market, S.I. 2004 (OFT403), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284423/oft403.pdf.

[49] Mark Jamison, *Defining Relevant Markets in Evolving Industries* (University of Florida, Department of Economics, Public Utility Research Center, Working Paper, 2014), available at http://warrington.ufl.edu/centers/purc/purcdocs/papers/1317_Jamison_Defining%20Relevant%20Markets%20in%20Evolving%20Industries%20Final.pdf.

[50] Case T-321/05 AstraZeneca v. Commission, 2010 ECR II-2805: MEMO/10/294. This action in competition law perhaps provided a more effective remedy than revoking the patent under the Patent Act which may well have been at the end of its term.

[51] The Patent Act would have, at best, allowed revocation of the patent, which may not be an effective sanction if the patent term had expired.

[52] The drug regulatory system in India works differently from that of the EU and it may well be argued that it may not have been possible for AZ to do what it did here. However, in *Roche v. Mylan & Biocon* (Delhi High Court, 2014), it was argued that the clinical trial data submitted by Roche should not be shared with Roche's competitors even though this is the only way that generics can show equivalence with the innovator product to comply

states, in violation of Article 102 of the Treaty on the Functioning of the European Union. In doing so, AZ raised barriers of entry for generic players, as they could no longer rely on AZ's clinical trial data on the original capsule version.[53] The EC imposed a fine of €60 million on AZ for abusing its dominant position. The CJEU held that as under Article 102, an undertaking that holds a dominant position has a special responsibility and cannot use regulatory procedures to prevent entry of competitors in the market. The General Court upheld the EC's decision but reduced the fine to €52.5 million.[54] The CJEU dismissed AZ's appeal.[55] The EC in the EU and the Federal Trade Commission in the US are currently challenging settlement agreements involving 'pay-for-delay', and reverse payment arrangements whereby patent holders pay generic companies to delay or impede the market entry of competing products.[56]

Switching patients from a successful branded product to its next-generation, patent-protected offspring before the onslaught of generics is a crucial tactic in what is often referred to as "*managing the lifecycle of a drug.*" The most common choices for oral solid dosage forms *i.e.*, pills, are modified-release systems (delayed, pulsatile, and extended), fast-dissolving tablets, and bioavailability enhancement technology to improve the onset of action, minimise a fed/fasted effect, or increase overall drug absorption. Two examples of successful dose frequency changes include Merck's Fosamax and Lilly's Prozac which went from daily therapies to weekly medicines for certain well-managed patients. In the extended-release area, GlaxoSmithKline's antidepressant Wellbutrin SR, Pfizer's Procardia XL, Abbott's antibiotic Biaxin XL Filmtab, Biovail's Cardizem LA, and Sanofi-Aventis'Ambien CR are a few of many such formulation changes designed to sidestep generics

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with drug regulation. It may be argued that Roche seeking an injunction is itself anti-competitive, based on *AstraZeneca* and the decision of the EU in *Apple v. Motorola Mobility* (European Commission Press Release regarding decision on anti-competitive use of standard essential patents by seeking and enforcing injunctions Docket No.IP/14/489 (Apr. 29, 2014), available at http://europa.eu/rapid/press-release_IP-14-489_en.htm).

[53] European Commission Press Release, Antitrust: Commission finds that Motorola Mobility infringed competition rules by misusing standard essential patents (Apr. 29 2014), available at http://europa.eu/rapid/press-release_IP-14-489_en.htm.

[54] *See* AstraZeneca, *supra* note 51.

[55] Case C-457/10 P, AstraZeneca AB and AstraZeneca plc v. European Commission (Dec. 6, 2012).

[56] The lack of a formal patent linkage in India makes it unlikely that this situation should arise. However, a new drug (whether or not patented) introduced in India has a three-year head start since a generic will not be able to introduce a competitive drug during that time. Together with courts being liberal in granting interim injunctions to patent holders, it could be argued that there is *de facto* patent linkage in India.

competition by offering the promise of "*improved patient compliance and convenience*."[57]

However, in an ongoing US case,[58] Actavis was directed to halt plans to pull Namenda, its Alzheimer's drug off the market. Alzheimer's disease is currently treated by five drugs; all the drugs except Namenda are acetylcholinesterase inhibitors ("CI") and work in the same basic manner. Namenda is the brand name for memantine, an N-Methyl D-Aspartate ("NMDA") receptor antagonist and works differently from CIs.[59] The CEO of Actavis made a public statement to analysts that the core of the brand strategy with the new extended release ("XR") version was to convert the existing business to Namenda XR as fast as possible to protect Namenda revenue from generic penetration in 2015 when patent exclusivity expires. "*If we do the hard switch and we convert the patients and caregivers to once-a-day therapy versus twice a day, it's very difficult for the generics then to reverse-commute back*."[60] The judge relied on this statement to establish intent and stated that while the mere possession of monopoly power is not unlawful, monopolists cannot run their businesses in an anti-competitive manner. The purpose of the hard switch was anticompetitive: to put barriers and obstacles in the path of producers of generic memantine and thereby protect Namenda's revenues from a precipitous decline following generic entry.

Although Section 3(5) of the Competition Act provides protection from competition law for enforcement of IPR, it should not be construed to mean that all actions permitted by IPR laws are immune to scrutiny under the Competition Act. In *Chemistree Homecare Ltd.* ("Chemistree") *v. AbbVie Ltd.* ("AbbVie"),[61] AbbVie supplied its HIV therapy drug Kaletra directly to hospitals, without the use of wholesalers. In addition, AbbVie also supplied the medicine to Chemistree to enable Chemistree to provide homecare services to patients treated in the clinics covered by the London HIV consortium. On Chemistree's orders increasing three-fold, AbbVie asked

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[57] *See Dealing with the Generic Threat,* PHARMAFILE (Sep. 15, 2005), available athttp://www.pharmafile.com/news/dealing-generic-threat.

[58] The People of the State of New York v. Actavis PLC and Forest Laboratories LLC, S.D.N.Y.14-cv-4624 (2nd Cir, 2015).

[59] There seems to be a clear acknowledgement of the monopoly of Namenda. *See* Stuart Silverman, *Second Circuit Affirms Preliminary Injunction in Antitrust Suit Against Drug Companies for Product Hopping*, American University WCL, National Law Review (May. 22, 2015) available athttp://news.monster.com/a/business/second-circuit-affirms-preliminary-injunction-in-antitrust-suit-against-drug-companies-for-pr-ff8e0f.

[60] The People of the State of New York v. Actavis PLC and Forest Laboratories LLC, SDNY14-cv-4624 (2nd Cir, 2015).

[61] Case No: A3/2013/0559 – Chemistree HomeCare Ltd. v. AbbVie Ltd., 2013 EWHC Civ 1338.

for an account of Kaletra. On receipt of the account, it was realised that 15% of the sales were home care, 40% of the sales were wholesale and 45% were prescriptions in the European Economic Area. AbbVie stopped supply for everything other than home care, stating that Chemistree's behaviour was disingenuous. The Court of Appeal concluded that if a patient was prescribed Kaletra then the patient required Kaletra alone, and that single drug could be its own relevant market. It was the prescribing doctor, either alone or in consultation with the patient, that made the decision as to whether or not Kaletra should be used and it was that part of the buying chain which was sensitive to increases in price. The Court stated that Chemistree was not the relevant customer. The pharmacist merely acted as a middleman and its role in the economic chain was irrelevant to the determination of the relevant product market. In addition to demonstrating how commercial arrangements can be anti-competitive, this case also highlights the importance of determining the relevant market in terms of product and the test of substitutability for the correct customer.

Testing activities that are permitted by IPR legislation on the touchstone of competition law will be the accomplishment of a milestone for the Indian legal system. Therefore, the decision in *Ericsson v. Micromax* will be significant since Standard-Essential Patents are, undoubtedly, monopolies. While the rest of the civilized world has accepted FRAND as the acceptable response to control the monopoly of SEPs, our courts are yet to find a theoretical basis for it in our law. Perhaps, we can then move on to establishing the basis for identifying the relevant market in a more scientific manner than we have done in *Coca Cola*, *Hiranandani*, *Honda Siel*, or *Sun-Ranbaxy*. Once we have been able to establish a good basis for the determination of the relevant market, we will be in a position to evaluate the effect of patents and of the activities of patent holders. Perhaps then, we will be able to look beyond the blinkers of traditional IPR remedies of revocation and compulsory licensing that have been employed to address the abuse of a patent monopoly.

VI. Effect of Trademarks on Market Definition

Trademarks affect both the demand side and the supply side substitutability of products in the Indian healthcare sector. A patent is a legalized monopoly for a specified period of time in relation to a product, whereas a trademark allows a product to be identified with one producer forever. The response to this allegation of an infinite monopoly by trademark owners is that there is no restriction on how many trademarks can exist in a market and it is free for anyone to enter the market with a trademark and compete fairly with

the existing products. There are several instances of brand leaders being displaced by late entrants to demonstrate this. While this is a very persuasive argument in itself, the infinite life of a trademark combined with a monopoly for a patented product in the Indian healthcare sector creates several challenges for competition law. That anyone can compete using their own trade mark assumes that it is possible to compete – which is not possible when there is a monopoly due to a patent, especially in the pharmaceutical sector.

We have always had trademarks for drugs and they have arguably made them more accessible, since the name Aspirin is easier to remember than acetylsalicylic acid. Why has this suddenly become an issue? Trademark law has come a long way and it is perhaps important for us to retrace its history to understand how far we have come from its roots and ask ourselves if we really want to be where we are.

While we are all taught that the origin of trademarks was for goods to be easily identifiable with their makers – originally the artisan guilds in medieval England – this quickly morphed into a right for the maker rather than a protection for the consumer. There is some evidence of Harappan marks embossed on goods traded with foreign countries such as Mesopotamia and Babylonia. The legal recognition of the trademark as a species of incorporeal property was first accorded by the Court of Chancery in the first half of the 19th Century. In *Millington v. Fox*[62], it was decided that it was not necessary to establish any intention to deceive on the part of an infringer against whom an injunction to restrain his use of another trademark is sought.

> "The concept of distinguishing goods or services of the proprietor from those of others was to be found in the requirements for a mark to be registrable. Essentially, whatever the wording used, a trademark or a service mark was an indication which enabled the goods or services from a particular source to be identified and thus distinguished from goods or services from other sources. In adopting a definition of 'trademark' which simply describes the function in terms of capability of 'distinguishing the goods or services of one undertaking from those of other undertakings' the new law is really saying precisely the same thing. (sic)"[63]

Thus, the most critical object of a trademark is to clearly identify the origin of the good.[64] The function of a trademark is to give an indication to

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62 Millington v. Fox, (1838) 3 My & Cr 338.

63 Ramdev Food Products (P). Ltd. v. Arvindbhai Rambhai Patel, (2006) 8 SCC 726 : (2006) 33 PTC 281, 299.

64 S. 2(1)(zb), Trade Marks Act, 1999.

the purchaser, or a possible purchaser, as to the manufacture or the quality of the goods,[65] to give an indication to his eye of the trade source or trade hands through which they pass on their way to the market. Thus, it is to be distinguished from a property mark which denotes that a movable property belongs to a particular person.[66] While registration confers a permanent and exclusive right in respect of a registered mark, it does not create a monopoly in the mark in the true sense of the word 'monopoly.' Trademarks give rise to exclusive rights as indications of the source and quality of goods; it is only when related to goods that they have life or value. A trademark is not a type of copyright.[67] It cannot exist in vacuum and should not therefore be considered property.[68] It can only exist in connection with the goods in relation to which it is used or intended to be used.[69] The proprietary rights in the trademark/service mark are not acquired merely on account of registration in India but on account of priority in adoption, use, and even on account of trans-border reputation spilling over to India.[70] For a drug, this means that it is possible, given the barriers to substitution in India by either the pharmacist or the patient, that a brand could well be treated as Kaletra was in *Chemistree*.

VII. Why Don't We Name Drugs Like Other Products?

All cars have light bulbs and no automobile company has its own special name for a light bulb in a car that it makes, but there does not seem to be a simple name for every drug or class of drugs.[71] As drugs come out of patent

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[65] Quality is not relevant for pharmaceutical brands since all drugs having the same chemical composition are approved before being allowed to be sold and it is a requirement of the Drugs and Cosmetics Act that a generic is the chemical and bio-equivalent of the innovator (patented) drug.

[66] Sumat Prasad Jain v. Sheojanam Prasad, (1973) 1 SCC 56 : AIR 1972 SC 2488, 2490.

[67] Glaxo Group v. Dowelhurst Ltd., 2000 FSR 529, 539.

[68] *But see* the recent reports of Phillip Morris claiming expropriation of property in respect of tobacco plain packaging laws of some countries, which highlights this issue once again. *See* M.C. Porterfield & C.R. Byrnes, *Philip Morris v. Uruguay: Will Investor-State Arbitration Send Restrictions on Tobacco Marketing up in Smoke,* Investment Treaty News (Jul. 12, 2011), available at http://www.iisd.org/itn/2011/07/12/philip-morris-v-uruguay-will-investor-state-arbitration-send-restrictions-on-tobacco-marketing-up-in-smoke/; Aylin A. Sahin, *Philip Morris v. Uruguay: Intellectual Property Debate in International Investment Arbitration*, Berkeley Tech. L.J. (Nov. 7, 2014), available at http://btlj.org/2014/11/philip-morris-vs-uruguay-intellectual-property-debate-in-international-investment-arbitration/.

[69] American Home Products Corpn. v. Mac Laboratories (P) Ltd., (1986) 1 SCC 465 : AIR 1986 SC 137, 154.

[70] McAtee v. Chem Shengula, (2007) 34 PTC 298.

[71] One may argue that there are families of drugs and they together with the International Non Proprietary Names are well known amongst the cognoscenti. For example, "*statins*"

protection and become open to competition, the use of a trade name for that drug is so prevalent that no one remembers the generic chemical name[72] – for instance, acetylsalicylic acid has always been overshadowed by the brand name Aspirin. This phenomenon of not having common names for products does not seem to prevail in any other industry. When brand names became common nouns like in the case of Yo-Yo (a children's toy), cellophane[73] (the plastic wrapping material), photocopying (Xerox[74]) or instant photography (Polaroid), there developed a theoretical basis for these trademarks to be genericised. But pharmaceuticals seem to have managed to sidestep this issue. In fact, the generics established their own pharmaceutical brands, rather than challenge the basis for innovators to name a product and then appropriate it to own the brand. The justification was patient safety – it is easier to prescribe and consume drugs which have simple, memorable names than having to remember the generic chemical name.

VIII. Brand Names for Drugs Cause Confusion

Consider the common substitutes for Aspirin[75] as an analgesic – Disprin, Crocin and Metacin. Disprin was initially a brand name for a generic version of Aspirin but the chemical composition of the drug sold as Disprin was later changed to paracetamol in India alone, leading to potentially fatal mistakes in prescriptions.[76] Similarly, Crocin and Metacin sound so very much like Aspirin, but are, in fact, similar to Calpol.[77] The use of Crocin and

as a family of drugs which help control cholesterol.

72 I have chosen to use the term "*generic chemical name*" rather than International Non-Proprietary Name ("INN"), the term of art used by the healthcare industry. International Non-Proprietary Names (INN) facilitate the identification of pharmaceutical substances or active pharmaceutical ingredients. Each INN is a unique name that is globally recognised and is public property. *See* Essential Medicines & Health Products: International Nonproprietary Names, World Health Organisation, available at http://www.who.int/medicines/services/inn/en/ (Last visited on Jul. 3, 2015).

73 *See* What you don't know about trademarks, World Intellectual Property Organisation (Nov. 2009), available at http://www.wipo.int/wipo_magazine/en/2009/06/article_0010.html.

74 *But see* the decision of the IPAB rejecting the genericisation of Xerox and its criticism by Prashant Reddy, *Xerox is not Generic … Yet?!,* SpicyIP L. Blog (Oct. 16, 2012), available at http://spicyip.com/2012/10/guest-post-xerox-is-not-genericyet.html.

75 Aspirin is also used to treat coronary thrombosis for which clopidogrel is a possible substitute. *See* Increasing the Knowledge & Understanding of Aspirin, Aspirin Foundation, available at http://www.aspirin-foundation.com.

76 *See* Priya Yadav, *Disprin is no Longer Disprin,* Times of India (Sep. 12, 2001), available at http://timesofindia.indiatimes.com/city/Disprin-is-no-longer-disprin/articleshow/1020224953.cms. There are more than 630 brands of paracetamol (with significant price difference) made by over 300 pharmaceutical companies in India. For a listing, *see* www.drugsupdate.com.

77 This continues to occur despite the clear direction from the Supreme Court in *Cadila Health Care Ltd. v. Cadila Pharmaceuticals Ltd.*, (2001) 5 SCC 73 : AIR 2001 SC 1952,

Calpol, different trade names and marks for the same drug, paracetamol, by one company, GlaxoSmithKline ("GSK") in this case, creates significant confusion for doctors, patients, and chemists.[78] From a competition law perspective, it allows pharmaceutical companies to create a segmentation of the market for analgesics, rather than just paracetamol – a smaller market than analgesics[79]– and justify the claim that they each have no significant market power in the analgesics market.[80] It is significant that paracetamol is covered by the Drug Price Control Order[81] and as a result, it is easily argued that by this measure, the government has ensured that no paracetamol manufacturer has significant market power, thereby negating the effect of brands causing any disruption to the working of market forces.[82] This does not however explain why patented drugs, which are very likely to have a monopoly, are not covered by price control in India, when a vibrant competitive market with over 300 producers, like generic paracetamol, is. Evidently, the economic basis for this policy of the Indian government is extremely difficult to understand.

establishing the standard for approval of drugs and their trade names pursuant to S. 17-B of the Drugs and Cosmetics Act, 1940: "*Exacting judicial scrutiny is required if there is a possibility of confusion over marks on medicinal products because the potential harm may be far more dire than that in confusion over ordinary consumer products.*"

[78] There is also a brand called Krocetamol, presumably a take on both Crocin and paracetamol and several variations on the Calpol brand – Calpol Plus which has paracetamol and ibuprofen, and Calpol T which has paracetamol with tramadol. These combinations are one of the reasons cited by Indian doctors to prescribe brands rather than generic chemical names. *See* K.K. Aggarwal, *infra* note 95.

[79] While it may seem like the relevant market is either analgesics or paracetamol in India, there are other aspects like price and substitutability that affect the definition of market.

[80] It is arguable based on the views of doctors, pharmacists, and patients, on substitutability, that combinations containing paracetamol, ibuprofen, and diclofenac for example, may be treated as being part of the analgesics market. However, this conclusion is not supported by the order of the Competition Commission of India in the matter of the Sun – Ranbaxy merger, *supra* note 46, where for example, atorvastatin and rosuvastatin were each considered as separate markets, although the family of statins all treat the same condition and act in a similar manner and are similarly priced by Sun. Interestingly, the Competition Commission considered spare parts for each car brand as a relevant market *Shamesher Kataria v. Honda Seil*, [2014] CCI 26 , available at http://www.cci.gov.in/May2011/OrderOfCommission/27/032011.pdf.

[81] Issued under the Essential Commodities Act, 1955. It has been and continues to be the subject matter of challenge before the Delhi and Bombay High Courts and the Supreme Court of India.

[82] *See* paragraph 23 of the order of the Competition Commission of India in the matter of the Sun-Ranbaxy merger, *supra* note 46 for an example of this concept being accepted, with little explanation, by the Competition Commission of India.

IX. Trade Dress is the Next Barrier to Competition

Another aspect of trademark law is trade dress. In a country like India, colour plays a significant role in patient retention and customer loyalty. For example, the use of a purple-coloured inhaler[83] is a sure way of keeping an asthmatic patient handcuffed to a brand for life if the colour of the inhaler is protected as a trade mark,[84] even after the patent on the drug expires and other cheaper and perhaps even more effective alternatives are available, albeit in different coloured inhalers.[85] "*The importance of colour-coded asthma treatment in patient education is well accepted. Traditionally, reliever medication inhalers are blue in colour and preventer inhalers brown. This custom is not always followed and the inconsistencies in the colour of inhalers create a lot of confusion.*"[86] It is unlikely that when an asthma attack comes on, a patient will read the label of the different inhalers in a medicine cabinet or bag. By force of habit, a patient will not risk changing the brand since a colour is strongly associated with relief from a feeling of certain death by suffocation. When a colour and/or a shape is associated with a drug or a device, the patent monopoly naturally gets extended for the life of the trademark and design. This principle also extends to the colour and shape of pills that need to be taken routinely or when several pills need to be taken by a patient. It is now widely acknowledged by empirical studies that changing the colour of pills has an extremely adverse effect on patient compliance making it difficult for competing products, usually significantly cheaper generics to enter the market.[87] As a consequence, the combination

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[83] The definition of trade mark was amended in 1993 to include "*shape of goods, their packaging and combination of colours*" to follow global norms on trademarks. *See* S. 2(1)(m) and S. 2(1)(xb), Trade Marks Act, 1999.

[84] See the decision of the Court of Appeal in *Nestle v. Cadbury*, 2013 EWCA 1174 where Cadbury was refused registration of its distinctive purple colour which it has used for over a century.

[85] The battle between GSK and Sandoz on the inhaler from Sandoz that competes with purple coloured inhaler sold as Advair (the multi-billion dollar blockbuster from GSK) is being keenly watched. GSK was granted CTM registration for the purple colour combination on the inhaler. While a Danish court refused GSK an interim injunction, a court in Cologne granted an interim injunction but the case was eventually settled.

[86] Dr. B. Jayakrishnan, *Asthma Inhalers And Colour Coding: Universal Dots*, 60(578) Br J. Gen Pract 690–691 (Sep. 1, 2010), available at http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2930224/.

[87] *See* Aaron S. Kesselheim, *et al*, *Variations in Pill Appearance of Antiepileptic Drugs and the Risk of Nonadherence*, 173(3) Jama Internal Medicine 202 (Feb. 11, 2013); Brady Dennis, *If Color or Shape of Generic Pills Changes, Patients May Stop Taking Them,* The Washington Post (Jul. 14, 2014), available at http://www.washingtonpost.com/national/health-science/if-color-or-shape-changes-patients-more-likely-to-stop-taking-much-needed-drugs/2014/07/14/60e687f4-0b8c-11e4-8341-b8072b1e7348_story.html. *See also* U.S. Federal Drug Administration, Guidance for Industry Size, Shape, and Other Physical Attributes of Generic Tablets and Capsules (Dec. 2013), available at http://www.fda.gov/downloads/drugs/guidancecomplianceregulatoryinformation/guidances/ucm377938.pdf.

of a patented drug with a trade name, unique shape and colour is a potent combination of IPR to keep competition out forever.

The use of a colour, shape, or trademark extends a patent monopoly for every patient who either has really no choice once the doctor prescribes a drug or device,[88] or suffers from such a medical condition that a change would be extremely disruptive of his treatment regimen, causing him to reject the choice of cheaper alternatives.[89] However, a Danish Court in *GSK v. Sandoz* (2014) attached importance to the fact that GSK had not proved to a sufficient degree that the purple colour served as a distinctive sign for its inhaler or could in any other way influence consumers' purchasing decisions. It concluded that the inhaler was a prescription medicine, and it could be assumed that the doctors who prescribed it would emphasise the special functionality of the product for the patient and his or her needs, while the patient would mainly consider the price. Since this was a decision on an interim injunction in a healthcare market which has rules on generic substitutability, it may well not apply in the Indian market.[90]

X. Trade Mark extends Patent Monopoly

It is perhaps time to question whether trademark law contemplated the extension of patent monopoly. The judgment in *Philips v. Remington*[91] establishes that trademark law cannot be used to protect from competition a shape marketed by one undertaking if the essential characteristics of that shape perform a technical function. Such shapes are excluded from registration and there are no ways to circumvent this prohibition. Does it not follow that this limitation ought to be applicable to drug and device colours as well, where there is a compelling patient interest to have uniformity to reduce confusion and mistakes?[92]

Despite there being a well-established understanding of the essential elements of a trademark and its role in a market economy, it was interesting that the CJEU sought to clarify the basis for a trade mark:

> "...to guarantee the identity of the origin of the marked product to the consumer or end-user by enabling him, without any possibility

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[88] *See* Chemistree, *supra* note 61.

[89] *See supra* note 86.

[90] A similar reasoning is offered by Indian doctors to prescribe brands rather than generic chemical names of drugs. *See* K.K. Aggarwal, *infra* note 94.

[91] Case C-299/99 – Koninklijke Philips Electronics NV v. Remington Consumer Products Ltd., 2003 RPC 2.

[92] See *supra* note 85.

> of confusion, to distinguish the product or service from others which have another origin, and for the trademark to be able to fulfill its essential role in the system of undistorted competition which the Treaty seeks to establish, it must offer a guarantee that all the goods or services bearing it have originated under the control of a single undertaking which is responsible for their quality… (sic)"[93]

This reaffirms the legal basis for a trademark to be the clear identification of the source of the goods, and no more. It also reminds us of the potential risk of trademarks distorting competition. In the Indian healthcare context, each brand seems to be a market in itself since doctors prescribe brands, not drugs by their generic chemical name,[94] and patients don't consider them substitutable because they would not be able to make the decision based on information available to them from pharmacists who are incentivized to sell more expensive drugs.[95] This is not much of an issue in the United Kingdom or most of Europe where healthcare is virtually free at the point of use and patients pay very little for drugs or devices, all of which are primarily funded by a national health service. In the United States, the oligopoly of insurers negotiates the price of drugs with pharmaceutical companies and it may well be argued that there is a fair balance of power. Brands therefore have little effect of distorting competition where the buyer, the national health service, or an oligopoly of insurers, with sufficient information and choice is able to evaluate (both on a cost-benefit basis as well as medical need) before listing the drugs that a doctor can prescribe. There is virtually a monopoly buyer negotiating with a potential monopolist patent holder, and the patient is rarely given a choice of the brand of the drug. In most of Europe, the patient is often only aware of the generic chemical name on the label of the container printed by the pharmacist.

Conclusion and Recommendations

While the Indian healthcare market is rapidly developing, there is a need to study it in much greater detail as a market than has been done until now.[96]

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[93] Case C-299/99 – Koninklijke Philips Electronics NV v. Remington Consumer Products Ltd., 2003 RPC 2, ¶ 30.

[94] *See* Dr. Ganapati Mudur, *Doctors in India Defy Guidelines on Generic Drugs*, BMJ 347 (2013) available at , http://www.bmj.com/content/347/bmj.f4244#.

[95] For a summary of the viewpoints of the various players in the Indian healthcare sector on competition between brands, *see* Dr. K.K. Aggarwal, *The Generic Drug Controversy*, 23(9) Indian Journal of Clinical Practice 485 (Feb. 9, 2013).

[96] As a part of the Drug Price Control Order, the Indian government is now requiring all manufacturers to register all products with details of price and sales. The Competition Commission of India relied on sales data from the All India Association of Chemists and Druggists who do not list all sales for all drugs. Information on direct sales to hospital

This will help us understand the impact of various regulations on the market and the operation of market forces. There is clear evidence of the disruption of the market by brands, especially with several combinations[97] which are used as reasons for doctors to prescribe them in clear violation of their ethical and legal obligations.[98] The natural consequence of the existence of brand names is their promotion by the brand owners. Since the doctor, being the decision maker, is the real customer, pharmaceutical companies are incentivized[99] to use corrupt practices to influence them to prescribe brands, rather than the generic chemical names of drugs.[100] As a result, the elimination of protection of brand names for drugs addresses several market distorting issues.[101] Corruption creates barriers to competition for those who are unwilling to participate in corrupt practices, and increases the cost of doing business which, in turn, is borne by patients. The belief that regulation of drug prices is an easy fix to overcome potential dominance of brands is a misconception that is disrupting the market by creating other barriers to competition and incentivizing brands to game the system.

It is possible to prevent the distortion of the healthcare market by brand names without any legislative measures. Section 13 of the Trade Marks Act clearly prohibits the use of the international non-proprietary name or any name deceptively similar to it from being registered as a trademark. If any attempt is made to use a mark without registration to overcome this

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chains, government, public sector undertakings, railways and defence and paramilitary services and the like, for example, where millions of patients are treated every year are routinely missed.

97 *See supra* note 78.

98 Indian Medical Council (Profession Conduct, Etiquette and Ethics) Regulations, 2002, Gazette of India, ¶ 1.5 (Apr. 6, 2002).

99 Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, ¶ 6 prohibits doctors from accepting gifts. Often, to overcome this stipulation, "*free samples*" or "*special schemes*" are provided to doctors by pharmaceutical companies. An example of a "*special scheme*" would be giving a doctor five free units for every one unit of a drug purchased. The doctor would therefore be able to sell six units at the retail price and make an astonishing profit without the patient ever knowing this.

100 A common definition of corruption is *the abuse of public or private office for personal gain*. *See* Asian Development Bank, *Anti-Corruption: Policies and Strategies, Description and Answers to Frequently Asked Questions* 1 (Manila, 2000).

101 *See* Corruption Explained, International Chamber of Commerce, available at http://www.iccwbo.org/advocacy-codes-and-rules/areas-of-work/corporate-responsibility-and-anti-corruption/corruption-explained/ (Last visited Jul. 3, 2015), for the position of the International Chamber of Commerce; Guidance Note of the International Monetary Fund, "*Role of the IMF in Governance Issues*." *See* The IMF and Good Governance, International Monetary Fund, (Apr. 9, 2015), available at http://www.imf.org/external/np/exr/facts/gov.htm (Last visited Jul 3, 2015); Business and Governments Against Corruption: Factsheet, United Nations Office Against Drugs and Crime, available at http://www.unodc.org/documents/congress//background-information/Corruption/4._Factsheet_-_An_Anti-Corruption_Ethics_and_Compliance_Programme.pdf.

prohibition, Section 17-B of the Drugs and Cosmetics Act, 1940 can be used to disapprove the sale or marketing of a drug or product. Since limitations can be placed on the use of a mark,[102] the trademark registry can very easily restrict the use of the name for the period of the patent,[103] with the express condition that the name be then made available thereafter to every competitor to use, so long as the source is clearly identified on the product or packaging. Therefore, if Aspirin is a trade name for acetyl salicylic acid during the term of the patent, the name "*Aspirin*" and the generic chemical name should be used by every manufacturer or seller (after the patent on Aspirin expires) together with the name or mark of the manufacturer clearly stated, in order to distinguish products of different manufacturers of Aspirin. Similarly, the colour of pills, devices, and packaging should be uniformly used and industry standards established so that there is consistency and confusion is avoided,thereby ensuring patient compliance. With the elimination of competing brand names, it will be easier for ethical pharmaceutical companies to compete, and for doctors to comply with their legal and ethical professional obligations.[104]

Each drug name could automatically be listed under Section 23(1) of the Trade Marks Act[105] upon patent expiry so that they become generic, instead of being registered. The colour of the drug or device, the text on the packaging, and the design elements, all of which have a functional element, should not be allowed to be owned separately from the product. This prevents the composition of the drug from being changed while selling it under a well-known brand name,[106] and further ensures that patient interest is not compromised and patients have real choice of products in a market that allows competition to thrive.

While we can look to the West for ideas on how to regulate our markets, we need to be very vigilant about how different India is and why we need to be wary of blindly implementing western models of market regulation. Instead, we should focus on leapfrogging them to avoid the regulatory challenges that they have created in the process of their learning and growth.

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[102] S. 18, Trade Marks Act, 1999.

[103] S. 2(1)(l), Trade Marks Act, 1999 defines "*limitations*" to mean any limitation of the exclusive right to the use of a trade mark given by the registration of a person as proprietor thereof, *including limitations of that right as to mode* or area of use within India or outside India.

[104] *See supra* notes 98, 99.

[105] So far, the Central Government has listed names and pictures of gods and goddesses.

[106] *See* for example, *supra* note 76.

Investigation of Cartels: A Comparative Assessment of the Approaches Adopted by the Indian and EU Competition Regulators

Nisha Kaur Uberoi[*]

Over the last six years, the CCI has investigated several enterprises across various sectors and levied significant penalties for their role in cartel conduct. This article sets out the differences in the approaches adopted by the Indian and European regulators while investigating cartels. The CCI has been actively promoting its leniency program to encourage cartel members to avail lesser penalties by providing information about their involvement in cartels. Additionally, the CCI is also likely to increase its use of dawn raids to investigate anti-competitive conduct in India. While the CCI might not have reached the same level of sophistication as the European Commission, in a relatively short span of time, it has progressed tremendously in its war against cartelisation.

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Introduction

Competition law is the cornerstone of a free market economy, where enterprises compete with each other and allocation of resources takes place through market forces of demand and supply. Competition law seeks to promote, maintain, and sustain competition in the market. In the context of competition, regulation is necessary to deal with market imperfections.

When left to determine their own conduct, firms are often tempted to co-operate or collude in a manner which is profitable for them collectively, but which works to the detriment of the consumer and society as a whole.

Cartels are typically concerned with price fixing, but may also engage in other arrangements such as customer allocation, production manipulation, market partitioning or bid rigging. Cartels may also take the form of a concerted action or practice, which does not require the blessing of a formal agreement. Across the world, cartels are recognized as harmful to consumers, resulting in pernicious effects on consumer welfare. To deter this anti-competitive behaviour, one of the primary objectives of competition law in any jurisdiction is to unearth cartels, punish the participants, and establish mechanisms to discourage such unlawful activities in the future.

A. Competition Law in the European Union[1] ("EU")

Origins of competition law principles and regulations in the EU can be traced back to the Declaration by Robert Schuman on May 9, 1950,[2] which formed the basis for the European Coal and Steel Community ("ECSC"), devised to counter an "*international cartel aimed to divide and exploit national markets through restrictive practices and to maintain high profits*," thereby ensuring the integration of markets and increasing production of coal and steel. It was believed that conditions would gradually emerge which would

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1 The European Union was formerly known as the European Economic Community [hereinafter "EEC"].
2 Robert Schuman was the French Foreign Minister at the time.

ensure "*the most rational distribution of production and the highest level of productivity*" by means of "*pooling of resources.*"[3]

It is in this particular context that the word 'competition' is first mentioned – as a means to counteract price-fixing, the allocation of production quotas and the division of markets. Cartels were associated with a "*permanent elimination of competition resulting in the exploitation of markets by a particular profession*" and essentially secret agreements serving professional, rather than public interest.[4] In the fight against cartels, the High Authority instituted under the ECSC was entrusted with the duty to ensure that the same market conditions which existed under perfect competition would prevail, without which the establishment of competition would face an insurmountable hurdle.[5]

Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU")[6] form the basis of all competition rules in the EU. The Articles are supplemented by delegated legislation, guidance notices and other instruments, as well as by decisions of the European Commission ("EC") and the Court of Justice of the European Union ("CJEU"). Council Regulation (EC) No. 1/2003 of 16 December 2002 ("Regulation 1/2003") provides the framework for competition law as enforced in the EU today.

B. Treatment of cartels under EU competition law

Article 101[7] of the TFEU prohibits agreements, decisions of associations of undertakings, and concerted practices, which have as their object or effect,

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[3] The ECSC Treaty was signed in Paris in 1951, and brought France, Germany, Italy and the Benelux countries together in a community with the aim of organising free movement of coal and steel, and free access to sources of production. In addition to this, a common High Authority supervised the market, fostering respect for competition rules and price transparency. This treaty is the origin of the EU institutions as we know them today.

[4] *See* Martina Gillen, *DRM and Modchips: Time for the Court of Justice to do the "Right" Thing*, 11(3) SCRIPTed 229 (2014) available at http://script-ed.org/?p=1664.

[5] Anca D. Chirita, *A Legal-Historical Review of the EC Competition Rules*, 63 Int'l. & Comp. L.Q. 281 (2014).

[6] Consolidated Version of the Treaty on the Functioning of the European Union arts. 101 & 102, Oct. 26, 2012, 2008 O.J. (C 326), 1-390.

[7] *See* Article 101 of the Consolidated Version of the Treaty on the Functioning of the European Union, Dec. 13, 2007, 2008/C 115/01, which states:

"1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

(*a*) directly or indirectly fix purchase or selling prices or any other trading conditions;

(*b*) limit or control production, markets, technical development, or investment;

the prevention, restriction, or distortion of competition, and which may affect trade between Member States. Article 101 also sets out an illustrative list of such agreements and concerted practices which distort competition. For the prohibition in Article 101(1) to apply, the following ingredients must be established:

a) *The existence of undertakings (or an association of undertakings)* – the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed;

b) *Collusion (an agreement between undertakings, a decision by an association of undertakings, or a concerted practice)*– the EC interprets the term 'agreement' liberally to refer to a concurrence of wills between economic operators on the implementation of a policy, the pursuit of an objective, or the adoption of a given line of conduct on the market.[8] In other words, the term 'agreement' would include a mere joint intention between undertakings to conduct themselves in a specific way, whether formal or informal. The term 'concerted practice,' refers to even looser forms of collusion, *i.e.*, coordinated behaviour with an intent to reduce effective competition through informal arrangements;

c) *Collusion which has as its object or effect the prevention, restriction, or distortion of competition* – the EC interprets 'object or effect' disjunctively. Therefore, if by the terms of an agreement it is clear that the agreement, in the economic context, has as its object, prevention,

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(*c*) share markets or sources of supply;
(*d*) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(*e*) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
— any agreement or category of agreements between undertakings,
— any decision or category of decisions by associations of undertakings,
— any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(*a*) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(*b*) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

8 Case T-41/96, Bayer AG v. Comm'n, 2000 ECR II-3383, aff'd on appeal Cases C-2 &3/01 P, 2004 ECR I-23.

restriction, or distortion of competition, there is no need to examine its effects.[9] Certain agreements, for example, cartel agreements fixing prices, restricting output, or sharing markets, are generally considered to have the restriction of competition as their object, and are prohibited unless they meet the criteria under Article 101(3) of the TFEU. However, where the object of the agreement cannot be said to restrict competition, an analysis of the effect of the agreement on the market and in the context in which it occurs is necessary, before it can be determined whether the agreement infringes Article 101(1) of the TFEU; and

d) *An appreciable effect on competition*[10]– in this context, the EC has issued a series of notices indicating when, in its view, an agreement is likely to be considered to be of minor importance. The most recent notice was published in 2001 (Commission Notice on Agreements of Minor Importance which do not Appreciably Restrict Competition under Article 81(1) (now known as Article 101(1) of the TFEU)).[11] However, the Notice is inapplicable to (*i*) agreements between competitors which fix prices, limit output or sales, or allocate markets or customers; and (*ii*) such agreement or concerted practice or decision that affects trade between Member States.

C. Competition Law in India

The Competition Act, 2002 ("Competition Act") is the principal legislation dealing with competition law in India. Though enacted in 2002, the Competition Act was brought into effect in phases. The provisions relating to anti-competitive agreements and abuse of dominance, and the enforcement powers of the Competition Commission of India ("CCI") – the competition authority established under the provisions of the Competition Act – came into effect on May 20, 2009, while the merger control regime came into effect on June 1, 2011.

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[9] Case 54/64 & 58/64, Consten and Grudig v. Comm'n, 1966 ECR 299.

[10] Please note that Article 101 of the TFEU, itself, does not provide that the effect on competition and trade must be an appreciable one. The Court of Justice [hereinafter "ECJ"] has by way of its decisional practice held that an agreement falls outside the prohibition of Article 101 of the TFEU if its effect on the market is insignificant. Specifically, refer *Volk v. Vervaecke*, 1969 ECR 295.

[11] Consolidated Version of the Treaty on the Functioning of the European Union [2001] OJ C368/13. The EC does not consider agreements between competitors where market share held by parties to the agreement does not exceed 10 per cent on any of the relevant markets affected by the agreement, where the agreement is made between the undertakings which are actual or potential competitors on any of these markets (agreement between competitors).

The Competition Act seeks to regulate activities that raise competition concerns by preventing practices having an adverse effect on competition, promoting competition in the market to protect the interests of consumers, and ensuring freedom of trade carried on by other participants in the market.[12] To achieve these objectives, the Competition Act regulates the following activities:

- anti-competitive agreements (Section 3);
- abuse of dominant position (Section 4); and
- combinations (Sections 5 and 6).

D. Treatment of cartels under Indian competition law

Similar to the approach adopted in other jurisdictions, the Competition Act prohibits cartels and imposes stringent penalties on participants of such cartels. Section 2(c) of the Competition Act defines a 'cartel' to include "*an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.*"

In other words, a cartel is essentially an agreement amongst competitors to fix prices or production quantities or allocate markets or customers, either by limiting supply in the market or otherwise altering distribution patterns.

In order to establish the existence of a cartel under the Competition Act, the following ingredients must be satisfied:

a) an agreement (– the term 'agreement' is very widely defined under the Competition Act to include any arrangement or understanding or action in concert, whether or not such arrangement, understanding, or action in concert is formal or in writing; or whether or not the same is intended to be enforceable by legal proceedings);[13]

b) among producers, sellers, distributors, traders, or service providers;

c) to limit, control, or attempt to control the production, distribution, sale, or price of, or trade in, goods or provision of services.

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[12] Preamble, Competition Act, No. 12, Acts of Parliament, 2003 [hereinafter "Competition Act"].

[13] S. 2(b), Competition Act, 2002.

Under Section 3 of the Competition Act, cartels are presumed to cause an appreciable adverse effect on competition ("AAEC") in India and as such, are void under the provisions of the Competition Act.

While competition law in the European Union has been in effect for over six decades, competition law in India is a relatively recent development. Since the enactment of the Competition Act in 2002, practitioners of competition law worldwide have proceeded on the basis that the Indian law on competition is broadly patterned on European competition law. In its six years of operational existence, the CCI, particularly in relation to cartel investigations, has adopted an approach similar to that of its European counterpart, albeit with suitable modifications where required, in keeping with the economic scenario in India. The objective of this article is to compare the approach adopted by the EC and the CCI, with respect to cartel investigations. In this context, the article also compares the standard and burden of proof adopted by the Indian and EU regulators, the trend in penalties imposed on cartel participants, the role of trade associations in both these jurisdictions, and the success of their leniency regimes.

I. Standard of Proof

Detecting the existence of a cartel itself presents the main difficulty in any jurisdiction and to any investigator. Cartels tend to operate in secrecy and considerable efforts are devoted by the participants to avoiding detection by the authorities. Therefore, the task of proving the existence of a cartel is an onerous one. In modern day multi-jurisdictional cartels, meetings are held in cities around the globe, incriminating documents are destroyed or stored outside the premises of the companies, and practices are arranged so as to simulate normal market behaviour, making the task of unearthing conclusive evidence of a cartel increasingly difficult.

A. Standard of Proof in the EU

Regulation 1/2003 does not directly deal with the standard of proof which the EC is required to adopt in order to establish an infringement of Article 101 of the TFEU. However, the EC has consistently held that the evidence produced must be "*sufficiently precise and coherent*" to prove the infringement.[14] From an investigative standpoint, while Regulation 1/2003 provides broad investigative powers to the EC to enable it to gather evidence,

[14] Case 29 and 30/83, Compagnie Royale Asturienne des Mines SA and Rheinzink GmbH v. Comm'n, 1984 ECR 1679.

obtaining direct and unquestionable evidence is not always possible, given the increasingly complex and challenging *modus operandi* being adopted by cartel participants.

Often the market structure is such that undertakings monitor their competitor's behaviour and resort to mimicking the same – this is particularly true of oligopolistic markets. In such a situation, the EC must determine whether parallel conduct by firms operating in an oligopolistic market can be relied upon as circumstantial evidence to justify a finding that an agreement or concerted practice existed between the undertakings concerned. Such imitation of market strategy can only be considered as explicit collusion if the behaviour cannot be explained by any other possible scenario or the general conditions of competition in the market.

The European Court of Justice ("ECJ") in the *Woodpulp judgment*[15], delivered the most categorical understanding on the relationship between conscious parallelism and concerted practice. The ECJ explained that the prohibition to enter into anti-competitive agreements did not deny market players the right to adapt themselves to the existing and anticipated conduct of their competitors. The ECJ noted that the similarity in the dates of price announcements could be a direct result of the high degree of market transparency. Further, the parallelism of prices and price trends could also be explained by the oligopolistic nature of the market and by the specific circumstances prevailing in the market. In the absence of a "*firm, precise and consistent body of evidence*," the ECJ held that the parallel price announcements did not establish an agreement or concerted practice.

As such, the ECJ clearly stated that:

a) tacit collusion is not in itself prohibited by Article 101(1) of the TFEU; and

b) although parallel behaviour may furnish circumstantial proof of explicit collusion, parallel behaviour can only be considered as explicit collusion if the behaviour cannot be explained away by the conditions of competition in the market.

It is thus clear that mere parallel oligopolistic behaviour is not prohibited *per se* by Article 101(1) of the TFEU. The requirement of proving concertation demands reciprocal co-operation through direct or indirect contact, designed to influence the conduct of an actual or potential competitor or to

[15] Ahlström Osakeyhtiö v. Comm'n, Joined Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 TO C-129/85, [1993] ECR I-1307.

disclose to them the course of conduct that will or may be adopted on the market.

However, where direct evidence of reciprocal co-operation is not available, parallel behaviour may furnish circumstantial proof of an agreement or concerted practice if it is not the kind of behaviour which can be explained or anticipated on the market involved.

B. Standard of Proof in India

The Competition Act and accompanying regulations do not stipulate the standard of proof required in cartel cases and based on the CCI's past decisional practice it appears that the standard of proof for cartel such cases is the standard followed in cases relating to civil offences.

As such, there is a marked similarity in the approach adopted by the EC and the CCI. However, over the years, there has been a considerable dilution of the standard of proof relied upon by the CCI in order to establish cartel conduct. For instance, in *In re: Sugar Mills*,[16] the CCI required evidence of the fact that the alleged cartel participants met and decided to take concerted action, evidence of implementation of the concerted action, as well as conclusive evidence of meeting of minds. However, subsequently, in the *Gas Cylinder Manufacturers' case* ("*LPG Cartel*")[17], the CCI held that cartelisation not being a criminal offense, the test for proof to be employed should be the "*balance of probabilities*" and "*liaison of intention*" test, which can be established with the support of indirect and circumstantial evidence. Emphasising that direct evidence of a cartel is difficult to obtain, the CCI noted that existence of cartels can be established through indirect or circumstantial evidence.

Establishing an agreement through a "*balance of probability*" test implies that the acts and conduct of the market participants cannot be explained "*but for*" some sort of anti-competitive agreement and action in concert amongst them.[18] In other terms, the CCI will infer the existence of a cartel from "*a number of coincidences and indicia which, taken together, may in the absence of another plausible explanation, constitute evidence of the existence of an agreement.* (sic)"[19] For instance, common mistakes in several

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16 In re: Sugar Mills, Case No. 1 of 2010 (CCI).

17 Suo Motu Case Against LPG Cylinder Manufacturers, In re, [2012] CCI 11.

18 All India Tyres Dealers' Federation v. Tyres Manufacturers, Case No. RTPE 20 of 2008 (CCI).

19 DGS&D, M/o Commerce, Government of India v. M/s Puja Enterprises & Ors., Ref. Case No. 1 of 2012 (CCI) [hereinafter "Shoe Makers Cartel"].

tender documents of competitors would be sufficient to establish an understanding and meeting of minds amongst the bidders.[20] Further, quotation by companies of near identical prices despite their units being located in different geographical locations, varying tax structure and profits margins, a bidder's knowledge of commercially sensitive information in relation to the value of orders of the other bidders, meetings under the aegis of a trade federation and failure on the part of the bidders to provide any plausible explanation for the same, would be sufficient for the CCI to conclude the existence of a cartel.[21]

On similar lines as *LPG Cartel*, in *In re: Aluminium Phosphide Tablet Manufacturers* ("*Aluminium Phosphide Cartel*")[22], identical pricing in bids, despite varying cost structure of the parties, and common entry in the visitors' register for all the three parties when submitting the bids, was held to be sufficient evidence to establish the existence of an understanding between the parties. The CCI observed that since such matters relate to secret or clandestine understandings, it is difficult to obtain "*well-documented*" proof. On appeal, the Competition Appellate Tribunal ("COMPAT") upheld the CCI's decision and rejected the parties' arguments on this being a mere case of identical pricing. According to the COMPAT, a "*consistent practice and common pattern*" which continues for a long time would necessarily constitute cartelisation. The COMPAT noted that the appellants had submitted identical prices that were "*odd figures*" from 2007 to 2011 and had also boycotted a tender which could have only been achieved by an agreement between the appellants.

C. Plus Factors

In *Builders Assn. of India v. Cement Manufacturers' Assn.* ("*Cement Cartel*")[23], the CCI held that in the absence of direct evidence, the existence of a cartel can be concluded on the basis of circumstantial evidence alone. In addition to establishing price parallelism by taking into consideration the increased cement prices, timed after two meetings of the Cement Manufacturers' Association ("CMA"), the CCI considered various other 'plus' factors to establish cartelisation in the cement industry, such as decrease in capacity utilisation, production, and dispatch parallelism inter alia. The

[20] Foundation for Common Cause & People Awareness v. PES Installations (P) Ltd., [2012] CCI 21.

[21] DGS&D, M/o Commerce, Government of India v. M/s Puja Enterprises &Ors., Ref. Case No. 1 of 2012 (CCI).

[22] Aluminium Phosphide Tablets Manufacturers, In re, [2012] CCI 23.

[23] Builders Assn. of India v. Cement Manufacturers' Assn., 2012 CCI 42. The case is currently under appeal at the COMPAT.

requirement to establish 'plus' factors was re-emphasized by the CCI in *In re: Alleged cartelisation by steel producers,*[24] where the CCI explained that plus factors are economic actions and outcomes, in addition to the parallel conduct by firms in an oligopolistic market, that "*are largely inconsistent with unilateral conduct but largely consistent with coordinated action.*"

D. Role of Trade Associations

The CCI has cautioned in the past that the mere existence of a trade association, where members meet and exchange certain information, could not be said to be in contravention of the provisions of the Competition Act. The meeting would have to necessarily be followed by parallel conduct of the conspirators, such as price increase, in order to constitute circumstantial evidence. The CCI would regard the exchange of information among competitors through the trade association as a 'plus' factor. Unless such 'plus' factors were coupled with other circumstantial or economic evidence to indicate that the platform was used by competitors to collude amongst themselves, they alone would not establish the existence of an anti-competitive agreement.[25] However, after *Cement Cartel*[26] in which the anti-competitive arrangements were given effect to pursuant to the exchange of information through the CMA, significant scrutiny of the role of trade associations as a platform for cartel conduct is inevitable.

II. Burden of Proof

A. Burden of proof in the EU

Regulation 1/2003 places the burden of proof in case of anti-competitive agreements, including cartels, on the party or authority alleging the infringement of Article 101 of the TFEU. Once this burden is discharged, the burden of proof shifts on the alleged cartel participants to prove otherwise or to establish that the exception provided in Article 101(3)[27] is applicable. Interestingly, the complainant/investigator's burden of proof is considered to be discharged when the other party fails to provide an explanation or justification in relation to the evidence relied upon.[28]

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[24] In re: Alleged cartelisation by steel producers, Case No.RTPE No. 09 of 2008 (MRTP).

[25] Film & Television Producers Guild of India v. Multiplex Association of India & Ors., Case No. 37 of 2011 (CCI).

[26] Builders Assn. of India v. Cement Manufacturers' Assn., [2012] CCI 42. The case is currently under appeal at the COMPAT.

[27] *Supra* note 5.

[28] Aalborg Portland A/S v. Commission, Joined Cases C-204/00 P, C-205/00 P, C-211/00 P, C-213/00 P, C-217/00 P and C-219/00 P. [2004] ECR I-123 (EC).

B. Burden of proof in India

In contrast, the provisions of the Competition Act presume that a cartel will have an AAEC and the only ingredients that need to be established are that there exists an agreement amongst competitors of the type mentioned in Section 3(3) of the Competition Act. However, the aforesaid presumption, set out under Section 3(3), is a rebuttable presumption. As noted by the CCI in *FICCI – Multiplex Assn. of India v. United Producers/Distributors Forum*[29], opposite parties can adduce evidence to rebut the presumption that a cartel causes an AAEC. Consequently, once the existence of an anti-competitive agreement is established, the burden of proof shifts on the parties to such agreement to prove that the agreement does not cause any AAEC.[30]

As such, once the existence of an anti-competitive agreement is established, it is not necessary to also prove an effect on competition.[31] As held by the CCI in *LPG Cartel*[32] which pertained to bid rigging – the presumptive rule approach was to be adopted in case of bid rigging, *i.e.* once the essential ingredients constituting bid rigging are established, the impact of such conduct on the market need not be examined and the adverse effect on competition is presumed. The burden of proof then shifts to the contravening parties and they must rebut the presumption by providing evidence that their conduct does not result in an AAEC in India.

To conclude, there is a difference in the approach adopted by the EC and CCI when it comes to proving a cartel – under EU law, the object or effect of the anti-competitive agreement to prevent, restrict, or distort competition must also be established while before the CCI, merely proving the existence of such an agreement is sufficient. However, in practice, as the EC tends to proceed on the 'object' of anti-competitive agreements which can often be established by the very nature of some agreements (such as price fixing or market allocation agreements), in effect the approach adopted by the EC and CCI, given the same set of facts will tend to be similar if not identical.

III. Leniency Regimes

Given that cartels are carried out in secrecy and cartel participants endeavour to leave no evidence or paper trails behind, most jurisdictions have adopted leniency programs which provide such participants with an opportunity to

[29] FICCI – Multiplex Association of India v. United Producers/Distributors Forum & Ors.,[2011] CCI 32.
[30] Uniglobe Mod Travels (P) Ltd., In re, [2011] CCI 64.
[31] *Id.*
[32] Suo Motu Case Against LPG Cylinder Manufacturers, In re, [2012] CCI 11.

obtain immunity from imposition of monetary penalties. As a result, leniency programs encourage cartel participants to turn whistle blowers and provide competition authorities with undisputable evidence of cartels, thereby enabling them to detect and deter cartels. Additionally, leniency programs may also have a deterrent effect on cartel formation itself and tend to destabilise existing cartels by sowing seeds of distrust amongst members.[33]

A. EU Leniency Program

The leniency regime in the EU is provided under the Notice on Immunity from Fines and Reduction of Fines in Cartel Cases ("EU Leniency Notice").[34] The EC can grant total immunity if an undertaking is the first to submit evidence which enables the EC to carry out a "*targeted inspection*" or to find an infringement of Article 101 of the TFEU. The whistle blower is required to provide a corporate statement setting out information such as the description of the cartel, its aims and activities, and the names and office locations of entities involved in the alleged cartel. The EU Leniency Notice stipulates that the leniency applicant provide genuine and continuous co-operation to the EC throughout the EC's administrative procedure. Further, the applicant should not have destroyed, falsified, or concealed any relevant evidence, and should have ceased its involvement in the cartel.

In addition to total immunity, the EU Leniency Notice also empowers the EC to grant a reduction in fines to those entities which cannot meet the conditions for immunity, if they are able to provide evidence of the infringement which "*represents significant added value with respect to the evidence already in the EC's possession*."[35] The leniency policy prescribes a 30-50% reduction for the first undertaking, 20-30% for the second and up to 20% for any subsequent undertakings (there is no limit on the maximum number of leniency applicants).

Though the EU Leniency Notice also grants the EC the discretion to award total immunity, the terms of the EU Leniency Notice are more definite and an applicant can avail immunity by providing the evidence listed therein.[36]

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33 European Comm'n, Leniency, available at http://ec.europa.eu/competition/cartels/leniency/ leniency.html.

34 Commission Notice on Immunity from Fines and Reduction of Fines in Cartel Cases, OJ [2006] C 298/17.

35 *Id.*

36 Press release, European Commission, Competition: Revised Leniency Notice – Frequently Asked Questions (Dec. 7,2006), MEMO/06/469, available at http://europa.eu/rapid/ press-release_MEMO-06-469_en.htm?locale=en.

Interestingly, the EU Leniency Notice also provides for a leniency application in hypothetical terms. A cartel participant may opt to initially present the information and evidence in hypothetical terms, in which case the undertaking must present a detailed descriptive list of the evidence it proposes to disclose at a later agreed date. The entity is required to demonstrate the evidence available to meet the relevant immunity threshold, although it can show edited copies of the data without disclosing the identity of the company and the cartel.[37]

Accordingly, the EU leniency program lays down a comparatively more encouraging framework which permits companies to ascertain whether the evidence in their possession would meet the immunity threshold before disclosing their identity or the infringement.[38]

B. Leniency in India

In India, the leniency regime is set out under Section 46 of the Competition Act[39] and the Competition Commission of India (Lesser Penalty) Regulations, 2009 ("Leniency Regulations"). The Leniency Regulations govern the procedure and extent to which leniency can be granted to the applicants who

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37 *Ibid.*

38 *Id.*

39 S. 46, Competition Act, No. 12, Acts of Parliament, 2002 states:

"The Commission may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated Section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations:

Provided that lesser penalty shall not be imposed by the Commission in cases where the report of investigation directed under section 26 has been received before making of such disclosure.

Provided further that lesser penalty shall be imposed by the Commission only in respect of a producer, seller, distributor, trader or service provider included in the cartel, who has made the full, true and vital disclosures under this section.

Provided also that lesser penalty shall not be imposed by the Commission if the person making the disclosure does not continue to cooperate with the Commission till the completion of the proceedings before the Commission.

Provided also that the Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,—

(*a*) not complied with the condition on which the lesser penalty was imposed by the Commission; or

(*b*) had given false evidence; or

(*c*) the disclosure made is not vital, and thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, had lesser penalty not been imposed."

make "*vital disclosures*" on cartel activity. The term "*vital disclosure*" means full and true disclosure of information or evidence which would be sufficient to enable the CCI to form a *prima facie* opinion in relation to the existence of a cartel.[40] In addition to providing vital disclosure, an applicant seeking leniency is also required to cease participation in the cartel (unless ordered otherwise by the CCI), and fully and continuously co-operate with the CCI.[41] The Leniency Regulations also require that the leniency applicant not conceal, destroy, manipulate, or remove relevant evidence of the cartel. Similar to the EU Leniency Notice, the Indian Leniency Regulations stipulate that the leniency applicant provide genuine and continuous co-operation to the CCI throughout investigation. Typically, an applicant seeking leniency should provide information relating to the cartel arrangement, the goods/services involved, the geographic market covered, the duration of the cartel, an estimate of the volume of the business affected by the cartel, and evidence supporting the existence of the cartel.

The leniency program in India uses a marker system whereby a "*priority status*" is granted to leniency applicants in order to determine the quantum of reduction in their penalties. The CCI is empowered to grant up to 100% reduction in fines, *i.e.* complete immunity, to the applicant who is the first to make "*vital disclosure*" to the CCI.[42] Subsequent leniency applicants, who disclose evidence that provides "*significant added value to the evidence*" already in possession of the CCI, may also be granted leniency. An applicant marked as 'second priority' may be granted a reduction in penalty of up to 50%, whereas an applicant marked as 'third priority' may be granted a reduction in penalty of up to 30%.[43] Pertinently, though a leniency applicant can potentially be granted complete immunity, such grant is subject to the CCI's discretion. Terms such as "*vital disclosure*" and "*up to*" leave much to the CCI's discretion and it remains to be seen if the CCI will, in practice, grant absolute immunity to any cartel participant. Certainty is the corner stone of any successful leniency regime and any deviation from this is likely to derail the leniency process.

The CCI is bound to treat any information submitted under the Leniency Regulations, including the identity of the applicant, as strictly confidential, despite the explicit mandate of the Leniency Regulations; nevertheless, reports of cartel participants applying for immunity have, on previous

[40] Reg. 2(1)(i), Competition Commisson (Lesser Penalty) Regulations, No. 4 of 2009, No. L-3(4)/Reg-L.P./2009-10/CCI. ["Leniency Regulations"].

[41] Reg. 3, Leniency Regulations.

[42] Reg. 4(a), Leniency Regulations.

[43] Regs.4 (b) and (c), Leniency Regulations.

occasions, become available in the public domain.[44] It is apparent that if the Leniency Regulations are required to serve their purpose and the leniency program is to encourage enterprises to reveal the existence of cartels, strict confidentiality would have to be maintained in such cases.

IV. Dawn Raids

A. Powers under EU law

Council Regulation 1/2003 empowers the EC to conduct on-site inspections of undertakings suspected of competition law violations and, as part of that authority, to *inter alia* enter any premises, examine the books and other records related to the business, and take or obtain copies or extracts from such books or records. During a dawn raid, the EC also has the power to examine and copy not just hard copies of business records, but also electronic information.

However, the EC does not have the power to conduct 'fishing expeditions' and has to specify the scope of its investigation. At times, this requirement can also allow the entity being raided to limit its co-operation to those activities in respect of which the EC has reasonable grounds for suspecting an infringement of the competition rules.

B. Powers under Indian law

The CCI's extensive powers of investigation also include the power to conduct "*dawn raids*," *i.e.* unannounced inspections to search for relevant evidence. These search and seizure raids can be conducted at all office premises (head office and branch offices), homes of management personnel, vehicles of management personnel, and any other premises which the CCI officials consider necessary.[45] Further, the scope of investigation can include the use of forensics and information technology experts to trace and obtain all electronic communication, confiscation of computer hard-disks, and confiscation of all internal company documents, calendars and diaries. For the purpose of conducting a dawn raid, the CCI must first obtain a warrant from the Chief Metropolitan Magistrate, New Delhi, prior to conducting the raid.[46] The Competition Law Amendment Bill, which recently lapsed, contemplated a proposal to strengthen the dawn raid procedures under the

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[44] Maulik Vyas, *Antitrust Regulator CCI may be Lenient on Cartel Whistleblower,* The Economic Times, (Feb. 27, 2014) available at http://articles.economictimes.indiatimes.com/2014-02-27/news/47739680_1_alleged-cartel-competition-commission-regulator.

[45] S. 41(3), Competition Act, No. 12, Acts of Parliament, 2002.

[46] *Id.*

Competition Act by further empowering the CCI to issue search warrants under the authority of CCI's Chairperson, without recourse to the courts.

The first dawn raid in India was conducted by the CCI in September 2014, when the CCI raided the registered and corporate offices of J.C. Bamford Excavators Ltd. ("JCB") and JCB India Ltd. Typically, the competition law authorities conduct dawn raids in relation to alleged anti-competitive agreements (including cartels). However, JCB is currently being investigated by the CCI for alleged abuse of dominance in the market for manufacturing and sale of backhoe loaders in India. Subsequent to the dawn raid, JCB approached the Delhi High Court, which asked the DG to file a personal affidavit detailing the reasons that prompted him to take the "*drastic action*."

In terms of powers of inspection, search, and seizure, the CCI may be at par with the EC. However, the administrative process required to be followed in India and the porous manner of doing business in India, have thus far made it difficult for the CCI to make full use of its powers. Nevertheless, the JCB raid seems to have set the ball rolling and there is every possibility that the CCI will now use its powers more aggressively, which, in turn, may lead to more leniency applications by cartel participants wanting to avoid penal liability.

V. Penalties for Cartels

As stated above, cartelisation is a heinous offence which is very difficult to detect, and competition law authorities in all jurisdictions impose significant fines on cartel conduct so that there may be a deterrent value attached to their investigations and orders. However, competition law authorities are equally concerned with "*the reasonableness and proportionality of penalties imposed*" and punishment ought not to inadvertently eliminate a market participant. As such, there is constant tension involved in balancing two concerns: *first*, deterrence, and *secondly*, reasonableness and proportionality. Publication of detailed guidelines for assessment of penalties is one way in which the penalty process can be made more transparent and predictable. Unlike the United States, neither EU nor Indian law provides for imprisonment as a penalty for cartelisation.

A. Penalties in the EU

Under Regulation 1/2003, a fine of up to 10% of the worldwide turnover of the undertaking concerned in the financial year preceding the decision, can be imposed for breach of Article 101 of the TFEU.

The EC has wide discretion in setting the level of fines on companies within these limits. The highest fines imposed by the EC in cartel cases include:

a) *Car Glass Cartel* – €1.38 billion on four undertakings (reduced to €1.185 billion, pursuant to judgments of the General Court and ECJ). Saint Gobain was individually penalised an amount of €896 million;[47]

b) *Cathode Ray Tube Cartel* – €1.47 billion on seven undertakings;[48] and

c) *Euro interest rate derivatives and Yen interest rate derivatives* – €1.71 billion on eight undertakings.[49]

B. Factors considered

The EC imposes fines on companies based on the Guidelines on the Method of Setting Fines imposed pursuant to Article 23(2) of Regulation No 1/2003, OJ C210, 2006 ("2006 Penalty Guidelines"). The methodology for imposing fines can be summarised as follows:

a) *Value of sales* – the EC starts by applying a percentage of the undertaking's value of sales in the *market affected* by the cartel. The percentage applied in each case is based on the gravity of the infringement and, as a general rule, is set at a level of up to 30% of sales. In determining the proportion of the value of sales, the EC takes into account the nature of the infringement, its actual impact on the market, and the size of the relevant geographic market;

b) *Duration* – the amount determined based on the value of sales is multiplied by the number of years of participation in the infringement;

c) *Entry fee* – an additional sum of 15-25% of the value of sales is added to deter undertakings from participating in cartels;

d) *Adjustments taking into account aggravating and mitigating circumstances*; and

e) *Settlement discounts* – in cartel cases, the EC also offers a reduction of 10% in the fine if the EC reaches a settlement with the company, as such settlements reduce the administrative costs of cartel decisions and free up resources which can be devoted to new investigations.

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47 Car Glass, Case COMP/39.125 (2008).

48 TV and Computer Monitor Tubes, Case COMP/39.437 (2012).

49 Euro Interest Rate Derivatives, Case COMP/39.914 (2013).

C. Penalties in India

Under Section 27 of the Competition Act, the CCI has the power to impose, upon every cartel participant, a penalty of up to three times its profit for each year of continuance of the cartel, or up to 10% of the turnover for each-year of continuance of the cartel, whichever is higher. However, there are no penalty guidelines that list out aggravating or mitigating factors, or the facts that may be considered to determine the gravity of a given cartel case. Thus far, the CCI has levied varying penalties for cartelisation – for instance, a penalty of 5% of the average turnover was imposed on eleven shoe makers in *Shoe Makers Cartel*,[50] a penalty of 0.5 times of the net profit for 2009-10 (from 20 May 2009) was imposed on eleven cement manufacturers and 10% of average turnover was imposed on the Cement Manufacturers' Association in *Cement Cartel*,[51]a penalty of 7% of the average turnover was imposed on 48 LPG manufacturers in *LPG Cartel*,[52] and a penalty of 9% of the average turnover was imposed on three aluminium phosphide manufacturers in *Aluminium Phosphide Cartel.*[53]

The CCI has wide discretion in imposing penalties on entities. The highest penalties imposed by the CCI in relation to cartel cases include:

a) *Cement Cartel* –Rs. 6317.32 crores on eleven cement manufacturers and the Cement Manufacturers' Association;

b) *Aluminium Phosphide Cartel* –Rs. 317.91 crores on three aluminium phosphide manufacturers;

c) *LPG Cartel* – Rs. 165.58 crores on 48 LPG manufacturers; and

d) *Shoe Makers Cartel* – Rs. 6.25 crores on eleven shoe makers.

D. Factors considered

1. Cement Cartel

The CCI merely indicated that "*considering the totality of the facts and circumstances of the instant case...*" a penalty of 0.5 times of net profit of each of the eleven cement manufacturers was justified. The penalty was imposed for the period 2009-2010 (20 May 2009 onwards)[54] to 2010-2011.

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[50] In re: Puja Enterprises [2013] CCI 42 [hereinafter "Shoe Makers Cartel"].

[51] Builders Assn. of India v. Cement Manufacturers' Assn., 2012 CCI 42. The case is currently under appeal at the COMPAT.

[52] Suo Motu Case Against LPG Cylinder Manufacturers, In re, 2012 CCI 11.

[53] Aluminium Phosphide Tablets Manufacturers, In re, 2012 CCI 23.

[54] The date on which Section 3 of the Competition Act was brought into force.

2. *Aluminium Phosphide Cartel*

The CCI imposed a penalty of 9% of the average turnover on three aluminium phosphide manufacturers for the period of 2008-2009 to 2010-2011. The CCI did not provide any reasoning for the quantum of penalty imposed. However, the COMPAT on appeal, while upholding the order of the CCI in substance, reduced the penalty imposed by the CCI on the cartel participants. The COMPAT specifically held that the reference to 'turnover' in Section 27(b) of the Competition Act "*...would have to be relevant turnover.*"[55] While this point of law is now pending in appeal before the Supreme Court of India, the CCI continues to impose penalty, based on the entire turnover of the enterprise, irrespective of whether it is generated through an unrelated line of business.

3. *LPG Cartel*

The CCI observed that *"[c]onsidering the totality of facts and circumstances of the present case and the seriousness of the contravention ... a penalty on each contravening company at the rate of 7% of the average turnover of the company"i.e.*, on all 48 LPG manufacturers for the period 2008-2009 to 2010-2011, was justified. Specifically, in the case of Hyderabad Cylinders Ltd., the CCI imposed a penalty of 2.1 times its net profit for the period 2006-2007 to 2009-2010, as turnover details were not available.

4. *Shoe Makers Cartel*

Similarly, the CCI observed that *"[c]onsidering the totality of facts and circumstances of the present case and the seriousness of contravention ... a penalty on each contravening company at the rate of 5% of the average turnover of the company," i.e.*, for the period 2008-2009 to 2010-2011 on each of the eleven shoe makers, was justified.

It is clear that the CCI, like most other foreign competition law authorities, believes in heavily penalising cartel participants. However, to date the CCI has not framed any guidelines which might provide clarity on the manner in which the quantum of penalty imposed is determined. It would be interesting to see whether the observation by the COMPAT that reference to 'turnover' in Section 27(b) of the Competition Act would have to be 'relevant turnover,' is upheld by the Hon'ble Supreme Court of India, as this would provide some much needed guidance on the parameters for imposition of penalty.

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[55] Excel Crop Care v. Competition Commission of India , Appeal No. 27 of 2012 (COMPAT).

Conclusion

The CCI has been a proactive regulator with a significant focus on competition advocacy programs designed to spread awareness about the fundamentals of competition law and the benefits of a truly competitive market. In the six years since the Competition Act was brought into effect, the CCI has investigated enterprises engaged in *inter alia* the cement sector, pharmaceutical sector, steel sector, real estate sector, shoe manufacturing sector, LPG cylinders sector, and tyre sector. The CCI has also initiated various competition advocacy programs with a specific focus on cartelisation. The CCI's leniency program is being actively publicised in order to encourage cartel members to turn informants and discourage participation in cartel activities. It is believed that increased public awareness will encourage whistle blowers to report instances of cartelisation and other anti-competitive practices, thereby making the CCI's task of ensuring a competitive market easier.

Given that certainty is the key to an effective leniency regime, it would significantly enhance the success of CCI's leniency program if the uncertainty stemming from CCI's discretion in determining the quantum of immunity granted in leniency applications is done away with. A move guaranteeing absolute immunity *i.e.*, 100% immunity from penalty to the first leniency applicant, as opposed to "up to" 100% immunity, will determine the extent to which India's leniency regime will be successful.

The past six years of enforcement have also clearly demonstrated the urgent need for the CCI to formulate penalty guidelines. The CCI has informally indicated that a competition compliance program could act as a mitigating factor in favour of the enterprise being investigated. However, there is a need for more guidance on the factors (mitigating and aggravating) which influence the CCI in its determination of the extent of penalty *i.e.*, up to 10% of turnover or up to three times the profit, to be levied on an enterprise for every year of continuance of the cartel.

Given the increased seriousness with which both the government and the industry are viewing the scope and need for effective competition regulation in India, it is clear that the CCI will continue to have full support of both, in its use of deterrence and public awareness to combat the distorting effects of cartels on markets in India.

There is definitely a long way to go before the CCI reaches the same level of sophistication as the EC in terms of conducting dawn raids and addressing confidentiality concerns. However, the former has progressed tremendously in the short span of its existence, and it is clear that the CCI is likely to follow in the footsteps of the EC in continuing its war against cartelisation.

Commercial Litigation or Litigation Commercial: Specialised Commercial Courts in India

*Justice V. Ramasubramanian**

*The Indian judiciary is plagued with heavy work load and inadequate number of judges. Consequently, several committees have been created with the objective of examining the problems of delay and arrears in the disposal of cases. It is in this context that the subject matter of specialised commercial courts in India, as propounded in the Law Commission of India's 188*th *Report titled* "Proposals for Constitution of Hi-Tech Fast Track Commercial Divisions in High Courts," *is examined in this paper. The Commercial Courts, Commercial Division, and Commercial Appellate Division of High Courts Bill, 2015, which seeks to set up commercial divisions and commercial appellate divisions of High Courts was recently introduced in Parliament, after having been in flux for twelve years. The article conducts a critical examination of this Bill, primarily in the context of commercial court structures prevalent in the United States, United Kingdom, and Singapore.***

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** Abstract supplied by the Editorial Board.

Introduction

When the great historian Charles A. Beard was asked if he could summarise the lessons of history, he said he could do it with four simple observations: (*i*) whom the gods would destroy, they first make mad with power, (*ii*) the mills of the gods grind slowly, but they grind exceedingly fine, (*iii*) the bee fertilises the flower it robs, and (*iv*) when it is dark enough, you can see the stars.

A close look at the history of mankind shows that at different points of time, different things assumed power. What was once possible by the power of the sword later became possible with the power of the pen. After the fall of monarchies and the rise of democratic systems, a shift took place making the power of the ballot replace the power of the sword. But today, the power of currency has displaced everything else. The economic power, more than the military power, of a country, today decides the position of a country and its system. As a result, countries place importance more on economic empowerment than on anything else today. This is fortified by the fact that at the behest of several nations, the World Trade Organisation was formed in 1995 to protect the commercial interests of all nations.

Like individuals, nations seek prosperity. The prosperity of a nation is measured by several indices such as Gross Domestic Product, Human Development Index *inter alia*. These indicators depend upon the strength of the nation's economy, which in turn depends upon its ability to produce, to trade, to consume, and to market. This ability is directly dependent upon the efficacy of the system of administration of justice. Just as there can be no trade and commerce without disputes, there can be no contract without breach, and there can be no dispute without resolution. Therefore, the strength of the economy of a country is directly proportionate to the strength of its judicial system.

After adopting a socialistic pattern of economy in the first four decades after independence, the Indian economy was liberalised in 1991. The period of transition was critical and our problems were compounded by various factors that are peculiar to India.

In their paper *Law and Finance in Transition Economies,*[1] the authors contend that the most fundamental problems faced with respect to corporate governance in the transition from central planning to market econ-

[1] Katharina Pistor, Martin Raiser, and Stanislaw Gelfer, *Law and Finance in Transition Economies*, 8 Economics of Transition, 325-368 (2000), available at http://dx.doi.org/10.2139/ssrn.214648.

omy is that of external finance. In the central economy, the State managed most of the assets. Enterprises did not have to worry about raising external finance. As the role of the State reduces from being a direct co-ordinator of economic activities to that of an impartial arbiter,[2] the lack of external finance becomes a serious constraint on the enterprises after the transition.[3] Therefore, dealing with the issue of external finance is the crux of solving the puzzle of corporate governance problems. The State will have to ensure that the private rights will be recognised, enforced, and not be crippled by state intervention, in order to ensure a free flow of productive and efficient external private finance. This not only requires an extensive change in the statutory and administrative regime, but also a sea change in the way the institutions concerned with administration of justice function. The assessment of the legal environment in transition shows that the quality of law enforcement is at least as important as (if not more than) the extensiveness of the law.[4]

Unfortunately, our country has gained a bad reputation – albeit neither wholly justified nor unjustified – of being a jurisdiction where contracts can rarely be enforced through courts within a reasonable time frame. According to the World Bank,[5] contract enforcement in India takes 1420 days (viz. 150 days taken in Singapore, ranked as the most efficient country), costs 39.6% of the value of the claim (viz. 9% in Iceland) and requires 46 procedures (viz. 21 in Singapore).[6] Globally, India ranks 186th among 189 economies in terms of ease of enforcing contracts.[7]

I. Historical Background to the Woes of the Judiciary

The workload that every officer of the Indian judiciary carries on his shoulders is phenomenal. In a statistical analysis carried out recently, it was found that despite India having a total population of about 127 crore, the total sanctioned strength of judges in the Supreme Court, all the High Courts, and the Subordinate courts put together is only about 20,533. Even if the

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2 *Ibid*, at 15.

3 G. Calvo and F. Coricelli. *Stagflationary Effects of Stabilisation Programmes in Reforming Socialist Economies: Enterprise-side versus Household-side Factors*, 6(1) World Development Review 71-90 (1992).

4 *Supra* note 2, at 3; *see* European Bank for Reconstruction and Development, *Transition Report 1998: Financial Sector in Transition*, EBRD Ann. Rep. (1998) available at http://www.ebrd.com/downloads/research/transition/TR98.pdf.

5 World Bank, *Doing Business 2015: Going Beyond Efficiency*, DOI: 10.1596/978-1-4648-0351-2 (2014).

6 *Ibid*, at 104.

7 *Supra* note 5.

working strength of judges in all courts in India is equal to the sanctioned strength (*i.e.* without leaving any vacancy) the judge-population ratio would be 1:61,865. But today, the working strength of judges in all the 24 High Courts put together is only about 630 as against the sanctioned strength of 984. Thus, one-third of the number of posts in the High Courts is lying vacant. In so far as the subordinate judiciary is concerned, the working strength as on December 31, 2014 was 15,115 as against the sanctioned strength of 19,518. Thus, nearly 25% of the posts are lying vacant in the subordinate judiciary. If the judge-population ratio is worked out on the basis of the average working strength of judges, it will be somewhere near 1:80,000.

Yet, it is not as though the courts have crumbled because of such a heavy workload. A look at the inflow-outflow ratio of cases would show that the current strength of the judiciary is sufficient to man the inflow. In fact, it is actually the accumulated arrears that has made things extremely difficult. An analysis of the data relating to the institution of cases in High Courts every year, the arrears brought forward from the previous year, and the disposals made during the year, reveals that the disposals very closely match the institution.

Unfortunately, the Indian judiciary carries the legacy of the British Raj, and even the Englishmen were unable to tackle the problem of arrears. Numerous committees were constituted for over a hundred years to tackle the problem of arrears, but social conditions have made the implementation of any ideal solution impossible.

The first committee to examine the problem of delay was set up in 1924 under Justice Rankin. Since then, several Committees have put forth recommendations but little progress has been made on the implementation front. These include the Justice S.R. Das High Court Arrears Committee (1949), the Trevor Harris Committee in West Bengal (1949), the Wanchoo Committee in Uttar Pradesh (1950), Justice J.C. Shah Committee (1972), Satish Chandra Committee (1986) and the first Malimath Committee (1990). In addition, the Law Commission of India has addressed this issue in several reports since 1955 – namely the 14th, 79th, 80th, 120th, 121st and 124th reports. More recently, other reports on this issue such as the 221st, 222nd and 229threports, have touched upon the issues of delay, pendency, and arrears.

Though several steps were taken to improve the overall performance of the judiciary in terms of clearance of backlog and speedy disposal of cases, particular focus was placed by the 17th Law Commission on commercial litigation of high value, pending particularly in High Courts exercising Ordinary Original Civil Jurisdiction.

The 17th Law Commission of India *suo moto* took up the issue of speedy disposal of high value cases so as to provide assurance to the investors in view of the transition of the Indian economy in 1991. The Law Commission, in its 188th Report titled "*Proposals for Constitution of Hi-tech Fast Track Commercial Divisions in High Courts*" submitted in 2003, recommended the setting up of Commercial Divisions in the High Courts. This Bill was considered and accepted in the Conference of Chief Ministers of the States and Chief Justices of the High Courts in 2009. After it was passed in the Lok Sabha, the Bill was referred to the Select Committee on the Commercial Division of High Courts Bill, 2009 by the Rajya Sabha. As more time was sought for incorporating the amendments suggested by the Select Committee of the Rajya Sabha, the Bill was referred to the 20th Law Commission of India.

The 20th Law Commission collected data from several courts, to enable it to comprehend the magnitude of the problem before making any suggestions. The statistics collected from the Madras High Court presented a dismal picture, as can be seen from the following:

1. Status of pendency of main Cases (all types) as on 01.01.2014

Sr. No.	Case Type	Less than 2 years	2 – 5 years	5 – 10 years	More than 10 years	Total
1	Civil Suits	1536	1451	2196	1143	6326
2	Company Petitions	360	128	194	63	745
3.	Original Petitions	1233	712	468	166	2579

2. Details of Cases involved in Commercial Disputes Pending as on 01.01.2014

Sr. No.	Case Type	Less than 2 years	2 – 5 years	5 – 10 years	More than 10 years	Total
1	CS	1325	1250	2190	1100	5865
2	Arbitration OP	572	354	176	60	1162
3	CP	360	128	194	63	745

3. Value of Pending Commercial Disputes Cases

Less than Rs 1 crore	Rs 1 crore – Rs 2 crore	Rs 2 crore – Rs 5 crore	More than Rs 5 crore
6020	463	274	221

After a critical analysis of the data collected from various courts, the Law Commission submitted its 253rd Report titled "*Commercial Division and Commercial Appellate Division of High Courts and Commercial Courts Bill, 2015*." It is seen from newspaper reports that appeared on April 22, 2015 that the Government has approved the bill to set up commercial benches in select High Courts to deal with high value business disputes. Accordingly, the 2015 Bill was introduced in the Rajya Sabha on April 29, 2015.

The Bill seeks to set up commercial divisions in High Courts such as Delhi, Bombay, Calcutta, Madras and Himachal Pradesh, which already exercise ordinary original civil jurisdiction. The Bill has travelled far from the stage of its incubation, and it has travelled back and forth for the past twelve years. Hence, it maybe useful to take note of similar legislative attempts in other jurisdictions before taking a critical look at the Bill.

II. Specialised Commercial Courts in Other Jurisdictions

A. United Kingdom

The history of the establishment of Commercial Courts in England can be traced to the late nineteenth century. In response to the criticism recorded by Sir Sidney Water low in the Report of the Judicature Commission in 1874 about the delay in judicial administration affecting the confidence of the traders, the Judges of the Queen's Bench Division resolved to set up a "*Commercial List*" in 1895. The first "*commercial cause*" was argued before Mr. Justice Mathew as the Commercial Judge in March 1895 concerning the claim of an account by Flemish cloth manufacturers against their London agent.[8] The Commercial Court in the United Kingdom which was designated by a resolution of the judges in 1895 still continues to be a part of the Queen's Bench Division in the High Court.[9] However, it was statutorily recognised as a division of the High Court in 1970 by the Administration of Justice Act, 1970 (replaced by Administration of Justice Act, 1981). This Court was called the Commercial Court (England and Wales) and was given legislative backing under Sections 6(1)(b) and 62(3) of the Senior Courts Act, 1981. Schedule I of the said Act lists the matters of business of Chancery and Queen's Bench Divisions. The Commercial Court deals with complex

[8] V. Veeder, *Mr. Justice Lawrence: The "True Begetter" of the English Commercial Court*, 110 Law Quarterly Review 292 (1994).

[9] K. Malleson and R. Moules, The Legal System (4th edn, 2010).

cases arising out of national and international business disputes, particularly international trade, banking, commodity trade, and arbitration disputes.[10]

Although the commercial court in the United Kingdom has many competitors overseas, a research survey has shown that in 80% of cases in the Commercial Court, one of the parties carried on business outside its jurisdiction, and in 52% of cases, both parties did.[11] Thus, a great many of the disputes handled by the Commercial Court in England involve overseas parties, who have chosen the Commercial Court in London as their forum.[12] More than 60% of litigants in English commercial courts now come from overseas, according to a study by communication agency Portland.[13]

The other Commercial Courts in England under the Queen's Bench Division are (*i*) the Admiralty Court dealing with shipping and maritime disputes, such as collision, salvage, carriage of cargo, limitation, mortgage disputes,[14] (*ii*) the Mercantile Court dealing with business disputes, national and international, of lesser value,[15] and (*iii*) the Technology and Construction Court dealing primarily with engineering disputes, claims relating to design, supply and installation of computers, computer software and related network systems.[16] Other Commercial Courts in England under the Chancery Division are (*i*) the Bankruptcy and Companies Court dealing with cases under the Insolvency Act, 1986, the Company Directors Disqualification Act, 1986, the Companies Act, 1985, and the Financial Services and Markets Act, 2000,[17] (*ii*) the Patents Court,[18] and (*iii*) Intellectual Property Enterprise Court.[19]

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[10] Roger E. Meiners, Al H. Ringleb and Frances L. Edwards, The Legal Environment of Business 37 (11th edn, 2015).

[11] The Stationery Office, Review of Civil Litigation Costs: Final Report (2009) (UK).

[12] *Ibid.*

[13] IdilOyman, *Who Uses the Commercial Courts,* Portland Communications (2014), http://www.portland-communications.com/wp-content/uploads/2014/05/Portland_Who_Uses_the_Commercial_Court.pdf.

[14] Admiralty, Commercial and London Mercantile Courts, H.M Courts & Tribunals Service, http://www.justice.gov.uk/courts/rcj-rolls-building/admiralty-commercial-mercantile-courts (Last visited Jul. 1, 2015).

[15] Mercantile Court, H.M Courts & Tribunals Service, http://www.justice.gov.uk/courts/rcj-rolls-building/mercantile-court (Last visited Jul. 1, 2015).

[16] Technology and Construction Court, H.M Courts & Tribunals Service, https://www.justice.gov.uk/courts/rcj-rolls-building/technology-and-construction-court (Last visited Jul. 1, 2015).

[17] Bankruptcy and Company Court, H.M Courts & Tribunals Service,https://www.justice.gov.uk/courts/rcj-rolls-building/bankruptcy-and-companies-court (Last visited Jul. 1, 2015).

[18] Patents Court, H.M Courts & Tribunals Service,https://www.justice.gov.uk/courts/rcj-rolls-building/patents-court (Last visited Jul. 1, 2015).

[19] IntellectualProperty Enterprise Court, H.M Courts & Tribunals Service,https://www.justice.gov.uk/courts/rcj-rolls-building/intellectual-property-enterprise-court (Last visited

The efficient functioning of the Commercial Courts in England is demonstrated by the fact that Dubai and Qatar set up commercial courts that are modeled on the same lines as the Commercial Courts in England, which have former appellate judges of England on the benches. In fact, the enhancement of court fees by the English Commercial Courts has resulted in loss of business to other courts, although preference for English law prevails in international contracts. In March 2015, the court announced a 576% hike in court fees (making the arbitration regime lucrative and the arbitration lobby happier).[20]

B. United States

The Commercial Division of the Supreme Court of the State of New York was established pursuant to an administrative decision of the Chief Justice of the Supreme Court of the State of New York, in November 1995, at Monroe County (Rochester) and in New York County.[21]

In 1993, four Commercial Courts were established on an experimental basis under the management of the then Administrative Judge Stanley S. Ostrau.[22] The Commercial Courts Task Force then proposed the expansion of the Commercial Division and suggested recommendations for case management, technology, and other issues to promote the efficient resolution of commercial cases.[23] The Commercial Division is strictly a commercial court that presides over all types of business disputes ranging from breach of contract, business torts, partnership disputes, and unfair competition claims to corporate governance issues, commercial insurance coverage disputes, shareholder derivative actions, commercial financing disputes, and so on.[24] The efficient functioning and the success of the Court is evidenced by the reduction in the number of days taken from filing to disposition of breach of contract cases from 648 days in 1992 to 412 days in 1998. By 2006, 80% of contract cases in the Commercial Division were resolved in 340 days or

Jul. 1, 2015).

[20] Parish Matthew, *London's Commercial Court sinks under its own weight*, Global Arbitration Review (Feb. 6, 2015), available at https://www.linkedin.com/pulse/londons-commercial-court-sinks-under-its-own-weight-matthew-parish?trk=seokp_posts_primary_cluster_res_title.

[21] Commercial Division – NY Supreme Court, New York State Unified Court System, available at http://www.nycourts.gov/courts/comdiv/ (Last visited Jul. 1, 2015).

[22] History – Commercial Division – NY Supreme Court, New York State Unified Court System, available at https://www.nycourts.gov/courts/comdiv/history.shtml (Last visited Jul. 1, 2015).

[23] *Ibid*.

[24] *The Court That's All Business*, 25 (Smith, Gambrell & Russell LLP, Winter 2009/2010), http://www.sgrlaw.com/resources/trust_the_leaders/leaders_issues/ttl25/1416/.

less, and the ADR program continues to result in settlement for a majority of cases referred to the program.[25]

The New York courts have adopted new age technology to improve the efficiency of their courts with the help of case management software and electronic filing of court documents. Owing to the success of the Filing by Electronic Means (FBEM)[26] pilot program launched in 1999 to test the efficacy of electronic filing in cases (where the parties had agreed to the same), the Chief Administrative judge issued an order expanding electronic filing through the New York State Courts Electronic Filing (NYSCEF) system. Thus, e-filing became mandatory in all Commercial Division cases initiated on and after February 2013.[27]

Presently, there are 28 Commercial Division justices state-wide and the Commercial Division spans ten different jurisdictions namely, Albany, Kings, Nassau, New York, Onondaga, Queens, Suffolk and Westchester Counties as well as the entire Seventh and Eighth Judicial Districts.[28]

C. Singapore

The establishment of the Singapore International Commercial Court (SICC) was in pursuance of a proposal by way of the report of the Singapore International Commercial Court (SICC)[29] Committee released on November 2013. This suggested framework was adopted by way of Parliamentary amendments to the Singapore Supreme Court of Judicature Act (Chapter 332), the Legal Profession Act (Chapter 161) and the Singapore Rules of Court. The SICC was formally established on January 5, 2015 with the aim of boosting Singapore as a leading forum for dispute resolution in Asia. The SICC is to be a part of the Supreme Court of Singapore[30] and has been constituted as "*a statutory division of the High Court under the Supreme Court of Judicature Act (SCJA)*."[31] Thus, the SICC resembles the Qatar International

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25 *Ibid*.

26 Jonathan Lippman C.A.J., *Report on the Unified Court System's Filing By Electronic Means Pilot Program 1999-2004*', New York Unified Courts System 5 (Jun. 6, 2005), https://www.nycourts.gov/reports/FBEM.pdf.

27 Clara Flebus, *Electronic Filing: A Paperless Future in New York State Courts*, 8(26) New York County Lawyer (Dec. 2014).

28 *Supra* note 21.

29 Report of the Singapore International Commercial Court Committee (Ministry of Law, Nov. 2013) (Singapore), available at http://www.sicc.gov.sg/documents/docs/Annex%20A%20-%20SICC%20Committee%20Report.pdf.

30 *Ibid*, at 17.

31 *Ibid*, at 15.

Court and Dispute Resolution Centre and the Dubai International Financial Centre Courts in some respects.[32]

The SICC has jurisdiction to try an action or claim that is: (*a*) international and commercial in nature, and (*b*) one that the High Court may hear and try in its original civil jurisdiction.[33]

There has been a shift in preference from London to Singapore among Indian companies, who have filed as many as 49 cases in the Singapore International Arbitration Center in 2012 – double the number since 2009.[34] In fact, India is just behind China (52 cases) and above Indonesia (28 cases). The other specialised commercial courts in Singapore are the Admiralty Court, Intellectual Property Court, and Arbitration Court.

III. The 2015 Bill: A Critical Analysis

Keeping in mind the developments that have taken place in England, United States, and Singapore, let us now have a look at the present Bill.

A review of the preamble and the objects of the Bill would show that it seeks to provide (*a*) for the constitution of Commercial Divisions and Commercial Appellate Divisions in the High Courts, and (*b*) for the creation of Commercial Courts in other parts of the country. However, only those commercial disputes which are of high value are sought to be brought within the purview of these Divisions and Courts.

The Bill provides for a very comprehensive definition of the expression "*commercial dispute*" in Section 2(1)(a), to include all kinds of commercial transactions, maritime matters, joint venture agreements, construction contracts, shareholders agreement, partnership disputes, disputes relating to intellectual properties, insurance, and technology development agreements *inter alia*. By virtue of two explanations incorporated under Section 2(1)(a), disputes that relate to the recovery of immovable property, and disputes to

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32 Beth Cubitt, Ian Roberts, Rupert Coldwell and Yicheng Chen, *Recent legislative bills passed paving the way for the Singapore International Commercial Court* (Clyde & Co., Nov. 27, 2014), http://www.clydeco.com/insight/updates/view/recent-legislative-bills-passed-paving-the-way-for-the-singapore-internatio.

33 *New Singapore International Commercial Court* (Gard A.S., Jan. 16, 2015), http://www.gard.no/ikbViewer/web/updates/content/20810563/new-singapore-international-commercial-court.

34 *Singapore's Planned International Commercial Court to Take Business Away from London and Hong Kong,* South China Morning Post (Feb. 12, 2014), http://www.scmp.com/business/companies/article/1426528/singapores-planned-international-commercial-court-take-legal.

which the State or an instrumentality of the State is a party are also brought within the definition, if they are fundamentally commercial disputes.

Section 3 of the Bill empowers the Central Government (*a*) to constitute a Commercial Division in every High Court having ordinary original civil jurisdiction, and (*b*) to constitute a Commercial Court, in places where the High Court does not have ordinary original civil jurisdiction. Section 3 also empowers the States and the Union Territories to create Commercial Courts in areas over which the High Court does not exercise ordinary original civil jurisdiction.

Section 4 empowers the Chief Justice of the High Court to nominate judges to the Commercial as well as Commercial Appellate Division, for a period of two years, while Section 5 prescribes the procedure for appointment of Judges of Commercial Courts (not to be confused with the Commercial and Commercial Appellate Division of the High Courts). The latter provision makes the High Court itself the appointing authority.

The jurisdiction of the Commercial Divisions of High Courts, the jurisdiction of the Commercial Courts, and the jurisdiction of the Commercial Appellate Divisions of the High Courts are defined in Sections 6 to 8 of the Bill. Further, Section 9 imposes a bar against the filing of any revision against any interlocutory order of a Commercial Court, including an order relating to the question of its jurisdiction.

Section 10 provides for the transfer of any suit to the Commercial Division or Commercial Court, even if the subject matter of the suit does not fall within the definition of the expression "*commercial disputes*" provided that the counter claim relates to a commercial dispute of a specified value. Section 11 is devoted entirely to the question of jurisdiction in respect of arbitration matters.

Interestingly, Section 12 bars the Commercial Division or the Commercial Court from entertaining any suit, application, or other proceeding relating to a commercial dispute, if the jurisdiction of the civil court is expressly or impliedly barred under any other law, in respect of such dispute.

Section 13 provides the definition of the expression "*specified value*" and the procedure for determination of the same. Sections 14 and 15 provide for appeals from orders of Commercial Divisions and Commercial Courts.

Section 16 goes a step further by providing that any appeal or writ petition filed in a High Court against the orders of certain Tribunals, such as (*i*) Competition Appellate Tribunal, (*ii*) Debts Recovery Appellate Tribunal,

(*iii*) Intellectual Property Appellate Board, (*iv*) Company Law Board or National Company Law Tribunal, (*v*) Securities Appellate Tribunal, and (*vi*) Telecom Disputes Settlement and Appellate Tribunal, shall be heard and disposed of only by a Commercial Appellate Division, if the subject matter of the appeal or writ petition relates to a commercial dispute.

Section 18 lists out, with reference to the Schedule to the Act, the provisions of the Code of Civil Procedure that would stand amended in cases heard by these specialised courts. Section 19 provides for transfer of pending cases. Section 20 mandates the provision of infrastructural facilities and Section 21 mandates training and continuous education for judges.

A very innovative provision is incorporated in Section 22 to provide for the uploading of statistical data relating to the suits, applications, and appeals filed before these Courts, the status of each one of them, and other information on the website of the High Court every month. The Act is also given an overriding effect in respect of other enactments, under Section 24.

Though the Act appears to be novel and comprehensive, there are some shortcomings:

First, though the Bill mandates an increase in the number of judges of the High Courts, it provides only for the nomination of existing judges to the Commercial Divisions and the Commercial Appellate Divisions. Therefore, it is not known as to how effective such a creation would be, especially considering that one-third of the posts in the High Courts are presently lying vacant.

Second, in so far as the provision for the creation of an independent Commercial Court is concerned, it is not known as to how the provisions contained in the Bill could be harmoniously construed with Article 233 and 234 of the Constitution of India. Article 233 vests the power of appointment of District Judges in any State, with the Governor of the State, to be made in consultation with the High Court of the State. Similarly, Article 234 vests with the Governor of the State the power of appointment of Subordinate Judges (other than District Judges) in accordance with the Rules made by him, after consultation with the State Public Service Commission and with the High Court concerned. Therefore, Commercial Courts at the level of District Judges and Subordinate Judges cannot be created except with the concurrence of the State Governments and the creation of a separate cadre and sanction of posts by the State Government.

Third, under Article 217(2)(a) of the Constitution, a person shall not be qualified for appointment as a Judge of a High Court unless he is a citizen

of India and has for at least ten years held a judicial office in the territory of India. In *Kumar Padma Prasad v. Union of India*[35], the Supreme Court interpreted the expression "*judicial office*" to mean judicial office as defined in Article 236(b). Article 236(a) defines the expression "*district judge*" to include Judge of a City Civil Court, Additional District Judge, Joint District Judge, Assistant District Judge, Chief Judge of a Court of Small Causes, Chief Residency Magistrate, Additional Chief Residency Magistrate, Sessions Judge, Additional Sessions Judge, and Assistant Sessions Judge. Article 236(b) defines the expression "*judicial service*" to mean a service consisting exclusively of persons intended to fill the post of District Judge and other civil judicial posts inferior to the post of District Judge. Therefore, it is not known whether the posts occupied by judges appointed to man these Commercial Courts (other than in the High Courts) would fall within the definition of the expression "*judicial office*" in Article 217(2)(a).

Fourth, the above question assumes significance in the light of the judgment of the Supreme Court in *S.D. Joshi v. High Court of Bombay*[36], where the Supreme Court was concerned with the question of whether the Family Court Judges are eligible and entitled to be considered for elevation as Judges of the High Court in terms of Article 217 of the Constitution or not. The Court finally held that the Principal and other Judges of the Family Court may be Judges presiding over such courts in the generic sense, but *stricto sensu* they are not members or an integral part of the judicial service of the State of Maharashtra as defined in Article 236, and hence, they do not hold a judicial office as contemplated under Article 217 of the Constitution. Therefore, this is one area which has not been addressed by the Bill.

Fifth, Section 16 of the Bill mandates that an appeal or a writ petition filed in a High Court against the orders of certain Tribunals, such as the Competition Appellate Tribunal, Debt Recovery Appellate Tribunal, Intellectual Property Appellate Board, Company Law Board or National Company Law Tribunal, Securities Appellate Tribunal, and Telecom Disputes Settlement and Appellate Tribunal shall be heard and disposed of by the Commercial Appellate Division of such High Court, if the subject matter of such appeal or writ petition relates to a commercial dispute. However, it is not clear whether Section 16 would apply notwithstanding anything contained in the respective enactments under which the tribunals indicated in Section 16 are constituted. Take for instance, the Competition Appellate Tribunal constituted under the Competition Act, 2002. Any order of the Competition Appellate Tribunal can be challenged only before the

[35] Kumar Padma Prasad v. Union of India, (1992) 2 SCC 428.

[36] S.D. Joshi v. High Court of Bombay, (2011) 1 SCC 252.

Supreme Court under Section 53-T of the Competition Act, 2002. Despite the decision of the Constitution Bench of the Supreme Court in *L. Chandra Kumar*[37], today the question remains at large as to whether the Tribunals, whose orders are appealable only to the Supreme Court, are also amenable to the jurisdiction of the High Court. Some of the Acts under which the Tribunals indicated in Section 16 of the Bill are constituted, contain two type of provisions: (*a*) a provision relating to the overriding effect of the Act, and (*b*) a provision barring the application of other laws. This is an area which does not appear to have been addressed in the Bill in question.

Finally, the very question as to whether a case filed in the Commercial Division of the High Court or the Commercial Court relates to a commercial dispute or not is likely to be fought by cantankerous litigants and consenting lawyers. This is due to the fact that though the definition of the expression "*commercial dispute*" is very exhaustive, it is impossible to bring everything within the written code. Take for instance a petition for oppression and mismanagement, filed under Sections 397 and 398 of the Companies Act, 1956 before the Company Law Board in relation to a closely held family company. All issues arising for such consideration in such a petition need not necessarily be commercial disputes, even if they are of high value. The role of the Company Court or for that matter, the role of the National Company Law Tribunal is well defined in such cases, since they are not concerned about the commercial or non-commercial nature of such disputes.

Conclusion

I am conscious of the difficulties that the draftsmen face while drafting legislation. As part of the Rules Committee of the High Court, I have realised the difficulties of drafting legislation (including subordinate legislation). Therefore, the shortcomings that I have pointed out herein are not aimed at belittling the efforts of the lawmakers, but only to highlight that these problems may have to be addressed before it takes final shape.

[37] L. Chandra Kumar v. Union of India, (1997) 3 SCC 261 : AIR 1997 SC 1125.

The Depository Receipts Scheme, 2014: Lessons in Policy Implementation

Pratik Datta[*]

Contemporary financial policy making in India is undergoing a sea-change. Hitherto opaque processes are becoming more transparent. More lawyers are involved at the policy formulation stage and in converting them into precise legal drafts. This article illustrates the various factors affecting contemporary financial policy making in India and its implementation, in light of the experience from the recent depository receipt reforms. It analyses the political economy that shaped the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, and argues that the skewed sectoral preference evident therein was not based on sound economic and regulatory policies. Finally, it concludes that the conceptualisation of the policy behind the Depository Receipts Scheme, 2014 through an expert committee has been extremely transparent and progressive. However, a major challenge in the co-ordination of a multi-pronged implementation strategy remains in the form of a diffused governmental and regulatory set-up, which creates obstacles in the implementation of policies.

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Introduction

Capital markets across jurisdictions are segmented from each other by various barriers like capital controls, legal restrictions, information costs, and transaction costs. Finance literature shows that there is much to be gained by overcoming these barriers.[1] The depository receipt is a time-tested tool to overcome these barriers and integrate capital markets internationally.

Originally developed to raise equity funding off-shore, a depository receipt is a security issued in a foreign jurisdiction on the back of domestic securities in the home jurisdiction. Domestic securities are deposited with a domestic custodian on-shore and depository receipts are issued off-shore by a depository bank against such deposited domestic securities. Being foreign securities, depository receipts are traded and settled in the foreign jurisdiction like any other security in that jurisdiction.[2] At the same time, they are but mirror-images of the domestic securities deposited with the domestic custodian. Foreign investors can invest in depository receipts like any other security in their home jurisdiction, while simultaneously reaping the benefit of investing in a security outside their home jurisdiction. Domestic entrepreneurs can use depository receipts to tap these foreign investors and markets.

India's tryst with depository receipts can be traced back to the balance of payments crisis in 1991 and the consequent gradual liberalisation of the capital account.[3] The depository receipt mechanism was one of the earliest areas of post-liberalisation reform.[4] The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 ("1993 Scheme") focused on off-shore listings – it allowed Indian firms to issue depository receipts off-shore against their domestic

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[1] The price of stocks of a domestic listed firm may get enhanced if it cross-lists in a completely segmented foreign capital market. *See* R.C. Stapleton & M.G. Subrahmanyam, *Market Imperfections, Capital Market Equilibrium and Corporation Finance*, 32(2) Journal of Finance (1977); the expected return of a pure domestic security with a dual listing may be greater than the expected return of the same security without a dual listing. *See* Cheol S. Eun Gordon, J. Alexander, and S. Janakiramanan, *Asset Pricing and Dual Listing on Foreign Capital Markets: A Note*, 42(1) Journal of Finance (1987).

[2] The Supreme Court has recently held that such depository receipts are "*securities*" as defined under Section 2(h) of Securities Contracts (Regulation) Act, 1956. Therefore, the Securities and Exchange Board of India has adequate powers under the Securities and Exchange Board of India Act, 1992 to investigate and pass orders in suspected cases of market abuse. See *SEBI v. Pan Asia Advisors Ltd.*, 2015 SCC OnLine SC 626.

[3] For a detailed account, *see* Sumit Ganguly & Rahul Mukherji, India since 1980 (2011).

[4] *See* Report of the Committee to Review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 (Ministry of Finance, 2013) [hereinafter "Sahoo Committee Report"].

equity shares on-shore.[5] The recent reforms in off-shore depository receipts, leading up to the Depository Receipts Scheme, 2014 ("2014 Scheme"), go beyond equity underlying, thereby greatly expanding the scope and utility of these instruments.[6] From a wider perspective, these ongoing reforms are crucial because they throw light on the financial policy-making process in India and the hardships faced in a multi-pronged policy implementation strategy. The purpose of this article is to analyse these reforms and understand the hurdles faced, at an institutional level, in the implementation of new policies in the Indian financial sector.

Part I of this article examines the political economy that shaped the 1993 Scheme from its inception and across the two decades of its existence. It argues that the skewed sectoral preference evident in the 1993 Scheme was not based on sound economic and regulatory policies. This was a major shortcoming in the scheme, which led to its review and ultimately, the notification of the 2014 Scheme. Part II explains the committee process followed by the Indian government to review the policy framework on off-shore depository receipts and the philosophy that guided these reforms. Part III analyses the 2014 Scheme from this new perspective along with the implementation challenges ahead. The article concludes that the conceptualisation of the policy behind the 2014 Scheme through an expert committee has been extremely transparent and progressive. However, policy implementation in India remains diffused across various government departments and regulators, which renders the coordination of a multi-pronged implementation strategy difficult and time-consuming.

I. The 1993 Scheme

It is no coincidence that the 1993 Scheme, the first post-liberalisation reform in financial law, was itself overtly biased towards equity investment into Indian companies.[7] The Indian political economy at the time preferred equity

[5] *See* Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, GSR 700(E) (Nov. 12, 1993) [hereinafter "1993 Scheme"]; although beyond the scope of this article, it may be worthwhile to note that the on-shore depository receipt reforms began in 1996 when the Finance Minister set up a working group to re-draft company law, culminating in the introduction of the Indian Depository Receipt (IDR) in Section 605A of the Companies Act, 1956 and the Companies (Issue of Indian Depository Receipts) Rules, 2004.

[6] *See* Depository Receipts Scheme, 2014 (Oct. 21, 2014).

[7] The 1993 Scheme treated investments in depository receipts on underlying Indian equity shares as Foreign Direct Investment (FDI). Such FDI could not exceed 51% of the company's issued and subscribed capital. Investment by Foreign Institutional Investors (FIIs) was excluded from this 51% cap on FDI. *See* Schedule I, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, Notification No. FEMA 20/2000-RB dated 3rd May 2000 (2000).

market reform.[8] The balance of payments crisis in 1991 led to the devaluation of the rupee coupled with substantial reduction in import controls after 1991. This gave a major boost to the export-oriented services sector, especially information technology and other knowledge-based industries.[9] In the absence of substantial collateral necessary for debt financing, firms in the services sector tend to prefer equity investment. Given the high growth potential of the Indian services sector at that time, it was easier for such firms to raise capital through equity rather than debt. Further, the international capital market was more suitable than the domestic capital market for raising such equity capital since the former was likely to have more sophisticated analysts for new sectors like information technology. Consequently, Indian technology stocks could obtain a better valuation in off-shore equity markets. Moreover, the consumer-commercial market bonding theory would suggest that Indian services sector firms catering to the outsourcing demands of developed western economies would prefer to be listed on their stock exchanges, particularly in the United States.[10]

On the other hand, the Indian manufacturing sector already had well-established firms from the socialist regime, which had the necessary collateral for debt financing, as well as the reputation required to attract equity investors. In contrast, new entrants into the manufacturing sector may have the requisite collateral for debt-financing but would never have the reputation to attract equity investments. Therefore, the crucial players in both the services and manufacturing sector in India stood to benefit from equity market reforms rather than debt market reforms.[11] Consequently, the political economy preferred equity market reforms, with a focus on off-shore listings. The 1993 Scheme was the product of these undercurrents.

This skewed sectoral preference continued to manifest in the form of amendments to the 1993 Scheme. For example, on June 23, 1998, Indian software companies were permitted to issue depository receipt-linked employee stock options. In March 2000, other knowledge-based sectors like pharmaceuticals and biotechnology were also extended similar benefits. On June 16, 2000, the benefit was extended to employees of subsidiary companies. Companies generating 80% of their turnover (for the previous three

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8 *See* Vikramaditya Khanna & Umakanth Varottil, *Developing the market for corporate bond in India*, (National Stock Exchange, Working Paper, 2012), http://www.nseindia.com/research/content/WP_6_Mar2012.pdf.

9 *See* Ganguly & Mukherji, *supra* note 3, at 91.

10 This theory has been recently propounded. *See* Nicholas C. Howson & Vikramaditya Khanna, *Reverse cross-listings – The coming race to list in emerging markets and an enhanced understanding of classical bonding*, (Nov. 19, 2014), http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1219&context=law_econ_current.

11 *See* Khanna & Varottil, *supra* note 8.

financial years) from these sectors were permitted to offer depository receipts to resident or non-resident permanent employees (including directors) of those companies and of subsidiaries incorporated in India or abroad.[12]

Although the 1993 Scheme was the first piece of financial legislation of the liberal Indian economy, it bore clear imprints of the socialist legal drafting style.[13] The scheme allowed the issue of depository receipts by way of either public issue or private placement, subject to the prior approval of the Department of Economic Affairs of the Ministry of Finance. The criteria for such approval closely resembled the philosophy behind merit-based regulation. The government would approve companies which had a track record of good performance (financial or otherwise) – a purely subjective test left to the complete discretion of the government.[14]

As stated earlier, depository receipts help overcome market segmentation by integrating the issuer's capital market with the capital market in which the depository receipts are traded. These markets are said to be perfectly integrated if the 'law of one price' holds across them. Any price differential between similar financial instruments traded in two different geographical locations leads to entry of arbitrageurs who profit out of this differential and ultimately help restore the law of one price and integrate the markets.[15] In fact, this phenomenon actually played out, once depository receipt programs on Indian equity shares were in place, motivating the amendment to the 1993 Scheme in March 2001 to allow two-way fungibility in an effort to remove the impediments to the free play of the law of one price.[16]

On July 29, 2002, Indian companies were permitted to sponsor depository receipt issues against underlying shares at a price determined by a lead manager. However, this required prior or simultaneous listing on a domestic stock exchange and the facility to offer underlying shares against which the depository receipts were to be issued *pari passu* to all categories of shareholders. Unlisted Indian companies were thus prevented from raising capital abroad.[17] Consequently, Indian stock exchanges enjoyed a *de facto* monop-

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12 *See* 1993 Scheme, *supra* note 5, at ¶ 3C.

13 Legal drafting suffers from inertia. *See generally*, Umakanth Varottil, *The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony* (Working Paper, 2015), http://law.nus.edu.sg/wps/pdfs/001_2015_Umakanth_Varottil.pdf.

14 *See* 1993 Scheme, *supra* note 5, at ¶ 3(2).

15 *See* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 Va. J. Int'l L563, 590 (1998).

16 *See* 1993 Scheme, *supra* note 5, at ¶ 7(1A).

17 This position is in stark contrast with Israel, where unlisted companies took full advantage of the opportunity to list on United States exchanges. Ultimately, with the intent of promoting dual listing on the Tel Aviv Stock Exchange (TASE), the Israeli Securities Authority (ISA) amended its securities law to exempt domestic firms already traded in the United

oly on account of the 1993 Scheme, at the cost of promoting healthy competition. Some relaxations were made to the simultaneous listing requirement on September 14, 2005, and unlisted companies were permitted to issue depository receipts, if they took verifiable and effective steps to list domestically. On October 11, 2013, unlisted companies were allowed to raise capital abroad without prior or subsequent listing for a period of two years, subject to certain conditions.[18]

On August 31, 2005, the 1993 Scheme was amended to prevent companies, which were otherwise ineligible to access Indian capital markets, from accessing the depository receipt route. Moreover, pricing norms were introduced – the issue price could not be less than the higher of (*a*) the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the six months preceding the relevant date, and (*b*) the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date. On November 27, 2008, the pricing formula was aligned with the formula applicable to Qualified Institutional Placements (QIPs).

A. Need for review

Reliance Industries was the first Indian corporation to avail the 1993 Scheme by setting up a depository receipts program in 1992.[19] Since then, over 330 Indian companies have created depository receipt programs, of which 13 are listed either on the New York Stock Exchange(NYSE) or NASDAQ stock market, 24 are listed on the London Stock Exchange (LSE), and the vast majority have approached the Luxembourg Stock Exchange or the Singapore Exchange to raise capital.[20]

Nevertheless, the volume of FDI through the depository receipt route did not increase substantially during this time, compared to the increase in the

States from the burden of reporting to the ISA in addition to the US reporting requirements. *See* Shmuel Hauser, Rita Yankilevitz, and Rami Yosef, *The effects of dual listing on share prices and liquidity in the absence of registration costs*, 4 Journal of Service Science and Management 15, 21 (2011).

[18] *See* Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Mechanism) (Amendment) Scheme, Ministry of Finance, Notification No. GSR 684(EF. No.4/13/2012-ECB) (Oct. 11, 2013).

[19] It is interesting to note that the 1993 Scheme came into effect retrospectively from April 1, 1992. *See* 1993 Scheme, *supra* note 5, at ¶ 1(2).

[20] This was the position in 2013. *See* BNY Mellon, *India: Easing Conditions for investors, Non Capital-Raising Depository Receipts for Indian Corporates are a Strategic Opportunity*, http://www.adrbnymellon.com/files/PB37020.pdf (Last visited May 23, 2015).

volume of FDI in Indian equity during 2000-2014.[21] This disparity may have resulted due to additional eligibility criteria for issuers of depository receipts over and above capital controls on foreign investment in domestic securities.[22]

Beside the economic implications, two decades of legal development in financial and corporate laws also required a relook at the 1993 Scheme.[23] For example, the Companies Act, 2013for the first time gave statutory recognition to depository receipts by defining 'global depository receipt' (GDR),[24] albeit in language different from that of the 1993 Scheme. Moreover, the same depository receipt was treated differently under two different regulatory regimes. While depository receipt holders having the right to give voting instructions have obligations under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations, 2011"), such depository receipts themselves were not calculated as part of the public shareholding under the 1993 Scheme.[25]

The policy thinking in Indian finance has also undergone a sea change in the last two decades. State intervention in financial markets is now focussed solely on addressing market failures.[26] The next section will elaborate on the influence of this approach on the recent reform in off-shore depository receipts.

II. The Reforms Process

The Indian Government set up a committee in September 2013, under the chairmanship of Mr. M.S. Sahoo, to comprehensively review the 1993 Scheme, keeping in view the 'needs of the Indian companies and foreign investors' as well as the 'need for simplification and legal clarity.'[27] The Committee consulted stakeholders including some Indian issuers, depository banks, exchanges and trading platforms, and the financial market regulators, to delineate the relevant policy issues which were subsequently debated and deliberated upon by Committee members internally. Based on

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21 *See* Sahoo Committee Report, *supra* note 4, at 17.

22 *See* 1993 Scheme, *supra* note 5, at cl. 3.

23 *See* Sahoo Committee Report, *supra* note 4, at 14-16.

24 *See* S. 2(44), Companies Act, 2013.

25 *See* Reg, 2(1)(v), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, (2011); *see also* Sahoo Committee Report, *supra* note 4, at 42.

26 *See generally*, Report of the Financial Sector Legislative Reforms Commission (Government of India, 2013) http://finmin.nic.in/fslrc/fslrc_index.asp.

27 *See* Constitution of a Committee to Review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993 (Ministry of Finance F.No.9/1/2013- ECB, Sept. 23, 2013).

these deliberations, the Committee prepared a report with its policy recommendations ("Sahoo Committee Report (Phase I)") along with a draft legal scheme, and submitted it to the Government of India. The Government accepted the recommendations, and based on the draft scheme provided by the Committee, notified the 2014 Scheme.[28]

The 2014 Scheme is a reflection of the broad economic and regulatory philosophy behind the Sahoo Committee Report (Phase I). This philosophy is well-reflected in the following passage:

> "Some markets left to themselves may fail to produce efficient allocation of resources. Such an event is referred to as 'market failure.' Regulations exist in order to address such market failures. This framework for thinking about market failures, when translated into the field of finance, induces a clear categorisation of the tasks of the government, as has been clarified by the Financial Sector Legislative Reforms Commission. (sic)"[29]

The Financial Sector Legislative Reforms Commission (FSLRC) had identified four potential areas of market failure in the field of finance: *(a)* consumer protection; *(b)* micro-prudential regulation; *(c)* systemic risk; and,*(d)* resolution.[30] After discussing these four areas in the context of depository receipts, the Sahoo Committee Report (Phase I) concluded:

> "DRs [(depository receipts)] are foreign securities. They are purchased and traded by foreign investors in a foreign jurisdiction. When underlying Indian securities are bundled into DRs or the DRs are cancelled and converted into the underlying Indian securities, the Indian investor or the securities market in India may be affected. Regulations should be framed accordingly."[31]

In other words, state intervention (regulation) should only ensure that depository receipts issued abroad on the back of underlying Indian securities do not in any way compromise the interests of Indian investors investing in

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[28] *See* Sahoo Committee Report, *supra* note 4.

[29] *See* Sahoo Committee Report, *supra* note 4, at 29.

[30] The FSLRC was set up by the Indian Government to comprehensively review the entire Indian financial legislative framework. The FSLRC report made major policy recommendations for the Indian financial sector and also provided a draft Indian Financial Code (IFC) to replace the archaic legislative framework. In his 2015 Budget speech, the Indian Finance Minister has categorically stated the intention of the Government to table the IFC in Parliament soon. For the report, *see generally*, *supra* note 26; for the 2015 Budget Speech, *see Full text of Budget 2015-16 speech*, THE HINDU 2015, http://www.thehindu.com/news/resources/full-text-of-budget-201516-speech/article6945026.ece.

[31] *See* Sahoo Committee Report, *supra* note 4, at 30.

those underlying domestic Indian securities in India.[32] This clear economic and regulatory rationale forms the backbone of the 2014 Scheme.

III. The 2014 Scheme

The Sahoo Committee Report (Phase I) observed that "*the law should be neutral to a foreign investor's choice of the mode of purchasing Indian securities and to the Indian issuer's choice of mode of raising capital as long as the basic capital controls are complied with.* (sic)"[33] It recommended that if, under the capital controls regime, a foreign investor can invest in "*securities as defined in the Securities Contracts (Regulation) Act, 1956 whether issued by a company, mutual fund, government or any other issuer and the similar instruments issued by private companies*," depository receipts should be allowed to be issued against them.[34] Accordingly, the 2014 Scheme defines a 'depository receipt' only with reference to 'permissible securities'.[35] The definition avoids any reference to the issuer of such 'permissible securities'. This allows depository receipts to be issued on the back of any domestic Indian security in which a foreign investor can invest. Unlike the 1993 Scheme, the 2014 Scheme does not restrict the potential underlying securities to domestic equity shares alone.[36] For example, Indian debt instruments can now be used as underlying to the extent that foreign investors can invest in them under the FDI route. Moreover, this approach allows the possibility of unsponsored depository receipts being issued on the back of Indian shares without the involvement of the company whose shares are being used for the program. Any person holding 'permissible securities' can transfer the same to a depository bank for issuance of depository receipts.[37] This would enhance the liquidity of the underlying domestic Indian securities by further integrating the Indian and foreign capital markets.[38]

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[32] In the past, Global Depository Receipts (GDRs) have been misused for committing market abuse in India. However, precedents show that this kind of market abuse requires presence of a colluding party in India and cannot be done solely by investors in GDRs abroad. See *Securities Exchange Board of India v. Pan Asia Advisors,* 2015 SCC OnLine SC 626, order dated 06/07/2015.

[33] *See* Sahoo Committee Report, *supra* note 4, at 35.

[34] *See* Sahoo Committee Report, *supra* note 4, at 35.

[35] *See* 2014 Scheme, *supra* note 6, at cl. 2(1)(a).

[36] *See* 2014 Scheme, *supra* note 6, at cl. 2(1)(h).

[37] *See* 2014 Scheme, *supra* note 6, at cl. 3(1)(c).

[38] Recent research across India, Australia, and Israel shows that listing of American Depository Receipts (ADRs) has helped improve liquidity of the underlying securities in the domestic capital market. *See* Sahoo Committee Report, *supra* note 4, at 42-43; also *see generally*, Alex Frino, Elisa Di Marco and Andrew Lepone, *The impact of ADR listing on liquidity*, Market Insights: Australian Securities Exchange 28 (2009), https://otcquote.com/content/doc/asx-adr-whitepaper.pdf; Hauser, Yankilevitz, & Yosef, *supra* note 17.

The Sahoo Committee Report (Phase I) was of the view that "*businesses should be free to structure financial products as per their business needs*." Business prudence may demand depository receipts "*with the right to instruct voting or with a right to the underlying cash flows without voting rights*." Accordingly, it recommended that "*the law should not prescribe anything about voting rights or exercise of such rights*" in respect of depository receipts as long as the Takeover Regulations, 2011 are complied with.[39] However, minimum public float is a unique requirement under Indian securities law, aimed at maintaining reasonable liquidity of listed shares in the domestic market. This ensures that the shares are widely held, resulting in better price discovery and reduced possibility of manipulation. Listed shares used for the issue of depository receipts were originally excluded from the calculation of this public float.[40] The rationale was that such underlying listed shares, being deposited with the domestic custodian, go out of circulation, thereby reducing the liquidity in the domestic market. However, the Sahoo Committee Report (Phase I) showed that this assumption was incorrect. It used an event study to show that an issue of depository receipts did not have any impact on domestic trading volume of the Indian securities in the short run.[41] Moreover, the Sahoo Committee Report (Phase I) observed that there was a mismatch in the treatment of the same depository receipt under two different regulations. While depository receipt holders having right to give voting instructions have obligations under the Takeover Regulations, 2011, such depository receipts themselves were not calculated as part of the public shareholding.[42] Based on these observations, the Securities Contracts (Regulation) Rules, 1957 was amended on February 25, 2015, to include listed shares underlying depository receipts within the ambit of 'public shareholding.'[43]

However, this measure alone was not sufficient; three issues persisted. *First*, the board of an Indian listed company could issue depository receipts without any voting instruction rights, instead retaining the voting rights for

[39] *See* Sahoo Committee Report, *supra* note 4, at 43-44.

[40] *See* rr. 19(2) and 19A, Securities Contracts (Regulation) Rules, 1957 (as they stood before February 25, 2015).

[41] *See* Sahoo Committee Report, *supra* note 4, at 42-43. This position is also supported by recent research in this field. *See* Frino, Di Marco, & Lepone, *supra* note 38; Hauser, Yankilevitz, & Yosef, *supra* note 17.

[42] *See* Reg. 2(1)(v), Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, (2011) (see n. 24).

[43] Currently, this benefit is available only if the holder of such depository receipts has the right to issue voting instruction and such depository receipts are listed on an international exchange. *See* Securities Contracts (Regulation) (Amendment) Rules, (2015).

themselves.[44] This could go against the spirit of the minimum public float norm, and yet the company could continue to enjoy the status of a public listed company.[45] To avoid such abuse, the law was amended on February 25, 2015, such that, holders of depository receipts are required to have the right to issue voting instructions, for such depository receipts to form part of public shareholding.[46]

Second, minimum public float raised another unique challenge for unsponsored depository receipts on listed shares of Indian companies. Since the company would not be involved in the issue of depository receipts, it would be unfair to let its shares be used for depository receipts leading to a breach of the minimum public shareholding. Therefore, it was essential to mandate that holders of unsponsored depository receipts on listed securities be given the right to issue voting instructions so as to ensure that all such unsponsored depository receipts form part of the public shareholding.[47]

Third, the Committee was divided in its opinion on whether depository receipts on listed shares should be permitted to be traded in Over-The-Counter (OTC) markets abroad that may include dark pools *inter alia*. Although the majority of the members took the view that depository receipts issued on the back of any Indian securities, listed or unlisted, may be listed on international exchanges as well as traded on OTC systems abroad, they agreed that the listing of depository receipts on international exchanges would carry certain privileges.[48] Accordingly, it was recommended that depository receipts issued on the back of listed Indian equity shares form part of the minimum public shareholding only if the depository receipts entitle the holders to give voting instruction to the foreign depository, and if such depository receipts are listed on an international exchange. Further, it was clarified that 'international exchange' for this purpose would mean any platform in a foreign jurisdiction for the trading of depository receipts which is accessible to the public and which provides pre-trade and post-trade transparency.[49] This position is reflected in the 2014 Scheme as well as the amended Securities Contracts (Regulation) Rules, 1957.[50]

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[44] *See* Securities and Exchange Board of India, *Agenda and decision of the SEBI Board on Voting Rights of GDR / ADR holders*, ¶¶ 12-16 (May 19, 2010).

[45] *See* Sahoo Committee Report, *supra* note 4, at 42-43.

[46] *See* R. 2, Securities Contracts (Regulation) Rules, 1957 (*see* n. 42).

[47] *See* 2014 Scheme, *supra* note 6, at cl. 3(2)(a).

[48] *See* Sahoo Committee Report, *supra* note 4, at 40.

[49] *See* Sahoo Committee Report, *supra* note 4, at 43.

[50] *See* 2014 Scheme, *supra* note 6, at cl. 2(1)(f); R. 2, Securities Contracts (Regulation) Rules, 1957.

A. Implementation challenges

The implementation of any new policy measure is fraught with challenges,[51] and the 2014 Scheme is no exception. It was notified in the official gazette on October 21, 2014 but came into force on December 15, 2014. This time-lag was intended to give the various other agencies like the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) adequate time to make the necessary legal changes before the 2014 Scheme came into effect.[52]Nevertheless, implementation challenges persist. This part will focus on the implementation challenges specifically with respect to capital controls and taxation.

1. Capital controls

Pursuant to the 2014 Scheme, the RBI amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("FEMA 20") with effect from December 15, 2014. The terms 'domestic custodian' and 'depository receipt' have now been specifically defined.[53] Major changes have also been made to Schedule I of FEMA 20. It now clarifies that the foreign investment limit in companies engaged in activities in which FDI is permitted include depository receipts issued on the back of equity shares, compulsorily and mandatorily convertible preference shares, compulsory and mandatorily convertible debentures, warrants, or any other security in which FDI can be made in terms of Schedule I.[54] A new schedule, Schedule X, has also been added to FEMA20.

However, some aspects of the amendments to FEMA 20 have caused much confusion in the market. For example, Schedule I previously permitted a registered broker in India to purchase shares of an Indian company on behalf of a person resident outside India for the purpose of converting the shares into depository receipts.[55] This provision has been deleted from Schedule I, and instead Schedule X allows only a domestic custodian to purchase eligible securities for the same purpose.[56] This is clearly an inadvertent error since

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[51] Most statutes provide powers to the Government to remove difficulties during implementation. *See* Pratik Datta, *Amendments by Stealth: MCA resurrects Henry VIII's legacy*, Economic and Political Weekly (Dec. 27, 2014), http://www.epw.in/commentary/amendments-stealth.html.

[52] *See* 2014 Scheme, *supra* note 6, at cl. 1(2).

[53] *See* Reg. 2, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Seventeenth Amendment) Regulations, (Notification No. FEMA 330/2014-RB, Dec. 15, 2014) [hereinafter "FEMA 20 Amendment"].

[54] *See* FEMA 20 Amendment, *id*, reg. 3(c).

[55] *See* FEMA 20, *supra* note 7, cl. 4A of Schedule 1 (as it stood before Dec. 15, 2014).

[56] *See* FEMA 20 Amendment, *supra* note 54, cl. I(c) of Schedule 10.

custodians are not in the business of purchasing securities. Further, Schedule X states that the domestic custodian must report to the RBI regarding the issue of any depository receipts in such manner as may be prescribed.[57]

Accordingly, on January 22, 2015, the RBI prescribed Form DRR which must be filed by the domestic custodian who has arranged the issue or transfer of depository receipts.[58] Curiously, although the Form DRR clearly envisages the possibility of 'unsponsored' depository receipts, it still requires certification from the 'company' that all conditions laid down by the Government of India and the RBI have been complied with. Some custodian banks have been interpreting this to mean that even in 'unsponsored' programs, the consent of the issuer company is required, effectively going against the very notion of 'unsponsored' depository receipts.[59] Moreover, for depository receipt issues resulting in an increase of equity capital of a company or a sponsored issue, Form DRR requires details of the equity capital.[60] It is submitted that not all sponsored issues involve a fresh capital raising exercise. Therefore, for sponsored non-capital raising depository receipts, these details required by Form DRR are superfluous. Moreover, this may actually amount to duplication of work over and above the filing of Form FC-GPR.[61]

2. *Taxation*

Another major challenge in the implementation of the 2014 Scheme is taxation. The Sahoo Committee Report (Phase I) made some far reaching recommendations in respect of the taxation of depository receipts.[62] It noted that depository receipts are foreign securities that are traded beyond the territorial jurisdiction of India. Therefore, there is no reason to tax capital gains from such transactions. Moreover, on cancellation of depository receipts, the foreign investor who was holding the depository receipt becomes the owner of the underlying domestic Indian security. The records show a change in ownership of the underlying domestic Indian security from the depository bank to the foreign investor. However, there is no actual transaction in the underlying security. A similar situation arises in the case of re-conversion of domestic Indian securities into depository receipts. Therefore, the Sahoo

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[57] *See* FEMA 20 Amendment, *supra* note 54, cl. III of Schedule X.

[58] *See* Reserve Bank of India, Depository Receipts Scheme (A.P. DIR Series Circular No. 61, Jan. 22, 2015), http://rbidocs.rbi.org.in/rdocs/notification/PDFs/AP61DIR220115DRR.pdf [hereinafter "Circular 61"].

[59] *See* Circular 61, *supra* note 58, cl. 6 of Form DRR.

[60] *See* Circular 61, *supra* note 58, cl. 12 of Form DRR.

[61] *See* Annex–I, Reserve Bank of India, Foreign Direct Investment – Reporting under FDI Scheme: Amendments in form FC-GPR (A.P. DIR Series Circular No. 102, Feb. 11, 2014), http://rbidocs.rbi.org.in/rdocs/notification/PDFs/102APD110214.pdf.

[62] *See* Sahoo Committee Report, *supra* note 4, at 46.

Committee Report (Phase I) recommended that such transactions ought not to be treated as a taxable event.[63] Further, a shareholder selling listed shares on a recognised exchange is exempt from long-term capital gains tax and need only pay Securities Transaction Tax (STT). However, if the same shareholder intends to make an off-market tendering of the shares for the purpose of issuing depository receipts, the benefit of long-term capital gains tax exemption is not available.[64] This differential tax treatment results in a limited appetite for transferring shares to a foreign depository towards the issue of depository receipts.[65]

The Finance Bill, 2015 not only fails to implement these recommendations but lags behind contemporary financial reform. Clause 28 proposes some cosmetic amendments to Section 115 ACA of the Income Tax Act, 1961. It replaces the words 'non-resident investors' with 'investors' recognising that resident Indians may also invest in depository receipts under the Liberalised Remittance Scheme.[66] However, it fails to recognise the concept of 'unsponsored' depository receipts, sponsored non-capital raising depository receipts, as well as the economic advantages of allowing unlisted Indian companies to access international capital markets. Consequently, it only envisages the possibility of issuing depository receipts against 'ordinary shares of issuing company, being a company listed on a recognised stock exchange in India.'[67] Further, when a foreign investor cancels a depository receipt and transfers the underlying domestic Indian securities, he has to pay capital gains tax in India. To compute the same, the cost of acquisition of the underlying domestic Indian securities must be ascertained. The Finance Bill, 2015 fails to provide any guidance on this aspect as well.

Conclusion

Expert committee reports have played an important role in the evolution of financial economic policy in India.[68] However, most of these policy recommendations need to be implemented through precise legal instruments. If the drafter of these legal instruments is not involved in the committee process, there is a risk of divergence between the intended policy and the subsequent

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[63] Essentially, this should not be regarded as a 'transfer' for the purposes of computing capital gains. *See* S. 47, Income Tax Act, 1961.

[64] *See* S. 10(38), Income Tax Act, 1961.

[65] *See* Sahoo Committee Report, *supra* note 4, at 46.

[66] *See* Reserve Bank of India, *Liberalised Remittance Scheme*, 2014, http://www.rbi.org.in/scripts/FAQView.aspx?Id=66

[67] *See* Cl. 28, Finance Bill, 2015.

[68] *See* Ajay Shah, *Expert Committee Reports in Indian Finance* (Feb. 5, 2015),http://ajayshahblog.blogspot.in/2015/02/expert-committee-reports-in-indian.html

draft law. To overcome this risk, recent expert committees set up by the Ministry of Finance have started involving lawyers who can draft the necessary legal instruments. This helps the committee submit a comprehensive policy report along with a draft legal instrument that the government or regulator can implement.[69] The Sahoo Committee Report (Phase I) is one such example. Its recommendations on off-shore depository receipts were shaped by economics, finance, and law. The final recommendations were collated and translated into a precise legal instrument to reduce the risk of ambiguity to the maximum extent possible.

However, implementation remains a bottleneck. Policies once accepted by the government may need to be implemented by different departments and regulators. Co-ordination among them is difficult. Moreover, policy recommendations that are not aligned with the incentives of an agency may not find favour with it, and consequently, implementation suffers. For example, if meeting the revenue target is the sole criterion for measuring the performance of the tax department, it is difficult to see how that department will be inclined to implement a policy that apparently reduces tax collection.[70] Similarly, a securities regulator will not be keen to let domestic companies directly list abroad. This would clearly show its failure in developing the domestic market for capital raising, and increase competition for the intermediaries in the domestic market from which the regulator earns its fees. Therefore, the interests of the securities regulator are also misaligned with these reforms.[71]

The ongoing off-shore depository receipt reforms stand testimony to these various factors influencing the formulation and implementation of financial policies in India. On one hand, it shows how the involvement of stakeholders and lawyers at the policy formulation stage can help in drafting an actionable

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[69] In Indian finance, the FSLRC was probably the first expert committee to comprehensively review the entire financial legal framework and submit a policy report along with a draft law based on the proposed policy recommendations. *See generally* Financial Sector Legislative Reforms Commission, Indian Financial Code (Mar. 2013), http://finmin.nic.in/fslrc/fslrc_report_vol2.pdf%E2%80%8E.

[70] *See* Tax Administration Reform Commission, First Report of the Tax Administration Reform Commission, tech. rep., 12-13 (Ministry of Finance, May 30, 2014).

[71] From early 2015, SEBI has taken various initiatives to facilitate listing of Indian start-ups on domestic Institutional Trading Platforms (ITPs). The idea is to ease capital raising by Indian start-ups in the knowledge-based sectors like information technology, pharmaceuticals *inter alia*. Moreover, after being listed on the ITP, the companies can move on to the main board as and when they mature. These initiatives by SEBI are in the right direction and, if implemented, would be a worthwhile reform in the Indian capital markets. However, these reforms seem to be a direct consequence of the Depository Receipts Scheme, 2014 – a last ditch effort by the securities regulator to lure Indian start-ups in the knowledge based sectors to list in India rather than venture abroad in search of greener pastures.

policy report along with the necessary legal instruments. On the other hand, it illustrates how a diffused governmental set-up, with multiple departments and regulators with misaligned incentives, can delay the implementation of even the most precisely drafted policy recommendations. Although the institutions may not be broken, evidently, the institutional structures have become obsolete and incapable of smoothly implementing necessary policy changes. It is time to rethink the entire institutional architecture to streamline the financial policy implementation process,[72] acknowledge the present institutional weaknesses and muster the political will necessary to initiate institutional reform.

[72] The FSLRC report recommended overhauling the present financial regulatory architecture and replacing it with a modern one. For the report, *see generally*, Financial Sector Legislative Reforms Commission, Justice B.N. Srikrishna Report (see n. 25).

Revisiting the Dual Class Share Structure Debate in India Post the Alibaba IPO: Attempting to Tread the Middle Ground

Arka Saha[*] *& Deekshitha Srikant*[**]

In December 2014, Chinese e-commerce giant Alibaba listed dual classes of shares on the New York Stock Exchange in the largest initial public offering in history. The Hong Kong Stock Exchange's refusal to grant Alibaba an exemption from its prohibition on dual class share listing resulted in the revival of the long standing debate on multiple class share structures with differential voting rights. This paper attempts to locate this debate within the context of the Indian regulatory framework, and discusses the viability of a hands-off approach by contrasting the Indian experience with those of the United States, Hong Kong and Singapore. The paper concludes in favour of a stricter regulatory regime in order to adequately protect shareholder interests, thereby achieving a middle ground by allowing companies to benefit from the advantages of dual class share structures.

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Introduction

The Hong Kong Stock Exchange ("HKSE") was moved to an uncomfortable frenzy, when Jack Ma's Alibaba Group Holding Ltd. ("Alibaba") chose to shun the native securities market in favour of the New York Stock Exchange ("NYSE") for what turned out to be the largest initial public offering in history, generating funds worth $25 billion.[1] The paramount consideration for Alibaba in making the offering of dual classes of shares was the HKSE's stricter listing norms which disallow weighted shares, in keeping with the golden 'one vote for one share' rule of corporate democracy. The NYSE on the other hand, allows for shares with differential voting rights to be listed, making it inherently attractive to companies which have different classes of shares with different rights attached thereto. The governance structure adopted by Alibaba, as evident from its prospectus,[2] confers on its 'partnership', which comprises twenty-eight members including its chairman and various other promoters, the right to nominate the majority of its Board of Directors[3]– a right seen as essential to "*set the company's strategic course without being influenced by the fluctuating attitudes of the capital markets so as to protect the long-term interests of Alibaba's customers, the company itself and all shareholders.*"[4]

The popularity of dual class capitalisation has been on the rise with companies such as Google Inc. (traded on NASDAQ) and Facebook, Inc. (traded on NASDAQ) choosing to adopt the same method of capitalisation. Prior to these technology companies, media houses such as The New York Times, The Washington Post and News Corp adopted a similar capital structure as they claimed it helped them in maintaining journalistic integrity. In India, Section 43(a) of the Companies Act, 2013 allows for equity share capital with voting rights[5] or with differential rights as to dividend, voting and any other right subject to prescribed rules in that regard.[6]

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1 After an initial accumulation of about $21.8 billion, the underwriters to the online marketing giant are reported to have exercised a green-shoe option in the underwriting agreement that allowed for over-allotment of 48 million shares, in light of increased demand, thereby taking the total funds raised to $25 billion.

2 Securities Exchange Commission, *Registration Statement under Securities Act, 1933 of Alibaba Group Holding Limited* (May 6, 2014), http://www.sec.gov/Archives/edgar/data/1577552/000119312514184994/d709111df1.htm.

3 *Id.*

4 Joe Tsai, *Alibaba Offers an Alternative View of Good Corporate Governance*, Alizila, September 26, 2013, http://www.alizila.com/alibaba-offers-alternative-view-good-corporate-governance.

5 Sec. 43(a)(i), Companies Act, 2013, (Act No. 18 of 2013).

6 Sec. 43(a)(ii), Companies Act, 2013.

In light of these recent developments in global capital financing, the merits and demerits of dual class capitalisation must be revisited. This article seeks to outline the advantages and disadvantages of dual class share structures and examine their feasibility in the Indian market. Part I of the article elucidates the history and mechanics of dual-class share structures in India. Part II deals with the benefits of dual class share structures and its utility as a pre-bid takeover defense, while Part III enumerates the risks involved in such capitalisation and the corporate governance issues arising from the same. Part IV contrasts the experiences of the United States, Hong Kong and Singapore with dual class capitalisation, and drawing lessons from their experience, Part V recommends strengthening the existing regime regulating such structures in order to ensure better protection of shareholder interests.

I. History of Dual Class Capitalisation in India

The effect of dual class capitalisation is the separation of cash flow-rights from voting rights by means of creation of two or more classes of shares with different sets of rights attached. This phenomenon was discovered for the first time in 1926, in a study which traced the increasing tendency of common stock offerings to restrict voting rights of certain classes of shareholders.[7] Legal devices to maintain control in companies where the management owns a minority shareholding, such as non-voting stock, 'pyramiding' non-voting preferred stock and vote-trusts became so popular[8] that they were employed by as many as 42 of the 200 largest companies to maintain control.[9]

In 1991, an expert study on the establishment of new stock exchanges recommended that corporations which had a track record of declaring legitimate dividend be permitted to issue shares without the right to vote.[10] The Companies Bills of 1993 and 1997 further proposed to legitimise shares with differential voting rights (DVRs) in India, positing that such issues be limited to 25% of the total issued share capital[11] – a notion that was actualized vide the Companies (Amendment) Act, 2000, which amended Section 86 of the Companies Act, 1956 (with effect from December 13, 2000). The

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[7] Stevens, *Stockholders' Voting Rights and the Centralization of Voting Control*, 40 Q.J. Econ. 353, 355 (1926).

[8] A. Berle & G. Means, The Modern Corporation and Private Property, 69-75 (rev. ed. 1968).

[9] *Id* at 88-89.

[10] Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 Geo. Wash. L. Rev. 687 (1985-1986) (hereinafter 'Seligman').

[11] *See generally*, Souvik Roy and Kumar Akarshan, *Differential Voting Rights: A Necessity or a Burden*, Taxmann, http://www.taxmann.com/datafolder/Flash/flashart6-8-09_5.pdf (hereinafter 'Roy and Akarshan').

amendment to Section 86 had the effect of dividing equity shares into equity with voting rights and equity with differential rights to dividend, voting or otherwise.[12] Section 2(46A) was also inserted to define 'shares with differential rights' in terms of Section 86.[13] Section 88 of the Companies Act, 1956, which restricted the issue of shares with differential rights as to voting, dividend, capital or otherwise, by public companies, was simultaneously repealed.

In order to enable companies to issue shares with DVRs, the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 were promulgated by the Department of Corporate Affairs. The rules set down conditions for an issue of shares with differential voting rights,[14] and allow for the issue equity shares with both higher and lower voting rights. Section 43(1)(a) of the Companies Act, 2013 recognises and allows for shares with differential voting rights in respect of voting, dividend or 'otherwise' *i.e.* other rights which can be contractually attached to shares.

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[12] *Id.*

[13] Sec. 2(46A), Companies Act, 1956 (Act 1 of 1956).

[14] A few important conditions laid down include the following:

1. The company must have had distributable profits for a minimum of three financial years prior to the year in which shares with differential voting rights are to be issued.
2. The company, for three financial years preceding the year in which shares with differential rights are to be issued, must not have defaulted in filing annual accounts and annual returns.
3. The company must not have failed to repay its deposits or the interests thereon and further, must not have failed to redeem debentures on the due date.
4. The company must not have been convicted under any offence under the Securities Exchange Board of India Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Foreign Exchange Management Act, 1999.
5. The company must not have defaulted in meeting investor grievances.
6. A listed public company must have obtained approval of extant shareholders by the means of postal ballot.
7. The company must have obtained approval of the shareholders in its general meeting by passing a resolution as required under Sections 94(1)(a) and 94(1)(b).
8. The notice of such meeting must have accompanying it, an explanatory statement consisting of
   a) The proposed rate of voting rights that the equity share capital with differential rights will carry.
   b) The scale or proportion to which such voting rights will vary.
   c) A declaration that the company shall not convert its equity capital with voting rights to equity capital with differential voting rights and vice-versa.
   d) A declaration that the shares with differential voting rights shall not exceed 25% of the total share capital issued.
   e) A declaration that a member holding any equity share with a differential right shall be entitled to bonus shares and right shares of the same class.
   f) A declaration that the holder of equity shares with differential voting rights shall enjoy all other rights to which the holder is entitled, for the differential right accorded to the equity share with regards to voting.

Tata Motors issued shares with differential rights to fund their acquisition of Jaguar Land Rover in 2008, becoming the first company in India to raise capital by means of such an issue.[15] The company issued 6.4 crore shares with differential rights, carrying one-tenth of the voting rights attached to ordinary shares, while commanding a higher dividend. Subsequently, Pantaloons Retail India issued shares with DVRs with one-tenth the voting rights attached, offering a 5% additional dividend as opposed to normal equity shares. Subsequently, the legality of shares with DVRs was upheld by the Company Law Board ("CLB") in *Anand Pershad Jaiswal v. Jagatjit Industries Ltd*.[16] The case was centered on a petition to declare a resolution passed at an Extraordinary General Meeting void, by means of which preference shares (each containing 20 votes) had been allocated to K.P. Jaiswal & Sons. This action was upheld by the Company Law Board in light of the enabling framework under Section 86 and the 2001 Rules. Consequently an order was passed to purchase the stake of Anand and Jagajit Jaiswal on the company's behalf as buyback of shares in cash, resulting in a reduction of the equity share capital to that extent.[17]

The Securities and Exchange Board of India ("SEBI") has also attempted reforms with respect to shares with DVRs from time to time – by relaxing the requirements for listing shares with DVRs under the Securities Contracts (Regulation) Act, 1956 by amending the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000. In 2009, the SEBI Board Meeting on Primary Market Reforms' proposal that no listed company be permitted to issue shares with superior voting rights, culminated in SEBI transforming the concept of DVRs by introducing Clause 28-A of the Listing Agreement.[18]

Dual class shares can be created either at the time of the initial public offer (capitalisation) or by subsequent disenfranchisement through the recapitalisation method.[19] Some of the means of recapitalisation available are: (*a*) exchange mechanisms (where shares with greater voting rights would lose these rights if transferred beyond a specified group), (*b*) exchange

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[15] Rahul Oberoi, *How to Benefit from Shares with Differential Voting Rights*, MIRROR IMAGE, MONEY TODAY, March 2013, http://businesstoday.intoday.in/story/how-to-benefit-from-shares-with-differential-voting-rights/1/192706.html.

[16] Anand Pershad Jaiswal v. Jagatjit Industries Ltd., (2010) 1 Comp LJ 509.

[17] *Supra* note 15.

[18] Clause 28-A of the Listing Agreement states that the listing company must agree to not issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed.

[19] *See*, Peter N. Flocos, *Toward a Liability Rule Approach to the "One Share, One Vote" Controversy: An Epitaph For The SEC's Rule 19c-4*, 138 U. PA. L. REV., 1761, 1762 (1990) (hereinafter 'Flocos').

offers (where shareholders are given the option to give up voting rights for increased dividend or maintain the existing voting and dividend rights), and (*c*) limited phased voting (limiting the voting rights of a shareholder who has acquired a certain threshold of shares). Other mechanisms include (*d*) leveraged buy-outs (where the company's shareholders themselves buy the stock with increased voting rights), and (*e*) super-voting stock (where after an amendment to the articles of association, new stock with decreased dividend and increased voting rights is issued, curbing transferability of shares).[20]

II. Justifications for Dual Class Share Structures

A. Berle and Means' Separation of Ownership and Control

The management of large public corporations is based on a wide hierarchical structure vested with the ultimate objective of maximising the value of the company, and in effect, shareholder wealth. Such a system is typically characterised by a vast information asymmetry between the managers and the shareholders, owing to the former's inside knowledge of business plans and tactics, as well as the wide resources available to them for studying capital markets and other information regarding the sector in which the company operates.

One fear prevalent among corporate management is that shareholders, owing to misinformation or the lack of information, may sell control of the firm to a hostile bidder.[21] Such a situation may prevent management from taking decisions and framing policy which is difficult to reveal to shareholders, though it may potentially result in wealth maximisation. The management is thus constantly burdened with short-term profit maximisation, often compromising the long term aspirations of the company.[22] Further, corporate decisions relating to financing and dividend payouts are increasingly being considered indicative of management's intentions,[23] and affect share prices – presumably on account of the increasing relevance of the 'irrelevancy' theorem',[24] which states that the value of a firm is independent

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[20] *See generally*, Weston, Takeovers, Restructuring and Corporate Governance 365-380 (7th ed., 2009); Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice* 76 Cal. L. Rev. (1988) (hereinafter 'Gordon').

[21] Allen Franklin and Michaely Roni, *Payout Policy*, North-Holland Handbook of Economics and Finance (Wharton Financial Institutions Center Working Paper No. 01-21-B, April 2002).

[22] DeAngelo & De Angelo, *Managerial Ownership of Voting Rights*, 14 J. Fin. Econ.35 (1985).

[23] Gonedes, *Corporate Signaling, External Accounting, and Capital Market Equilibrium: Evidence on Dividends, Income, and Extraordinary Items*, 16 J. Acct. Res. 26 (1978).

[24] Modigliani & Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*,Am. Econ. Rev., (June 1958).

of its capital structure. Thus, corporate management may hesitate to take wealth-maximising decisions based on the signals given by such decisions.[25]

Profit-oriented investors welcome increases and reject cuts in dividend. As a result, the management typically maintains a constant rate of dividend even when performance declines in order to avoid shareholder dissatisfaction. Due to these behavioral tendencies, an increase in dividend causes shareholders to assume that such rate will be maintained over a long duration, providing a causal impetus for a rise in share price.[26] However, a decline in the rate of dividend declared results in speculation that the earnings of the company will decline in the future, thus bringing down share prices. Proviso (1) to Section 123 of the Companies Act, 2013 allows for a company to transfer such percentage of its profits that it deems necessary to its reserves before the declaration of dividend.[27] However, in light of the above findings, the company's management may, view any such proposal as detrimental to share prices, thereby leaving the company vulnerable to hostile takeovers. Dual class share structures, which often vest control in the management by virtue of them possessing shares with greater voting rights, is thus an effective solution to the information asymmetry between the shareholders and the management. Such a structure allows the management to devise and implement financial decisions without being weighed down by aforementioned concerns.

B. Takeover Defense

In a competitive market, companies are often faced with the threat of predatory takeover tactics by competitors or other companies, intended to result in a hostile takeover. Furthermore, a company may face a situation wherein it has to acquire shares at a premium to ward off a 'green-mailer' from taking control. Faced with such hostile situations, a company can adopt a slew of defensive strategies to ward off the raider. Some of these 'kamikaze' defensive strategies intended to make the target company appear less attractive to a raider include the 'fat-man' defense, which involves increasing the target company's debt load by acquiring assets; the 'sale of crown jewels' defense, which involves alienating the company's most prized assets; and the 'macaroni' defense, which involves issuing a vast number of bonds with the condition that they shall be redeemed at a higher rate if the company is taken over. However, the difficulty with these strategies lies in the fact that

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[25] Gordon, *supra* note 20.
[26] Gordon, *supra* note 20.
[27] Section 123, Companies Act, 2013.

they adversely affect the financial standing of the company, to the detriment of shareholders.

Dual class capitalisation is thus an extremely effective means of thwarting off hostile takeovers as most of the voting rights rest with the management.[28] A company with such capital structure may negotiate for an optimum price on behalf of the shareholders in the event of a takeover bid, so as to maximize overall shareholder wealth.[29] Thus, non-controlling shareholders are protected from coercive takeovers, and the possibility of them giving up control is checked.[30]

Dual class capitalisation as a pre-bid takeover defense assumes great importance in India, where traditionally promoters hold a small percentage of shares, as the need to maximise monetary returns which can be satiated by the takeover premium offered by a raider, can make promoters vulnerable to shareholder opportunism.[31]

III. The Downsides to Dual Class Share Structures

First, one of the strongest arguments against dual class capitalisation is that it is completely antithetical to the golden 'one share, one vote' rule of corporate democracy by allowing insiders to take control without investing in a significant amount of equity. A company is a creature of contract, and authorisation for any delegation is to be done by the shareholders voting at a general meeting.[32] Abrogation from this principle results in a disconnect between the residual income rights of a shareholder[33] and control rights. A shareholder who holds disproportionate voting rights is more likely to pursue self-interest to the detriment of the company's interests, as he is able to transfer his risk to the company, and thereby to the rest of the shareholders, without bearing the full repercussions of corporate decisions.[34]

The degree of variation from the existing shareholder-manager relationship is determined by whether dual class capitalisation happens during the company's initial public offering (where the right to vote never existed in the

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28 Gordon, *supra* note 20.

29 Gordon, *supra* note 20.

30 Abhishek Nath Tripathi and Uttam Maheshwari, *Shares with Differential Voting Rights: A Legal and Economic Analysis*, 15 Student B. Rev. 74, 76(2003) (hereinafter "Tripathi and Maheshwari").

31 *Id.*

32 Section 96 of the Companies Act, 2013 stipulates that every company (other than a one person company) is to hold an annual general meeting of its shareholders.

33 A shareholder has a right only to the "*residual income*" of the company.

34 Tripathi and Maheshwari, *supra* note 30, at 76.

first place due to the company making an IPO with a disproportionate share structure)[35] or recapitalisation (where shareholders are disenfranchised due to a change in the company's share structure). The latter has been the subject of greater scrutiny.

Second, crafting a shareholder voting policy should strive to promote maximum corporate efficiency, capital raising, flexibility, and equity. Perhaps the strongest argument for dual class stock is enabling the management to more easily set and achieve long-term goals, without diluting control of the firm. However, what this concomitantly does is remove all checks on managerial conduct, as the largest shareholder (usually, the Chief Executive Officer) effectively elects the board of directors.[36] In the context of the Alibaba IPO, this danger is especially highlighted as certain members of the company's management formed a partnership, which retains the exclusive right to nominate majority members of the board of directors.[37]

The sphere of decision-making and allocation of power between the shareholders in the general meeting and the board of directors are separate, and the former cannot encroach upon the latter unless specifically empowered by the articles of association, or remove/refrain from re-electing a director if unsatisfied with his/her work. Dual class stock would allow directors to re-elect themselves with the support of the controlling shareholders, thus upsetting the balance of power and removing the only check upon the director.[38] For example, the board of directors of Google unanimously approved the issuance of non-voting stock further focusing control on its founders, in order to avoid resignation or failure to be nominated to the board the following year.[39]

Third, dual class stock also curtails the independence of executive directors, making them susceptible to the decisions of those who possess the support of shareholders with greater voting rights.[40] This would be particularly problematic in India in light of the new corporate governance regime, post the enactment of the Companies Act, 2013 and revised Clause 49 of SEBI's Listing Agreement. In fact, the introduction of the concept of independent director (in Section 149(5) of the Companies Act, 2013 and Clause 49(IIB) of

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[35] *See*, Flocos, *supra* note 19.
[36] Tian Wen, *supra* note 37.
[37] *Supra* note 2.
[38] Tripathi and Maheshwari, *supra* note 30, at 80.
[39] Andrew Ross Sorkin, *Stock Split for Google that Cements Control at the Top*, N.Y. Times Dealbook (Apr. 16, 2012), http://dealbook.nytimes.com/2012/04/16/stock-split-for-google-thatcements-control-at-the-top.
[40] George W Dent, Jr., *Dual Class Capitalization: A Reply to Professor Seligman* 54 Geo. Wash. L. Rev 725, 739 (1986).

the Listing Agreement) to ensure unbiased decisions and check managerial conduct is diluted in the case of dual class structures.[41] Such concentration of ownership also increases the likelihood of related party transactions.[42]

Fourth, managerial entrenchment is another consequence, due to lack of pressure from non-controlling shareholders. Rupert and Jane Murdoch, for example, retained their positions even after being embroiled in criminal charges as their own respective voting rights were sufficient to ensure their positions.[43] Oversight by institutional investors also dwindles, as they usually depart from companies with dual class structures – see for instance, Morgan Stanley's exit from The New York Times.[44]

Fifth, although one of the justifications of dual class stock is its utility as a takeover defense, it could in fact prove to be the opposite. Inefficiently managed companies are the target of takeovers by efficiently managed companies, and the efficiency of a company is usually reflected in the price of its stock. Dual class stock, in turn, fosters poor standards of management by allowing greater control to holders of lesser equity, ultimately leaving the company vulnerable to takeover bids.[45] Stock price is a reflection of the success of the firm, and success can often be directly related to managerial action.[46]

Sixth, a fall in the price of common stock is also another usual consequence, due to the amount an investor would be willing to pay to gain control over the company. Since there exists a class of stock equal to the remaining stock in all aspects except for the fact that it carries additional voting rights, this stock trades at a higher price, devaluing the remaining.[47]

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[41] KPMG, *SEBI's Amendments to Corporate Governance norms* (Apr. 22, 2014), https://www.in.kpmg.com/SecureData/aci/Files/SEBI%60samendmentstocorporategovernancenorms.pdf.

[42] Organisation for Economic and Co-operative Development, *Guide on Fighting Abusive Related Party Transactions in Asia*, September 2009, Asian Corporate Governance Association, ACGA White Paper on Corporate Governance in India (January 2010).

[43] *See*, Richard Blackden, *Rupert Murdoch's Iron Grip on News Corp Dealt a Blow*, Telegraph (Oct. 17, 2012), http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/media/9613863/Rupert-Murdochs-iron-grip-on-News-Corp-dealt-a-blow.html.

[44] Press Release, *Morgan Stanley Investment Management. Ltd., Calls for Elimination of Dual-Class Capital Structure to Enable All Shareholders to Hold Board of Directors and Management Accountable for Company's Performance* (Apr. 18, 2006), http://www.businesswire.com/news/home/20060418005896/en/MSIMs-Global-Franchise-Investment-Program-Announces-Withhold.

[45] Icahn, *The Case for Takeovers,* N.Y. Times 34 (29 Jan. 1989); Karen D. Bayley, *Rule 19c-4: The Death Knell for Dual-Class Capitalizations* 15 J. Corp. L. 1, 12(1989-1990).

[46] *Id.*

[47] Gordon, *supra* note 20.

The other oft-cited argument is efficiency, and allocation of such rights to those who most value them.[48] However, since votes are tied to the residual rights of a company, unless each element of residual interest has equal voting rights, optimal decision-making will remain out of reach.[49]

Seventh, the jurisprudential justification for dual class shares is grounded in the freedom of contract, and autonomy of the shareholder – *i.e.*, that the shareholder should be entitled to purchase dual class of shares, if he so desires, knowing fully the consequences of the same during an IPO. However, this premise does not consider the 'freeness' of this choice, which is often manufactured as a result of seemingly massive, irresistible deals, such as the Facebook IPO in 2012.[50] Improper discounting of stocks at the stage of initial public offer or failure on the part of merchant banks working with issuers to furnish adequate information are also unaccounted for, as in the case of Facebook when it realized that its revenues were not as high as initially estimated.[51] Hence, dual class share structures have a fair share of complexities and complications as the media has begun to point out in the context of the Alibaba IPO.[52]

IV. Comparison with Other Jurisdictions

Alibaba is not the first company to take refuge in the United States to launch their IPO as a different jurisdiction did not allow their dual class structure. In 2012, Manchester United listed themselves in the United States, as the London Stock Exchange did not permit their structure and the Hong Kong Stock Exchange refused a waiver on similar grounds.[53] This Part, therefore, attempts to delineate this decision-making by studying the position on dual class structures in the United States, Hong Kong, and Singapore, before

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48 *See*, the usage of the Coase theorem in Douglas C. Ashton, *Revisiting Dual Class Stock* 68 St. John's L. Rev. 863 1994 ('Ashton'); Tripathi and Maheshwari, *supra* note 30, which envisage allocation of a right to those who most value it for maximum efficiency.

49 Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 5 (1st ed. 1996).

50 ISS, *The Tragedy of Dual Class Commons* (Feb. 13, 2012), http://online.wsj.com/public/resources/documents/facebook0214.pdf.

51 Khadeeja Safdar, *Facebook, One Year Later: What Really Happened in the Biggest IPO Flop Ever,* Atlantic (May 20, 2013), http://www.theatlantic.com/business/archive/2013/05/facebookone-year-later-what-really-happened-in-the-biggest-ipo-flop-ever/275987.

52 *See*, for example, David Reidel, *Four Reasons To Avoid The Alibaba IPO*, Forbes (Sept. 15, 2014) http://www.forbes.com/sites/investor/2014/09/15/four-reasons-to-avoid-the-alibaba-ipo/.

53 Steven M. Davidoff, *In Manchester United's I.P.O., a Preference for American Rules*, N.Y. Times Dealbook (Jul. 10, 2012), http://dealbook.nytimes.com/2012/07/10/in-manchester-unitedsi-p-o-a-preference-for-u-s-rules.

attempting to draw a conclusion on what the ideal position on dual class stock should be.

Some jurisdictions, such as the United States, permit dual class stock both in their company law and listing rules, whereas others such as Germany, Spain and China do not allow such stock in either the legislation or the listing rules. Other countries such as Hong Kong and Singapore only allow them in their respective company law regimes.[54]

A. United States of America

The United States, initially in favour of the 'one share, one vote' principle, has had a fluctuating attitude towards dual class stock. In 1925, the listing of non-voting shares by two well reputed corporations, namely Dodge Brothers, Inc. and Industrial Rayon Corporation, was severely criticised as being opposed to public policy– the same was being utilised for the recovery of purchase prices of businesses by banking houses by the sale of new shares, bereft of voting rights.[55] Subsequent to this, various listings of non-voting stock were rejected by the NYSE on the ground that it was against public policy. Competition from the National Association of Securities Dealers' ("NASD") NASDAQ and American Exchange ("AMEX") however lead to the appointment of a sub-committee on Shareholder Participation and Qualitative Listing Standards by NYSE to review listing norms. This inquiry became necessary as a multitude of corporations began exploring such governance structures as an effective pre-bid defense to hostile takeovers. This led to the adoption of a proposal allowing dual class stock in 1986,[56] when the dual class debate resurfaced due to the General Motors' acquisition of Ross Perot's Electronic Data Systems Corporation.[57] Thus, NYSE now allows the listing of companies with dual class share structures, subject to the conditions of approval by a majority of shareholders and a majority of independent directors, failing which the company runs the risk of delisting.[58]

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[54] Hong Kong Stock Exchanges and Clearing Limited, *Concept Paper: Weighted Voting Rights* 43 (Aug. 2014).

[55] Seligman, *supra* note 10.

[56] Seligman, *supra* note 10, at 688.

[57] M.G. Warren III, *One Share, One Vote: A Perception of Legitimacy*89J. Corp. L 92–3 (1988).

[58] This was a significant relaxation of the earlier conditions framed by the subcommittee formed:

a) Two-thirds of all shareholders eligible to vote must approve the creation of another class of shares;

b) Approval by a majority of independent directors if the Board is contains a majority of independent directors, or consent of all such directors if they comprise of a minority;

c) A ratio of differential rights of not more than ten to one;

Non-voting stock is also permitted, provided that such class of shares meets all the original listing requirements, that all classes of stock carry the same rights in all aspects except voting and holders of such shares receive all communication sent to all shareholders.[59] State law now governs the regulation of voting rights, and NYSE and AMEX are granted exemptions from prohibitions by most states, after the notorious *Business Round table* decision[60] and the Security Exchange Commission's ("SEC") Rule 19c-4 which was introduced to deal with the inconsistencies in the listing standards applicable to dual class stock.[61] However, the degree of SEC opposition has since waned, thus making the United States one of the few jurisdictions that allow dual class stock subject to minimal preconditions.[62]

B. Hong Kong

Although the concept of dual class stock is not alien to this jurisdiction, the Hong Kong Stock Exchange has historically been apprehensive about it, as seen from its refusal to grant a waiver in this regard to Manchester United's IPO, as well as the rejection of Jardine Matheson Holding Limited's application to change its share structure in 1987.[63] As a result, Jardine Matheson shifted its Asian listing to Singapore from Hong Kong in 1994, causing unease amongst Hong Kong's business circles[64] – the last ripple caused by dual class shares in Hong Kong until the Alibaba episode.

Alibaba, after entering Hong Kong in a partnership in 2005 with Yahoo China, grew to become one of China's biggest e-commerce platforms, and

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d) All stock must carry equal rights in all other respects except voting. *See*, New York Stock Exchange, *Dual Class Capitalization: Initial Report of the Subcommittee on Shareholder Participation and Qualitative Listing Standards* (New York Stock Exchange: New York, NY, 1985) 3.

[59] *See*, NYSE Listed Company Manual, §313(B).

[60] Business Roundtable v. Securities and Exchange Commission, 905 F 2d 406 (DC Cir 1990).

[61] Ashton, *supra* note 49.

[62] This is further facilitated by certain legislations such the Jump start Our Business Startups Act ('JOBS Act'. Pub. L. No. 112-106, 126 Stat. 306 (2012)), which relaxes regulatory requirements of internal control audits and disclosure of executive compensation among others for IPOs of emerging growth companies. Rule 405 of the Securities Act, 1933 further loosens requirements for foreign private issuers. It is no wonder, therefore, that along with Alibaba, other companies such as Weibo, China's version of Twitter, are also moving to the US; *See*, Wen, *supra* n. 44.

[63] Kana Nishizawa and Richard Frost, *Hong Kong Seeks Debate on Dual-Class Shares After Losing Alibaba*, The Washington Post (Aug. 29, 2014), http://washpost.bloomberg.com/Story?docId=1376-NB1ZGC6TTDS501-1C5IS8NEPO864NHIMQE8SLT1F6.

[64] *Jardine Matheson Holdings Limited History,* Funding Universe, http://www.fundinguniverse.com/company-histories/jardine-matheson-holdingslimited-history/.

was privatised in 2011 after a scam involving sale of fake products.[65] CEO Jack Ma sought to re-enter Hong Kong markets in 2013, while retaining control via a dual class share structure. Hong Kong's Companies Ordinance states that each member of the company has a single vote per share in a general meeting, subject to the company's articles of association. However, dual class shares are permissible, if provided for in the articles, thereby showing that unlisted companies are permitted to possess such a capital structure.[66] However, the Hong Kong Stock Exchange's Main Board Listing Rule 8.11, which prohibits shares with differential voting rights (with exceptions only for existing companies with dual class shares, or where the Exchange agrees to make an exception),[67] stood in his way. Alibaba's request for such an exemption on grounds of its partnership model was rejected, and till date, the Exchange has never listed a company under this exception.[68]

Although there have been whispers of a revamp of this prohibition in light of the Alibaba episode,[69] some scholars argue that the United States can afford to entertain such structures in its environment which affords strong protections to minority shareholders, its factious culture (allowing for securities collective action,[70] prohibited in Hong Kong), and a deeper professional investor base, all of which are absent in Hong Kong due to the stronghold of family-controlled companies.[71]

C. Singapore

The SGX-ST Listing Manual of the Singapore Exchange ("SGX"), does not permit the listing of companies with dual class share structures. However, in 2012, Singapore amended its company law regime to allow for non-voting shares and shares with multiple votes (subject to the company's articles and other safeguards), in order to maintain its position as a leading

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[65] *Alibaba Chiefs Quit After Probe into Sales Fraud*, SOUTH CHINA MORNING POST (Feb. 22, 2011).

[66] *See*, Hong Kong Companies Ordinance, Cap 622, §588(3)(a) and (4).

[67] Hong Kong Stock Exchange's Main Board Listing Rule 8.11(1) and (2), respectively.

[68] E. Yiu, *Alibaba Open to IPO Concessions*, SOUTH CHINA MORNING POST (Sept. 25, 2013).

[69] Greger Stuart Hunter, *Hong Kong Exchange Considers Rule Change After Losing Alibaba IPO*, WALL STREET JOURNAL (Aug. 29, 2014), http://www.wsj.com/articles/hong-kong-exchange-considers-rule-change-after-losing-alibaba-ipo-1409311411('HKEX').

[70] The Private Securities Litigation Reform Act 1995 read with Rule 10-b of the Exchange Act allows for this.

[71] *See generally*, Raymong Siu Yeung Chan and John Kang Shan Ho, *Should Listed Companies be Allowed to Adopt Dual-Class Share Structure in Hong Kong?* COMM. L. WORLD. REV. 43, 155–182 (2014); *see generally*, HKEX, *supra* n. 81.

financial centre.[72] In October 2014, the Singapore Companies Act was amended to extend the same permission to public companies,[73] and SGX and the Monetary Authority of Singapore are currently reviewing the possibility of lifting the prohibition on listed companies.[74] Singapore has clarified that such permission shall be subject to certain safeguards to ensure that investors are well informed and the rights of shareholders are protected, for example:

a. Conversion of shares from one class to another is made possible provided the company's constitution permits it and lays down the rights attached to these classes;[75]

b. A higher threshold for approval (by special resolutions) is required for issuance of such shares;[76]

c. The holder of a non-voting share must have one vote in resolutions proposing a change in any of the rights attached to that share or winding up;[77]

d. Where more than one class of shares exist, the notice of a meeting where such resolution is to be passed must also carry an explanatory statement explaining the voting rights attached to each class.[78]

The legal position in respect of dual class shares in public listed companies remains unclear till date. Nevertheless, Singapore appears to be embracing dual class stock while bearing in mind the risks that they carry especially for public companies, thereby attempting to strike a balance.

Conclusion

The OECD Steering Group on Corporate Governance in 2007 released a report that did not make any *prima facie* findings against the concept of dual class structures. Nevertheless, the report identified certain essential

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[72] Reuters, *Singapore to allow dual-class shares to attract listings* (Oct. 3, 2013), http://www.reuters.com/article/2012/10/03/singapore-listings-rules-idUSL3E8L35UI20121003.

[73] Baker & Mckenzie, *Corporate and Securities Client Alert* (Jun. 2013), http://www.bakermckenzie.com/files/Uploads/Documents/Asia%20Pacific/ASEAN/al_singapore_mofacra-feedback_jun13.pdf.

[74] *Fact Sheet on the Companies (Amendment) Bill*, https://www.acra.gov.sg/uploadedFiles/Content/Legislation/Companies_Act_Reform/Companies%20(Amendment)%20Bill%20-%20factsheet.pdf('Singapore Companies Fact Sheet').

[75] Herbert Smith Freehills, *South East Asia Dispute Resolution Update* (Oct. 28, 2014).

[76] Singapore Companies Fact Sheet, *supra* note 75.

[77] Ministry of Finance, *Consultation Paper: Report of the Steering Committee for Review of the Companies Act*, 137-138 (Jun. 2011).

[78] *Id.*

prerequisites such as liquid and well-informed capital markets and recommended the introduction of shareholder grievance redressal mechanism so as to ensure that private advantage extraction does not reach intolerable levels.[79] In this regard, India still needs to focus on the underlying liquidity of its capital markets,[80] and on corporate governance reforms. However, the fact that India shares many of the same concerns as Hong Kong, including a stronghold of family-run businesses, and scarce collective action by shareholders, cannot be ignored or denied.[81]

The regulatory framework in India governing dual class shares is centered on Section 43 of the Companies Act, 2013 (*i.e.* Section 86 of the erstwhile Companies Act, 1956), the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 and the SEBI (Disclosure and Investor) Protection Guidelines, 2000 (as amended in 2009).[82] While the issuance of shares with superior voting rights is prohibited in India,[83] the only pre-requisites set out in the 2001 Rules are availability of distributable profits, no defaults in filing annual returns, resolving investor grievances or repayment of deposits, and no convictions for offences under the Securities Contract (Regulation) Act, 1956, Foreign Exchange Management Act, 1999 and Securities Exchange Board of India Act, 1992. In addition to authorisation under the articles of association, shareholder consent must be obtained at a general meeting by means of a resolution. In the case of a public listed company, this can be by means of a postal ballot. An explanatory statement is to be issued detailing the rate of voting rights, degree of variation, and prohibition on conversion of shares with voting rights to shares with differential voting rights, inter alia. Significantly, the explanatory statement should clarify that holders of such shares are entitled to bonus or rights issues, and will possess all the same rights as all other classes of shares other than voting.[84]

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[79] OECD, *Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion* (Dec. 2007).

[80] Mobis Philipose, *India has a lot to do in building liquidity in equity trading*, MINT (Nov. 18, 2013) http://www.livemint.com/Money/BnQOHxGA7upjd9wES24KqN/India-has-alot-to-do-in-building-liquidity-in-equity-trading.html?utm_source=copy.

[81] Although the same is not prohibited, its lack of popularity in India has led to SEBI having made attempts to create incentives for class action in India through the SEBI (Investor Protection and Education Fund) Guidelines, 2009; *see generally*, SEBI (Investor Protection and Education Fund) Guidelines, 2009; Umakanth Varottil, *Shareholder Activism and Class Action*, INDIACORPLAW (Jun. 22, 2009), http://indiacorplaw.blogspot.in/2009/06/shareholder-activism-and-class-action.html.

[82] ROY AND AKARSHAN, *supra* note 11.

[83] *See*, SEBI, *Amendments to the Listing Agreement* (Circular SEBI/CFD/DIL/LA/2/2009/21/7 dated July 21, 2009).

[84] Rule 3, Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001.

It is surprising that the legislators chose to amend the Listing Agreement itself to prohibit the issue of shares with superior voting rights (vide Clause 28-A), instead of simply amending the SEBI (Disclosure and Investor Protection) Guidelines, 2009 or the 2001 Rules. The language of Clause 28-A gives rise to further ambiguity: "*the company agrees that it shall not issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed*."[85] The usage of the term 'superior rights' in imposing the prohibition creates several anomalies and raises complex questions for consideration. Shares with lower or inferior voting rights are allowed to be listed, but will this become the new benchmark and prevent the issuance of the standard equity that companies have consistently been issuing? Will the amendment affect, for instance, the issuance of preference shares with differential rights as to dividend or special rights (such as affirmative vote) to investors under the articles of association?[86]

The inclusion of additional safeguards such as obtaining consent of shareholders through special resolution, preferably by means of a super-majority, as in the United Kingdom, would be a step in the right direction. In addition, in order to prevent managerial entrenchment, holders of subordinate shares should be allowed to directly elect a part of the board of directors,[87] and equal treatment of all shareholders in the face of a takeover bid must be ensured.[88] The Toronto Stock Exchange, for instance, has a mandatory 'coat-tail' provision that allows minority shareholders to tag along at the same price as the holders of superior shares in a takeover bid, ensuring that the control premium is equally distributed between different classes of shares.[89] Indeed, a minimalist regulatory framework as followed in the United States, cannot work in a country where control is so concentrated in the hands of a few family-controlled businesses.

Further, the authors suggest that several concerns surrounding dual class shares can be addressed by the mandatory incorporation of a sunset clause in the company's governance structure. Such a clause would specify that when a certain growth or strategic landmark is reached, the shares carrying

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85 Clause 28-A, SEBI Listing Agreement.

86 Jayant Thakur, *SEBI Prohibits Issue of Shares with 'Superior' Voting Rights*, IndiaCorpLaw (Jul. 22, 2009), http://indiacorplaw.blogspot.in/2009/07/sebi-prohibits-issue-of-shares-with.html.

87 Barry J. Reiter, *Dual-Class Shares: Not the Enemy*, Lexpert, http://www.bennettjones.com/Images/Guides/external9759.pdf..

88 Robert A.G. Monks, and Nell Minow, Corporate Governance 373 (4th ed., Wiley).

89 Barry J. Reiter et al., *Dual Class Shares – Good or Bad or Both?*Bennett Jones, *available at* http://www.bennettjones.com/uploadedFiles/Publications/Articles/DUAL%20CLASS%20SHARES(2).pdf.

superior voting rights will automatically lapse or convert to ordinary shares, mitigating some of the long-term consequences of a dual class share structure.[90] Since investors can then make informed decisions knowing the expiry date of the control mechanism, it gives the promoters of the company sufficient time post-IPO for the development of the company, paving a middle ground between shareholder rights and competitiveness.[91]

[90] Deliotte Insights, *Dual-class Share Structure: Weighing the Risks and Rewards* (Apr. 9, 2014), http://deloitte.wsj.com/riskandcompliance/2014/04/09/dual-class-share-structure-weighing-the-risks-and-rewards/; Simon C.Y Wong, *Rethinking One Share, One Vote*, Harvard Business Review (Jan. 29, 2013), https://hbr.org/2013/01/rethinking-one-share-one-vote.

[91] Peter L. Simmons, *Dual Class Recapitalization and Shareholder Voting Rights*, 87 Colum. L. Rev. 106, 114 (1987).

Mathai Mathai v. *Joseph Mary*: A Step Backwards?

Anirudh Wadhwa[*]

Indian law relating to contracting with minors has remained fundamentally unchanged since the 1903 decision of the Privy Council in Mohori Bibee v. Dharmodas Ghose*, ILR (1903) 30 Cal 539 (PC). Subsequent High Court decisions carved out certain exceptions to the rule in* Mohori Bibee*, the most important of which was the* "executed contract" *exception which implied that contracts which were completely executed on the minor's side so that there were no further liabilities on his part, could be enforced by the minor for the reason that nothing further remained to be done by him. In the recent decision of* Mathai Mathai v. Joseph Mary, ((2015) 5 SCC 622) *the Supreme Court has revisited this area of law and has done away with the executed contract exception to* Mohori Bibee *as being based on an* "erroneous interpretation" *of* Mohori Bibee. *This note examines the legal import of the decision in* Mathai Mathai*, and in particular, whether that decision necessarily follows from the decision in* Mohori Bibee.

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Introduction

Indian law relating to contracting with minors has remained fundamentally unchanged since the 1903 decision of the Privy Council in *Mohori Bibee v. Dharmodas Ghose* ("*Mohori Bibee*").[1] Subsequent High Court decisions carved out certain exceptions to the rule in *Mohori Bibee,* the most important of which was the "*executed contract*" exception. In the recent decision of *Mathai Mathai v. Joseph Mary* ("*Mathai Mathai*"),[2] the Supreme Court has revisited this area of law and has done away with the executed contract exception to *Mohori Bibee* as being based on an "*erroneous interpretation*" of *Mohori Bibee*. In this note, I examine the legal import of the decision in *Mathai Mathai*, and in particular, whether that decision necessarily follows from the decision in *Mohori Bibee.*

The structure of the note is as follows – in Part I, I provide a brief introduction of the law relating to contracts with minors. In Part II, I analyse the decision of the Privy Council in *Mohori Bibee*, which remains the *locus classicus* on the subject in Indian law. In Part III, I analyse the various exceptions to the *Mohori Bibee* rule developed through the years by the various High Courts. In Part IV, I analyse the decision of the Supreme Court in *Mathai Mathai*, and I conclude in Part V with some comments.

I. The Law on Contracting with Minors

The law provides certain special rules for contracts with minors. The presumption is that minors are legally incompetent to give consent, and thus, are in need of protection in their dealings with other persons. Under common law, two basic principles can be said to govern the law relating to contracts with minors – *first*, a minor is legally incapable of contracting as he is unable to provide the requisite consent, and thus he is required to be protected in his dealings with other persons. *Second*, the law must mitigate the hardships that come with this rule so that adults dealing fairly with minors are not caused unnecessary hardships. Under this principle, certain contracts with minors are valid and enforceable, yet others are voidable at the option of the minor.[3] English common law also stands modified by statutes that deal with the subject.[4]

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1. Mohori Bibee v. Dharmodas Ghose, ILR (1903) 30 Cal 539 (PC).
2. Mathai Mathai v. Joseph Mary, (2015) 5 SCC 622 : .
3. *See* Trietel, The Law of Contract, ¶ 12-002 (Edwin Peel ed., 12th edn. 2007).
4. *See* Minors' Contract Act, 1987 (Eng.).

Indian law however, is slightly different, being codified in Sections 10, 11, and 68 of the Indian Contract Act, 1872 ("Contract Act"). Section 10 of the Contract Act provides that "*all agreements are contracts if they are made by the free consent of the* parties competent to contract…(emphasis supplied)"[5] Section 11 of the Contract Act provides that "*every person is competent to contract who is of the* age of majority *according to the law to which he is subject…*(emphasis supplied)"[6] Under Indian law, the age of majority is regulated by the Indian Majority Act, 1875. Section 3 of that Act provides that "*every person domiciled in India shall be deemed to have attained his majority when he shall have completed his age of 18 years.*" In case however, a guardian has been appointed with respect to a minor, this age of majority is deemed to be attained on completing the age of 21 years.[7] Section 68 of the Contract Act deals with contracts for necessities, and provides that "*if a person, incapable of entering into a contract… is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.*"[8]

A literal reading of the provisions, particularly Section 11, requires being of the age of majority according to one's personal law as a necessary element of contractual capacity. However, the language leaves unclear the nature of agreements entered into by minors since Section 11 approaches the issue from the standpoint of *capacity* and not *incapacity*. Prior to 1903 therefore, there existed confusion as to whether such agreements with minors were void or merely voidable. It was in the context of this legal uncertainty that the issue arose in 1903 before the Privy Council in *Mohori Bibee*.

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[5] S. 10, Indian Contract Act, No. 9, Acts of Parliament, 1872 [hereinafter "Contract Act"] states –

"What agreements are contracts.—All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void."

[6] S. 11, Indian Contract Act, 1872 states –"Who are competent to contract.—Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject."

[7] S. 3, Indian Majority Act, No. 9, Acts of Parliament, 1875.

[8] S. 68, Indian Contract Act, 1872 states –

"Claim for necessaries supplied to person incapable of contracting, or on his account.— If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person."

II. Understanding the Decision of the Privy Council in *Mohori Bibee*

The facts of *Mohori Bibee* are as follows – the agent of the defendant advanced money to the plaintiff, a minor. This advance was secured by mortgage of a property belonging to the plaintiff. The plaintiff subsequent to receipt of the money, commenced an action to get the mortgage declared as void. It was proved during the course of trial that the fact of infancy of the plaintiff was within the knowledge of the agent of the defendant, and the same was thus attributable to the defendant. There was therefore no question of the defendant being misled by any false statement made by the plaintiff. The argument made by the defendant was however that the cancellation of the mortgage could not be ordered without ordering the plaintiff to repay the defendant the sum paid to him as part of the consideration for the mortgage. In support of this contention, the defendant relied upon Section 64 of the Contract Act that requires restitution from the party at whose option a contract is voidable and who so lawfully rescinds such "*voidable contract*."[9] The Privy Council analysed the issue of whether the remedy of restitution under Section 64 applicable to a "*voidable contract*" is also available in a case where the defence of infancy is raised, and noted that the same would turn on whether contracts with a minor are treated as void or merely voidable. In this context it was held –

> "The general current of decision in India certainly is that ever since the passing of the Indian Contract Act (IX, of 1872), the contracts of infants are voidable only. This conclusion, however, has not been arrived at without vigorous protests by various judges from time to time, nor indeed without decisions to the contrary effect. Under these circumstances, their Lordships consider themselves at liberty to act on their own view of the law as declared by the Contract Act, and they have thought it right to have the case reargued before them upon this point. They do not consider it necessary to examine in detail the numerous decisions above referred to, as in their opinion the whole question turns upon what is the true construction of the Contract Act itself. (sic)"

[9] S. 64, Indian Contract Act, 1872 states –
"Consequences of rescission of a voidable contract.—When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he had received any benefit thereunder from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received."

The Privy Council contrasted the foundation of the rule in Indian law as being distinct from that in common law and held –

> "Their Lordships observe that the construction which they have put upon the Contract Act seems to be in accordance with the old Hindu Law as declared in the laws of Manu, ch. viii. 163; and Colebrooke's Dig. iii. 2, vol. ii. p. 181; although there are no doubt, decisions of some weight that before the Indian Contract Act, an infant's contract was voidable only in accordance with English law as it then stood. (sic)"

On this premise, and upon an analysis of the wording in the provisions of the Contract Act, the Privy Council in *Mohori Bibee* held that contracts entered into by minors are void and not merely voidable in these terms –

> "Looking at these sections, their Lordships are satisfied that the Act makes it essential that all contracting parties should be "*competent to contract*," and expressly provides that a person who by reason of infancy is incompetent to contract cannot make a contract within the meaning of the Act. This is clearly borne out by later provisions of the Act. Section 68 provides that, "*if a person incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person*." It is beyond question that an infant falls within the class of persons here referred to as incapable of entering into a contract, and it is clear from the Act that he is not to be liable even for necessaries, and that no demand in respect thereof is enforceable against him by law, though a statutory claim is created against his property... The question whether a contract is void or voidable presupposes the existence of a contract within the meaning of the Act, and cannot arise in the case of an infant. Their Lordships are, therefore, of the opinion that in the present case there is not any such voidable contract as is dealt with in Section 64. (sic)"[10]

The Privy Council also rejected the argument that restitution or compensation could be possible under Section 65 of the Contract Act,[11] which is

[10] Mohori Bibee v. Dharmodas Ghose, ILR (1903) 30 Cal 539 (PC).

[11] S. 65, Indian Contract Act, 1872 states –

"Obligation of person who has received advantage under void agreement, or contract that becomes void.—When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it."

applicable where an "*agreement is discovered to be void, or when a contract becomes void*" and held –

> "A new point was raised here by the appellants' counsel, founded on s. 65 of the Contract Act, a section not referred to in the Courts below, or in the cases of the appellants or respondent. It is sufficient to say that this section, like s. 64. starts from the basis of there being an agreement or contract between competent parties, and has no application to a case in which there never was, and never could have been, any contract."[12]

III. Executed Contract Exception to *Mohori Bibee*

Mohori Bibee appears to lay down an uncompromising rule. Contracts with minors are void *ab initio*, and even the provisions under the Contract Act requiring restitution are not applicable in such cases because they presume existence of an agreement or contract between competent parties.[13] This may be contrasted with the position in common law, where contracts with minors are, in general, voidable at the instance of the minor, though binding upon the other party. Exceptions to this rule in common law are contracts for necessaries, and certain other contracts such as contracts of service and

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[12] Mohori Bibee v. Dharmodas Ghose, ILR (1903) 30 Cal 539 (PC).

[13] In case however a person is subject to a fraud orchestrated by a minor, the Court can in *equity* order restitution from the minor. This was also recognised in *Mohori Bibee*, however the Court did not so order because it was held, as a matter of fact, that the Defendant had specific knowledge of the infancy of the Plaintiff. In this context one may note S. 33 of the Specific Relief Act, 1963, which lays down the statutory rule requiring restitution in case either the Plaintiff or the Defendant pleads lack of competency to contract. *See* S. 33, Specific Relief Act, 1963 which states –

"Power to require benefit to be restored or compensation to be made when instrument is cancelled or is successfully resisted as being void or voidable.—

(1) On adjudging the cancellation of an instrument, the court may require the party to whom such relief is granted, to restore, so far as may be any benefit which he may have received from the other party and to make any compensation to him which justice may require.

(2) Where a defendant successfully resists any suit on the ground—

(*a*) that the instrument sought to be enforced against him in the suit is voidable, the court may if the defendant has received any benefit under the instrument from the other party, require him to restore, so far as may be, such benefit to that party or to make compensation for it;

(*b*) that the agreement sought to be enforced against him in the suit is void by reason of his not having been competent to contract under section 11 of the Indian Contract Act, 1872 (9 of 1872), the court may, if the defendant has received any benefit under the agreement from the other party, require him to restore, so far as may be, such benefit to that party, to the extent to which he or his estate has benefited thereby."

apprenticeship, if they are clearly for the minor's benefit – such contracts are good and binding upon an infant.

One situation however where the rigour of *Mohori Bibee* was held not to apply was the case of executed contracts. It was in fact the rule even prior to *Mohori Bibee*, that contracts which were completely *executed* on the minor's side so that there were no further liabilities on his part, could be enforced by the minor for the reason that nothing further remained to be done by him. The decision of the Court in such cases only operated to confer rights and not liabilities upon the minor and as such only protected the interests of the minor. Thus, it was held by the Bombay High Court as far back as 1888, that a minor could sue under a bond in his own favour.[14] This exception continued even subsequent to *Mohori Bibee*. For instance, a Full Bench of the Madras High Court held in *A.T. Raghava Chariar v. O.A. Srinivasa Raghava Chariar*[15] that a mortgage in favour of the minor, where he has advanced the whole of the mortgage amount, could be enforced by him. This was also the position taken by the Patna High Court.[16] These cases of executed contracts may be distinguished from a case where the contract is merely executory and thus imposes obligations upon the minor; for instance, in *Pramila Balidas*, it was held that a lease in favour of a minor will be void as it imposes obligations upon him to pay rent and to perform covenants.[17]

In practice, the distinction between executory and executed contracts could be tough to draw. In certain situations, it is difficult to conclude that there might be no further liabilities on or obligations to be performed by the minor. For instance, in *Abdul Ghaffar,*[18] the executed contracts exception was applied to a case where the minor plaintiff who had supplied goods to the defendant, had sued the defendant for the price. The verdict did not consider that there exist various covenants and warranties that might operate to impose liability upon the minor plaintiff in the event that such goods were defective or did not meet the required criterion. Of course, one could always distinguish between cases where minors have paid money and completely performed their obligations (such as, under a mortgage or bond) and no further liability of the minor exists or could exist, and situations like in *Abdul Ghaffar* of sale of goods, where it is *possible* for such liability of a minor to arise. This could be a good reason to not apply the executed contracts

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[14] Hanmant Lakhshman v. Jayarao Narsinha, ILR (1889) 13 Bom 50.

[15] A.T. Raghava Chariar v. O.A. Srinivasa Raghava Chariar, AIR 1917 Mad 630 (FB).

[16] Madhab Koeri v. Baikuntha Karmaker, ILR (1919) Pat 561; Satyadeva Narayan Sinha v. Tirbeni Prasad, AIR 1936 Pat 153.

[17] Pramila Balidas v. Jogesher Mandal, AIR 1918 Pat 626 : (1918) 3 Pat LJ 518.

[18] Abdul Ghaffar v. Piare Lal, ILR (1935) 16 Lah 1.

exception to such latter cases, but that does not detract from the sound legal and policy basis of the exception itself.

The policy reasoning behind the exception is apparent enough. If the exception were to be discarded, it would follow that the law relating to the contracts of minors meant for their protection, would in numerous cases have exactly the opposite effect and result in manifest injustice. To take a simple instance, if a minor sent a money order to a shopkeeper towards payment for certain selected goods to be forwarded, the shopkeeper having knowledge of the status of the minor, could keep the money and refuse to deliver the goods. In this case, the shopkeeper might be within his right in refusing to complete the contract entered into with a minor, but justice demands that the shopkeeper who has accepted the money having knowledge of the status of the minor cannot now refuse to perform obligations voluntarily undertaken by him.[19] The demands of justice would be no different if the shopkeeper who did not initially have such knowledge but having acquired it later, attempts to use that to get out of the bargain.

The exception is also justifiable by a reading of the statutory scheme of the Contract Act. A 'contract' is defined in Section 2 of the Contract Act and its definition is built upon the series of elements which go towards making such contract, viz. proposal, acceptance, promise, promisor, promisee, consideration and agreement. Promises forming the consideration or part of the consideration for each other are defined as reciprocal promises. An agreement enforceable in law is a contract.

Out of the various definitions in Section 2, it is useful to particularly consider the definitions of "*consideration*," "*agreement*," and "*reciprocal promises*." Section 2(e) of the Contract Act provides that "*every promise and every set of promises, forming the consideration for each other, is an agreement*." Consideration is defined in Section 2(d) of the Contract Act as "*when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing something, such act or abstinence or promise is called a consideration for the promise*." Section 2(f) provides that "*promises which form the consideration or part of the consideration for each other, are called reciprocal promises*."

Thus, it may be seen that the statutory scheme provides that *every promise* is an agreement. It is not essential that the consideration for the agreement be another promise (that is only required for reciprocal promises) – and

[19] *See* the example discussed in *Madhab Koeri v. Baikuntha Karmaker*, ILR (1919) Pat 561.

consideration could also include any act or abstinence *done* at the desire of the promisor. A promise made by an adult in favour of a minor is thus an agreement by the adult. If the consideration for such an agreement is a reciprocal promise by the minor, the whole thing is void – for instance, in *Mohori Bibee*, the agreement which the plaintiff sought to enforce was a *promise by a minor*; which was held to be void. In *Pramila Balidas*, the decision that the lease in favour of a minor was void was based on a *promise by a minor*, as an element in the agreement. If the consideration for the agreement by an adult is not a promise, however, but is something actually done by the minor, there seems no bar in the statute and no reason in principle why the result should not be a valid contract.[20] The same is also the principle discernable from a reading of Section 58 of the Transfer of Property Act, 1882 ("TP Act") which defines a "*mortgage*". It provides that mortgage is "*the transfer of an interest in specific immoveable property for the purposes of securing the payment of money* advanced or to be advanced (emphasis supplied)," that is to say, it takes effect as a transfer either when money has been advanced, or there is a promise to advance such money (or both). The exception thus applies where payment of money has already been advanced by the minor and no question of a "*promise to pay*" on the part of the minor arises.

IV. Decision of the Supreme Court in *Mathai Mathai*

The recent decision of the Supreme Court in *Mathai Mathai* appears to do away with the executed contracts exception to *Mohori Bibee*. The facts of the case are simple. The Appellant pleaded that his mother had advanced Rs. 7,000 (the amount given to her as dowry upon marriage) to the uncle of the Appellant, who in turn had mortgaged certain land as collateral security to her. The Appellant further contended that his mother had been in possession of the said land for more than fifty years. On the strength of both these facts, the Appellant filed an application to be declared as a deemed tenant under Section 4A of the Kerala Land Reforms Act, 1963, in terms of which he would be entitled to a purchase certificate and would have a statutory right to purchase the said land at a pre-determined rate. Various arguments were raised on the side of the Respondents. It is noteworthy that as a matter of undisputed fact, the mother of the Appellant was a minor (15 years) when she executed the mortgage deed with her uncle, though this was never the

[20] *See also* the discussion in *Satyadeva Narayan Sinha v. Tirbeni Prasad*, AIR 1936 Pat 153. Of course, if the minor is incapable of performing any act or assenting to the proposal in terms of S. 2(b) of the Contract Act, say if he is an infant, then the executed contracts exception will not be applicable. *See* S. 2(b) of the Contract Act which states – "*When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise.*"

subject of any argument before the forums below, nor was this issue raised by the Respondents before the Supreme Court. On the basis of this fact *inter alia* the Supreme Court ultimately rejected the case of the Appellant.

The Supreme Court specifically noted the facts of the case, and referred to the decision in *Mohori Bibee* and also the decisions of the "*many courts*" laying down the executed contracts exception (as above), and ultimately held that they represent an "*erroneous application of the law.*" It would be useful to quote the reasoning of the Supreme Court in full –

> "Many courts have held that a minor can be a mortgagee as [mortgage] is transfer of property in the interest of the minor. We feel that this is an erroneous application of the law keeping in mind the decision of the Privy Council in *Mohori Bibee* case. *As per the Indian Contract Act, 1872 it is clearly stated that for an agreement to become a contract, the parties must be competent to contract, wherein age of majority is a condition for competency.* A deed of mortgage is a contract and we cannot hold that a mortgage in the name of a minor is valid, simply because it is in the interests of the minor, unless she is represented by her natural guardian or guardian appointed by the court. *The law cannot be read differently for a minor who is a mortgagor and a minor who is a mortgagee as there are rights and liabilities in respect of the immovable property would flow out of such a contract on both of them.* Therefore, this Court has to hold that the mortgage deed… is *void ab initio* in law and the Appellant cannot claim any rights under it. (sic) (emphasis supplied)"

The above paragraph reveals that the characterisation by the Supreme Court of the rule in *Mohori Bibee* as being uncompromising (and treating as void *ab initio* even contracts where minors are transferees), is based on the fact that "*rights and liabilities in respect of the immovable property would flow out of such a contract on [the minor].*" In this context, two preliminary comments are necessary.

First, *Mathai Mathai* cannot be an authority for the proposition that minors can never be a party to a contract at all. If the decision is read as authority for *such* proposition (viz. that a minor cannot be a party to a contract at all), it would lead to absurd consequences. Minors would be unable to enforce a contract where a contract is entered into for his benefit without imposition of any liability upon the minor, and where the entire consideration has been paid or promised to be paid by a third party (say his father). It should make no difference that the contract is entered into with the minor, or with somebody else for the benefit of the minor, as long as no liabilities are

sought to be imposed upon the minor by reason of such contract. Similarly, one can also consider Section 25 of the Contract Act which lays down the rule that agreements made without consideration are void, but provides certain exceptions.[21] Section 25(1) provides an exception to the requirement of consideration in cases where there is a written and registered agreement on account of natural love and affection between parties in a near relation. It would be patently absurd if the ratio of *Mohori Bibee* (on the strength of the bare reasoning quoted above in *Mathai Mathai*) is extended to such cases and it is held that a minor cannot be a party to even such a contract at all.

Second, and at best, the decision in *Mathai Mathai* can be said to be an authority only in respect of those types of executed contract cases, where minors are transferees of immovable property *and* liabilities in respect of the transaction are imposed upon the minor consequent to an executed document. *Mathai Mathai* does not at all deal with those cases of executed contracts where there is no transfer of property involved (for instance, bonds executed in favour of the minor). To the extent that the executed contracts exception to *Mohori Bibee* has been developed by the High Courts, in such cases they would, it is submitted, continue to be good law.

However, even for these limited types of cases involving transfer of property for which *Mathai Mathai* does appear to be an authority, it is submitted that the reasoning in the decision is unsound and its understanding of *Mohori Bibee* overbroad for the following reasons:

First, the decision in *Mathai Mathai* does not at all consider the argument (set out above) that what is sought to be enforced in cases of executed

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[21] S. 25, Contract Act, 1872 states –

"Agreement without consideration, void, unless it is in writing and registered or is a promise to compensate for something done or is a promise to pay a debt barred by limitation law.—An agreement made without consideration is void, unless—

(1) it is expressed in writing and registered under the law for the time being in force for the registration of [documents], and is made on account of natural love and affection between parties standing in a near relation to each other; or unless

(2) it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do; or unless.

(3) It is a promise, made in writing and signed by the person to be charged therewith, or by his agent generally or specially authorized in that behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits. In any of these cases, such an agreement is a contract. Explanation 1.—Nothing in this section shall affect the validity, as between the donor and donee, of any gift actually made. Explanation 2.—An Agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate; but the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was freely given."

contracts where the minor is a transferee is not a "*reciprocal promise*" involving any agreement by the minor but only the agreement of the other person, which is supported by the consideration of an already *executed* act by the minor. The courts in such cases do not and are not required to enforce any agreement of the minor; but only to judicially recognise the *fact* of the minor performing the act that is the consideration for the promise by the other person. This is in no way different from the situation where a minor is the promisee under any of the situations in Section 25 of the Contract Act; for instance, if a person has voluntarily done something for the promisor under Section 25(2) it seems inconceivable that a Court would refuse to *recognise* that *act*, and refuse to enforce the contract just because such a person happens to be a minor. *Mohori Bibee*, it is submitted, deals only with a case where the minor was the mortgagor and where the promise by the minor was a necessary part of the agreement sought to be enforced, and as such, the *ratio* of *Mohori Bibee* should be read as being restricted to such cases only. As set out above, it would be a strange consequence of the rule that is based on the rationale of protecting the interests of minors, if they are to take nothing under transfers in consideration for which they have already parted with their money and fulfilled their obligations.

Second, the decision in *Mathai Mathai* does not consider the scheme of the Transfer of Property Act, under which there is a clear distinction between prohibitions attaching to minors being *transferors* and *transferees* of immovable property. In this context, it would be useful to note Section 7 of the TP Act, which requires that a *transferor* of the property can only be a "*person competent to contract*" Thus, as per this provision, a minor cannot be a *transferor* of immovable property, which also is consistent with and explains the decision in *Mohori Bibee* where the minor was the *mortgagor* of the immovable property in question. Section 6 of the TP Act however deals with *transferees* and Section 6(h)(3) of the TP Act provides that the transferee must not be a "*legally disqualified transferee.*" Legally disqualified transferees are prescribed under the Act, for instance, under Section 136 of TP Act, which provides that judges, legal practitioners, and officers connected to the court are disqualified from dealing in actionable claims. There is nothing in the TP Act according to which it can be said that a minor is disqualified to be a *transferee*, except in the case of onerous gifts dealt with under Section 127, which provides that "*a* donee not competent to contract *and accepting property burdened by any obligation is not bound by his acceptance. But if, after becoming competent to contract and being aware of the obligation, he retains the property given, he becomes so bound.* (emphasis supplied)" Even the special provision in Section 127 of the TP Act is consistent with the general proposition that minors can be donees of a property without

even needing to make an election, as long as no *onerous conditions* (or liabilities) are attached to such gift; and even where such onerous conditions are attached, they can still assent to such gift and upon achieving the age of majority, elect to keep it. A similar theme appears to run through the other legislation that contain special provisions relating to minors. For instance, under Section 184 of the Contract Act, a minor can be an agent, however he cannot be made responsible to his principal.[22] Similarly, as per Section 30 of the Partnership Act, 1932,[23] minors can be admitted to the benefits

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[22] *See L.C. DeSouza, In re*, AIR 1932 All 374.

[23] S.30, Partnership Act, No. 9, Acts of Parliament, 1932 states –

"Minors admitted to the benefits of partnership.—

(1) A person who is a minor according to the law to which he is subject may not be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

(2) Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon, and he may have access to and inspect and copy any of the accounts of the firm.

(3) Such minor's share is liable for the acts of the firm, but the minor is not personally liable for any such act.

(4) Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm, and in such case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in section 48: Provided that all the partners acting together or any partner entitled to dissolve the firm upon notice to other partners may elect in such suit to dissolve the firm, and thereupon the court shall proceed with the suit as one for dissolution and for settling accounts between the partners, and the amount of the share of the minor shall be determined along with the shares of the partners.

(5) At any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, such person may give public notice that he has elected to become or that he has elected not to become a partner in the firm, and such notice shall determine his position as regards the firm: Provided that, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

(6) Where any person has been admitted as a minor to the benefits of partnership in a firm, the burden of proving the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority shall lie on the persons asserting that fact.

(7) where such person becomes a partner,—

 (*a*) his rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership, and

 (*b*) his share in the property and profits of the firm shall be the share to which he was entitled as a minor.

(8) Where such person elects not to become a partner,—

 (*a*) his rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice,

 (*b*) his share shall not be liable for any acts of the firm done after the date of the notice, and

 (*c*) he shall be entitled to sue the partners for his share of the property and profits in accordance with sub-section (4).

(9) Nothing in sub-sections (7) and (8) shall affect the provisions of section 28."

of a partnership, though cannot be held personally liable for any obligation of the firm. The Negotiable Instruments Act, 1881 also provides for similar treatment for minor drawers and indorsers.[24] All these provisions are consistent with the intention of the legislature being in conformity with the general proposition that although no liability can be attached to minors or their actions, the law recognises acts done by minors and they are entitled to take advantage of benefits and exercise rights available to them consequent to such actions.

Third, *Mathai Mathai* seems to conflate the distinction between rights and liabilities attached to *holding* of property by a minor, and those rights and liabilities which flow consequent to a *contract* dealing with such property. It is trite that minors are entitled to ownership of immovable properties in their own name. Minors can acquire interest in such properties by way of intestate succession, bequest as well as a gift (subject of course to the special requirements in cases of "*onerous gifts*" in Section 127 above). No doubt rights and liabilities follow from and consequent to such ownership – however, the same is equally applicable to minors as well as non-minors. The law protects minors only where such rights and liabilities follow consequent to a contract. In the event the contract is executed from the side of the minor, viz. the minor is a mortgagee, nothing further is required to be done by the minor and no liability attaches to the minor as a consequence of such contract (although there might be liability attaching to the minor as a consequence of being in possession of such property, where the mortgage is say a usufructuary one, but that liability is no different from the liability attaching where the minor has ownership over and is in possession of any other property as well). Of course, if it is the case that there are certain conditions imposing liability upon the minor even where the minor is a mortgagee, such contracts would be void. But that would have been the case even prior to *Mathai Mathai*, and the blanket holding in that decision that no distinction can be drawn between minors as mortgagors and mortgagees is, it is respectfully submitted, incorrect.

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[24] *See* S. 26, Negotiable Instruments Act, No. 26, Acts of Parliament, 1881, states –
"Capacity to make, etc., promissory notes, etc. – Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, indorsement, delivery and negotiation of a promissory note, bill of exchange or cheque. Minor. A minor may draw, indorse, deliver and negotiate such instrument so as to bind all parties except himself. Nothing herein contained shall be deemed to empower a corporation to make, indorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered."

Conclusion

For a judgment of such significant import, the decision in *Mathai Mathai* is surprisingly bereft of reasoning. It is difficult to consider the holding of the Supreme Court on the point of capacity of minors as being mere *obiter dicta*, as that is the first reason given by the Court to reject the appeal, and the observations are not made merely in passing. However, the Court could have always avoided getting into this issue given that neither of the parties had ever raised it in any of the forums below, nor did it appear that this point was argued by any party even before the Supreme Court. Having chosen to entertain this argument, the prior decisions of the various High Courts on this subject should have at least been considered, and distinguished or expressly overruled. There is an inherent logic to the executed contracts exception to *Mohori Bibee* – and a reading of *Mohori Bibee* in *Mathai Mathai* that appears to render all contracts with minors as being void *ab initio* is over broad, and with respect, requires re-consideration.